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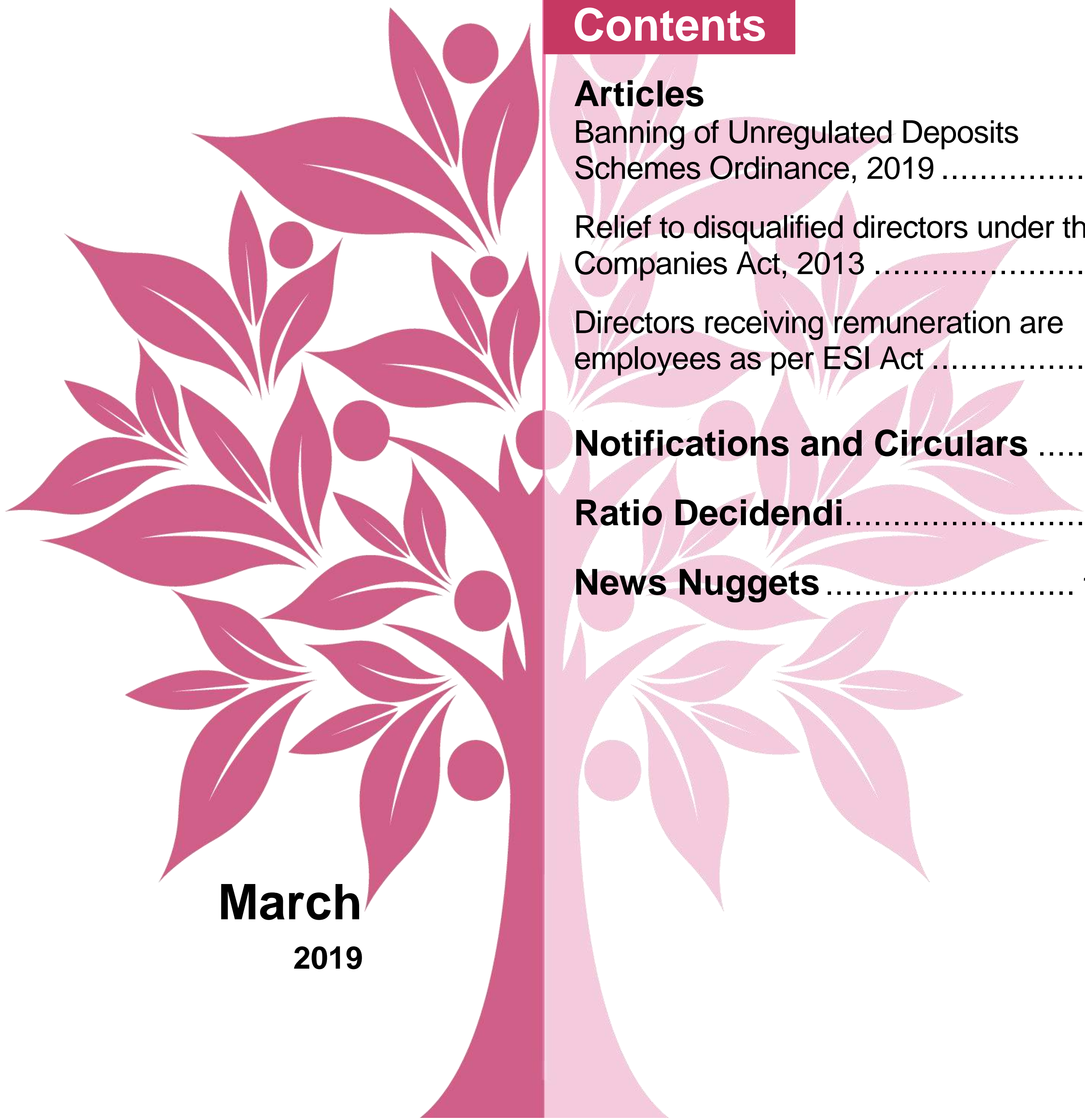


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## Articles

# Banning of Unregulated Deposits Schemes Ordinance, 2019

*By* **Sudish Sharma and Vishakha Singh**

Indian economy in the recent times has witnessed a plethora of fraudulent corporate malpractices. The issue of illegal deposit-taking activities has been a concerning one, causing various financial frauds in forms of 'ponzi' schemes, 'chit funds' scams etc. There has been a dire need to counter such illicit practices, and to initiate another deterrent action against the black money generated out of such illicit-deposit taking activities. Therefore, in order to address the illegal deposit taking activities, subsequent issues arising therefrom, and to regulate them, the Government of India introduced, 'Banning of Unregulated Deposits Schemes Bill, 2018' ("Bill") in the Parliament. However, the Bill could not be passed in Rajya Sabha of the Parliament. Subsequently, the Government of India promulgated, "Banning of Unregulated Deposits Schemes Ordinance, 2019" on February 21, 2019 ("Ordinance"). From the date of its promulgation, the Ordinance completely bans all the 'unregulated deposits schemes'.

Aimed at protecting the unwary investors from fraudulent 'chit-funds' schemes or 'ponzi' schemes, and to safeguard interest of the stakeholders, the Ordinance not only bans and regulates the illicit deposit taking practices but also penalizes the defaulters.

The Ordinance provides for punishment involving both fine and imprisonment for the offences involving (i) soliciting deposits under the unregulated deposit schemes, (ii) acceptance of deposits under the unregulated deposit schemes, (iii) fraudulent default in registered deposit schemes and (iv) wrongful inducement in relation to unregulated deposit schemes.

The Ordinance defines the term 'unregulated deposits schemes' to mean "***a scheme or an arrangement under which deposits are accepted or solicited by any deposit taker by way of business*** *and which is not a Regulated Deposit Scheme…*". Regulated deposits schemes, on the other hand, are defined as the schemes which are operated by the government-controlled authorities such as SEBI, RBI, IRDA, and statutory authorities under any state government.

Section 3 of the Ordinance puts a complete ban on the unregulated deposits scheme. Therefore, any scheme or arrangement, not being a regulated deposit scheme, whereby the deposits are accepted or solicited by the deposit taker by way of business, will be 'unregulated deposit scheme', and shall stand banned after the promulgation of the Ordinance.

Section 2(4) of the Ordinance, *inter alia*, defines the term 'deposit' as an amount of money received by way of an advance or loan or in any other form, by any deposit takes with a promise to return either in cash or in kind in the form of a specified service and which does not include amount received by an individual by way of loan from the **relatives** of any of its partners.

Under Section 2(77) of the Companies Act, 2013, Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014, the term 'relative' is defined to include family members and blood relatives. It is to be noted here that the

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term, 'relative' under the Companies Act, 2013, does not include friend and other acquittances. Given that the intention of the Ordinance is to ban the illicit deposit taking activities and ponzi schemes only, the individuals taking loans from friends for any personal work or business should not have adverse implications.

In relation to companies, partnership firms, proprietorship or other small businesses, another concern which may be raised, is taking of unsecured loan from the unrelated sources. In terms of Section 2(4)(l) of the Ordinance, it can be implied that the unsecured loan can be taken from any unrelated entity. Therefore, taking of unsecured loan from the unrelated sources by such small businesses may fall outside the scope of this Ordinance.

The Ordinance is, undoubtedly, aimed and intended to prohibit the acceptance of illicit deposits by deceitful and unscrupulous sources. However, in light of raising issues pertaining to the funds, ambiguities in the interpretation and in absences of official clarifications, the speculations are needed to be addressed promptly in order to protect interests of the stakeholders.

**[The authors are Executive Partner and Associate, respectively in Corporate practice, Lakshmikumaran & Sridharan, New Delhi]**

## Relief to disqualified directors under the Companies Act, 2013

*By* **Tanya Sharma and Anantha Desikan**

Section 164 of the Companies Act, 2013 ("Companies Act") deals with the eligibility criteria for appointment of a director in a company and one of the eligibility criteria is that in case a company does not file the financial statements or annual returns for a continuous period of 3 (three) years, then the directors of such company will become disqualified from being (i) re-appointed in such company and (ii) appointed in other companies as directors for a period of 5 (five) years from the date of becoming disqualified.

The Section 164 of the Companies Act was critically analysed by different courts after the notification of Ministry of Corporate affairs ("MCA") issued on September 12, 2017 ("MCA Notification") wherein MCA had published a list of directors who were associated with "struck off companies" by exercising the powers assigned to it under Section 248 of the Companies Act and showcased the status of those 3,09,614 directors of the struck off companies as "disqualified" directors.[1]

It was a move towards removal of shell companies that were one of the sources of generating black money. However, one of the issues with the given MCA Notification was its retrospective applicability on the companies. Typically, all statutes have prospective application unless contrary intentions can be construed from it.[2] However, the MCA Notification had come into force with effect from April 1, 2014 and took into its ambit non-compliance vis-à-vis Section 248 of the Companies Act in relation to financial years 2014-15, 2015-16, and 2016-17.

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[1] http://www.mca.gov.in/MinistryV2/disqualifieddirectorslist.html
[2] 1951 AIR 128

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In furtherance of exercise of the powers, a scheme namely "Condonation of Delay Scheme 2018" ("CODS")[3] was introduced by MCA pursuant to which a three-month long window was provided to defaulting companies to submit their annual filings starting January 1, 2018 to March 31, 2018. Such move came as a sigh of relief for several directors who were disqualified.

In a writ petition filed by *M/s. Dr. Reddy's Research Foundation & Ors. v. The Ministry of Corporate Affairs & Anr.,* the Hyderabad High Court directed to restore the Director Identification Number ("DIN") of the directors to enable such directors to submit annual returns in respect of the defaulting company for the years 2011 and 2016. In another important judgment, even Bombay High Court granted relief to the directors of the companies, who were disqualified by MCA, by passing an interim order, pursuant to which such directors were no longer be considered as disqualified. The Bombay High Court also directed the Registrar of Companies to accept the physical documents of the companies which were struck off and whose directors were disqualified and to treat them as applications for voluntary striking off. Similar stands were taken by various high courts such as High Court of Delhi and High Court of Rajasthan. Few directors were reinstated in furtherance of CODS while others were struck off in the cross fire.

A legal recourse finally provided a glimmer of light to the aggrieved parties when in the case of *Gaurang Balvantlal Shah v. Union of India,*[4] the Hon'ble Gujrat high Court quashed the MCA Notification and held that Section 164(2) of the Companies Act will have prospective effect and not retrospective effect and consequently, the default in filing the financial statements or the annual returns shall be counted from the F.Y. 2014-15.

The judgement of Hon'ble Gujarat High Court is a sigh of relief for 3,09,614 directors who have been disqualified by the MCA since the judgement will have effect throughout the territory of India unless contrary judgement is given by another High Court or the Hon'ble Supreme Court of India.

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## Directors receiving remuneration are employees as per ESI Act

*By* **Ankit Parhar**

In *Employees' State Insurance Corporation v. Venus Alloy Pvt. Ltd.*[5], the Supreme Court has held that Directors of a company, who are receiving remuneration, would fall within the definition of an "employee" as provided under Section 2(9) of the Employees' State Insurance Act, 1948 ('Act') and that the company is bound to deposit contributions in relation to the remuneration paid to such Directors.

The judgment was passed by the Supreme Court in an appeal arising out of a judgment of the High Court of Madhya Pradesh, wherein the High Court had upheld the decision of the Employees'

[3] vide General Circular No. 16/2017 dated 29.12.2017

[4] C/SCA/22435/2017

[5] Civil Appeal No. 1464 of 2019 decided on 05th February

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State Insurance Court ('ESI Court') holding that a company is not bound to deposit contributions in relation to the remuneration paid to its Directors.

The facts before the Supreme Court were that during an inspection carried out by the Appellant ('Corporation'), it was discovered that the Respondent ('Company') had not been depositing contributions in relation to the remuneration paid to its Directors. Subsequently, the Corporation raised a demand calling upon the Company to deposit contributions in relation to the remuneration paid to its Directors.

This demand was challenged by the Company before the ESI Court under Section 75 of the Act. The ESI Court referred to the judgment of the Supreme Court in *Employees' State Insurance Corporation v. Apex Engineering Pvt. Ltd.*[6] wherein the Supreme Court had held that the provisions of the Act were applicable to the remuneration received by a 'Managing Director'. However, the ESI Court held that the judgment in *Apex Engineering* (supra) would not apply to the remuneration received by a 'Director' and set aside the demand raised by the Corporation.

The Corporation challenged the judgment of the ESI Court under Section 82 of the Act before the High Court. The High Court relied upon the judgments of the Bombay High Court in *Sakal Papers Pvt. Ltd. v. Employees' State Insurance Corporation*[7] and *Employees' State Insurance Corporation v. Apex Engineering Pvt. Ltd.*[8] and upheld the decision of the ESI Court.

The Corporation challenged the judgment of the High Court before the Supreme Court. The Corporation relied upon the decisions of the Supreme Court in *Apex Engineering* (supra) and *Saraswath Films v. Regional Director, Employees' State Insurance Corporation, Trichur*[9]. The Company argued that the decision in *Apex Engineering* (supra) was distinguishable as the Managing Director in that case was discharging additional duties over and above his duties as a Director.

The Supreme Court referred to the definitions of the terms "employee" and "wages" as provided in Section 2(9) and Section 2(22) of the Act, respectively. The Supreme Court also referred to the judgment in *Saraswath Films* (supra), wherein it was held that the definition of the term "employee" under Section 2(9) of the Act is wide and comprehensive. The Supreme Court referred to the relevant portions of the judgment in *Apex Engineering* (supra) wherein it was held that there was nothing in the Act to indicate that a 'Managing Director' cannot also be an 'employee' for the purposes of the Act. After referring to the relevant provisions of the Act and the judgments stated above, the Supreme Court concluded that the ratio of *Apex Engineering* (supra) applies with greater force in relation to a Director of the Company, if the Director is paid remuneration for discharging the duties entrusted to him.

The Supreme Court also stated that the manner in which the ESI Court attempted to distinguish the decision of the Supreme Court in *Apex Engineering* (supra) was 'curious' and that the High Court fell in error by failing to appreciate that the decisions of the Bombay High Court in *Sakal Papers* (supra) and *Apex Engineering* (supra) stood effectively overruled by the decision of the Supreme Court in *Apex Engineering* (supra).

The judgment of the Supreme Court in *Apex*

[6] (1998) 1 SCC 86
[7] MHLJ 1995 Vol. 2 Page 69
[8] MHLR 1990 Vol. 2 Page 850 2019
[9] (2010) 11 SCC 553

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*Engineering* (supra) had settled the issue as far as the remuneration received by a 'Managing Director' is concerned. Even though it is apparent that the ratio of the said decision would squarely apply to the remuneration received by a 'Director', it appears that the ESI Court and the High Court failed to appreciate the position. With this judgment, one can hope that the issue of the applicability of the Act to the remuneration received by any Director of a company would finally stand settled.

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## Notifications and Circulars

**ECB facility for resolution applicants under Corporate Insolvency Resolution Process:** The Reserve Bank of India by way of a Circular dated February 07, 2019 has relaxed the regulatory regime on ECBs. Accordingly, resolution applicants under the Corporate Insolvency Resolution Process under Insolvency and Bankruptcy Code, 2016 ('Code') can raise ECBs from the recognised lenders, except from the branches/ overseas subsidiaries of Indian banks, for repayment of Rupee term loans of the target company under the approval route. Further, the resolution applicants, who are otherwise eligible borrowers, can forward such proposals to raise ECBs, through their AD bank for RBI approval.

**Amendments to Indian Stamp Act, 1899 by Finance Act, 2019:** Part I of Chapter V of the Finance Act, 2019 amends the Indian Stamp Act, 1899. The amendments introduce a single point for collection of stamp duty by authorized entities for issuance and transfer of securities and subsequent disbursement of the duty collected to the respective states. The amendments have come into force from 21st of February 2019.

*Definitions:* Certain definitions have been amended:

The definition of 'Instrument' has been amended to include a document, electronic or otherwise, created for a transaction in a stock exchange or depository by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded; and any other document mentioned in Schedule I.

'Market value' in relation to an instrument through which any security is traded in a stock exchange, is defined as the price at which it is so traded; any security which is transferred through a depository but not traded in the stock exchange, means the price or the consideration mentioned in such instrument; any security is dealt otherwise than in the stock exchange or depository, means the price or consideration mentioned in such instrument.

*Key Changes:*

All issuance and transfers of 'securities' will be subject to stamp duty. Till now, securities in dematerialised form were exempt from stamp duty. Pursuant to the amendment, stamp duty on dematerialised securities is to be collected by stock exchanges/ clearing corporations/ depositories on the market value of such securities at the time settlement of the transaction and shall within three weeks of the end of each month be remitted to respective state governments.

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The state government for the purpose of remittance of stamp duty is (i) the state where the residence of the buyer is located; (ii) in case the buyer is located outside India, to the state government in which the registered office of the trading member or broker of such buyer is situated; and (iii) in case where there is no such trading member of the buyer, to the state government having the registered office of the participant.

All rates shall be applicable only on one side (either by the buyer or by the seller but not by both), while presently, some states charge stamp duty on both sides. As per press release dated February 21, 2019, stock exchanges/ clearing corporations/ depositories shall be eligible for commission on facilitating stamp duty collection.

From the commencement of the amendments, no stamp-duty shall be charged or collected by the state government on any note or memorandum or any other document, electronic or otherwise, associated with the transactions done through a stock exchange or a depository. For transactions not on the depositories or on the floor of the exchange, stamp duty must be paid by issuer / transferor.

Prior to the amendments, the transfer of (i) registered ownership of securities from a person to a depository or from a depository to a beneficial owner; (ii) beneficial ownership of securities, dealt with by a depository; (iii) beneficial ownership of units, such units being units of a Mutual Fund including units of the Unit Trust of India established under sub-section (1) of section 3 of the Unit Trust of India Act, 1963 (52 of 1963), dealt with by a depository were exempt from stamp duty. Under the proposed changes, transfer of beneficial ownership of securities and the beneficial ownership of mutual fund units that are dealt by a depository are liable to stamp duty.

Revised rates of stamp duties are as follows:

| **Instrument** | **Stamp duty payable on market value** |
|---|---|
| Issuance of debentures (irrespective of whether marketable or not) | 0.005% |
| Transfer of debentures (irrespective of whether marketable or not) | 0.0001% |
| Issuance of securities (other than debentures) | 0.005% |
| Transfer of security (delivery basis) | 0.015% |
| Transfer of security (non-delivery basis) | 0.003% |
| Equity and commodity futures | 0.002% |
| Equity and commodity options | 0.003% |
| Currency and interest rate derivatives | 0.0001% |
| Other derivatives | 0.002% |
| Government securities | 0% |
| Repo on corporate bonds | 0.00001% |

A new Section 62A has been introduced to prescribe penalties for default by the stock exchange or a clearing corporation or the depository in collecting the stamp duties or transferring the same to the respective state governments within 15 days of the expiry of the specified time.

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# Ratio Decidendi

## Insolvency and Bankruptcy Code is constitutionally valid

*Brief Facts:*

The present writ petition challenged the constitutional validity of various provisions of the Insolvency and Bankruptcy Code, 2016 (Code).

*Issues for Consideration:*

1. Whether the classification between financial creditors and operational creditors is violative of Article 14 of Constitution of India?
2. Whether Section 12A of IBC is violative of Article 14 of Constitution of India?
3. Whether the resolution professional is performing adjudicating functions?
4. Whether Section 29A is constitutionally valid?

*Held:*

***On distinction between Financial and Operational Creditors:***

On the issue relating to classification of financial and operational creditor, it was held that the financial creditors are mostly secured creditors while operational creditors are unsecured creditors. The Court held that the distinction between secured and unsecured creditors is not only justified but also beneficial. An event of default is far easier to establish and verify for financial creditors as electronic records of the financial creditors are usually filed in the Information Utilities. Further, financial creditors who are mostly banks are better equipped to engage in restructuring of loans as well as reorganization of the corporate debtor's business.

The Court further held that a claim gives rise to a debt only when it becomes due and a default occurs only when a debt becomes due and payable and is not paid by the debtor. It is for this reason that a financial creditor has to prove default as opposed to an operational creditor who merely claims a right to payment of a liability or obligation in respect of a debt which may be due. When this aspect is borne in mind, the differentiation in the triggering of insolvency resolution process by financial creditors under Section 7 and by operational creditors under Sections 8 and 9 of the Code becomes clear.

The Apex Court noticed the fact that a resolution plan cannot pass muster under Section 30(2)(b) read with Section 31 unless a minimum payment is made to operational creditors, being not less than liquidation value. It was finally held that the operational creditors are not discriminated on the ground of equals being treated unequally or on the ground of manifest arbitrariness.

***On Section 12A:***

The Apex Court held that the Code gets triggered by admission of a creditor's petition under Sections 7 or Section 9 or Section 10. The proceeding that is before the Adjudicating Authority, being a collective proceeding, is a proceeding *in rem*. It was held that once the resolution process commences, the proceedings are no longer between the applicant creditor and debtor, but it is one which involves all creditors. This is solely to prevent settlements to the exclusion of the other creditors. Hence, the high threshold of ninety percent approval for withdrawal of application admitted under Section 7 or Section 9 or Section 10. However, it was also clarified that at any stage where the CoC is not yet constituted, a party can approach the

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NCLT directly, and the NCLT may in exercise of its inherent powers permit such withdrawals.

***On adjudicatory powers of Resolution Professional:***

The Apex Court held that unlike the liquidator, the resolution professional cannot act in a number of matters without the approval of the CoC under Section 28 of the Code, which can, by a two-thirds majority, replace one resolution professional with another, in case they are unhappy with his performance. It was held that the resolution professional is really a facilitator of the resolution process, whose administrative functions are overseen by the CoC and by the Adjudicating Authority.

***On the constitutional validity of Section 29A:***

It was held that the restriction imposed under Section 29A(j) of the Code would apply only if the said resolution applicant was connected to the business activity of the resolution applicant. The expression related party, therefore, and relative contained in the definition must be read *noscitur a sociis* with the categories of persons mentioned in Explanation I to the said section, and so read, would include only persons who are connected with the business activity of the resolution applicant.

[*Swiss Ribbons Pvt. Ltd.* v. *Union of India* - 2019 SCC OnLine SC 73]

**Directors of corporate debtor can have access to documents relevant for matters to be discussed in CoC meetings**

*Key Point:*

The scheme of the Insolvency and Bankruptcy Code, 2016 (Code) makes it clear that the directors, though not members of the Committee of Creditors (CoC), have a right to participate in every meeting of the CoC. The notice of the CoC meeting, which is required to be given to the directors as well, must contain copies of all the documents relevant for matters to be discussed, including the resolution plans.

*Brief Facts:*

The present appellant prayed before the NCLT that a suspended director of the corporate debtor be allowed to effectively participate in the meetings held by the CoC. By an order, NCLT held that the directors have the right to attend the CoC meetings as per Section 24 of the Code. However, the directors could not receive the information that is considered confidential by the resolution professional or the CoC, including the resolution plans. The order of NCLT was appealed before NCLAT. Dismissing the appeal, NCLAT upheld the decision of NCLT, which was then carried to the Supreme Court.

*Issues Raised:*

Whether directors of corporate debtor can have access to all the documents relevant for matters to be discussed in CoC meetings, including the resolution plans?

*Held:*

The Hon'ble Supreme Court held that the scheme of the Code makes it clear that the directors, though not members of the CoC, have a right to participate in every meeting of the CoC. However, it was held that under Regulation 21(3)(iii) of the CIRP Regulations, the notice of the CoC meeting, which is required to be given to the directors as well, must contain copies of all the documents relevant for matters to be discussed, including the resolution plans.

The Apex Court further held that pursuant to the powers under Regulation 7(2)(h) of the IBBI (Insolvency Professionals) Regulations, 2016, read with paragraph 21 of the First Schedule

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thereto it is clear that the resolution professional can take an undertaking from members of the suspended Board of Directors, as has been taken in the facts of the present case, to maintain confidentiality of the information. This can be in the form of a non-disclosure agreement in which the resolution professional can be indemnified in case information is not kept strictly confidential.

[*Vijay Kumar Jain* v. *Standard Chartered Bank* - 2019 (2) SCALE 352]

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## News Nuggets

### Companies (Incorporation) Rules – Rules 30(5) and 38(2) amended

No fee is payable on INC-32 (SPICe), filed in case of application for incorporation of a company, if nominal capital of company is less than or equal to Rs. 15 lakhs. Rule 38(2) of Companies (Incorporation) Rules, 2014 has been amended by a Notification dated 6-3-2019 to substitute the henceforth available limit of Rs. 10 lakhs.

Further, Rule 30(5) has also been amended to state that in respect of shifting of the registered office, an advertisement must be published in an English newspaper with 'wide publication'. The words were 'widest publication' before the amendment.

### Civil court does not have jurisdiction in any transaction created under IBC

Observing that IBC Sections 63 and 231 bar the jurisdiction of a civil court in any matters of NCLT and that non-obstante clause of Section 60(5) ensures that NCLT alone has jurisdiction to entertain matters relating to IBC, Delhi High Court has held that High Court cannot interfere even in cases where resolution process has not been approved by CoC.

Court in *Liberty House Group v. SBI*, rejected the suit for restraining encashment of bank guarantee observing that plaintiff, the resolution applicant, had delayed payments under Bid Bond Guarantee. Court directed plaintiff to pay suit costs.

### New Delhi International Arbitration Centre – Ordinance promulgated

New Delhi International Arbitration Centre Ordinance 2019 has been promulgated by the President of India on 2nd of March 2019. It provides for establishment of New Delhi International Arbitration Centre for creating an independent and autonomous regime for institutionalised arbitration in India.

Ordinance also calls for taking over undertakings of International Centre for Alternative Dispute Resolution and for declaring the new Centre as institution of national importance. The Centre will establish a Chamber of Arbitration which will empanel arbitrators.

### Adjudicating officer can determine quantum of penalty outside SEBI Section 15-J

Larger Bench of Supreme Court has held that clauses (a), (b) and (c) of Section 15-J of the SEBI Act are not exhaustive and that there can be other circumstances which can be

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noted by adjudicating authority for determination of quantum of penalty. It also held that provisions of Section 15-J are never eclipsed in cases of default and must be read harmoniously with Sections 15A(a) to 15HA.

The court in *Adjudicating Officer SEBI v. Bhavesh Pabari* opined that the provision of one section cannot be used to nullify another unless it is impossible to reconcile the two.

**CCI may choose not to carry investigation when prima facie case absent**

NCLAT has held that investigation can be conducted by DG of CCI only on *prima facie* case warranting investigation into alleged contravention of the provisions s.3(1) and s.4(1) of the Competition Act.

NCLAT in *Reprographic India v. CCI,* upheld CCI order of closing an information file on alleged bid rigging of a tender, without carrying investigation, and held that low participation in bidding process does not indicate that respondents are involved in bid rotation. The Appellate Tribunal also observed that officials of one respondent company working earlier with the other respondent company is a routine affair of information technology industry and cannot be used to infer meeting of minds for the purpose of bid rigging.

**No interest for delayed payment if arbitration agreement prohibits**

Supreme Court has held that when agreement between parties imposes a complete bar on arbitral tribunal to award *pendente lite* interest, interest cannot be imposed. It noted that legal position has taken a paradigm shift from Arbitration Act 1940 to the 1996 Act as clarified in *Sayeed Ahmed v. State of UP.*

Court in *Jaiprakash Associates v. Tehri Hydro Development Corp.* refused to interfere with the High Court order quashing arbitral award of interest. It also held that rule of *ejusdem generis* is applied only in distinct category which is lacking in the instant case.

**Registration of company name under Section 22 not to be challenged beyond 5 years**

Delhi High Court has held that registration of a name cannot be challenged under Section 22(1)(ii) of the Companies Act if said name is in use for more than 5 years, and that period of limitation cannot be extended by claiming ignorance. Case involved challenge to name NTK Bearings, when applicant was proprietor of trademark NTK.

Court in *NGK Spark Plug v. UOI* refused to interfere with the decision rejecting application seeking rectification of company's name. It was held that details of company once placed in public domain, to be contested within 5 years from said date. .

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