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PCA for NBFCs

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CREATE & GROW
RESEARCH FOUNDATION

INDEX

குறள்: 758
குன்றேறி யானைப்போர் கண்டற்றால் தன்கைத்தொன்று உண்டாகச் செய்வான் வினை.

Thirukural: 758
Starting to do an act having money in his hand, is as safe as someone from a hill-top watching tuskers fighting fiercely.

From the Editor's Desk

Dear Readers of CGRF SandBox

Take a deep breath… Another year has gone past us. It's curtains for 2021 and time to bid farewell.

Albert Einstein's famous explanation for the theory of relativity might be interesting to hear but it might be misunderstood in today's context. So, I take the liberty of saying it in a slightly different way: "**When you sit with someone you love for two hours you think it's only a minute, but when you sit on a hot stove for a minute you think it's two hours. That's relativity."** The kind of trauma the pandemic brought upon the humanity in 2020 was so huge, it appeared the year was so long. In comparison, 2021 seemingly flew away as travel restrictions were relaxed to a larger extent. In hindsight, the pandemic brought the world closer by way of digital connectivity. Let's therefore thank both 2020 and 2021 while welcoming 2022.

Prompt Corrective Action (PCA) mechanism for NBFCs

The Reserve Bank of India, vide its notification dated 14th December 2021, has proposed to put in a PCA framework for Non-Banking Financial Companies which will take effect from 1st October 2022. Recent failures of NBFCs like ILFS, DHFL, Srei Infrastructure, etc., have prompted the central bank to prescribe some bitter pills to strengthen the supervisory mechanisms.

There are three key financial parameters that the RBI will be monitoring – **capital, asset quality and leverage**. The PCA framework lays out specific thresholds for each of these metrics and if an NBFC breaches these thresholds, it will be subjected to the PCA framework which could lead to halting expansions, limiting disbursals, suspending dividend distribution, raising capital or expediting recoveries. It may also require NBFCs to formulate a time-bound strategy to reduce exposure and strengthen their balance sheets.

As the NBFC sector is considered as a shadow banking channel, subjecting them to a PCA framework similar to the banks is a welcome step.

Infrastructure Investment Trusts

It was interesting to read a newspaper story recently which said the Government itself would push hard to set up and promote infrastructure investment trusts which would enable the small investors to reap the benefit of a better return on their investment compared to bank deposits. It would be great, if such an initiative fructifies at the earliest.

75 years of Independent India

The Government has taken several initiatives to celebrate and commemorate the 75 years of political independence and spread awareness amongst the younger citizens about the glorious history of India's people and culture and the reforms measures taken to achieve economic independence. **Azadi Ka Amrit Mahotsav (AKAM)** is expected to focus on the power of youth to achieve all-round progress for the country.

(Image source: website)

Happy New Year 2022

The global climate challenges are getting formidable these days with extreme instances of cyclones, rains, forest fires and volcano eruptions across the planet. Before it is too late, the humanity as a whole has to put its act together to reduce emissions. It would be ideal if 2022 could be named as "The Year of Clean Earth". "Net Zero" should become a reality sooner.

Our heart-felt condolences to the families of the Chief of Defence Services and the veterans who lost their lives in a tragic helicopter crash in Tamil Nadu on 8th Dec. 2021. On a positive note, it is exciting to see some more Indians breaking the glass ceiling: Parag Agarwal as CEO of Twitter, Leena Nair as CEO of Chanel. Not to miss the coveted glory of Harnaaz Sandhu becoming Miss Universe 2021, after a gap of 21 years!!

Yours truly

S. Rajendran

Understanding Prompt Corrective Actions for Banks and NBFCs by Reserve Bank of India

S. Venkataraman
Chief General Manager (Retd.) SBI
Insolvency Professional

Prompt Corrective Action (PCA) for Banks

The Reserve Bank of India's Prompt Corrective Action (PCA) Framework was first introduced for Banks in the year 2002. PCA Framework is applicable to all banks operating in India including foreign banks operating through branches or through subsidiary route. PCA has been introduced to have a structured intervention mechanism, to address certain critical weaknesses in Banks at an early stage itself to prevent any catastrophic event which would have far reaching effect on the society at large.

The objective of the PCA framework is to enable a supervisory intervention at the appropriate time, before it becomes too late, in order to create an effective discipline in such banks which are brought under PCA framework. This framework would facilitate the supervised entity, to initiate and implement remedial measures in a time bound manner, so as to restore its financial health which would ultimately result in strengthening its balance sheet, which in turn would lead to a greater public confidence.

(Image source: website)

The RBI has recently (2/11/2021) modified the trigger points for banks, subjecting them to PCA. They are Capital (Breach of either CRAR or CET 1 ratio), Asset Quality (Net NPA) and Leverage.

Breaches of any risk threshold (as detailed under) may result in invocation of PCA.

PCA matrix – Parameters, indicators and risk thresholds				
Parameter	**Indicator**	**Risk Threshold 1**	**Risk Threshold 2**	**Risk Threshold 3**
(1)	(2)	(3)	(4)	(5)
Capital (Breach of either CRAR or CET 1 ratio)	CRAR - Minimum regulatory prescription for Capital to Risk Assets Ratio + applicable Capital Conservation Buffer (CCB) **and/or** Regulatory Pre-Specified Trigger of Common Equity Tier 1 Ratio (CET 1 PST) + applicable Capital Conservation Buffer (CCB)	Upto 250 bps below the Indicator prescribed at column (2) Upto 162.50 bps below the Indicator prescribed at column (2)	More than 250 bps but not exceeding 400 bps below the Indicator prescribed at column (2) More than 162.50 bps below but not exceeding 312.50 bps below the Indicator prescribed at column (2)	In excess of 400 bps below the Indicator prescribed at column (2) In excess of 312.50 bps below the Indicator prescribed at column (2)
	Breach of either CRAR or CET 1 ratio to trigger PCA			
Asset Quality	Net Non-Performing Advances (NNPA) ratio	>=6.0% but <9.0%	>=9.0% but < 12.0%	>=12.0%
Leverage	Regulatory minimum Tier 1 Leverage Ratio	Upto 50 bps below the regulatory minimum	More than 50 bps but not exceeding 100 bps below the regulatory minimum	More than 100 bps below the regulatory minimum

When a bank is placed under PCA, one or more of the following corrective actions may be prescribed by the RBI:

<table>
<tr><th colspan="3">Mandatory and Discretionary actions</th></tr>
<tr><th>Specifications</th><th>Mandatory actions</th><th>Discretionary actions</th></tr>
<tr><td>Risk Threshold 1</td><td>i. Restriction on dividend distribution/remittance of profits.
ii. Promoters/Owners/Parent (in the case of foreign banks) to bring in capital</td><td rowspan="3"><u>Common menu</u>
i. Special Supervisory Actions
ii. Strategy related
iii. Governance related
iv. Capital related
v. Credit risk related
vi. Market risk related
vii. HR related
viii. Profitability related
ix. Operations/Business related
x. Any other</td></tr>
<tr><td>Risk Threshold 2</td><td>In addition to mandatory actions of Threshold 1,
i. Restriction on branch expansion; domestic and/or overseas</td></tr>
<tr><td>Risk Threshold 3</td><td>In addition to mandatory actions of Threshold 1 & 2,
i. Appropriate restrictions on capital expenditure, other than for technological upgradation within Board approved limits</td></tr>
</table>

Discretionary Actions

It encompasses special supervisory monitoring/ inspection/audit. Review of business model, recovery plans, restructuring of operations, business process reengineering, change of management/ board, superseding Board, restriction on directors/management compensation, capital planning including raising of capital, measures to bolster reserves, restriction on investment, implementing measures to conserve capital, reduction of NPAs containing generation of NPAs, improvement in loan review mechanisms and improvement in other credit risk related areas, restriction on borrowing from inter-bank markets, raising of high cost funds, restrictions on capital expenditure, reduction in variable costs, branch expansion entering new/risky businesses etc.

We must also understand that the PCA Framework does not preclude RBI from taking any other further actions, as it may deems fit at any time, on these banks to protect the overall interest of all stakeholders.

To remove the bank(s) who are under PCA, the following measures would be considered undertaken by RBI for withdrawal of restrictions imposed under the Framework:

a) if no breaches are observed in risk thresholds in any of the parameters which are observed in the last four continuous quarterly financial statements, one of which should be Audited Annual Financial Statement (subject to assessment by RBI); and

b) based on its Supervisory comfort, including an assessment on sustainability of profitability status of the bank.

In the last two decades, RBI has placed eleven PSBs under the PCA framework , *(i)* Dena Bank (merged with Bank of Baroda), (ii) Central Bank of India <u>(only bank still continuous to be under PCA)</u>, (iii) Bank of Maharashtra (moved out of PCA in Jan 2019), UCO Bank (moved out of PCA in Sept 2021), (v) IDBI Bank (moved out of PCA in Feb 2021), (vi) Oriental Bank of Commerce (merged with Punjab National Bank), (vii) Indian Overseas Bank (moved out of PCA in Sept 2021) , (viii) Corporation Bank (merged with Union Bank of India) , (xi) Bank of India (moved out of PCA in Jan 2019) , (x) Allahabad Bank (merged with Indian Bank), (xi) United Bank of India (merged with Punjab National Bank) and (xii) Syndicate Bank (merged with Canara Bank).

Recent Policy measures undertaken by RBI in relation to operations of Non-banking Finance Companies (NBFCs)

(i) Scale based regulation for NBFCs

In October 2021, the RBI has introduced a scale-based regulation (SBR) for NBFCs which shall come into effect from October 1, 2022. Under this, the regulatory structure for NBFCs comprises of four layers, which is based on their size, activity and perceived riskiness. The scale-based framework encompasses different facets of regulation for NBFCs covering capital requirements, governance standards, prudential regulations etc. Under this framework, RBI has also tweaked the NPA classification methodology (like banks, overdues beyond

90 days will be classified as NPA for all categories of NBFCs). Additional requirements would be that the NBFC boards should have at least one director with relevant experience in having worked in a bank or NBFC. The guidelines also stipulate that a ceiling of Rs.1 crore per borrower for financing subscription to IPOs by the NBFC will be imposed (which can be tweaked by the NBFC to a lower limit).

As per SBR, the lowest layer will be known as NBFC – **Base Layer** (NBFC-BL) - an asset size up to Rs 1,000 crore including NBFCs-P2P (platforms offering peer-to-peer lending and borrowing) and NBFC Account Aggregators (where customer information is shared between RBI-regulated entities).

The **middle layer** will be known as NBFC – middle layer (NBFC-ML) - an asset size over Rs 1,000 crore and housing finance companies, core investment companies, infrastructure finance companies will be part of it.

Upper layer will be known as NBFC – upper layer (NBFC-UL). The upper layer NBFCs will be identified by the RBI. RBI will determine which NBFCs warrant enhanced regulatory requirements based on a set of parameters. The top 10 eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factors.

The **top layer** will for the time being remain empty. This layer would get populated if the RBI is of the opinion that there is a substantial increase in the potential systemic risk from any specific NBFCs in the upper layer. Such NBFC(s) would move to top layer from upper layer.

(ii) **The Prompt Corrective Action Framework for NBFCs**

NBFCs have traditionally enjoyed light-touch regulation by the RBI compared with banks. The RBI started paying more attention to NBFCs after the collapse of Infrastructure & Leasing Financial Services (IL&FS) in late 2018 which was followed by the crisis in Dewan Housing Finance Ltd. These episodes triggered high risk aversion and severe liquidity problems in the NBFC sector. The regulator stepped up scrutiny on NBFCs subsequently to avert similar episodes. The RBI on 14th December 2021 issued PCA framework for NBFCs. This means they will have to strictly meet benchmarks on capital requirement, non-performing assets (NPAs), and asset quality. The PCA framework for NBFCs, excluding government NBFCs, shall come into effect from October 1, 2022, based on the financial position of NBFCs on or after March 31, 2022.

NBFCs, have in the recent years, grown enormously in size (some equivalent to a small bank) and have substantial inter-connectedness with other segments of the financial system. NBFCs are also one of the largest borrowers from the banking system, as well as from markets in the form of deposits, bonds, NCDs etc. Accordingly, it is absolutely necessary a PCA framework for NBFCs is also put in place to further strengthen the supervisory tools applicable to NBFCs. These revised guidelines would be applicable to:

(Image source: website)

a) All deposit taking NBFCs (excluding government companies),
b) All non-deposit taking NBFCs in middle, upper and top layers (excluding - (i) NBFCs not accepting/not intending to accept public funds; (ii) government companies, (iii) primary dealers and (iv) housing finance companies).

The PCA framework introduced now for NBFCs is largely on similar lines of Banks. The core focus is on capital adequacy and NPA levels. The RBI framework has created three risk thresholds, failing each of which will attract different levels of regulatory actions viz. mandatory actions and discretionary actions.

According to the framework, the apex bank will impose PCA on NBFCs if there is any breach of risk threshold. For instance, if the CRAR falls up to 300 basis points (bps) below the regulatory minimum CRAR, tier-1 capital ratio falls up to 200 bps below the regulatory minimum and net NPA ratio goes beyond 6 percent, the NBFC will fall under **risk threshold-1**. The RBI will then impose restrictions on various business operations and will conduct special inspections and targeted scrutiny of the company.

For an NBFC under risk threshold-1, the RBI will impose mandatory restrictions on dividend distribution / remittance of profits; also, there will be restrictions on the issue of guarantees or taking on other contingent liabilities on behalf of group companies.

Similarly, if the CRAR falls more than 300 bps but up to 600 bps below the regulatory minimum, and the tier-1 capital ratio falls more than 200 bps but up to 400 bps below the regulatory minimum and net NPA shoots up beyond 9 percent and upto 12%, the NBFC will fall into

risk threshold-2. For such companies, in addition to the mandatory restrictions mentioned above, the RBI will impose mandatory restrictions on branch expansion also.

If the CRAR falls 600 bps below the regulatory minimum, the tier-1 capital ratio falls more than 400 bps below the regulatory minimum and the net NPA is greater than 12 percent, the NBFC will fall in the **risk threshold-3** category. In such cases, in addition to the mandatory actions of threshold 1 and 2, the RBI will take appropriate restrictions on capital expenditure and will impose restrictions on variable operating costs as well.

Once an NBFC is placed under PCA, taking it out of the framework or withdrawal of restrictions imposed under it will be considered only if no breaches in risk thresholds in any of the parameters are observed in four continuous quarterly financial statements, one of which should be the annual audited financial statement and also based on the supervisory comfort of the RBI, including an assessment on the sustainability of the NBFC's profitability. (which are similar to Banks).

Conclusion

In the financial system, in India, there are about 10,000 NBFCs. They are highly interconnected to both bond markets and banks. Hence, RBI's decision to introduce a Prompt Corrective Action (PCA) framework for NBFCs, on the lines similar to banks is a welcome move to attempt to institute an early-warning system on such NBFCs to protect the interest of all stakeholders, especially the gullible general public, who invest their hard earned money either as deposits or by subscribing to NCDs for better returns (as the interest offered by banks, currently, is much lower).

Compared to the PCA norms for banks, RBI appears to have set somewhat liberal thresholds for NBFCs before they attract PCA norms. The framework will apply only to middle and upper layer NBFCs, deposit-taking NBFCs and Core Investment Companies. RBI has perhaps set relaxed norms for NBFCs in recognition of the fact that they lend to far riskier borrowers than banks. But this leeway offered, may make an NBFC to land in considerable stress before it invites regulatory actions.

PCA norms for NBFCs will not immediately apply to government companies and leaves out all 'base layer' NBFCs. NBFCs promoted by the Central and State governments in India rely quite heavily on bond funds raised from public markets and sometimes on public deposits, with some undoubtedly in precarious financial shape. Given that public sector banks are very much under the PCA framework, there's a strong case for applying the same norms for government-owned NBFCs too.

The decision to exclude the base layer of NBFCs, (expected to be around 9300) with a less than ₹1,000 crore asset base including P2P lenders, digital lenders, account aggregators and small lenders — from PCA may also need a revisit by the regulator at an appropriate time, which however should not be long. Given that the digital lending and fintech revolution in India is increasingly being powered by small NBFCs, P2P firms, allowing such a large number of them to get away with light-touch regulations may pose risks to public confidence in the financial system, too.

A Snapshot of critical

Financial Parameters of major listed NBFCs

(in %)

	CAR	Tier1	NNPA
Cholamandalam Investment	19.6	16.7	4
M&M Financial Services	26.1	22.3	6.4
Shriram City Union Finance	29.1	28.0	3.5
Shriram Transport Finance	23.2	21.1	4.2
Manappuram Finance	31.8	31.5	1.3
Muthoot Finance	27.2	26.3	0
Poonawalla Fincorp	52.2	50.0	2
Bajaj Finance	27.7	24.9	1.1
HDFC	22.4	21.6	2

Note: Data as of Q2FY22; NPA for HDFC is gross;
CAR: Capital adequacy ratio,
NNPA: Net non-performing asset

(Source: Business Standard dated on 16th Dec. 2021)

Clarification on holding of AGM

MCA vide General Circular No. 21/2021 dated 14th Dec. 2021 has decided to allow the companies who are proposing to organize AGMs in 2022 for the Financial Year ended / ending any time on/before 31.03.2022 through VC or OAVM as per respective due dates by 30th June 2022.

Blow More Whistles

Mr. Hargovind Sachdev
General Manager (Retd.) SBI

"Keep blowing the whistle until people wake up from deep slumber & demolish corruption"

Acting as whistleblowers,employees of IndusInd Bank subsidiary,Bharat Financial Inclusion (BFIL) have alerted RBI and the Board about lapses in governance and accounting norms to allegedly evergreen loans worth thousand of crores since the outbreak of Covid-19. If the IndusInd management is unable to correct the practice of adjusting new loans with overdues from earlier loans, the subsidiary BFIL would eat into the financials of the parent. These alleged transactions to dress-up the books have damaged the micro lending business built over the years, the employees said in emails to IndusInd Bank CEO and RBI.

The step brings in focus the importance and utility of the Whistleblower in public life. A whistleblower is someone who reports waste, fraud, abuse, corruption or dangers to public health and safety to someone who is in the position to rectify the wrongdoing. A whistleblower typically works inside the organization where the wrongdoing is taking place. Thousands of people blow the whistle around the world each year on everything from bad accounting to tax fraud to pollution to illegal wildlife trade. These crimes can have a significant financial impact on the government, company shareholders, and taxpayers, and many would be extremely difficult for law enforcement to discover on their own. **Without whistleblowers, crimes go undetected**.

There are two types of whistleblowers: internal and external. Internal whistleblowers are those who report the misconduct, fraud, or indiscipline to senior officers of the organisation such as HR Head or CEO. External whistleblowing is a term used when whistleblowers report the wrongdoings to outside the organisation such as the media, government officials, or police.

The word whistleblowing is linked to the use of a whistle to alert the public or a crowd about a bad situation, such as the committing of a crime or the breaking of rules during a game. The phrase whistle blower attached itself to law enforcement officials in the 19th century because they used a whistle to alert the public. Sports referees, who use a whistle to indicate an illegal or foul play, also were called whistle blowers. Whistleblowers exposed Watergate and failed Vietnam War; massive accounting fraud that brought down Enron and WorldCom in the early 2000s; secret Swiss bank accounts; health dangers of nicotine in tobacco products.

Whistleblower Policy & Protection Act are laws of land for several years but India's rating in World Corruption Index, continues to fall. **We rank low in fighting corruption at serial 86 much below countries like Botswana, Chile, South Africa, Uruguay, Jordan & Estonia.** Transparency International, the non-governmental organization based in Germany, monitors this index. **It defines corruption as the misuse of public power for private benefit.** The organization's Corruption Perception Index states that the failure to control corruption is fueling a global crisis in democracies across world.

Corruption has the greatest impact on people's lives as it erodes trust, weakens democracy, hampers economic development and creates inequality, poverty, social division and the environmental crisis. There is urgent need to expose the systems and networks that enable corruption to thrive, with greater transparency and integrity in all areas of public life. We should endeavour to desist corruption, promote transparency, accountability and integrity at all levels across all sectors of society. We should carve out a world, in which government, politics, business, civil society and the daily lives of people are free of corruption. It is becoming clear that the only people who don't want to disclose the truth are the people with something to hide.

Exposing corruption and holding the corrupt to account can only happen if we understand the way corruption works and the systems that enable it. Detailed survey by Transparency International reveals that corruption can take many forms, and behaviours like:

- **Public servants demanding money or favours in exchange for services,**
- **Politicians misusing public money or granting public jobs or contracts to their sponsors, friends and families,**
- **Corporations bribing officials to get lucrative deals**

Corruption can happen anywhere: in business, government, the courts, the media, and in civil society, as well as across all sectors from health and education to infrastructure and sports. Corruption can involve anyone: politicians, government officials, public servants, business people or members of the public. Corruption happens in the shadows, often with the help of professional enablers such as bankers, lawyers, accountants and real estate agents, opaque financial systems and anonymous shell companies that allow corruption to flourish and the corrupt to launder and hide illicit wealth. Corruption adapts to different contexts and changing circumstances. It continues to evolve in response to changes in rules, legislation and technology. Unfortunately, in societies where exposing a crime is treated as committing a crime, the rulers are also criminals masquerading as leaders.

Iraq is perceived to be the most corrupt country in the world, according to U.S. News' 2021. Best Countries Rankings a survey of more than 17,000 global citizens. The United States is ranked at no. 24 for being seen as not corrupt, a drop of two positions from 2020. Conversely, Denmark, Canada and Germany are seen as the most transparent countries. The 10 Most Corrupt are Iraq, Colombia, Mexico, Brazil, Russia, Guatemala, Kazakhstan, Lebanon, El Salvador and Azerbaijan. **India is at bottom, as we can't get different result by doing things, that encourage undue enrichment.**

In recent past, more employees have blown the whistle on wrongdoing by their employers. And the law has encouraged this growth. Whistleblower Protection Act 2014 offers new incentives and protections. Still, reporting wrongdoing at work is not easy.

Many employers value employee integrity, but many fear it. Employers do not cultivate such employees. On the other hand, employees driven by personal honor are offended by the illegal actions of management. This is stressful for them; in some cases, they literally cannot sleep. Many whistleblowers have reported problems internally to a compliance officer at their organisation but remain disappointed by the response. Many whistleblower employees experience retaliation by their employer. Punishment may be simple or brutal, like getting fired for speaking out. Or it may be more subtle: a change in job duties, reassignment to a distant office, or exclusion from key meetings.

Retaliating against a whistleblower is illegal, but it happens anyway. In some cases, employers keep retaliating even after a whistleblower no longer works at the organisation. Whistleblower protection laws have a common goal: To ensure that whistleblowers are not penalized for their good-faith report of wrongdoing, so that honest people will continue to speak up. In the USA, whistleblowers profit from their honesty: If a fraud is reported and dishonest employer ends up paying financial penalty to the government, Whistleblower gets 30% of the payback. **Whistleblowers have won rewards as high as several hundred million dollars.**

(Image source: website)

In Indian context a whistleblower as defined by Whistleblower policy is an employee who reports an activity that he/she considers to be illegal or dishonest. The whistleblower is not responsible for investigating the activity or for determining fault or corrective measures; appropriate management officials are charged with these responsibilities. Examples of illegal or dishonest activities are violations of union, state or local laws; billing for services not performed or for goods not delivered; and fraudulent financial reporting. If an employee has knowledge of illegal or dishonest fraudulent activity, the employee is to contact his/her immediate supervisor or the Head of Audit Committee of the Board. The employee must exercise sound judgment to avoid baseless allegations. **An employee who files a false report will be subject to discipline up to and including termination.**

Section 177(9) of the Companies Act, 2013 mandates the following classes of companies to constitute a vigil mechanism through the **Whistle Blower Policy** for directors and employees to report concerns of unethical behaviour, actual or suspected fraud or violation of the Company's Code of Conduct :-

i. Every listed company
ii. Every other company which accepts deposits from the public
iii. Every company which has borrowed money from Banks and public financial institution in excess of Rs.50 crore

Further, in accordance with the guidelines dated 17.04.2014 issued by SEBI in clauses 49 of Listing agreement between the listed entity and the Stock Exchange and guidelines dated 01.07.2016 issued by RBI under Section 35(A) of Banking Regulation Act, specifically provide for a 'Whistle Blower Mechanism" for the employee of the organisations, to report allegations of-corruption or misuse of office by the authorities of that organisation. Banks, being company, are under the purview of Section 177 of Companies Act, 2013. Each Bank has formulated Whistle Blower Policy for Its employees to raise voice to reduce corruption by highlighting misuse of power by Executives/ Officers/ employees in the bank.

An employee making the complaint/disclosure under this policy is referred to as complainant, who may cover the areas such as corruption, misuse of office, criminal offences, suspected / actual frauds, acts which are detrimental to customers' interest/public interest.

Anonymous / pseudonyms complaints are not covered under the scheme and such complaints should not be entertained. The bank may take action against complainant making motivated/ vexatious complaints under this Policy.

The Chairman of the Audit Committee of Board (ACB) of the Bank is authorized as Designated Authority to receive complaints on any allegation of corruption or misuse of the Office by the employee. Complaints under Whistle Blower Policy can be sent directly to him through designated portal. The complaint may also be sent in a closed / secured envelope to the CEO and Managing Director, who would forward the same confidentially to Audit Committee. Procedure for lodging a complaint under the Policy is:

1. Disclosure should be factual and not speculative or In the nature of conclusion, and should contain as much specific information as possible to allow for proper assessment of the nature and extent of the concern and the urgency of a preliminary Investigation procedure.

2.The Whistle Blower must disclose his / her identity like name, designation, department and place of posting while forwarding the complaints. The complaint should be sent through bank's Whistle Blower portal or in a closed and secured envelope.

3.The complainant should ensure that the Issue raised Involves dishonest intention/moral angle. He/ She should study all the facts and understand their significance. The details of complaint should be specific and verifiable.

4. A separate link for the Whistle Blower should be created Inside Bank's internal portal. The link must be accessible to all employees of the Bank to share Information about any unlawful activities going on within organization / frauds / steps required to implement preventive vigilance.

5.The portal should capture all Information about the Whistle Blower and details of Incident/Information. The details entered using this link portal are accessed exclusively by Chairman of the Audit Committee of Board.

The wheels of justice may turn slowly, but they grind exceedingly fine. This is especially true for whistleblowers, who have a special status in our laws: Legislators have gone out of their way to write laws to encourage whistleblowing. Some of these laws are just finding their feet. **They send a consistent message that Whistleblowers improve our society, save them from catastrophe and protect them.** Not every whistleblower will win every case. But overall, justice favors a righteous whistleblower. Whistleblowing is hard, but faced with wrongdoing, it is the right thing to do. **Blow More Whistles.**

Rightly said, "A thief does not like to be robbed. Without robbing, a whistle blower can disrobe thief effectively and demolish. To escape being exposed, be the same person privately, personally and publically."

KIND ATTENTION!!

Articles are Invited!

We would be delighted to have you in our panel of writers to contribute articles / snippets / write-ups to add value to CGRF SandBox. This will go a long way in enhancing the quality of CGRF SandBox which is expected to have wide readership amongst top bankers, corporates, and professionals.

Your materials for publishing may please be sent to

createandgrowresearch@gmail.com
in 'MS Word'.

FAQS on Ordinance

S. Srinivasan, Senior Partner
SR Srinivasan & Co LLP

Q. What is the meaning of "Ordinance"?

A. "Ordinance" is a law that is promulgated by the President of India/Governor of a State

Q. Does the President have an arbitrary power to promulgate any law and at any time?

A. No. The law can be promulgated by him only on the recommendation of the Union Cabinet (headed by the PM) on only those matters on which the Parliament can make laws. It is therefore considered to be a law made by the Executive and not by the Legislature.

Q. Is the President bound by the aid and advice of the Council of Minister while promulgating an Ordinance?

A. Article 74 of the Indian Constitution states that there shall be a Council of Ministers with the Prime Minister at the head to aid and advice the President, who shall in the exercise of his function, act under such advice. The 44th Constitutional Amendment inserted a proviso that the President may require the Council of Minister to reconsider the advice, and the President shall act according to the advice given after such reconsideration. The President cannot function without a Council of Minister, nor can it exercise its executive power without the aid and advice of the Council of Minister.

Q. That is only the laws which come under Central Legislation for which the President can promulgate an "Ordinance." What if the law is under the State Legislation?

A. In that case similar to the powers of the President of India, the Governor of the concerned State has the power to promulgate an Ordinance covering a law coming under the State Legislation.

Q. Does the Governor have an arbitrary power to promulgate any law and at any time?

No. The law can be promulgated by him only on the recommendation of the State Cabinet (headed by the CM) on only those matters on which the State Legislature can make laws.

Q. From where do the President or Governor draw their power to promulgate ordinances?

A. The Government of India Act,1935, allows the issuing of ordinances with proper safeguards. Article 123 of the Constitution grants the President and Article 213 grants the Governor certain law-making powers to promulgate ordinances during recess of the Parliament or Assembly.

The framers of the Constitution were very much aware of the **traumas and travails** of the Ordinance making power given in that Act and were not restricted by any force not to chose to have or not to have Ordinance making power conferred to the President. Taking into account the English and American Constitutions which do not have such provisions, yet they opted for such provisions in good faith that the power would be exercised only in extraordinary situations and not for partisan gains.

Q. Is the President or Governor answerable to any court on his decision to promulgate an ordinance?

A. Article 361 states that a President shall not be answerable to any court for the exercise and performance of the powers and duties of his office or for any act done or purporting to be done by him in the exercise and performance of those powers and duties. The advice of the Ministers is not enforceable by Court in virtue of Article 74(2). The only action that can be brought against a President is through the impeachment of the President if he does not follow the advice of the Ministers on a crucial matter.

Q. What is the effect of these ordinances?

A. They have the same effect on policies as the parliament's or state legislature' acts have.

Q. What are the conditions under which the President or the Governor can promulgate an "Ordinance"?

A. The conditions under which the President can promulgate ordinance is as under:

(i) Either the Lok Sabha or the Rajya Sabha, should not be in session for the President to promulgate an Ordinance. Similarly, the concerned State Assembly, when it is a unicameral or both the Assembly and the Legislative council (if there is one), that is when it is the bicameral legislature, either of them should not be in session for the Governor to promulgate an Ordinance;

(ii) The President or the Governor cannot promulgate an ordinance unless he or she is satisfied that there are circumstances that require taking "immediate action"; and

(iii) the ordinance to be issued has to be recommended by the Union Cabinet or State Cabinet as the case may be;

Q. Can the President or the Governor withdraw their ordinances?

A. Yes. They can at any time, giving grounds, can withdraw the ordinances they have promulgated.

Q. What is the life of each ordinance?

A. The maximum validity of an ordinance is 6 months and 6 weeks from the day it is promulgated. That is the life of the ordinance is 6 months before which the parliament session must commence. Once the sessions commence the houses have 6 weeks to enact the law based on the ordinance and if they do not do so within the 6 weeks, the ordinance will automatically expire.

Q. From when is 6 weeks calculated---from the time the Lok Sabha session starts or from the time Rajya Subha session starts?

A. The Ordinance shall be laid before both Houses of Parliament and shall cease to operate at the expiration of six weeks from the reassembly of the Parliament, or, before the expiration of that period if a resolution disapproving it is passed by either of the Houses.

Explanation: Where the Houses of Parliament are summoned to reassemble on different dates, the period of six weeks shall be reckoned from the later of those dates for the purposes of this clause.

"The President shall from time to time summon each House of Parliament to meet at such time and place as he thinks fit, but six months shall not intervene between its last sitting in one session and the date appointed for its first sitting in the next session."

Q. Is the same rule applicable to the ordinance promulgated by the Governor?

A. Yes.

Q. How many times the same ordinance can be issued?

A. An ordinance can be re promulgated only thrice.

Q. Is there a limit on the number of Ordinances that the President or Governor can issue?

A. No. Article123 or 213 do not place any numerical restrictions on the number of ordinances that can be promulgated.

(Image source: website)

Q. Are there similar provisions in other countries in the issue of ordinances?

There are only three parliamentary democracies in the world that permit the ordinance route — India, Pakistan and Bangladesh. But there are countries who issue municipal ordinances. The practice in India was adopted from the Government of India Act, 1935, where the viceroy could do as he pleased. In every other country, Parliament has to be convened in order to get a law passed.

Q. What is the difference between "Ordinance" and "Ordnance"?

A. The terms **ordinance** and **ordnance** are separated by a single extra letter "i". Despite their similarity in appearance, these words are worlds apart in terms of their meanings. The term **ordinance** is used as a noun referring to "an authoritative decree or direction" or "a law set forth by a governmental authority, specifically, a municipal regulation." On the other hand, the word **ordnance** is also used as a noun which refers to "military supplies including weapons, ammunition, combat vehicles, and maintenance tools and equipment."

Q. Can an ordinance have retrospective effect?

A. Ordinances may have retrospective effect.

Q. Can an ordinance modify or repeal an Act of Parliament or other Ordinances?

A. Yes. Ordinances may modify or repeal any act of parliament or other ordinances. It may be used to amend any law, but it can never amend the Constitution.

Conclusion

The only conclusion is that an ordinance is described as a legislative power of the President; however, it is issued on the advice of the council of ministers and is hence considered to be a law made by the executive. The aid and advice of the Ministers is mandatory while exercising the executive power of the President, and any such act without the advice of the Council of the Ministers shall be unconstitutional as being violative of Article 74(1). 15 The satisfaction of the President is actually the satisfaction of the council of the minister and the satisfaction of a President, or a Governor must be based on such facts and circumstances which show objectivity even in subjectivity. To make sure that the power is not misused by the ones who bear it, the Supreme Court limited the government's power to issue ordinances. The sanctity of the Constitution rests on the fact that there be a never-ending tussle amongst the three branches of the government, so that the bird of democracy may sing its beautiful song all day.

Doctrine of Privity of Contract

Doctrine of privity of a contract is a principle according to which only parties to a contract can enforce their rights and liabilities and no stranger is allowed to confer obligations upon any person who is not a party to contract even though the contract might have been entered into for his benefit. The rule of privity is based on the 'interest theory' which implies that only person having an interest in the contract is entitled as per law to protect his rights. Privity is intended to protect third parties to a contract from lawsuits arising from that contract.

The exceptions to the above principle are:

1. **A beneficiary under a contract :-** If a contract has been entered into between 2 persons for the benefit of a third person not being a party, then in the event of failure by any party to perform his part, the third party can enforce his right against the others.

2. **Conduct, Acknowledgement or Admission :-** There can also be situation in which although there may be no privity of contract between the two parties, but if one of them by his conduct or acknowledgment recognizes the right of the other, he may be liable on the basis of law of estoppel.

3. **Provision for maintenance or marriage under family arrangement :-** These type of provisions are treated as an exception to the doctrine of privity of contract for protecting the rights of family members who are not likely to get a specific share and also to give maximum effect to the will of the testator.

A deep dive into Section 12A of IBC

M.S. Elamathi, ACS, LLB
Legal Team

Introduction

The Insolvency and Bankruptcy Code, 2016 allows creditors to file an application before the Adjudicating Authority (National Company Law Tribunal) to initiate Corporate Insolvency Resolution Process (CIRP) against a company in case of default. The Code intends to provide insolvency resolution in a time bound manner for maximisation of value of assets of the Company, to promote entrepreneurship availability of credit and balance interest of all stakeholders.

Though, the provision for withdrawal of an application was not inserted when the Code was enacted, NCLT had powers under Rule 8 of Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules of 2016, to allow withdrawal of an application filed before Tribunal prior to its admission. Thus, NCLT did not have explicit powers to allow withdrawal of an application under the Code after its admission and initiation of CIRP.

Rule 8 of IB (Application to Adjudicating Authority) Rules 2016 empowers NCLT to permit withdrawal of the application made under IBC on a request made by the applicant before its admission. Rule 11 of NCLT Rules and NCLAT rules provide inherent powers to the Tribunal.

However, NCLT and NCLAT were handicapped to allow withdrawal after admission of an application.

In *Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LLP*, Hon'ble NCLAT held that "*before admission of an application under Section 7, it is open to the Financial Creditor to withdraw the application but once it is admitted, it cannot be withdrawn…Even the Financial Creditor cannot be allowed to withdraw the application once admitted, and matter cannot be closed till claim of all the creditors are satisfied by the corporate debtor*."

On an appeal before the Hon'ble Supreme Court in *Uttara Foods and Feeds Pvt Ltd Vs. Mona Pharmachem,* the Apex Court was of the view that instead of all orders coming to Supreme Court under Article 142 of the Constitution of India, relevant Rules shall be amended by the competent authority so as to include such inherent powers with NCLT and NCLAT. Further, it was observed that this will obviate unnecessary appeals being filed before Supreme Court in matters where such agreement has been reached. In view of above, the Apex Court took on record the settlement between the parties and set aside the NCLAT order.

ILC Report - March 2018

ILC Report of March 2018 dealt with withdrawal of CIRP proceedings pursuant to settlement under point 29 of the Report. It was observed by the Committee that there have been instances where on account of settlement between the applicant creditor and the Corporate Debtor (CD), judicial permission for withdrawal of CIRP was granted. This practice was deliberated in light of the objective of the Code that *"all key stakeholders will participate to collectively assess viability. The law must ensure that all creditors who have the capability and the willingness to restructure their liabilities must be part of the negotiation process. The liabilities of all creditors who are not part of the negotiation process must also be met in any negotiated solution."* The Committee was of the view that once the CIRP is initiated, it is no longer a proceeding only between the applicant creditor and the CD but is envisaged to be a proceeding involving all creditors of the CD. The intent of the Code is to discourage individual actions for enforcement and settlement to the exclusion of the general benefit of all creditors.

On a review of multiple NCLT and NCLAT judgments in this regard, it was observed that a pattern has emerged that a settlement may be reached amongst all creditors and the CD for the purpose of withdrawal to be granted, and not only with the applicant creditor.

Based on the above discussions, the committee unanimously agreed that relevant provisions may be amended to provide withdrawal of CIRP post admission if the CoC approves such an action by a voting share of ninety percent.

Accordingly, Section 12A and Regulation 30A of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations were inserted for the purpose of withdrawal of an application from the CIRP after its admission.

An analysis of Section 12A read with Regulation 30A

Section 12A was inserted by IBC (Second Amendment) Act, 2018 w.e.f. 06.06.2018. It empowers the NCLT to allow the withdrawal of application admitted under Section 7 or 9 or Section 10, on an application made by the applicant with the approval of ninety per cent of voting share of the committee of creditors, in such manner specified under Regulation 30A.

Regulation 30A was inserted by the IBBI (Insolvency Resolution Process for Corporate Persons) (Third Amendment) Regulations, 2018, w.e.f. 03.07.2018. This regulation specified the conditions and procedure to be followed to withdraw an application filed under IBC.

An application for withdrawal under Section 12A may be made before NCLT at 3 stages:

1. Before Constitution of CoC
2. After Constitution of CoC but before issue of Expression of Interest (EoI)
3. After Constitution of CoC and after issue of EoI

(Image source: website)

1. Before Constitution of CoC

Before the constitution of CoC, the applicant has to withdraw the application through the Interim Resolution Professional (IRP). The application shall be made in Form FA of Schedule along with a bank guarantee towards estimated expenses incurred on or by the IRP for the purpose of Regulation 33, till the date of filing of the application. Expenses such as the fee to the paid to the interim resolution professional, fee to be paid to insolvency professional entity, if any, and fee to be paid to professionals, if any, and other expenses incurred till the date of filing of the withdrawal application on or by the interim resolution professional to the extent ratified under Regulation 33 of CIRP to be considered for the Bank Guarantee, in case of application filed before constitution of CoC. Upon receipt of Form FA and Bank Guarantee, the IRP shall submit the withdrawal application to NCLT on behalf of the applicant within 3 days of its receipt.

NCLT may, by order, allow the application. Where the application is allowed, the applicant shall deposit an amount, towards the actual expenses incurred till the date of approval of NCLT, as determined by the

IRP or RP, as the case may be, within 3 days of such approval, in the bank account of the corporate debtor, failing which the bank guarantee received shall be invoked, without prejudice to any other action permissible against the applicant under the Code.

2. After constitution of CoC but before issue of EoI

The applicant shall submit Form FA along with bank guarantee to the IRP or RP, as the case may be. The Bank Guarantee shall be towards estimated expenses incurred for the purpose of clauses (aa), (ab), (c) and (d) of Regulation 31 till the date of filing of the application. The following expenses are specified under Regulation 31 of CIRP regulations:

(aa) fee payable to authorised representative of creditors in a class for attending meeting of the CoC as specified under sub-regulation (8) of regulation 16A.

(ab) out of pocket expenses of authorised representative for discharge of his functions under Section 25A

(c) expenses incurred on or by the IRP to the extent ratified under Regulation 33. It includes the fee to be paid to the IRP, fee to be paid to Insolvency Professional Entity, if any, and fee to be paid to professionals and other expenses to be incurred by the IRP.

(d) Expenses incurred on or by the RP fixed under Regulation 34. It includes fee to be paid to RP, fee to be paid to professionals and other expenses to be incurred by the RP.

The CoC shall consider the application within 7 days of its receipt. The application for withdrawal shall be approved by the CoC with 90% voting shares, the IRP/RP shall submit such application along with CoC's approval to the NCLT within 3 days of such approval.

NCLT may, by order, allow the application. Where the application is allowed, the applicant shall deposit an amount, towards the actual expenses incurred till the date of approval of AA, as determined by the IRP or RP, as the case may be, within 3 days of such approval, in the bank account of the corporate debtor, failing which the bank guarantee received shall be invoked, without prejudice to any other action permissible against the applicant under the Code.

3. After constitution of CoC and after issue of EoI

Form FA and the Bank Guarantee shall be submitted by the applicant through the IRP/RP along with reasons justifying withdrawal after issue of EoI. The bank guarantee shall cover the expenses in the same manner as covered in point 2 above.

Upon receipt of the application, the CoC shall consider the application within 7 days. Accordingly, the RP shall submit the application along with 90% approval of CoC to NCLT within 3 days of such approval. Upon approval of NCLT, the applicant shall deposit the actual expenses incurred by the RP till the date of approval of NCLT within 3 days of such approval. Otherwise, the RP shall invoke the bank guarantee submitted.

Interesting Judicial pronouncements on withdrawal under Section 12A

1. Constitutional Validity of Section 12A:

In *Swiss ribbons and Anr Vs. UoI and Ors*., it was argued that Sec 12A derails the settlement process by requiring approval of 90% of CoC and that gives unbridled power to CoC to reject legitimate settlements entered into between creditors and the CD. The Apex Court has stated that the main thrust against Section 12A is the fact that 90% of CoC has to allow withdrawal. Referring to the ILC Report, the Court was of the opinion that if the CoC arbitrarily rejects a settlement and/or withdrawal claim, the NCLT and thereafter the NCLAT can always set aside such decision under Section 60 of the Code. Thus, the CoC does not have a last word on the subject. Accordingly, Section 12A was held to be constitutionally valid provision.

2. Withdrawal of Application after receipt of resolution plan

In *Satyanarayan Malu Vs. SBM paper mill - MA 1396 of 2018*, an application was filed by the CD for withdrawal of CIRP application filed under Section 10 by itself, as it proposes to settle the CoC as per OTS plan. However, in the meantime the CoC had approved a resolution plan. Hence, the Resolution Applicant had also filed an application for withdrawal of resolution plan after the approval of CoC. Both these applications were heard and decided together. It is pertinent to note that CoC comprises of only one Financial Creditor i.e., Allahabad Bank (Now Indian Bank). The CoC decided that the OTS proposal was economically advantageous when compared to the Resolution Plan submitted by RA. Hon'ble NCLT, Mumbai held that since 12A has not laid down a condition of pre-EoI advertisement, therefore, the application for withdrawal by the CD is maintainable. It was concluded by the Bench that the OTS proposal was in benefit of the CD for its revival along with all the stakeholders. As a result, the Bench permitted to allow the withdrawal application filed by the CD and imposed a cost of Rs. 5 lakhs for consuming the time of Court, RP and the CoC by withdrawing a Section 10 application. The application filed by the Resolution Applicant was allowed as it does not survive any purpose on account of withdrawal of the main petition (initiation of CIRP). However, the Tribunal emphasised that such attempt on the part of a RA to withdraw resolution plan is to be discouraged. Accordingly, out of the earnest money deposit of Rs. 50Lakhs, the RP was directed to retain a sum of Rs. 25 lakhs and utilise it towards CIRP cost and other expenses.

In *Brilliant Alloys Pvt Ltd Vs. S. Rajagopal and Ors SLP Civil No. 31557 of 2018,* the Hon'ble Supreme court allowed withdrawal of CIRP even after issue of EoI and set aside the order of NCLT and held that Regulation 30A must be read along with main provision Section 12A, which contains no such stipulation. Hence, stipulation under Regulation 30A can only be construed as directory depending on the facts of each case.

3. Withdrawal during liquidation

In *Navaneetha Krishnan Vs. Central Bank of India – CA AT Ins 288 and 289 of 2018,* the CoC decided to liquidate the CD as the resolution plan was not received within the stipulated time. This decision of CoC was challenged by the prospective resolution applicant. Hon'ble NCLAT, New Delhi held that in view of the provisions of Sec 12A, even during the liquidation period, if any person, not barred under Sec 29A satisfies the demand of CoC then such person may move before the AA by giving an offer which may be considered by the CoC and the CoC may by (90% voting share), accept the offer and decide for withdrawal of the application which was filed under Section 7 of IBC. Accordingly, the appeal was dismissed.

4. Non-Applicability of Section 29A to application under Section 12A

In *Shweta Vishwanath Shirke & Ors. – Company Appeal (AT) (Insolvency) No. 601 of 2019,* Hon'ble NCLAT, Delhi, relying on the decision of Hon'ble Supreme Court in Swiss Ribbons and the ILC report of March 2018, held that Section 29A is not applicable for considering an application under Section 12A. Hon'ble NCLAT set aside the order of NCLT initiating liquidation against the CD, and allowed the appellant (Andhra Bank / FC) to withdraw the application under 12A.

5.Applicability of Sec 12A to a resolution applicant

Hon'ble Supreme Court in *Maharashtra Seamless Ltd Vs. Padmanabhan Venkatesh & Ors.,* held that Resolution Applicant, cannot withdraw from the proceeding in the manner they have approached this Court. It was clarified that the exit route prescribed under Section 12A is not applicable to Resolution Applicant. Accordingly, it was held that Section 12A applies only to applicants invoking Sections 7,9 and 10 of IBC.

6. Withdrawal of application without the consent of Applicant whose claim is not maintainable

In *MR. K. Srinivas Krishna, Suspended Director of M/s C-Tel Infosystems (P) Ltd. Vs. Shyam Arora, RP of M/s C-Tel Infosystems (P) Ltd.,* an operational creditor filed an application under Section 9 of IBC for two claims. The IRP did not admit one claim due to unavailability of supporting documents. Against this rejection, the OC approached Hon'ble NCLAT. NCLAT held that the claim was not tenable and disposed of the appeal. This decision of NCLAT was challenged before Hon'ble Supreme Court by the OC. The Apex Court finally ruled that the said claim was not maintainable. In the meantime, the CD satisfied another claim of FCs and the CoC approved the resolution for withdrawal of the Application under Section 9 of IBC with 100% vote and the IRP filed necessary application along with Form FA and bank guarantee from the from CD before the AA. However, it is pertinent to note that the OC refused to sign the Form FA solely on the ground that its said claim was not considered by the CD. The NCLT rejected the application filed by the IRP solely on the ground that it was not signed by the OC.

This decision of NCLT was challenged before NCLAT. It was held by Hon'ble NCLAT, Delhi that in the peculiar facts and circumstances of this case no cause of action survives in favour of the OC to proceed with CIRP as the Apex Court has decided that the claim of OC is not maintainable. Thus, exercising the inherent powers under Rule 11 of NCLAT Rules, 2016, to prevent abuse of process, the Bench set aside the impugned order as well as the order of NCLT initiating CIRP against the CD.

Resultantly, the CD was released from the rigours of CIRP and was allowed to function through its Board of Directors from immediate effect. The IRP was directed to handover all the record to the Board of Directors.

(Image source: website)

7. In the Matter of Rolta India Limited

NCLT, Mumbai rejected withdrawal application under Section 12A read with Rule 11 of NCLT Rules, 2016, where CD entered into settlement only with a fraction of creditors. The application for withdrawal was vehemently opposed by the FCs and some other ex-employees of the CD. The Tribunal noted that there were several Financial Creditors and total financial claim collated by the IRP was for around Rs. 5,000 Crore. Thus, the Tribunal held that *"even in the event of the original creditor (and) the CD settling their disputes prior to the constitution of CoC, the Tribunal has sufficient jurisdiction to reject an application under Section 12A of IBC if the facts and circumstances of the case warrants such rejection."*

This decision of NCLT was challenged before the Apex Court in Civil Appeal No. 4993 of 2021 (Arising out of S.L.P.(Civil)No.12386 of 2021). It was noted that there was no dispute that CoC was not constituted in the matter. Referring to the judgment in Swiss Ribbons, where it was decided that before constitution of CoC, a party may approach NCLT directly under Rule 11 of NCLT Rules for withdrawal of application under IBC, the Hon'ble Apex Court in this matter allowed the appeal for withdrawal of CIRP against the CD as the matter was settled between the CD and the Applicant.

8. In the Matter of Siva Industries and Holdings Limited

NCLT, Chennai on 12th August 2021, dismissed an application filed under Section 12A on the following grounds:

a) The purported settlement plan proposed by the promoter of the CD was not settlement simpliciter as envisaged under Section 12A of IBC, rather, it was a "business restructuring plan".

b) As per the settlement plan, there was no final offer made by the promoter of the CD and no acceptance made by the CoC in this regard. There was no finality reached between the promoter and CoC as per the settlement proposal.

c) The prayer sought for liquidation of the CD in case of any default in the proposed settlement plan was beyond the scope of IBC.

d) The "commercial wisdom" of CoC applies to a resolution plan but not to a Sec. 12A plan. It is rather judicial wisdom to approve or reject a Sec. 12A application.

Upon the dismissal of the 12A application, NCLT ordered liquidation of the CD.

It is observed that a promoter of the CD has challenged the above order of NCLT initiating liquidation of CD, before the Hon'ble NCLAT, Chennai. The matter is pending for a decision.

Conclusion

Prior to insertion of Section 12A, there was no provision in the Code or the Regulations in relation to permissibility of withdrawal post admission of a CIRP application. However, post insertion of Section 12A, legitimate interest of promoters to relieve the CD from CIRP process is being taken care. In fact, the promoters have got a chance to even save the CD from slipping into liquidation.

However, there are high chances that the CD is wriggled out of CIRP under Sec. 12A, but the settlement is not successfully implemented by the promoters, then, an application of any creditor against the CD would again trigger the CIRP, whereby, the whole process would have to be started *de novo*. This would very much defeat the very purpose of IBC.

The "collective commercial wisdom" of CoC should not come in way of the powers vested with the AA under IBC. The AA is vested with the duty to examine whether the decision of CoC to approve withdrawals an application under Section 12A would fall within the contours of IBC.

Judicial activism has definitely led to a lot of clarity in interpreting the provisions with regard to withdrawal of application under Section 12A. However, case to case analysis by the judiciary is opening new doors for interpretation and implementation of Section 12A read with Regulation 30A.

Can a director of the Corporate Debtor authorise any other person to attend the CoC meetings on his behalf?

CGRF Bureau

Preamble

Readers may be aware that the Interim Resolution Professional is required to constitute a Committee of Creditors (CoC) after collating the claims received. Generally, the financial creditors form part of the CoC. They have the powers to decide on various matters like appointment or replacement of IRP / RP, extension of CIRP period or approval of a resolution plan, etc. Such decisions are taken with the required voting share possessed by them. Voting share is the proportion of a financial creditor's debt to the total admitted financial debt of the corporate debtor.

The voting share requirement for various decisions by the CoC ranges from 51% to 90%. While simple majority of 51% is required for all residual matters other than those specifically provided, 66% voting is required for important matters like appointment / replacement of IRP / RP, extension of CIRP period, approval of resolution plan or approving liquidation. Also, all matters listed under Sec.28 of Insolvency and Bankruptcy Code (IBC) require approval by 66% voting share. Another case of a higher voting requirement is 90% which is required for approval of Sec.12A withdrawal application.

It may be noted that IBC provides for participation in the CoC meetings by a representative of an operational creditor(s) who have not less than 10% of the total debt. Also, the directors of the corporate debtor can participate in the CoC meetings. However, both the representative of the operational creditors and the directors cannot vote at the CoC meetings.

Authorised representative to attend the CoC meetings

Now, a question arises as to whether the members can appoint authorised representatives to attend a meeting of the CoC and whether such authorised representatives can also vote on their behalf. In this regard it is interesting to note that the Code itself, in Sec.24(5) provides that **creditors** may authorise a representative on behalf of them to attend the meetings. The Code also says they may appoint an insolvency professional (other than the IRP /RP) to represent them.

The IBBI (IRPCP) Regulations also provide that "the notice of the meeting shall provide that a participant may attend and vote in the meting either in person or through an authorised representative" [Reg.21(2)]. It is also clearly provided that such participant shall inform the RP in advance of the meeting of the identity of the authorised representative who will **attend and vote** at the meeting on its behalf.

The wordings of the above provisions regarding authorised representation on behalf of the creditors stem out of practical requirements as mostly the financial creditors are banks, financial institutions, NBFC or corporates who need to authorise a corporeal person on behalf of their organisation to participate in a CoC meeting. The Code provides for appointment of an authorised representative in respect of financial creditors like deposit-holders, home-buyers, etc., who will be generally individuals and large in number also and therefore, they need someone to represent them in the CoC meeting proceedings.

Other participants in a CoC meeting

Now, it would be pertinent to note that in a meeting of the CoC, apart from the members of CoC, there will be other participants too. As briefed earlier, the IBC provides that a notice of the CoC meeting should be given to the directors of the corporate debtor also. [Sec.24(3)]. The Code also states that notice of a CoC meeting should be served on operational creditors or their authorised representatives if the amount of their aggregate debts is not less than 10% of the debt. Therefore, apart from the CoC members, the directors of the company are entitled to participate in the CoC meeting. Also, a major operational creditor or his authorised representative requires to be given notice if he meets the minimum threshold of 10% total debt of the company.

The question before us is, whether such other participants, i.e., other than the members of the CoC, are also entitled to appoint an authorised representative to attend the meeting on their behalf. Well, it can be clearly answered that the operational creditor having not less than 10% of total debt can authorise a representative to attend the CoC meeting on his behalf. However, in the case of a director of the corporate debtor, the answer is not clear. Let us examine the provisions of IBC in this regard.

Whether a director of the corporate debtor can authorise a person to attend the CoC meeting on his behalf?

Before we deal with this question, it would be better to understand as to why IBC provides that the directors of the corporate debtor are also entitled to be provided with the notice for the meeting along with the agenda items for them to participate in the CoC deliberations. The idea of providing for such participation by the erstwhile promoters of the company who also happen to be the directors of the corporate debtor, is that once the CIRP proceedings are commenced, the powers of the board of directors are suspended by virtue of Section 17 (1) (b) of the IBC and such powers shall be exercised by the IRP / RP and therefore, while conducting the CIRP proceedings, the CoC and RP may need some inputs / ideas / clarifications from the directors particularly in respect of the operations of the company, cause of default, guarantee obligations undertaken by them in respect of the debt of the corporate debtor, etc., which should be readily available to the CoC members. Also, as the Code clearly says, the resolution plan when approved by the Adjudicating Authority binds all the stakeholders including all creditors, guarantors, Central and State Governments, other authorities, etc., the participation of directors of the corporate debtor becomes essential as their interest could be affected by the terms of the resolution plan. In most of the corporates, the promoter directors would have given their personal guarantees for repayment of the amounts borrowed by the corporate debtor.

(Image source: website)

The directors of the company can attend the proceedings of the CoC but they do not have a voting right. At best, they can only express their views in the CoC meetings. Sec.24(4) says that "the directors, partners and one representative of operational creditors as referred to in sub-section (3) may attend the meetings of committee of creditors but shall not have any right to vote in such meetings." "Provided that the absence of any such director, partner or representative of operational creditors as the case may be shall not invalidate proceedings of such meeting."

Having said this, it may be relevant to highlight here that the Code, while allowing the participation of the directors of the corporate debtor, does not vest them with a voting right and even goes to say that the absence of the directors in a meeting of the committee will not invalidate the proceedings of the CoC. Why then the Code has given a seat for the directors in the CoC meetings, but it denies them any voting rights? The answer lies in the fact that the Code mandates the shots to be called by the committee of creditors during the CIRP period and not by the directors who have been the cause for the default of the company. And while the CoC takes steps for insolvency resolution within a specified time-frame, the directors need to be just informed of the steps lest they may seek legal remedy that behind their back the corporate debtor has been handed over to another person. This being the situation, the Code has thought about the participation by the directors (who also might happen to be the promoters of the company) also to be aware of the process of CIRP and later on they should not knock the doors of the adjudicating authority or the appellate authority that their interest has been compromised without their knowledge.

While this being so, whether such directors are also entitled to appoint an authorised representative to attend the meetings of CoC, like the way the creditors can appoint an authorised representative? Examining the provisions of IBC may throw some light.

The Regulations governing the conduct of the CoC meetings also provide that the resolution professional will conduct the proceedings in a secure manner and in a confidential way so that the deliberations are not free for everybody and only those who are permitted to attend the meeting can participate in the proceedings.

Reg.24 clearly states that at the commencement of the meeting, the RP as chairperson of the meeting, shall take a roll call when every participant attending the meeting shall state:

"a) his name;
b) whether he is attending in the capacity of a <u>member</u> of the committee or <u>any other participant</u>;
c) whether he is <u>representing a member or group of members</u>;
d) the location from where he is participating;
e) that he has received the agenda and all relevant material for the meeting; and
f) that no one other than him is attending or has access to the proceedings of the meeting at the location of that person."

One may observe that in the above Regulations the participant has to be either in the capacity of a member of the CoC or his authorised representative OR the participant himself. It is all the more clear that the directors of the corporate debtor have to attend the meeting by themselves and not through an authorised representative.

Having said that, the Regulation also says that "from the commencement of the meeting till its conclusion, no person other than the participants and any other person whose presence is required by the RP shall be allowed access to the place where the meeting is held or to the video conferencing facility, without the permission of the RP." This means that the RP has been vested with the powers to evict any person who is present in the meeting without his permission.

Definition of participant

It may be relevant here to see the definition of "participant" as given in Reg.2(1)(l). It says that a "participant means a person entitled to attend a meeting of the committee under Sec.24 or any other person authorised by the committee to attend to attend the meeting."

It is interesting that the Regulations provide for a situation where the committee may authorise any other person (other than the members and participants who are entitled to attend the meeting) also to attend the meetings of the committee of creditors. The intent of the Code is that the committee at any point of time should have the freedom to invite any person like a finance or valuation professional or a consultant or advisor or valuer, who can give valuable inputs to the CoC during the CIRP proceedings. It will be pertinent again to point out here that both the committee of creditors and the resolution professional have been vested with rights and powers to allow a person, other than the participants, to attend the meeting of the CoC but the underlying principle for such decision would be whether such participation by any other person is required in the interest of the CIRP proceedings of the corporate debtor for its resolution or revival.

(Image source: website)

Having said that, whether the directors of the corporate debtor can authorise any person, say an advocate or another insolvency professional, to represent them in the meetings? - this question begs an answer, and the answer would be that the very presence of the directors is to give an opportunity to the committee of creditors to seek any opinion views or comments in respect of the company's operations in the previous years leading to the financial failure and any transactions which might have been authorised by them or carried out by them during the period prior to the commencement of the insolvency resolution process. That being the case, the presence of directors by themselves is the objective of the Code and not representation by somebody like a legal representative or another insolvency professional or any other person who may not be conversant with the facts of the case.

A director cannot assign his office

Another aspect of the role of a director is that a director cannot delegate his office or responsibility to any other person. As per Sec.166(6) of Companies Act 2013, "a director of a company shall not assign his office and any assignment so made shall be void". Well, authorisation need not be construed as assignment. But in a limited sense and for the purpose of attending the CoC meeting, the authorisation by the director to represent himself in the meeting could be stated as an assignment of his office. Be that as it may, a director of a company has to attend the meetings of the board of directors by himself and not through any authorised representative. If for a moment it is assumed that a director can appoint a representative to represent him in a board meeting, it would not only be total chaos but a complete failure of corporate governance. More so in a company under CIRP, permitting such authorisation would amount to total abdication of responsibility of the position of a director.

Plea by directors

A point may be raised by the directors of the corporate debtor that they are not fully conversant with the IBC process, the legal ramifications and the impact of the decisions being taken by the CoC which will have a greater effect on their assets and liabilities they being the guarantors to the debt of the corporate debtor.

The response to this situation would be that a director is a director of the company and a director is supposed to have certain amount of knowledge, idea and experience of the business of the corporate debtor more so they happen to be the promoters of the company or belonging to the family of the promoters. He is also an officer of the company. A director cannot take an excuse and say that I am not aware of the proceedings of IBC, so I would like to engage a legal or other professional to attend the meetings of the CoC on his behalf. However, a director may make a request to the RP or the committee of creditors to permit any other person also to accompany him to the meetings of the committee of creditors. It is upto the CoC or RP to consider the request of the director.

RP or CoC may even permit such participation subject to certain conditions like the persons accompanying shall not be permitted to speak in the meeting.

Therefore, it can be safely concluded that representation of the directors in the meeting of CoC by anybody else is not contemplated in the provisions of IBC and therefore if a director ventures to say that I will be represented by my advocate to participate in the CoC meetings on my behalf, then the RP and CoC are clearly entitled to say “No”. Further, CIRP is time-bound and decisions are supposed to be taken within the time-lines. Permitting an authorised representative is not conducive to the discussions of the committee of creditors; more so the director is required to be present or expected to be present as the fate of the company is going to be decided by the deliberations in the CoC meetings. In the matter of Vijay Kumar Jain Vs Standard Chartered bank and others (Civil Appeal No. 8430 of 2018), Hon’ble Supreme Court that the directors of the corporate debtor are entitled to be provided with upheld resolution plans and all other documents placed in the CoC meetings. But interestingly the apex court did not say that the directors can authorise someone to attend the CoC meetings on their behalf.

Conclusion

Therefore, the conclusion on this discussion is that a director of the corporate debtor is not entitled to authorise someone to attend the CoC meeting on his behalf; but he may seek the permission or approval of the resolution professional and the committee of creditors to bring any other person(s) to accompany them to the meetings of the committee of creditors after providing their identity details and the reason as to why he would like to take such assistance, but it will be purely the discretion of the CoC and RP to allow the request and also to limit the number of such persons to one or two; and in case it is allowed, it would be subject to the signing of confidentiality undertaking by such other person(s) to keep all the discussions papers, documents which have been presented in the meetings absolutely confidential. Also, such authorisation has to be sought for each meeting to ensure that the confidentiality of matters discussed in each of the meetings is protected. No doubt, such persons accompanying the director have no right to speak in the CoC meetings.

Equity shares acquired by financial lenders under schemes of RBI – Situation in an IBC company

T. Deenadhayalan
Advocate

Introduction

Revitalising the Distressed Assets in the Economy is the intention of the RBI which has issued several model schemes and guidelines for the lenders to restructure the stressed assets of the borrowers.

The General Principle of Restructuring

The restructuring should be that the shareholders bear the first loss rather than the debt holders. With this principle in view and also to ensure more ‘skin in the game’ of promoters, JLF/Corporate Debt Restructuring Cell (CDR) may consider the following options when a loan is restructured:

- *Possibility of transferring equity of the company by promoters to the lenders to compensate for their sacrifices;*
- *Promoters infusing more equity into their companies;*
- *Transfer of the promoters’ holdings to a security trustee or an escrow arrangement till turnaround of company. This will enable a change in management control, should lenders favour it.*

It is therefore the option available to the lenders to recover their pending dues by way of choosing and implementing the restructuring scheme proposed by the lenders.

Conversion of loan into Equity Shares under Companies Act

In order to convert loan into share capital, as per provisions of section 62(3) of the Companies Act, the company shall have taken loan on the terms that the loan will be converted into share capital.

Procedure laid down under the Companies Act for conversion of loan into equity does not distinguish the creditor/lender by its nature of business etc., hence if conversion is done in accordance with the provisions of the Companies Act, there will not be any discrimination in the shares converted from debt i.e., once a debt is converted into capital, remains always capital. Even in the event of an agreement executed giving a mechanism to reverse the capital into debt, it is not possible because an agreement devoid of enforceability is void as per section 24 of Contract Act, 1872. Since there is no such law available to convert capital into debt, it cannot be reversed back.

(Image source: website)

Equity shares under IBC

IBC deals only with the debts of the Corporate Debtor. Whereas in the event of liquidation of the corporate debtor the equity share holders are considered as the last person for distribution of the assets realized. The relevant provisions of section 53 of IBC-Waterfall Mechanism- are highlighted:

Sec 53. Distribution of assets. –

(1) Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period as may be specified, namely: -

(a) CIRP cost
(b) debts which shall rank equally between and among
i) workmen's dues
ii) secured creditor who has relinquished
c) wages and any unpaid dues owed to employees
d) unsecured creditors
e) the following dues shall rank equally between and among
i. Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State
ii. debts owed to a secured creditor for any amount unpaid following the enforcement of security interest
f) any remaining debts and dues;
g) preference shareholders
(h) equity shareholders or partners, as the case may be.

It is therefore construed that the debts are considered in priority to the equity.

Views of NCLT and NCLAT on equity shares

The Hon'ble NCLT Hyderabad Bench in its order in IA No. 436 of 2018 in the matter of Canara Bank Vs IVRCL Limited took the following view on the equity shares converted from Loan:

Para 32

….. the Applicant Bank has not been able to show any provision of the scheme under CDR/SDR or any regulations or guidelines issued by Reserve Bank of India that the amount converted into equity will revert to the category of debt the moment the CDR/SDR fails.

Para 33
…………… obviously the debt converted into equity has been remaining as equity only and the JLF has not taken any decision even internally with respect to the revert prayed for. Therefore, the portion of the claim relating to equity cannot be admitted as claim of debt.
…………

The Hon'ble NCLAT New Delhi in its order in Comp. Appeal (AT) Insolvency No. 111 of 2020 In the matter of Rita Kapur Vs Invest Care Real Estate LLP took the following view on the equity shares converted from Loan:

Para 10

From the above provisions of law, it is latently & patently clear that once the 'Debt' is converted into 'capital' it cannot be termed as 'Financial Debt' and the applicant cannot be described as Financial Creditor.

Conclusion

The schemes selected by the lenders at the time of choosing the method of restructuring the stressed assets, may bring a situation wherein the lenders may be at risk of recovering their monies.

It is, therefore, the financial creditors who should be more cautious than any other stakeholders of the Corporate Debtor at the time of choosing the method of restructuring the stressed assets, to avoid such loss arising in the form of losing the amount of debt converted into shares in the event of corporate debtor going into insolvency resolution process.

Court Orders

CGRF Legal Team

Ngaitlang Dhar Vs. Panna Pragati Infrastructure Pvt. Ltd. & Ors.

Supreme Court of India | 17-Dec-2021

Civil Appeal Nos.3665-3666 of 2020 with Civil Appeal Nos. 3742-3743 of 2020

The orders of NCLT, Guwahati Bench – approving resolution plan submitted by Nagaitlang Dhar ("H1 Bidder") and dismissing the application filed by Panna Pragati Infrastructure Pvt. Ltd. (H2 bidder) to consider its revised resolution plan were challenged by Panna Pragati Infrastructure Pvt. Ltd. before Hon'ble NCLAT, New Delhi. The appeal was allowed.

The appeal before Apex Court was preferred against order of NCLAT, New Delhi.

A brief case history is given below

Prospective Resolution Applicants were invited to submit their respective Resolution Plans by 24th January 2020. In response to that, 4 Resolution Plans were received. The 5th meeting of the CoC was held on 11th February 2020. The minutes of the said revealed that the RP informed the CoC that there were numerous anomalies and deficiencies observed in the Resolution Plan submitted by H2 bidder and the same was intimated to the H2 bidder through email whereby the RP requested them to rectify/correct and submit the revised Resolution Plan within 1st February 2020. However, the H2 bidder failed to do so within the stipulated period.

Thereafter, the H2 bidder was called upon by the CoC to negotiate the bid amount. This request of CoC was refused. However, the H1 bidder agreed to enhance his bid after negotiation with the CoC. Immediately, the representative of H2 bidder sought adjournment of the meeting to enable them to revise their bid. This request was rejected by the CoC on the ground that it had to adhere to IBC timelines and the CoC decided to exclude the PRAs who were not present in the said meeting. Thus, the plan submitted by H1 bidder was approved by CoC. The Resolution Plan was also approved by the NCLT. Immediately, the H1 bidder paid the dues to financial creditors as per the approved resolution plan.

Observations of the Apex Court

The Hon'ble Apex Court observed that the RP as well as the CoC had acted in a transparent manner as equal opportunity was accorded to all the PRAs. It was noted that the H2 bidder without improving their bid amount, went on insisting for more time, which was specifically rejected by the CoC.

It was held that "*It is trite law that 'commercial wisdom' of the CoC has been given paramount status without any judicial intervention, for ensuring completion of the processes within the timelines prescribed by the IBC ...... It has been held that the opinion expressed by the CoC after due deliberations in the meetings through voting, as per voting shares, is the collective business decision and that the decision of the CoC's 'commercial wisdom' is non-justiciable, except on limited grounds as are available for challenge under Section 30(2) or Section 61(3) of the IBC.*"

Further it was observed that under Section 61(3)(ii) of IBC, an appeal would be tenable if there has been material irregularity in exercise of the powers by the RP during CIRP. However, the Apex Court did not find any material irregularity in the present case as the CoC and RP were transparent.

Taking note of the intent of IBC to revive the CD and keep it as a going concern, the Apex Court observed that in the present case, the purpose was already achieved, as all the dues to the financial creditors were already paid and CD was a going concern.

Accordingly, the Appeal was allowed, and the order passed by NCLAT was set aside.

Raja John

vs

Resolution Professional of Springfield Shelters Pvt Ltd

CA (AT) (CH)(INS) No.207 of 2021

NCLAT Chennai Order dated 1st Dec. 2021

To regain control of the Corporate Debtor being an MSME, the promoters/directors not obligatory to compete with other Resolution Applicants.

Corporate Insolvency Resolution Process (CIRP) in respect of Corporate Debtor viz., Springfield Shelters Pvt Ltd was initiated by NCLT, Chennai Bench on 12.02.2020. During the CIRP, CoC fixed the eligibility criteria in relation to submission of Resolution Plan by the prospective resolution applicant and in pursuance of the same, the Resolution Professional (RP) issued Expression of Interest (EOI). The Applicant being the Promoter /

Director of the Corporate Debtor, which is being an MSME, among other have also submitted the EOI.

EOI submitted by the Applicant was rejected by RP on the grounds that:

(a) he does not meet the eligibility criteria on minimum net worth fixed by CoC as per Section 25(2)(h) of the Code; and

(b) the Promoter's DIN is under defaulted directors list and hence he is not eligible as per Section 29A(e) of the Code.

Applicant (Promoter) filed an application with NCLT seeking direction to RP to consider his EOI as an eligible resolution applicant and also issue necessary directions.

NCLT Chennai Bench observed that Applicant (Promoter) does not meet the minimum net worth criteria fixed by the CoC to be an eligible prospective resolution applicant. Further, noted that with regard to his DIN being de-activated, the Applicant stated that he has filed a case before Madras High Court for re-activiation of the DIN, however, has not placed on record any document to purge himself from the said disqualification. Further, the MSME Certificate submitted by the Applicant show that the said certificate was only obtained on 19.12.2020 (i.e., after admission of CIRP).

NCLT rejected the application and was of the view that the RP was right in rejecting the Resolution Plan of the Applicant as he suffers disqualification under Section 29A(e) of the Code and observed that the Applicant (Promoter) trying to gain a backdoor entry on the guise of presenting themselves as MSME based on decision of NCLAT in the matter of **Harkirat Singh Bedi vs The Oriental Bank of Commerce & Anr**. in Company Appeal (AT) (Ins) No.40 of 2020, wherein the Hon'ble NCLAT, dealing with the facts which were similar to present case, had held as follows:

"On reading the provisions under Section 29A along with Section 240A of the Code, it can be concluded that the exemption is only in respect to clause (c) and (h) of Section 29A of the Code. However, in this case the Appellant is declared ineligible under clause (b) of Section 29A where no exemption has been given to MSME".

Aggrieved by the decision of the NCLT, the Applicant filed an appeal with Hon'ble NCLAT.

Lr. Senior Counsel for the Applicant submitted that Hon'ble NCLT has passed the above impugned order without considering the documents and submissions of the Applicant on the points placed before it.

(Image source: website)

He submitted that the minimum net worth criteria cannot be made applicable to the Corporate Debtor since the Corporate Debtor is an MSME as per the Certificate issued by the Government of Tamil Nadu, Department of Industries and Commerce dated 28.05.2013 and subsequently, the certificate was also issued by the Government of India Ministry of MSME, recognizing the Corporate Debtor as Micro Enterprise vide Certificate dated 19.12.2020. Hence, the status of the Corporate Debtor is an MSME. In this regard, the Learned Counsel relied upon the Judgment of Hon'ble NCLAT in Company Appeal (AT)(INS) No.203 of 2019 in the matter of ***Saravana Global Holdings Ltd. & Ors. v Bafna Pharmaceuticals Ltd. and Ors.,*** wherein it was held that if the Corporate Debtor is an MSME the promoters are not ineligible in terms of Section 29(A) of the Code. It was also held that it is not necessary for the CoC to find out whether the Resolution Applicant is ineligible in terms of Section 29A or not.

Lr. Senior Counsel, further submitted that the status of the DIN of the Appellant has been restored/reactivated pursuant to the directions of the Hon'ble High Court of Madras and the status of the Appellant i.e., Director is active as per MCA Portal, however, the same was not considered either by the RP or by the NCLT.

Lr. Counsel for the RP/CoC submitted that Applicant does not meet the minimum net worth criteria fixed by CoC and further the Applicant was disqualified as Director, as no order was obtained from the ROC in respect of removing the name of the Applicant from the list of Defaulted Directors. Further, the applicant filed and application before the Ministry of MSME and availed a certificate dated 19.12.2020, subsequent to the initiation of CIRP against the Corporate Debtor, therefore MSME certificate was not considered. He also submitted that the Commercial Wisdom of the CoC cannot be interfered by relaxing the minimum eligibility criteria fixed by the CoC under Section 25(2)(h) of the Code.

NCLAT heard the Lr. Counsels appeared for the respective parties, perused the pleadings documents and citations relied upon by them. After analysing the

NCLAT noted that the EOI of the Applicant (Promoter) was rejected on the following grounds:

a. He does not meet the eligibility norm as per Section 25(2)(h) of prescribed Net Worth
b. His DIN is under the 'default' Directors list and hence he is disqualified to act as a Director under the Companies Act, 2013 (18 of 2013). Accordingly, he is not eligible as per Section 29A(e)."

NCLAT noted that the RP has also recorded that the Applicant in response to ground No.(a) stated that he will be providing suitable Net Worth Certificate at the time of submission of Resolution Plan.

NCLAT observed the following:

- the Hon'ble High Court of Madras vide Judgment dated 08.12.2020 in WP No.17262 of 2020 filed by the Applicant herein, allowed the Writ Petition by quashing the disqualification as published by the ROC. Further the Hon'ble High Court directed the ROC to reactivate the DIN within 30 days from the date of receipt of copy of the order. In view of the directions of the Hon'ble High Court dated 08.12.2020, *the Registrar of Companies, Tamil Nadu has to comply with the order and reactivate the DIN of the Appellant (emphasis added).* They same was brought to the notice of the Learned Adjudicating Authority (AA) and the AA failed to consider the same.

- the Learned AA failed to consider the status of the Corporate Debtor as MSME by virtue of the Certificate issued by the Govt. of Tamil Nadu, Department of Industries and Commerce dated 28.05.2013. The Appellant applied for the status of the Corporate Debtor as Micro Enterprise and the Government of India had issued certificate in respect of Corporate Debtor treating it as Micro Enterprise vide Certificate dated 19.12.2020. Though the Government of India issued the Certificate on 19.12.2020, the status of the Corporate Debtor was already a medium enterprise pursuant to the certificate issued by the Govt. of Tamil Nadu.

- the AA has not given any finding on Net Worth criteria of the Appellant. However, in the written submissions of the Appellant, it was stated that the Appellant is ready to file his Net Worth Certificate even as on today, which would qualify the Appellant to act as Resolution Applicant for the Corporate Debtor.

NCLAT opined that by the insertion of Section 240A, the intention of the Legislation is to encourage the Promoters of MSME and accordingly the amendment was brought to the provisions of Code, by allowing the Promoters of MSME to file Resolution Plan, which is viable, feasible and fulfils other criteria as laid down by the Code. The intention of the legislature shows that the Promoters of MSME should be encouraged to pay back the amount with the satisfaction of the CoC to regain the control of the Corporate Debtor and entrepreneurship by filing Resolution Plan which is viable, feasible and fulfils other criteria as laid down by the IBBI and opined that in exceptional circumstances, if the Corporate Debtor is MSME, it is not necessary for the Promoters to compete with other Resolution Applicants to regain the control of the Corporate Debtor.

Hon'ble NCLAT reiterated that if the Corporate Debtor is an MSME it is not necessary for the Promoters to compete with other "Resolution Applicants" to regain the control of the Corporate Debtor *(emphasis added).*

NCLAT having considered the facts and the legal positions allowed the appeal and directed RP to consider the Resolution Plan of Applicant.

BSE Limited Vs KCCL Plastic Limited
Company Appeal (AT) (Insolvency) No. 134 of 2021
NCLAT- Chennai Bench
Dated 17.12.2021

An appeal was preferred against the order of Adjudicating Authority (National Company Law Tribunal), Ahmedabad Bench in BSE Ltd Vs KCCL Plastic Ltd - C.P. (IB) No. 349/NCLT/AHM/2019 which dismissed the application filed by BSE Limited under section 9 of the IBC.

A. Issue before NCLT:

   a) BSE Limited (Operational Creditor) is a Company incorporated under the provisions of the Companies Act, 1956 and is a stock exchange duly recognised by SEBI.
   b) KCCL Plastic Limited (Corporate Debtor) entered into a Listing Agreement on 10.09.1993 with BSE Limited.
   c) As per the Listing Agreement, every year, KCCL Plastic Limited has to pay the requisite Annual Listing Fees ("ALF") on or before the 30th day of April.
   d) KCCL Plastic Limited defaulted ALF payment to the tune of Rs. 10,12,336/- along with interest as on 03.04.2018.

e) BSE Limited issued demand notice under IBC, and filed a petition under section 9 of IBC before the NCLT, Ahmedabad Bench.

f) The Ld, Adjudicating Authority dismissed the application in CP(IB)No.349/NCLT/AHM/2019 for the below reasons as mentioned in the order dated 31.12.2020.

B. Reasons & orders passed by the Adjudicating Authority:

The Adjudicating Authority dismissed the application on two grounds, one is Limitation and other one is validity of documents relied by BSE Limited

I. Reasons given under Limitation

a. It is settled by the Apex court in *B.K. Educational* Services that Section 137 of the Limitation Act is applicable to Section 7, 9 and 10 of IBC

b. Since it is more than 3 years from the default occurred on 01.04.2015 till the date of filing of application before the NCLT i.e., on 15.05.2019, hence, the application under Section 9 is not admissible.

II. Reasons given under validity of documents

a. The Listing Agreement relied by BSE Limited has initials of the parties only in the last page and none of the pages of agreement contains the signature of the parties and there is no seal and signature for and on behalf of the Stock Exchange of Bombay. And it was also found that the Agreement was entered between "Kosha Cubidor Containers Ltd" with the Stock Exchange of Bombay not with KCCL Plastic Limited.

b. Admittedly, the name of Kosha Cubidor Containers Ltd got changed to KCCL plastic Ltd., but to that effect no agreement has been entered by the petitioner with that of KCCL Plastic Ltd.

c. Hence, the document relied upon by BSE Limited is not valid in the eye of law.

C. Question of law before NCLAT:

"Whether the right to apply under Section 9 should be subject to limitation when it is apparent that the Respondent's continuous default is not merely restricted to the initial date of default but on every subsequent occasion when the Respondent was obliged to make payments but failed to pay ALF"

D. Findings of NCLAT:

After perusing the pleadings of BSE Limited, the Bench came to a considered view that the Ld. Adjudicating Authority has rightly come to the conclusion that the agreement so filed cannot be relied upon, as the same is not a valid agreement in the eye of law, so Learned Counsel for the Appellant relied on an order passed by this Appellate Tribunal in 'B.S.E. Ltd. Vs. Neo Corp International Ltd. dated 05.04.2019' is not applicable in this matter.

Moreover, Listing Fees comes under the ambit of 'Regulatory dues' which SEBI is entitled to recover. The Respondent being an entity registered under SEBI, is under an obligation to follow the Regulations prescribed by SEBI for recovery of its dues. The dues so said are not 'Operational Dues' but 'Regulatory Dues'.

The Appellate Bench also observed that the Insolvency Law Committee suggests that Regulatory Dues are not to be recovered under 'Operational Debt.

It is observed from the NCLAT order that, the dues payable to BSE Limited is in the nature of the dues to the Regulator SEBI, and thus the dues of KCCL Plastic Limited to BSE Limited squarely falls under Regulatory dues. Therefore, recovery of regulatory dues are not covered under IBC and so application cannot be filed to initiate CIRP proceedings for recovery of regulatory dues.

Mrs. Ashu Gupta, RP (M/s Web Tech Packaging (India) Pvt. Ltd.)
Vs.
Mr. Sunil Tangri & Anr.
NCLT, New Delhi
12th Nov. 2021

An application was filed by the RP u/s 66 of the Code (for fraudulent transactions) primarily seeking the Respondents to return the sums which were misappropriated/embezzled, to the CD's account and to prosecute the Respondents as per law.

The Hon'ble Tribunal first went on to decide on the maintainability of the Application in respect of timelines prescribed by the Regulations since the main ground taken by the Respondents was that the Application filed by the RP was barred by limitation in view of Reg, 35A of the IBBI(IRPCP)Regulations, 2016 (which says that on or before 75th Day form an opinion whether the CD has been subjected to any transaction covered u/s 45, 45 or 66, on or before 115th Day make a determination and on or before 135th Day file an Application to AA) and in view of the Venus Recruiters Pvt. Ltd. – Delhi High Court Case (relied by the Respondents) and made following observations:

(Image source: website)

- That the said Model timelines as per Reg. 40A are based on the assumption that the CIRP should be completed within 180 Days. Subsequent amendments were made to Sec. 12 of the Code, by which the CIRP may also extend to 330 Days.
- That the IBBI has not updated Reg. 35A and Reg. 40A pursuant to amendment in Sec. 12 of the Code and therefore are not consistent with Sec. 12 of the Code.
- Further, the Hon'ble Court took note of the decisions of the Hon'ble Supreme Court (Surendra Trading Company Case – Civil Appeal No. 8400 of 2017 and, PT. Rajan Vs. T.P.M Sabir & Ors., (2003)), while considering the Regulations, observed that the Regulations are directory and not mandatory.
- Also, the delay in filing the Application was due to non-furnishing of necessary information by the suspended Board of Directors of the CD.
- That the aforesaid facts were not under consideration of the Hon'ble Delhi High Court in Venus Recruiters Case.
- Thus, in view of the above observations, the Hon'ble Tribunal has held that the Application filed by the Applicant is maintainable under the Code on the limitation aspect pointed out by the Respondent as aforesaid.

The 2nd issue was decided on the merits of the case and the Hon'ble Tribunal observed that a total sum of Rs. 29,75,73,550/- has been misappropriated or written off or diverted by the Respondents u/s 66 of the Code and therefore directed the Respondents to contribute such amounts to the Assets of the CD within 2 months. Also directed the RP to institute a Criminal prosecution against the Respondents under Chapter VII (Part II) of the Code under Sec. 69 and relevant provisions with the provisions of the law. Accordingly, the Application filed by RP u/s 66 of the Code was allowed.

High Courts to take up DRT cases

After 28 years, HCs to take up debt recovery cases as tribunals hit

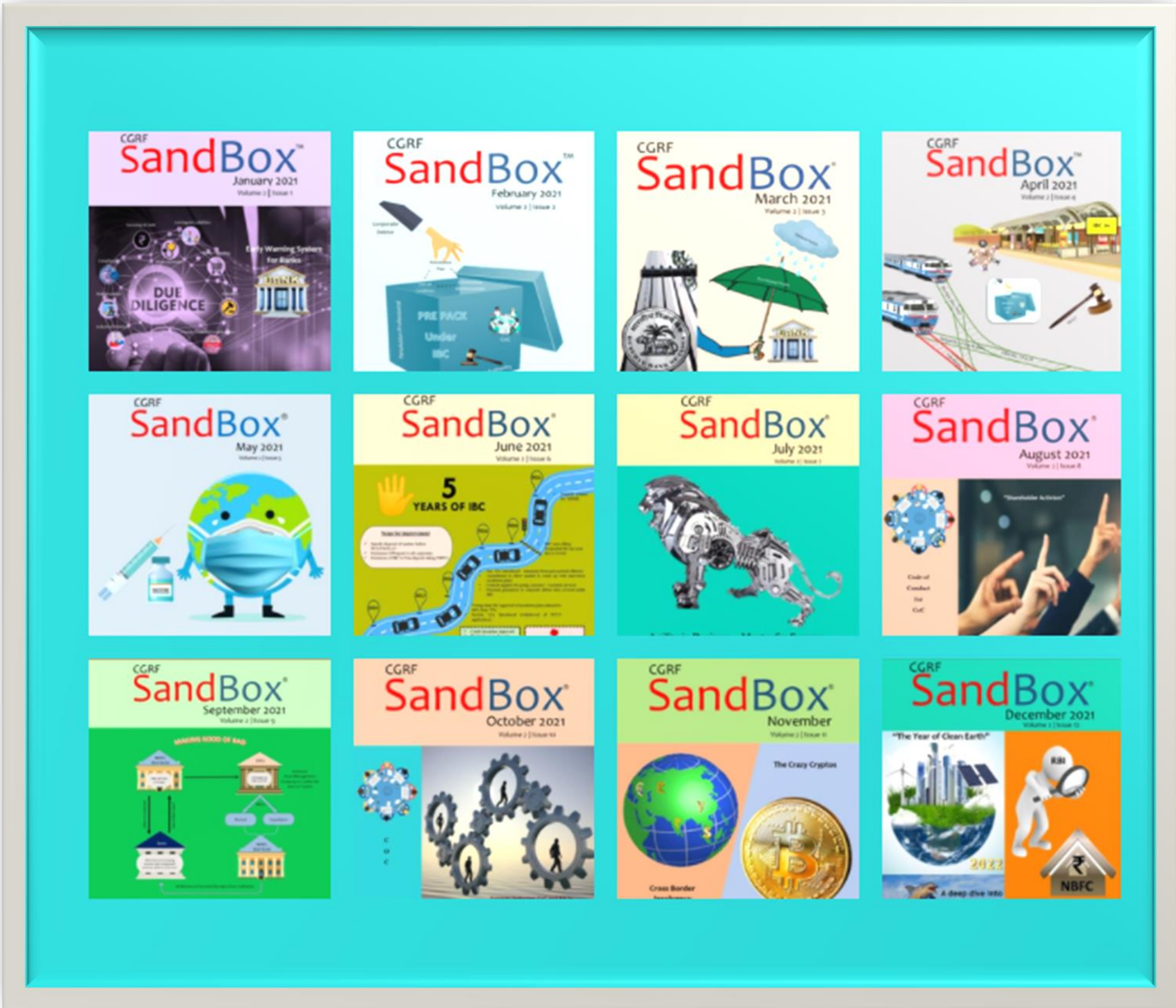
After a gap of 28 years, the high courts will take up debt recovery cases for adjudication, albeit temporarily, on the request of the Supreme Court, which on 16th December 2021 found that crippling vacancies have rendered debt recovery tribunals (DRTs) and appellate tribunals (DRATs) dysfunctional severely impeding banks and financial institutions from recovering dues.

If on one hand the banks and FIs have been crying hoarse over the stalling of recovery process during the pandemic-forced lockdowns, they appeared to be on their knees because of further delay caused due to non-availability of presiding officers and members as well as support staff in DRTs and DRATs because of long pending vacancies.

"Adjudication of debt recovery cases by DRTs and DRATs are critical for the economic health of the country", banks and FIs had said in their plea and pleaded with the SC bench of CJI N V Ramana and Justices D Y Chandrachud and L N Rao for an early solution.

(Source: Times of India dated on 17th Dec.2021)

2021 - The Journey of CGRF SandBox



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