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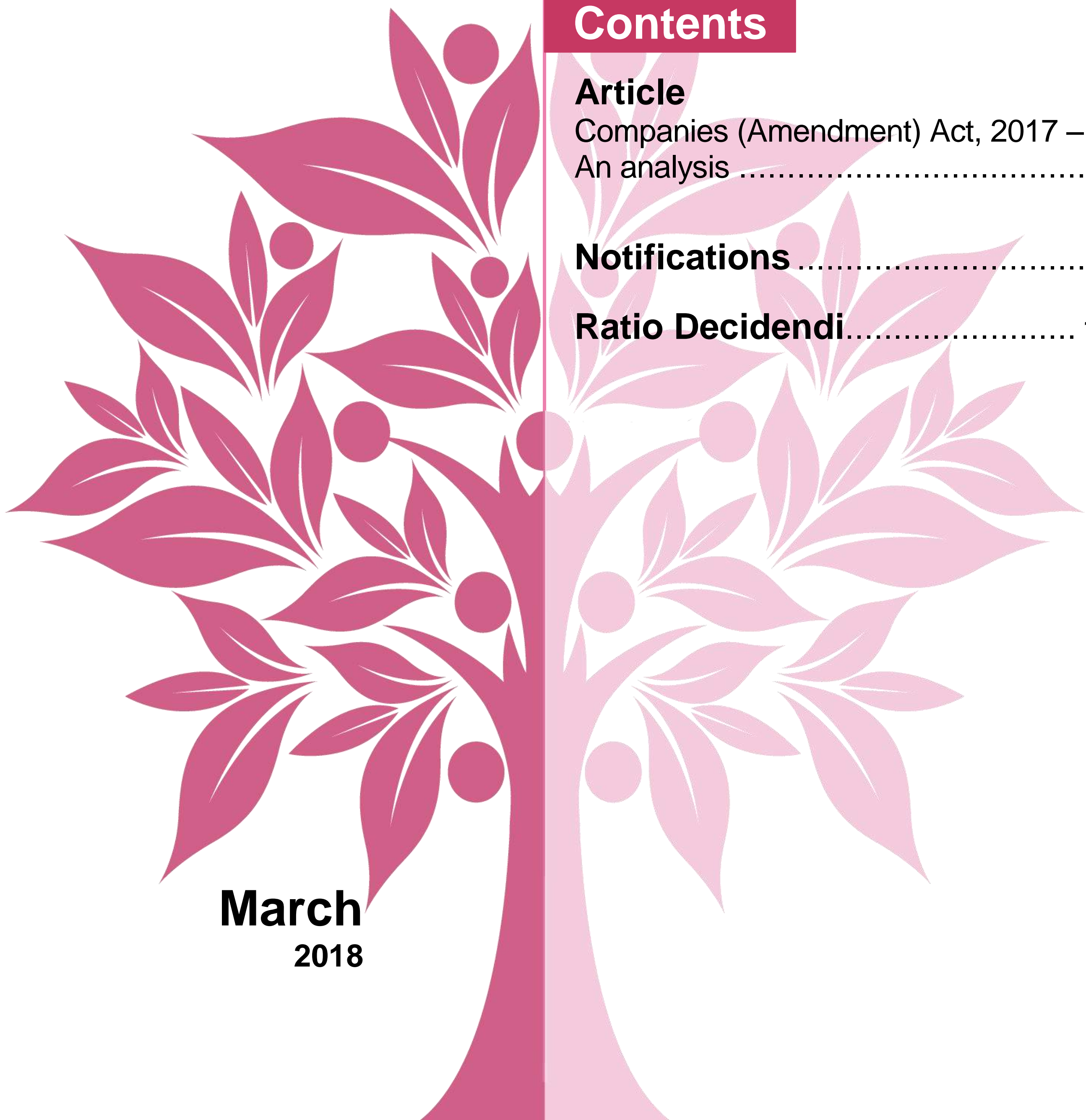

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Article

Companies (Amendment) Act, 2017 – An analysis

By **Pulkit Chaturvedi**

The Central Government has notified Companies (Amendment) Act, 2017 ("**Amendment Act**") on January 3, 2018 that was passed by the Parliament in its winter session.[1] The Companies Act (Amendment) Bill, 2016 ("**Bill**") was first introduced in the lower house of Parliament in March, 2016. The Bill, when presented before the Parliament, sought to make important revisions to the Companies Act, 2013 ("**Act**") in relation to structuring, disclosure, and compliance requirements for companies. The Amendment Act has been able to largely uphold the objectives that the Bill had sought out to achieve. These are discussed in detail in the present article.

The Bill, after it was introduced in the Lower House of parliament, was referred to the Standing Committee on Finance in 2016 and after incorporating its feedback, along with relevant expertise from the respective government chambers of commerce and industry and professional bodies, it was finally approved by the Lower House as the Companies Act (Amendment) Bill, 2017 on July 27, 2017. The Bill, though was passed by the Lower House in the Monsoon Session, due to the adjournment of the houses, could not clear the scrutiny of the Upper House until December 19, 2017. The Bill was eventually passed and received the President's assent on January 3, 2018.

The Bill was moved in the Lok Sabha by the Hon'ble Minister of State for Finance and Corporate Affairs, Mr. Arjun Ram Meghwal. While moving the Bill, he had stated that the main purpose of the Bill is for promoting businesses and for helping ease of business in India. He said that it was hoped that after passing these amendments, the procedure will be simplified, compliance will become easy and defaulting companies would be adequately punished.

Following the objectives and the purpose of the Amendment Act, it provides for prescribing a simple form of annual return for small companies, one-person companies and private companies with less than annual sales turnover of Rs. 100 crore from the previous limit of Rs. 20 crore. This may also apply to other form of companies to avoid repetitive information. The Standing Committee of the Parliament, while reviewing the Amendment Act, had recommended that this benefit should be provided to other companies as well if the Central Government, at a later point of time, decides to provide this leeway to such companies. The Government accepted the recommendation of the Standing Committee and provided for it in the Bill. The Amendment Act thus extends the power of the Central Government to prescribe abridged form of annual returns for other types of companies, in addition to one-person company or a small company.

The Amendment Act provides in clause 34 that the accounts of a company prior to eight years from the date of examination must not be reopened. This will be highly beneficial for companies as they will not have to carry on the cumbersome task of maintaining books of accounts for several years as they were required to do under the Act. Further, in order to resolve the problems faced due to unharmonized laws, the amendments in the Amendment Act are geared towards doing away with dual

[1] Notification No. DL-(N) 04/0007/2003-18, January 3, 2018.

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requirements under the SEBI Act, 1992 and the Act, especially in the context of separate prescriptions for prospectus and the contents of the board report. The Amendment Act omits the provision of prohibition on forward dealing and insider trading since those are relevant for listed entities which are already regulated by SEBI. The Amendment Act also allows unlisted companies to convene their annual general meetings at any place in India, and not necessarily at the place of their registered office, as provided earlier.

The Amendment Act has completely replaced Section 185 of the Act[2], that governs loans granted to, and security and guarantees provided on behalf of, directors and other parties in whom the directors are interested. The section in its form under the Act, provided that the companies could grant loans to, or provide loans or security on behalf of directors or entities they are interested in, provided the requisite permission was taken. Exemptions to this provision were provided to 'wholly owned subsidiaries' if such loans were utilised for the subsidiary's principal business activities. The Act also provided for exemptions for loans granted to a managing or whole-time director and to a company that provides loans or gives guarantees or securities for the due repayment of any loan in its ordinary course of business. Now the Amendment Act has bifurcated the regulatory framework into two categories: the first contemplating certain transactions which are prohibited and another consisting of transactions which may be permitted, subject to approval of the shareholders by way of a special resolution passed at a general meeting. The prohibition applies to loans, guarantees or security provided to a director of the company or a director of its holding company or any partner or relative of such director, and in any firm where such person is a partner.

The transactions pertaining to a private company wherein a director of the company provides loans, guarantee or security is also a director or member is now permitted by passing of a special resolution. This is subject to the condition that the explanatory statement for the general meeting, contains detailed disclosures regarding the proposed transaction. The permission given under the Act for providing such loans is also retained if the loans are utilised by the borrowing company for its principal business activities.

The amendment also retains its provisions under the Act applicable to managing or whole-time directors and companies providing loans and guarantees to its wholly owned subsidiaries or in its ordinary course of business. One difference in the exemptions is in the provision relating to the "ordinary course of business" where under the existing position of the Act such exemption could be availed of if the interest charged on the loans granted was at least equal to the bank rate declared by the Reserve Bank of India. The Amendment Act now provides for the interest to now at least at the rate of prevailing yield of one year, three year, five year or ten year Government securities, that is closest to the tenor of the loan. Though this amendment was much awaited from the industry and is highly beneficial from the perspective of large groups with a number of companies acting under its wing in different departments, as on February 20, 2018 this section has not been notified by the Ministry and hence is not into effect.

The Amendment Act also brings in line the provisions relating to the qualification of technical members of the National Company Law Tribunal ("**NCLT**") and composition of the selection committee for appointment of technical members of the NCLT and the National Company Law Appellate Tribunal ("**NCLAT**") with the judgment of the Supreme Court which had held them to be

[2] Section 61, Companies (Amendment) Act, 2017.

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invalid in *Madras Bar Association* v. *Union of India*.[3]

Some of the other major amendments proposed to the 2013 Act are outlined below:

- **Definition of 'associate company' –** Under the Act, the definition of an associate company's significant influence is derived from its control of share capital. The Amendment Act substitutes the explanation to Section 2(6) of the term 'significant influence' to having control of at least 20 percent of the total voting power or control of or participation in business decision-making.[4] This potentially impacts and affects the financial accounting of its holding company, if any. This will also be significant in lines of the insolvency management under the Insolvency and Bankruptcy Code, 2016. Amendment Act further defines a 'Joint Venture' also to mean a joint arrangement whereby the parties that have joint control of the arrangement, have rights to the net assets of the arrangement.
- **Definition of 'related party'–** The Amendment Act provides for expanding the existing definition of related party and now includes "an investing company or the venture of a company" also in the existing position.[5] The section clarifies that an investing company or the venture of the company means a body corporate whose investment in the company would result in that company becoming an associate company of the body corporate.
- **Definition of a 'small company' –** The Act provides a large number of benefits to companies falling within the definition of 'small company' like exemptions from filing cash flow statements, auditor regulations, reducing the number of board meetings etc. For a company to qualify as a 'small company', the Amendment Act has now raised the firm's maximum paid-up share capital amount from Rs. 5 crore (rupees five crore) to Rs. 10 crore (rupees ten crore). It also increases the prescribed turnover amount substantially from Rs. 20 crore (rupees twenty crore) to Rs. 100 crore (rupees hundred crore).[6] This provision will ensure that the benefits provided to these small companies are provided to a substantially larger number of companies.
- **Definition of a 'subsidiary company' –** The Act lays down that a company shall be deemed to be a subsidiary of another, if the holding company controls the composition of the Board of Directors or exercises or controls 'more than half of the total share capital'. The Amendment Act has amended Section 2(87) to now substitute the words 'total share capital' to 'total voting power'[7] This amendment was expected since various controversies relating to companies exercising voting power without holding share capital in the recent past.
- **Members severally liable** – The Amendment Act has added a new section regarding liability of members in situations wherein if the number of members in a company is reduced from the statutory minimum number prescribed, i.e. below 7 in the case of a public company, and below 2 in case of a private company. It provides that every person who is a member during that time the company carries on business and if they are cognisant of the fact that the company does not meet the minimum statutory criteria of members, shall be severally liable for the payment of whole

[3] *Madras Bar Association v. Union of India & Anr.,* Writ Petition (C) No. 1072 of 2013;
[4] Section 2 (i), Companies (Amendment) Act, 2017
[5] Section 2 (xi), Companies (Amendment) Act, 2017
[6] Section 2 (xii), Companies (Amendment) Act, 2017
[7] Section 2 (xiii), Companies (Amendment) Act, 2017

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debts of the company contracted during that time and can be severally sued.[8]

- **Private placement process –** The Amendment Act has substituted Section 42 of the Act that deals with the issue of subscription of securities on private placement. The Amendment Act has taken away the right of investors to renunciate their investment rights in favour of another entity, so that only investors whose names are mentioned in the information memorandum, filed by the issuer, can subscribe to the shares. It also provides that return of allotment has to be filed with the Registrar of Companies within 15 days instead of 30 days and the money received under the private placement shall not be utilized unless such return of allotment is filed.[9]
- **Annual Return -** The Amendment Act provides for prescribing a simple form of annual return for small companies, one-person companies and private companies with annual sales turnover of less than Rs.100 crore from the previous limit of Rs.20 crore. This may also apply to other form of companies to avoid repetitive information. The amendment extends the power of the Central Government to prescribe abridged form of annual returns for other types of companies, in addition to one-person company or a small company. The Amendment Act also provides that the accounts of a company prior to eight years from the date of examination must not be reopened.[10]
- **Issue of Sweat Equity Shares –** The Act prohibits the issuance of sweat equity shares for a period of one year from the date of commencement of business of the company. The Amendment Act has taken away this prohibition so that such shares can be issued at any time after registration of the company. This amendment will be beneficial for start-ups as these companies can issue such shares to directors or employees for providing their know-how and can attract talent by providing such incentives from the period it commences business.[11]
- **Meeting** – Relaxation has now been provided to unlisted companies to hold their annual general meeting at any place in India, instead of the requirement under the Act of it being held at its registered office or in the city, town or village where the registered office is situated. This relaxation is subject to the condition that all the members of the companies have given their consent for the same in writing or by electronic mode in advance.[12] The Amendment Act also provides an option for a wholly owned subsidiary of a company incorporated outside India to hold its extraordinary general meeting at a place outside India.[13]
- **Corporate Social Responsibility** – The Amendment Act has amended the eligibility criteria for the purpose of constituting the corporate social responsibility committee and incurring expenditure towards CSR. Till now, the Act provided for calculation of such eligibility criteria on the basis of preceding three financial years. However, the Amendment Act has now amended this to be based on only the immediately preceding financial year.[14]
- **Independent directors –** The Act defines an independent director as a person who has or has had no 'pecuniary' relationship with the company, its holding, subsidiary, or associate company, or their promoters, or

[8] Section 3, Companies (Amendment) Act, 2017
[9] Section 10, Companies (Amendment) Act, 2017
[10] Section 23, Companies (Amendment) Act, 2017
[11] Section 13, Companies (Amendment) Act, 2017
[12] Section 26, Companies (Amendment) Act, 2017
[13] Section 27, Companies (Amendment) Act, 2017.
[14] Section 37, Companies (Amendment) Act, 2017.

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directors during the two immediately preceding financial years or during the current financial year. The Amendment Act has excluded remuneration and transactions – not exceeding 10 percent of the independent director's total income – from what is defined as a pecuniary or financial relationship.[15] The requirement to deposit Rs. 1,00,000 (rupees one lakh) with respect to nomination of directors as provided under section 160 of the Act shall also not be applicable now in case of appointment of independent directors or directors nominated by nomination and remuneration committee.[16]

- **Director identification number –** The Amendment Act provides the central government the power to prescribe any other identification number to be treated as director identification number for the purposes of the Act and if the person holds such a number, he shall not be required to hold a director identification number. This amendment would potentially permit Aadhar number to be used as an alternative to the director identification number.[17]
- **Forward dealings and Insider trading -** Sections 194 and 195 of the Act which prohibit forward dealings in securities of company by director or key managerial personnel and prohibits insider trading of securities are now omitted as these actions fall under the domain of SEBI and are adequately provided for under its regulations.[18] It was also decided to omit these sections as it has no impact on private companies.
- **Loans to Directors and related companies –** The Amendment Act has completely replaced Section 185 of the Act[19], which governs loans granted to, and security and guarantees provided on behalf of, directors and other parties in whom the directors are interested. The original section in its form under the Act, provided that the companies could grant loans to, or provide loans or security on behalf of directors or entities they are interested in provided the requisite permission was taken. The Amendment Act has now provided to bifurcate the regulatory framework into two categories: the first contemplating certain transactions which are prohibited and another consisting of transactions which may be permitted, subject to approval of the shareholders by way of a special resolution passed at a general meeting.
- **Conversion into Companies –** The Act in section 366 provides for partnership firms, limited liability partnerships, cooperative society, society or any other business entity to be converted into a company if it is consisting of seven members or more. The Amendment Act provides for such a conversion if they consist of two members or more provided that in that case, the company shall register as a private company and not a public company.[20]
- **Members of NCLT and NCLAT -** The Amendment Act also brings in line the provisions relating to the qualification of technical members of the National Company Law Tribunal (**NCLT**) and composition of the selection committee for appointment of technical members of the NCLT and the National Company Law Appellate Tribunal (**NCLAT**)[21] with the judgment of the Supreme Court which had held them to be invalid.[22]

[15] Section 46, Companies (Amendment) Act, 2017.
[16] Section 50, Companies (Amendment) Act, 2017.
[17] Section 48, Companies (Amendment) Act, 2017
[18] Sections 64 & 65, Companies (Amendment) Act, 2017.
[19] Section 61, Companies (Amendment) Act, 2017.
[20] Section 75, Companies (Amendment) Act, 2017.
[21] Section 85, Companies (Amendment) Act, 2017
[22] *Madras Bar Association v. Union of India & Anr.*, Writ Petition (C) No. 1072 of 2013;

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There were a few clauses that were present in the Bill that couldn't eventually see the light of the day in the Amendment Act as they couldn't pass the scrutiny of the members of parliament. Some of these clauses were game changing and would have certainly helped in achieving the aim of the Bill. For example, the Bill had initially sought to provide for a universal objects clause for companies wherein if the company only specifies its object as to "*Engage in any lawful act or activity or business or any act, activity or business to pursue any specific object or objects*", it can be allowed to do so. This clause would have helped the genuine issues faced by growing companies wherein before starting any new vertical of business, they had to painfully amend their Memorandum of Association and intimate the registrar of companies before starting such vertical. Companies could have easily ventured into any area that is legally allowed in India without any such compliances. However, Standard Committee on Finance recommended that such a clause on universal objects may lead to creation of bogus entities. Therefore, it was said that such an amendment should not be accepted and status quo should be restored. Hence in the Amendment Act, the universal objects clause couldn't find its place.

The Bill had also sought to remove the leash reigned upon companies relating to layering of investment companies and subsidiaries through section 186 of the Act which provides that a company is restricted to make investment through more than two layers of investment companies. Number of Committees and their reports have suggested that this restriction, which was included to address practices of creating subsidiaries aimed at making it difficult to trace the source of funds and their ultimate use, and to reduce the usage of multiple layers of structuring for siphoning off funds, has failed at its objective.

The Bill initially sought to amend this provision so that genuine structuring issues faced by the corporates can be corrected and so that Indian companies are not put at a disadvantage in relation to structuring *vis-à-vis* their international counterparts. However, during the course of debates, a number of parties raised objections for removal of these restrictions. It was stated that removal of such a restriction will aid in creating shell companies which will in a way promote the conversion of black money. Though such a claim is not backed by factual proof, and such a restriction will only create hindrance in genuine business practices of Indian corporates, the Amendment Act thus continues to rein in the layering of both investment companies and subsidiaries. Interestingly, the Central Government, the proponent of removal of such a restriction in the initial stages, notified proviso to section 2(87) of the Act that provided that subsidiaries cannot have layers of subsidiaries beyond the numbers as may be specified[23]. It further notified the Companies (Restriction on number of layers) Rules, 2017[24] in September, 2017 thus bringing out the regulatory framework for these restrictions.

As of February 23, 2018, 45 sections out of the total 93 sections of the Amendment Act have been notified. Although the Amendment Act will definitely be helpful in promoting ease of doing business in India, however, in our opinion, if the Bill was passed without amending the original wording, it would have been much more efficient and helpful to the current corporate regime in India. Although this Amendment Act is a game changer, it genuinely feels like that the present Amendment Act is an opportunity only half utilized.

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[23] Ministry of Corporate Affairs Notification: G.S.R. 1176(E) dated September 20, 2017

[24] Ministry of Corporate Affairs Notification: S.O. 3086(E) dated September 20, 2017

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Notifications

Companies (Removal of Difficulties) Order, 2018: Previously, as per Section 149(1) of Companies Act, 2013 (CA 2013), although an independent director could be re-appointed by passing of a special resolution, as per Section 169(1) of CA 2013, such independent director could be removed by merely an ordinary resolution. Therefore, to remove this ambiguity in provisions dealing with the appointment and removal of independent directors and to promote better corporate governance, Section 169(1) has now been amended by this Order dated 21-2-2018 to the effect that an independent director reappointed under Section 149(10) of CA 2013 can be removed only by way of passing a special resolution and after giving such director a reasonable opportunity of being heard.

Acceptance of Bank Guarantees by Clearing Corporations in International Financial Services Centre (IFSC): SEBI had earlier issued a Circular on November 28, 2016, wherein the guidelines for functioning of Stock Exchanges and Clearing Corporations in IFSC were specified. Through Circular No. CIR/MRD/DRMNP/41/2018, dated February 20, 2018, Para 2.6.3 of the 2016 Circular, dealing with eligible collateral, has now been amended, to state as follows:

Cash and cash equivalents (including major foreign currencies as may be decided by the clearing corporation, term deposit receipts and bank guarantees issued by bank branches located in IFSC); Indian securities held with foreign depositories, foreign securities including units of liquid mutual funds and gold, as eligible collateral for trades in all product categories, may now be accepted by clearing corporations in IFSC. However, at all times, cash and cash equivalents shall form at least 50% of the total liquid assets.

Clearing corporations have been directed to take necessary steps in their systems.

Draft Companies (Beneficial Interest and Significant Beneficial Interest) Rules, 2018 *(issued by the Central Government dated February 15, 2018)*

In light of the amendment of Sections 89 and 90 through the Companies (Amendment) Act, 2017, dealing with provisions related to beneficial interest in a company, the draft Companies (Beneficial Interest and Significant Beneficial Interest) Rules, 2018 (Draft Rules) have been released. An overview of the Draft Rules is as follows:

- The draft Rules distinguish between a 'beneficial owner' and 'registered owner'. While a 'beneficial owner' has been defined as *a person having beneficial interest in a share but whose name is not entered in the register of members of a company as the holder of that share*, a 'registered owner' is *a person whose name is entered in the register of members of a company as the holder of shares in that company but who does not hold the entire beneficial interest in such shares.* The Draft Rules stipulate that a registered owner, beneficial owner and significant beneficial owner will be required to file declarations with the company, disclosing their interest in shares of the company, within the prescribed time period. Any change in such interest will also be required to be declared by them within 30 (thirty) days from the date of occurrence of such change.
- A company will also be required to maintain a register of beneficial owners holding significant beneficial interest and file returns with the Registrar in respect of such declarations received.

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- The draft Rules stipulate that where the registered owner is a body corporate whose equity shares are listed on any stock exchange or is a wholly-owned subsidiary of such body corporate, or a foreign listed company then the requirements pertaining to furnishing of declaration of significant beneficial interest in shares, filing of return of significant beneficial interest in shares and maintenance of register of significant beneficial owners, would not apply.

IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2017 and IBBI (Fast Track Insolvency Resolution Process for Corporate Persons) Regulations, 2017: The IBBI has on 6th and 7th of February, 2018 respectively amended the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2017 and IBBI (Fast Track Resolution Process for Corporate Persons) Regulations, 2017, in the following manner:

- Only registered valuers shall be appointed by the resolution professional (RP) to determine the fair value and the liquidation value of the corporate debtor, which shall be provided to each member of the committee of creditors in electronic form, on receiving a confidentiality undertaking, upon receipt of the resolution plans.
- An information memorandum is required to be submitted in electronic form by the RP to each member of the committee of creditors within 2 (two) weeks of his appointment as RP and to each prospective resolution applicant latest by the date of invitation of resolution plan, on receipt of confidentiality undertaking.
- The RP is required to issue an invitation, including the evaluation matrix (which may be modified by him), to the prospective resolution applicants. However, the prospective resolution applicant shall get at least 15 (fifteen) days from the issue of invitation or modification, whichever is later, to submit resolution plans. The resolution applicant will also get at least 8 (eight) days from the issue of evaluation matrix or modification, whichever is later, to submit resolution plans. On the corporate debtor's website or any website designated by the IBBI, an abridged invitation shall be made available.
- While the resolution applicant shall specify the sources of funds to be used in the entire resolution process, the committee of creditors shall specify the amounts payable from resources under the resolution plan.
- A resolution plan shall provide for measures for insolvency resolution of the corporate debtor for maximization of value of its assets and may include reduction in the amount payable to the creditors, extension of a maturity date or a change in interest rate or other terms of a debt due from the corporate debtor, change in portfolio of goods or services produced or rendered by the corporate debtor, and change in technology used by the corporate debtor.
- The resolution plan approved by the committee of creditors shall be submitted by the RP to the Adjudicating Authority, at least 15 (fifteen) days before the expiry of the maximum period permitted for the completion of the fast track CIRP.

IBBI seeks public feedback on contents of Request for Proposal: With the aim of promoting transparency in the Corporate Insolvency Resolution Process, IBBI has sought to standardize the process for invitation and evaluation of resolution plans by releasing a draft outlining the requisite contents of a 'Request for Proposal' (i.e. invitation for resolution plans from prospective applicants keen to bid for the business of a corporate debtor undergoing Corporate Insolvency Resolution Process). Having access to crucial information such as evaluation process, evaluation criteria and timelines, would help prospective bidders to submit informed bids. According to Press Release dated 23-2-2018, last date for receipt of comments is 9th of March, 2018.

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RBI introduces Ombudsman Scheme for NBFCs: Following an earlier announcement in the Monetary Policy Statement (7-2-2018), the Reserve Bank of India (RBI) has recently (23-2-2018) launched an Ombudsman Scheme to provide consumers with an inexpensive and expeditious redressal mechanism for their complaints regarding deficiency in services by Non-Banking Financial Companies (NBFCs). This Ombudsman Scheme is applicable to registered NBFCs which are authorized to accept deposits or have customer interface, with assets of Rs.1 billion or above, as on the date of the audited balance sheet of the previous financial year.

Currently, certain categories of NBFCs (including Core Investment Companies, NBFCs under liquidation) are excluded from the ambit of this Scheme. To begin with, this Scheme will be operationalized for all deposit-taking NBFCs, and based on the experience gained, would be extended to include the remaining categories of NBFCs.

Additional methods of achieving minimum public shareholding: Regulation 38 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 read with the Securities Contracts (Regulation) Rules, 1957 (the SCRR) *inter alia* requires listed entities to comply with Minimum Public Shareholding (MPS) requirements. Currently, listed entities are required to make minimum offer and allotment of 25% (MPS) of each class or kind of equity shares or debenture convertible into equity shares issued by the company, subject to other terms and conditions stipulated in the SCRR. SEBI *vide* its Circular dated November 30, 2015, has prescribed various methods that can be used by a listed entity to achieve compliance with the MPS requirements.

To further facilitate listed entities to comply with such MPS requirements, SEBI has prescribed additional methods of achieving MPS, *vide* its latest Circular No. SEBI/HO/CFD/CMD/CIR/P/43/2018, dated 22-2-2018, as follows,

(i) Open markets sale of shares held by promoter/promoter group has been allowed up to 2% (two per cent) of the total paid-up equity share capital of the listed entity, subject to five times average monthly trading volumes of shares of the listed entity. The listed entity is also required to comply with certain conditions (at least one trading day prior to every proposed open market sale), i.e. appropriate disclosures and undertakings to the stock exchanges where the share of company is listed.

(ii) Allotment of eligible securities through Qualified Institutions Placement in accordance with the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Banning of Unregulated Deposit Schemes Bill, 2018: The Union Cabinet has given its approval to introduce the Banning of Unregulated Deposit Schemes Bill, 2018 in the Parliament. This Bill is aimed at tackling the menace of illicit deposit taking activities prevalent in India by addressing the existing regulatory gaps by *inter-alia* –

1. Prohibiting unregulated deposit taking activity;
2. Creating three different types of offences – running of Unregulated Deposit Schemes; fraudulent default in Regulated Deposit Schemes, and wrongful inducement in relation to Unregulated Deposit Schemes;
3. Imposing severe punishment and heavy pecuniary fines to act as deterrent;
4. Enabling disgorgement or repayment of deposits in cases where such schemes nonetheless manage to raise deposits illegally;
5. Delegating powers and functions to the competent authority including the power to attach assets of a defaulting establishment for restitution to depositors;
6. Designation of Courts to oversee repayment of depositors and to try offences under the Act; ; and
7. Creating an online central database, for collection and sharing of information on deposit taking activities.

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Ratio Decidendi

Limitation period for filing appeals from Orders of NCLT

Key Points:

Section 421(3) of the Companies Act, 2013 provides the limitation period in respect of filing of an appeal from Orders of the National Company Law Tribunal. An appeal is required to be filed within a period of 45 days from the date on which a copy of the said order of the Tribunal is made available to the person aggrieved. Section 421 also provides a further grace period of 45 days, subject to the satisfaction of National Company Law Appellate Tribunal that the appellant was prevented by sufficient cause from filing an appeal within the initial 45 day-period. Further, Section 433 of the Act states that provisions of the Limitation Act, 1963, shall, as far as may be, apply to proceedings or appeals before the NCLT or NCLAT, as the case may be.

Brief Facts:

An appeal to NCLAT was preferred by the Appellant from an Order of the NCLT. However, such appeal had been filed with a delay of 9 days after expiry of the period of limitation and the grace period provided under Section 421(3) of the Act. Accordingly, the appeal was dismissed by the NCLAT. Assailing this order of the NCLAT, the Appellant preferred an appeal before the Supreme Court.

The Appellant placed reliance on Section 433 of the Act that the provisions of Limitation Act apply to the proceedings or appeals, and therefore Section 5 of the Limitation Act which provides for condonation of delay for sufficient cause in case of appeals would be applicable to condone the delay beyond the period provided under Section 421(3) of the Act.

Held:

The Supreme Court held that a cursory reading of Section 421(3) and its proviso makes it clear that the Act provides a period of limitation different from that provided in the Limitation Act, and also provides a further grace period of 45 days only if the NCLAT is satisfied that an appellant was prevented by sufficient cause from filing its appeal within such period. It was held that therefore, reliance cannot be placed upon Section 433 of the Act, to invoke the provisions of the Limitation Act as it applies to a limited extent possible, in view of the words "*as far as may be*" contained therein. The proviso to Section 421(3) of the Act being a special provision, Section 5 of the Limitation Act cannot apply.

Order:

The appeal was dismissed. [*Bengal Chemists & Druggists Association.* v. *Kalyan Chowdhury* - 2018 SCC OnLine SC 81]

Synchronized trading executed with a view to manipulate markets is in violation of SEBI Regulations

Brief Facts:

There were two groups of respondent parties – three traders and three brokers. Show causes notices were sent to the parties alleging that the parties had been buying and selling securities in the derivatives segment at a price which did not reflect the value of the underlying securities in synchronised and reverse transactions. A 'synchronised' trade is one where the buyer and seller enter the quantity and price of the shares they wish to transact at substantially the same time, either through the same broker or through two different brokers. Every buy and sell order

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has to match before the deal can go through. 'Reversal of trade' implies that for a buy transaction initially entered into by a broker for a particular client for a specific quantity, there is a corresponding sale transaction which takes place during the day for the same quantity between the same set of broker/clients and vice-versa.

In 2007, SEBI suspected manipulation in the trading of Futures & Options segment (F&O), and found that Rakhi Trading and some other firms had undertaken fictitious trades. The A.O. analysed trade logs and observed that trades executed by Rakhi Trading matched with the counter-party Kasam Holding Private Limited in a few seconds and that these trades were reversed between the same parties within few minutes, showing significant difference in prices without any significant change in the value of the underlying securities. Further, in all these transactions, the Appellant made profits while the counter-party suffered continuous losses, thus raising doubts about the geniuneness of these transactions.

SEBI proceeded against the traders for violating provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (the PFUTP Regulations) and against the brokers for violating provisions of SEBI (Stock Brokers and Sub-brokers) Regulations, 1992. According to the A.O., a manipulative/deceptive devise had been used for synchronization and reversal of trades and the trades were essentially fraudulent/fictitious in nature and resulted in creating a misleading appearance of active trading in those securities. Subsequently, SEBI imposed a penalty of Rs. 10.8 million in March 2009 for allegedly creating artificial volumes of F&O on the National Stock Exchange.

However, the Order was struck down by the Securities and Appellate Tribunal (SAT) in 2011 on grounds that synchronization and reversal of trades effected by the parties with a significant price difference, some in a few seconds and majority, in any case, on the same day had no impact on the market, had not affected the NIFTY index in any manner nor induced investors. SAT held that such trades are illegal only when they manipulate the market in any manner and induce investors.

Points for consideration:

'Synchronisation' or a negotiated deal *ipso facto* is not illegal. A synchronised transaction will, however, be illegal or violative of the PFUTP Regulations if it is executed with a view to manipulate the market or if it results in circular trading or is dubious in nature and is executed with a view to avoid regulatory detection or does not involve change of beneficial ownership or is executed to create false volumes resulting in upsetting the market equilibrium. Any transaction executed with the intention to defeat the market mechanism whether negotiated or not would be illegal.

Held:

The Supreme Court allowed the appeal preferred by SEBI against the traders, set aside the SAT order and held that the impugned transactions were indeed a manipulative and deceptive device. It was held that the trade reversals in the instant case amply demonstrated that the parties did not intend to transfer beneficial ownership through these transactions. Rather, the repeated reversals adversely affected the price discovery system, deprived other market players from participating in the trades, were a misuse of market mechanism and therefore violative of transparent norms of trading in securities. Considering the perfect matching of quantity, price and time and sale in the impugned transactions, parties being persistent in the number of such trade transactions with huge price variations (without any major variation in the price of the underlying securities) wherein one

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party repeatedly booked profits whilst the other repeatedly incurred losses, the Supreme Court noted that it would be too naïve to hold that such transactions were by mere coincidence. The Court further observed that SEBI cannot be expected to track persons who were actually induced to buy or sell securities as a result of such manipulation - once the fact of manipulation is established, it necessarily follows that investors in the market have been induced to buy or sell and no further proof in this regard is required as SEBI cannot be imposed with a burden which is impossible to be discharged.

With respect to the appeal preferred by SEBI against the brokers, in the absence of any material from SEBI suggesting negligence or connivance on the part of the brokers, the Supreme Court dismissed such appeal. [*Securities and Exchange Board of India* v. *Rakhi Trading Private Ltd.* - 2018 SCC OnLine SC 101]

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