CS Makarand Joshi

CORPORATE LAWS

Case Law Update

1. Company Law

Sandeep Agarwal & Anr. v. Union of India & Anr., Delhi High Court, Order dated 2nd September, 2020

Facts of the case

- The Petitioners were directors in two companies, one of the companies was struck off from the register of Companies on 30th June, 2017 due to non-filing of financial statements and annual returns
- The Petitioners, being directors of the struck off company, were also disqualified w.e.f. 1st November, 2016 for a period of 5 years till 31st October, 2021 u/s. 164(2)(a) of the Companies Act, 2013
- Pursuant to such disqualification, the Petitioners' DIN and DSC had also been cancelled
- Therefore, the Petitioners were not able to carry out business and file returns etc. in the active company
- Accordingly, the Petitioners had filed a writ petition to challenge the disqualification and sought quashing of the impugned list of disqualified directors

Arguments on behalf of the Petitioners

- Section 164(2) and Section 167(1)(a) of the Companies Act, 2013 were materially amended by Companies (Amendment) Act, 2017 and introduction of disqualification in proviso u/s. 167(1)(a) was made effective from 7th May, 2018
- The judgment of ***Mukut Pathak & Ors. vs. Union of India & Ors., 265 (2019) DLT 506*** was referred by the Petitioners. It was, further, submitted that the conjoint reading of both the sections referred above showed that the disqualification would not apply in a retrospective manner
- It was, further, stated that the active company wanted to take the benefit of the Companies Fresh Start Scheme (**"CFSS"** hereinafter), 2020 dated 30th March, 2020 introduced by Ministry whereby active companies were permitted to make good any defaults in filing of documents and seek immunity from disqualification

- However, since the directors, who had to sign the papers, had been disqualified and their DIN and DSCs had been deactivated. the active company was not able to avail the benefit of such scheme

Arguments on behalf of the Respondents

- The judgment in *Mukut Pathak (Supra),* referred to by the Petitioners, had been challenged by way of an appeal by the Ministry. This appeal which was pending, however no stay had been granted
- The Respondents also relied upon the recent order passed by the Division Bench in 2 writ petitions i.e. ***Anamika devi vs. Union of India & Anr.*** and ***Gaurav Kumar vs. Union Of India & Anrto*** submit that the disqualification list had been notified in 2017, the challenge to the same was extremely belated, hence the writ petition deserved to be dismissed

Held

- The judgement in Mukut Pathak, insofar as the merits of the case concerned, was squarely applicable in the present case. The said judgment clearly held that the proviso to Section 167(1)(a) of the Act couldn't be read to operate retrospectively
- Furthermore, the proviso to Section 167(1)(a), being a punitive measure with respect to rights and obligations of directors, couldn't be applied retrospectively unless the statutory amendment expressly provided so.
- the 2 writ petitions, on which the Division Bench had passed orders, as mentioned by the Respondents, sought the following directions:
  - ROC be directed not to treat the Petitioners as disqualified directors and to seek issuance of writ of mandamus, quashing publication of their names in the list of disqualified directors
  - The Respondents be directed to unfreeze the Petitioners' DINs and DSCs and to enable them to file documents/returns of behalf of company on which they had been serving as directors
- The Divisional Bench's order dismissed the mentioned petitions. However, the court highlighted that *"the power of judicial review are discretionary and the question of delay is to be examined in the particular facts and circumstances of each case"* in light of its observation that the filing of writ-petition was very belated.
- The facts and circumstances, in the present case, showed that, CFSS was new scheme which was notified on 30th March, 2020 which had not been invoked before the Division Bench.
- The scheme was obviously launched by Government. to give a reprieve to such companies who had defaulted in filing documents. Such companies were allowed to file requisite documents and to regularize their operations, so as to not face disqualification.
- In the present case, the Petitioners were directors of 2 companies– one whose name had been struck off and one, which was still active. In such

a situation, the disqualification and cancellation of DINs would be a severe impediment for them in availing remedies under the scheme, in respect of the active company.

- In order for the scheme to be effective, the Petitioners, directors of these companies, ought to be given an opportunity to avail such scheme. The launch of the scheme itself constituted a fresh and a continuing cause of action. Under such circumstances the question of delay or limitation would not arise
- Considering the COVID-19 pandemic, the MCA had launched the CFSS, which ought to be given full effect. Since it is not uncommon to see directors of one company being directors in another company, under such circumstances, to disqualify directors permanently and not allow them to avail of their DINs and DSCs could render the Scheme itself nugatory.
- In order to enable the directors of Koksun Papers i.e. the Petitioners, to continue the business of the active company in the fitness of things and also in view of the judgment in *Mukut Pathak (supra)*, the disqualification of the Petitioners as directors was set aside. The DINs and DSCs of the Petitioners were directed to be reactivated, within a period of three working days.

Footnote:

Although the order, passed by the court, stated that the disqualification of Petitioners as directors was set aside, in our understanding, the order had probably set aside the vacation of office of the directors from the active company and not the disqualification that occurred u/s 164(2) of the Companies Act, 2013.

Readers may refer to the following judgements:

1. ***Kaynet Finance Limited vs. Verona Capital Limited on 9 July, 2019 (Bombay HC)***
2. ***Mukut Pathak & Ors. vs. Union of India & Ors., 265 (2019) DLT 506 (Delhi HC)***

2. SEBI

Utsav Pathak ('Appellant') vs. Securities and Exchange Board of India (SEBI), ('Respondents'), Securities Appellate Tribunal ('SAT'), Order dated 12th June 2020

Facts of the case

1. CRISIL Ltd (**"the Company"**) is a credit rating agency and is registered with SEBI and its shares are listed on the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). SEBI, on the basis of reference received from NSE relating to suspected insider trading by certain persons, conducted an investigation of trading activity in the scrip of the Company.

2. On June 3rd, 2013 McGraw Hill Asian Holdings along with Persons Acting in Concert (**"PAC"**) namely, McGraw Hill Financial Inc., S&P India LLC and Standard & Poor LLC had made an announcement of open offer to acquire up to 1,56,70,372 equity shares of the Company which amounted to 22.23% of the total shareholding of the Company. The open offer was made @ ₹ 1210/- per share even though the price of the share on that date on the stock exchange was ₹ 1129.90/- per share. The announcement of the public offer led to an increase in the price of the shares by almost 20%.

3. This open offer was considered as a Price Sensitive Information (**"PSI"**) under the SEBI (Prohibition of Insider Trading) Regulations, 1992 (**"PIT Regulations"**).

4. A Confidentiality Agreement was entered between the McGraw Hill Asian Holdings and Morgan Stanley India Company Private Limited (**"Merchant Banker"**) on 4th April, 2013 to work on the open offer assignment for acquisition of the shares of the Company.

5. The Appellant was an employee of Merchant Banker during the unpublished price sensitive information period (**"UPSI period"**) and was also directly involved with the activities pertaining to the open offer. The Managing Director of Merchant Banker had confirmed the fact that the Appellant was one of the employees who was working on the open offer assignment of the Company and was privy to the PSI.

6. The Adjudicating Officer of SEBI ("the **AO**") after considering the material evidence on record and after giving an opportunity of hearing to the Appellant, found that the Appellant was a 'connected person' under Regulation 2(c)(ii) of the PIT Regulations and also an 'insider' as per Regulation 2(e). The AO further found that Ms Priyanka Pathak (sister of appellant), Husband of Ms Priyanka Pathak, mother-in-law of Ms Priyanka Pathak and Father in law of Ms Priyanka Pathak (collectively referred to as "Tippees") were 'persons deemed to be connected' as per Regulation 2(h)(viii) of the PIT Regulations.

7. The AO on the basis of circumstantial evidence came to the conclusion that the Appellant had tipped the Tippees with regard to the PSI and, therefore violated Regulation 3(ii) read with Clause 2.0 and 2.1 of Schedule I Part B of Model Code of Conduct of PIT Regulations for Other Entities. The AO further held that on the basis of information supplied by the Appellant, Tippees traded in shares of the Company in large quantities during UPSI period which had not been seen before based on the trading activity of Tippees.

8. Consequently, the AO by its order dated August 30th, 2019 held the Appellant guilty of insider trading, however, did not impose any penalty as Appellant.

Appeal filed

The Appellant had filed the appeal to the SAT as he was aggrieved by the charge of insider trading levied by AO.

Arguments made by Appellant before SAT

1. The Appellant argued that statements given by Tippees were not considered by the AO. If the said statements were considered, one would have found that the Tippees were all independent professional persons who could take their own decisions logically. Their statements would have adequately proven that Appellant was not having good terms with his sister and her family

2. It was, further, argued that finding of the AO that the Appellant had tipped the Tippees was based on surmises and conjectures and was not based on any foundational facts

or evidence. The mere fact that the Appellant was closely related to the Tippees could not lead to a finding of guilt without considering the second part of Regulation 2(e)(i) of the PIT Regulations which stated that to become an 'insider' it was necessary to prove whether the person was reasonably expected to have access to UPSI by virtue of connection in respect of securities of company. Reliance was placed on rulings in the case of ***Chintalapati Srinivasa Raju vs. SEBI, (2018) 7 SCC 443*** and order of SEBI in *A. Vellayan & A R Murugappan* dated 12th May, 2016 wherein it was held that finding of guilt on the basis of family relationship was not proper.

3. It was, further, submitted that SEBI had investigated Ajay Bhalla and his firm Kotak Premier Investment and was found to have traded far more than the Tippees in question and had made a profit of more than ₹ 5 crores. The Appellant highlighted that Ajay Bhalla, etc. had been let off, whereas the Appellant had been found guilty merely on the ground that he had close relationship with the Tippees.

Arguments made by SEBI before SAT

1. The Respondents submitted that in a case of insider trading, there is hardly any direct evidence and from the foundational facts itself, one could infer on a preponderance of probability or could infer from a circumstantial evidence as to whether a person was guilty of insider trading.

2. It was contended that the Appellant was a 'connected person' as well as an 'insider' being privy to PSI i.e. the open offer and also pricing of open offer. Based on these foundational facts, the AO had rightly come to a conclusion that the Appellant had tipped the Tippees.

3. It was, further, submitted that there was a close relationship between the Appellant and the Tippees. which the Appellant had tried to conceal before the SEBI. The trading pattern of Tippees was also brought to the notice of the SAT which as per the Respondents lead to an irresistible inference that the Appellant had passed on the information to the Tippees.

Held

1. It held that the Appellant had not denied the fact that he was privy to UPSI. The Appellant had also not denied that he was 'a connected person' and an 'insider'. Further he had also not denied that the fact that he had close relationships with Tippees. Consequently, Regulation 2(e)(i) of PIT Regulations were fully applicable upon the Appellant as he was a 'connected person' and was in possession of and had access to PSI. These facts were corroborated by the statement of the Managing Director of the Merchant Banker.

2. It was held that given the facts that (i) Appellant being a 'connected person' and an 'insider' was privy to UPSI, (ii) had close relationship with Tippees, (iii) during investigation he had made attempts to conceal his relationship with Tippees, (iv) Trading Pattern of Tippees showed that Tippees traded only in shares of the Company during

UPSI Period by purchasing large chunks and selling it immediately after announcement of the open offer, (v) the Tippees sold all other shares to finance buy orders of the Company led to draw reasonable, logical, and irresistible inference that the Appellant had passed on PSI to Tippees.

3. The order of the AO holding the Appellant guilty of insider trading needed no interference. It was, further, stated that the decisions cited by the Appellant on the issue that a person could not be held guilty only on the strength of proximity of relationship with the Tippees were distinguishable on facts and were not applicable in the instant case.

Cases referred

Appellant: ***Chintalapati Srinivasa Raju vs. SEBI, (2018) 7 SCC 443, SEBI AO Order A. Vellayan & A R Murugappan dated 12.05.2016, SEBI AO Order Sanjay Gala 02.12.2016***

Respondent: ***USA vs. Raj Ratnam, 09 Cr. 1184 (RJH), V. K. Kaul vs SEBI in Appeal No.55/2012 decided on 08.10.2012, Chintalapati Srinivasa Raju vs. SEBI (2018) 7 SCC 443, Rajiv Gandhi vs. SEBI in Appeal No.50/2007 decided on 09.05.2008,SEBI vs. Kishore R Ajmera(2016) 6 SCC 368,SEBI vs. Kanaiya Lal Baldevbhai Patel (2017) 15 SCC 753and SEBI vs Rakhi Trading Pvt. Ltd. (2018) 13 SCC 753.***

3. IBC

Rita Kapur ('Appellant') vs. Invest Care Real Estate LLP (Respondents), National Company Law Appellate Tribunal, (NCLAT) New Delhi, Order dated 2nd September 2020

Facts of the Case

- The Appellant had filed an application u/s Section 7 of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) with National Company Law Tribunal (**"NCLT"**) to initiate Corporate Insolvency resolution process (**"CIRP**") against the Invest Care Real Estate LLP (the Respondents/the Corporate Debtor)
- The Appellant had given loan of ₹ 40 Lakhs to the Corporate Debtor and the same was to be repaid in four instalments along with interest. However, the amount had not been repaid. The Appellant claimed to be regarded as a 'Financial Creditor' and hence invoked IBC.
- The Respondent contended that the Appellant was a general partner of the LLP and claimed that the amount was not loan but a capital contribution for being general partner of the LLP
- The NCLT had rejected the Appellant's petition on the grounds that the Appellant was not a 'Financial Creditor'.
- Aggrieved by the order of NCLT, the Appellant filed an appeal with NCLAT

Arguments by the Appellant

- The Appellant had given loan of ₹ 40 Lakhs to the Corporate Debtor and the same was to be repaid in four instalments. The late husband of the Appellant had also invested ₹ 1 Crore.
- It was, further, contended that neither the principal amount nor interest thereon had been paid to her and to her late husband.

- It was also alleged that the loan had been converted into equity on 25th March 2014, which was against the terms and conditions of the Loan Agreement 9th July, 2013.
- The Appellant also disputed the signature on the Amended Agreement dated 1st December, 2013.
- The Appellant claimed to be a 'Financial Creditor' and disputed how the Loan could be converted into equity based on a certified copy of the resolution signed by two designated partners and not by other partners. It was alleged as pre-planned acts to deceive, defraud the Appellant
- The Appellant relied on the judgments passed by the NCLAT/Supreme Court to prove her stand on the issue of (a) striking down and unfair and unreasonable contract and (b) the dishonesty should not be permitted to bear the fruits and benefits to the persons who played fraud or made misrepresentation amongst others.

Arguments by the Respondents

- Apart from raising several issues in the appeal regarding irregularity in signing of Power of Attorney/Authority Letter, the Respondent had alleged that the Appellant was the 'Investor' initially as a loan-provider in July, 2013.
- However, all the 40 Investors became either a designated partner or a general partner by way of the 'Amended Agreement' dated 1st December, 2013. This document had also been signed by the Appellant. In addition to this document, the Supplementary Agreement dated 25th March, 2014 was also executed by all the partners including the Appellant.
- The Auditor Certificate also certified the investment as capital contribution including that of the Appellant.
- The Respondents, further, submitted that the Appellant was not a 'Financial Creditor' rather was a related party.

Held

- The court noted the following facts:
  - o The Appellant, a senior citizen, and her late husband had invested huge amount in the Corporate Debtor
  - o The Corporate Debtor suffered from several irregularities
- The provisions of section 7 of the IBC provides for initiation of the CIRP by a 'Financial Creditor' only and that too, if there was a 'debt' and a 'default'. Therefore, the relevant question was whether the Appellant was to be considered as a 'Financial' Creditor u/s 5(7) of the IBC and whether the 'debt' was 'Financial Debt'.
- Since the 'debt' was converted into 'Capital', it could not be termed as 'Financial Debt' and the Appellant could not be described as a 'Financial Creditor'.
- Accordingly, it was held that the grievance of the Appellant did not fall under the provision of the IBC and the appeal was dismissed.

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