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CORPORATE LAWS

Case Law Update

Companies Act – (1)

Union of India (Petitioner) vs. Videocon Industries Limited and others (Respondent), NCLT, Mumbai Bench, order dated 31st August, 2021

Facts of the case

- Union of India, Ministry of Corporate Affairs through Joint Director of Regional Director office [Petitioner], Mumbai u/s 241-242 of the Companies Act, 2013 praying for certain interim reliefs which are as follows:
  - Respondent be directed to disclose on affidavit their moveable and immoveable properties/assets including bank accounts owned by them in India or anywhere in the world
  - CDSL and NSDL be directed those securities owned/held in any company/society be frozen
  - CBDT and IBA be directed to disclose information about all assets in their knowledge and such bank accounts and lockers respectively for the purpose of freezing with immediate effect
  - Permission to be granted to write to SG and Union territories to identify and disclose all details of immovable properties owned/held by the respondents
  - All movable and immovable properties be attached during the pendency of the company petition

Arguments on part of Petitioner

- Petition filed mainly concerns the aspects of mis-management with regards to funds and revenues of the Companies
- Petitioner argued as follows:
- After referring to the financial statements of the respondent company (Videocon which is the flagship Company) of the year 2014 and 2019,
  - the reserve and surplus as declared in the year 2014 compared to 2019 shows steep downfall and that is too within the period of 5 years
  - Same appears in the case of Secured loans, it shows a steep rise in the loan component

- Investments showing a rise, but the amount invested by the Company in fact dead investment which ought to have been made by the Company in any prudent manner, in view of accumulated loans resulting in depletion of net-worth
- Profit and loss account also reflected the same i.e. it indicates the Company's performance as completely derailed and the final net-worth of the Company has become negative

Particulars	2014	2019
Reserve and Surplus	10,028 crores	-2972.73 Crores
Secured Loans	20,149.23 Crores	28,586.87 Crores
Investment	5626.93 Crores	9,635.75 Crores
Adjusted P & L A/c	3.04 Crores	-5,347.41 Crores
Operating Income	18967.60 Crores	906.60 Crores

- The promoters have hardly any financial interest left in the Company as Annual Accounts for 2016-17 and 2017-18 shows that promoters hold 40.59% share capital of the Company out of which 98.16% of their equity is pledged with various FIs and Banks.
- SBI, lead banker filed petition u/s 7 of IBC in 2018 and CIRP was also initiated by order, but no one from the respondent company had come forward to oppose the said petition and respondent company stated that there is no defence and supported the petition
- Pursuant to the order of the Mumbai bench, while the CIRP process was going on, the Resolution Professional (RP) has filed an application u/s 43 and 66 of IBC, 2016 making serious allegations against the promoters.
- Subsequently, the transaction audit was conducted in which there are several serious acts of mismanagement on the part of erstwhile management/promoters had come out.
- In the transaction audit, the auditor had clearly noted that out of receivables from 36 entities aggregating to ₹ 2891.3 Crores, an aggregated amount of ₹ 1209.35 Crores was settled against the amount payable by the respondent company to 19 entities. On inquiring with respondent Company, the above settlements were made on approval from only Mr. Venugopal Dhoot, the approval from joint lender forum and Board of Directors was not taken.
- Further, no documentation was provided which could demonstrate that Venugopal Dhoot was authorised by the BOD to approve accounting adjustments of such nature, especially where it pertains to related parties or entities connected to respondent Company
- 46 entities engaged in the above settlement are connected as group

entities of the corporate debtor i.e., some are promoter group entities holding shareholding in respondent company or entities having common directors or where some of the family members of the respondent company hold directorship

- Auditor stated that it has not been able to establish the appropriateness or the business rationale of the abovementioned transactions. Failure of the representatives of Respondent No.1 to supply any supportive information or documents, the adverse inference must be taken against as these were not undertaken during the 'ordinary course of business'.
- Further, the auditor too has not made any qualifying remarks in his report which goes to show that the auditor's involvement in respect of purported fraud in Respondent Companies.
- Also argued that transactions mentioned above have had an effect of putting such creditor entities connected/known to the Respondent in a beneficial position than they would have been in the event of distribution of assets being made in accordance with Section 53 of the Code. So classified under Section 43 of the Code as preferential transaction
- On a review of the Consolidated Trial Balance Sheets of Respondent no. 1 for the financial year 2017-2018, the Auditor noted that ₹ 634.67 crores receivable from 967 customers was written off from the Sundry Debtor Account of Videocon without any reasonable grounds.
- Out of 967 – 7 customers were disclosed under promoter/promoter group entity holding shareholding, however, said entities were never disclosed as a subsidiary, joint venture or an associate company of the respondent
- On review of the standalone financial statements of Videocon for FY quarter 30.06.2018 wherein it was noted that ₹ 1413.35 crores was written off from the books of Videocon and the same was reflected under exceptional items, actual entries of write off was 30.07.2018 after the appointment of RP but the auditor was not provided with any express approval from the Resolution Professional for writing off the advances and backdating the same
- Petitioner stated that Respondent No. 1 and other connected declared group entities have not come clean before this Bench which goes to show the prima facie that Respondents were directly involved in the objectionable transactions with regard to the affairs of the Company.
- the transaction audit report is also more or less point out fraudulent conduct of erstwhile management. There have been thorough leakages taken place which has got a recurring effect until this day.

Arguments on the part of Respondent

- Respondent contends that Section 241(2) does not apply to this Petition at this point of time because the CIRP process has already been initiated and the provisions of Section 14 of IBC as already kicked in.
- Further stated that the words used are "the affairs are being conducted", only indicates present acts but not past acts of Respondent No.1.
- Further, it is argued that Section 14(1)(a) of IBC which clearly shows that the

institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgement, decree or order in any court of law.

Held

- The transaction audit reports reveal fraudulent conduct in the companies mentioned in the cause title and their affect felt till this date of filing the petition. The petitioner has taken initiative to curtail the acts of preferential and fraudulent transactions in the best possible manner and the public interest could be better served.
- Provisions of section 241(2)(m) of the Act are independent and have wide import as evident from IL&FS orders passed by this Bench and the Hon'ble NCLAT.
- We with all our little wisdom defer with the contentions raised by the Ld. Counsel of the Respondent, the reason being that the company is very much alive and the present actions are covered within the scope of Section 241(2) of the Act.
- The proviso 241(2) "The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order under this chapter."
- The use of words "are being conducted", does not mean it does not cover the past acts. It is to be interpreted that the acts so mentioned in the above proviso also indicates past acts of mis-management, the present acts of mis-management and also to contain the future acts, especially when it comes to dealing with fraudulent transactions.
- In this present case, the company is still in operation under the control of RP and hence all the acts so mentioned are not just past continuous but also present perfect continuous.
- This is **not a proceeding against the Corporate Debtor but for the Corporate Debtor**. We certainly agree that the contention that no suit or proceeding can be instituted against the Corporate Debtors.
- But here the **efforts made by the Union of India is to secure or restore the assets back to the ultimate victims of fraud** and it is **not any adversarial proceeding** that is the proceeding in rem which has **initiated by the Government of India to catch hold all the wrong doers and the fraudulent persons**.
- Adding further to the above analysis, the Petitioner Union of India has made a very categorical submission that **they have not sought any relief against any of the corporate debtors** in the above list of companies. Having established the prima facie case from the above submission, it is for the Bench to see the balance of convenience and the irreparable loss.
- The resolution plan as approved by this Bench has been stayed by the Hon'ble Appellate Tribunal and the Hon'ble Supreme Court did not interfere with the same.
- That means as of now, there is no Resolution Plan and the Resolution Professional's position is restored. It is to be considered that the **CIRP**

process is still on and it means that the company operations would continue under the control of RP.

- If at all an interim order as sought by the Union of India is not passed, the devastating effect would be that the wrong doers, fraudulent persons would get away and the valuable assets of the companies would get depleted, bringing the irreparable loss to the stakeholders.
- That means the balance of convenience and the irreparable loss coupled with the *prima facie* case are absolutely on the side of the petitioners and passing of interim orders in favour of the petitioners is extremely essential in order to protect the public interest and public estate which is intertwined with the estate of the Respondents.
- In addition to the above, this Bench is surprised with the manner in which the financial institution has come forward to grant loans to a sinking ship and again come forward to file a petition under Section 7 of IBC and again supports this petition. This certainly raises the eyebrows of the common man in the public.
- Bench is cautious that the Union of India is taking steps and also carrying out an investigation through SFIO, i.e., Serious Fraud Investigation Office to unearth the fraud. We direct the Petitioners to use all the powers available with it to extend their long arm to thoroughly investigate the affairs of the companies in all the above-mentioned Company petitions and others.

Companies Act – (2)

Economy Hotels India Services Private Limited vs. Registrar Of Companies

Before the National Company Law Appellate Tribunal – New Delhi Bench – order dated 24th August, 2020

Facts of the Case

(i) Economy Hotels India Services Private Limited (hereinafter referred to as 'Appellant Company') was a wholly-owned subsidiary of AAPC Singapore Pte. Ltd.

(ii) It was averred that the Company was incurring high operating costs over a period of time, resulting in a significant amount of losses from year to year. The total amount of accumulated losses appearing in the provisional financial statements of the Company as on 30th June 2019 was ₹ 48,90,74,571/- which resulted in erosion of the Net Worth of the Company. It was further stated that the present Issued, Subscribed and Paid-up Equity Share capital of the Appellate Company does not fairly represent its available assets and in order to give a fair representation of assets and liabilities, realign the size of equity share capital structure to the optimum and rational level and considering its current operations, the Company had proposed to reduce the Issued, Paid-up and subscribed share capital of the company from ₹ 67,47,90,000/- (6,74,79,000 Equity Shares of ₹ 10 each) to ₹ 4,90,00,000/- (49,00,000 Equity Shares of ₹ 10 each) by reducing or cancelling 6,25,79,000 Equity shares of ₹ 10 each.

(iii) The Annual General Meeting of the Appellant Company for approval of the Scheme was attended by both the

Equity Shareholders holding 100% of the issued, subscribed and paid-up equity share capital of the Appellant Company and they casted their votes in favour of the resolution.

(iv) There was a 'typographical error' in the extract of 'Minutes', which was filed with NCLT, which states that the Company has passed an Ordinary Resolution.

(v) The E-form MGT-14 which was filed with the ROC reflected that the resolution passed by the shareholders u/s 66 of the Companies Act, 2013 was a 'Special Resolution' which is taken on record in MCA21 Registry.

(vi) Hon'ble NCLT, Delhi Bench observed that the Company has passed the resolution for reduction of capital "as an Ordinary Resolution" instead of the prescribed requirement of Special Resolution, therefore requirements of section 66 were not complied. Therefore, NCLT rejected the petition.

Contentions of the Appellant Company

The Company aggrieved by the order of NCLT, approached NCLAT and argued that the Tribunal failed to appreciate that the resolution passed on 19th August 2019 was a 'Special Resolution' passed by the 'Shareholders' of the Appellant and was in complete compliance with the all the three requisites of Section 114(2) of the Companies Act, 2013.

- Article 9 of the 'Articles of Association' of the Appellant/Company specifies that the Company may, from time to time by a special resolution reduce its share capital in any manner permitted by law.
- The Appellant/Company had filed Petition under Section 66(1)(b) of the Companies Act praying for the passing of an order for confirming the reduction of share capital wherein it had averred as under: -

  "That Annual General Meeting of the Petitioner Company held on 19th August, 2019 was attended by both the equity shareholders holding 100% of the issued, subscribed and paid up equity share capital of the Petitioner Company. The said equity shareholders present at the said meeting have cast their votes in favor of the aforesaid resolution etc."
- The Appellant/Company had placed on record sufficient documents to prove that 'special resolution' as required under Section 66 of the Companies Act, 2013 as well as in terms of the requirement under Article 9 of the 'Articles of Association' of the Appellant Company.
- The Appellant stated that only due to a 'typographical error' in the extract of 'Minutes', a resolution passed unanimously by the shareholders will not cease to be a 'special resolution'. Which the Tribunal failed to appreciate that the resolution passed on 19th August, 2019 was a 'Special Resolution' passed by the 'shareholders' of the Appellant and was in complete compliance with all the three requisites of Section 114(2) of the Companies Act, 2013 and since the Tribunal treated the aforesaid 'resolution' as an 'ordinary' resolution the impugned order is liable to be set aside in the interests of justice.
- On behalf of the Respondents, it was represented that the members of the Appellant/Company at the 'Annual General Meeting' that took place on 19th August 2019 among other things resolved that pursuant

to Section 66 of the Companies Act, 2013 and subject to other requisite approvals, the paid-up share capital of the Company would reduce from its present level of ₹ 67,47,90,000/- to ₹ 4,90,00,000/-. It transpires that the 'Special Resolution' passed in the 'Annual General Meeting' as filed with the e-form MGT-14 reflects that the resolution passed by the shareholders u/s 67 of the Companies Act, 2013 on 19th August 2019 is a 'Special Resolution' which is taken on record in MCA21 Registry. The Resolution passed in the 'Annual General Meeting' of the Appellant's Company u/s 66 of the Companies Act was found to be in order by the Respondents. Even the report of Registrar of Companies, Delhi found that the Appellant/Company had filed the said resolution keeping in tune with the ingredients of Section 66 of the Companies Act, 2013.

- 'Reduction of Capital' is a 'Domestic Affair' of a particular Company in which, ordinarily, a Tribunal will not interfere because of the reason that it is a 'majority decision' which prevails. The term 'Share Capital' is a 'genus' of which 'Equity and Preference share capital' are 'species'.
- Section 66 of the Companies Act, 2013 mentions the term 'reduction of Share Capital'. For a valid resolution, it must satisfy the relevant provisions contained under the Companies Act. A 'special resolution' is required to determine those matters for which the Act requires a 'special resolution' and except these matters in all other situations, an 'Ordinary Resolution' is to be passed.
- It was pertinently pointed out that Section 114(2) of the Companies Act, 2013 enjoins that 'Special Resolution' means a resolution where a decision is reached by a special majority of more than 75% of members of a Company voting in person or proxy. In reality, Section 114(2) of the Act applies to all Companies.

Held by NCLAT

Allowed the Appeal by setting aside the impugned order passed by the 'National Company Law Tribunal and Stated the following:

- The Appellant Company has tacitly admitted its creeping in of typographical error in the extract of the minutes and also taking into consideration of the Respondent's stand that the Appellant Company had filed the special resolution with it, which satisfies the requirement of Section 66 of the Companies Act, 2013, allows the Appeal by setting aside the impugned order passed by the 'National Company Law Tribunal confirming the reduction of the share capital of the Appellant Company as resolved by the 'Members' in their 'Annual General Meeting' that took place on 19.08.2019 and further this Tribunal approves the form of Minutes required to be filed with Registrar of Companies, Delhi u/s 66(5) of the Companies Act, 2013, by the Appellant Company.

SEBI – (1)

Name of the Case: Adjudication Order no: Order/GR/KG/2021-22/13092 in respect of Mr Rashim Tandon, Partner – Deloitte, Haskins & Sells (Membership no: 095540)

Facts of the case

1. An article appeared on Bloomberg.com dt: February 09, 2018 which *inter-alia* mentioned that the promoters of Fortis

Healthcare Limited (hereinafter referred to as **'FHL'** or **"the company"**) have taken at least ₹ 5 billion rupees out of FHL. The said article also pointed out that Deloitte Haskins & Sells LLP, the Statutory Auditor of FHL had refused to sign off on the company's second quarter results until the funds were accounted for.

2. On the basis of this article SEBI initiated investigation into the matter of grant of Inter-Corporate Deposits (hereinafter also referred to as "ICDs") Best Healthcare Private Limited (**"Best**"), Fern Healthcare Private Limited (**"Fern"**) and Modland Wears Private Limited (**"Modland"**) ['Borrower Companies'] during the period from FY 2011-2012 till 2017-2018. SEBI appointed forensic auditor MSA Probe Consulting Pvt Ltd (hereinafter referred to as **"MSA/ Forensic Auditor"**) to examine the alleged diversion of funds from FHL/its subsidiaries for the benefit of promoter/ promoter connected entities.

3. MSA in its forensic audit submitted following observations:

   a. The ICDs amounts that were given by Fortis Hospitals Ltd ('FHsL') to Borrower Companies was diverted to erstwhile promoter related entities viz. RHC Holding Pvt. Ltd and Religare Finvest Limited and ultimately benefitted Mr Shivinder Mohan Singh (**"SMS"**) and Mr Malvinder Mohan Singh (**"MMS"**), the erstwhile Managing Director and Executive Director of FHL. The outstanding principal amount (excluding interest) that is owed by the Borrower Companies to FHsL was ₹ 403 crore (approx.).

   b. Misrepresentations were observed in the financial statements of FHL and FHsL for quarter ending June 30, 2016 to quarter ending June 30, 2017

   c. It was also observed that Deloitte Haskins & Sells LLP (**"Deloitte"**) were the Statutory Auditors of the company during the period when misrepresentation of financial statements of FY 2016-17 and first quarter of 2017-18 took place. It was further observed that their signatory to the financial statements viz, Mr Rashim Tandon, Partner, Deloitte, Haskins & Sells ('Noticee/Respondent'), had failed to comply with Code of Ethics issued by ICAI and conduct the audit in accordance with the auditing standards generally accepted in India. Also, the Noticee had certified that the audited financial statements of FHL for the FY 2016-17 (audited financials for FY 2017-18 were qualified) were free of material misstatement and gave an unqualified opinion that the said financial statements were giving a true and fair view, without having reasonable basis for the opinion.

Charges levied

1. Noticee has not complied with standards of audit as prescribed by ICAI in SA 200, SA 240 as well as Guidance notes of Loans & advances and Guidance notes on cash and bank balances. In view of above, it was alleged that the Noticee had indirectly aided in misrepresentation and non-disclosure of material information in consolidated financials of FHL during relevant period and thus, violated the provisions of

Sections 12A(a), (b), (c) of the SEBI Act, 1992 and Regulations 3(b),(c) & (d), 4(1) and 4(2)(f) & (r) of SEBI (PFUTP) Regulations, 2003.

Arguments made by Noticees

1. **Securities and Exchange Board of India ('SEBI') does not have jurisdiction to go into questions of negligence and non-adherence of Standards of Auditing ('SAs'):** Respondent submitted that this allegation made against him is that of negligence and non-adherence to SAs as prescribed by The Institute of Chartered Accountants of India ("ICAI") in SA 200, SA 240, Guidance Note of Loans and Advances and the Guidance Note on Cash and Bank Balances. So, the inquiry and redressal of these allegations fall solely within the purview of the Chartered Accountants Act, 1949, and therefore, SEBI (and consequently the Adjudicating Officer) lack jurisdiction to go into these questions.

2. **Noticee submitted that he is not involved in Fraud: He based this argument on the basis of following submissions.**

   a. ***SEBI has not evaluated the procedures followed by this Respondent against the relevant SAs and guidance notes before sending the Show Cause Notice:*** Respondent submitted that as a part of limited review process conducted by this Respondent, on FHL and FHsL, in addition to the inquiries from the management and other analytical procedures in accordance with the provisions of SRE 2410, Engagement Team, inter-alia, obtained aggregate quarterly movement schedule of the ICDs and interest income from the management of FHsL, reviewed the calculation of interest, as per terms of agreement(s), verified the aggregate amount of ICD repayment by each borrower, as stated in such schedule of ICDs provided by the management the bank statement and obtained requisite management representations and had discussions with the management. Further Respondent submitted that as soon as it came to be noticed that the ICDs were not repaid for quarter ended September 30, 2017 engagement team of Respondent raised queries with the management of FHL/ FHsL regarding the recoverability of the outstanding ICDs. Respondent further submitted that the engagement team were not satisfied with the responses of the management of FHL/ FHsL as regards recoverability of the outstanding ICDs. So Respondent and his engagement team decided to issue unqualified limited review reports and the insisted on additional procedures for the quarters ended September 30, 2017 and December 31, 2017. Further Respondent submitted that he also disclaimed his conclusion in the limited review reports for the quarters ended September 30, 2017 and December 31, 2017.

   b. ***No reason for Noticee to be suspicious of any transactions of FHL/FHsL:*** Noticee submitted that there was a practice of FHsL to place ICDs with Borrower Companies. It started in 2011. There was no concern regarding these ICDs raised by the previous auditor of FHL

and FHsL commencing from the financial year 2010-2011 up to the quarter ended June 30, 2015. Noticee further submitted that he in accordance with the professional standards on the audit acceptance process, sought certain clarifications from the previous auditor in relation to FHL and FHsL. Analysis of the information received from the previous auditor did not give rise to any reason for suspicion by this Respondent regarding the ICDs. Respondent and his team also had a meeting with the previous auditors in September 2015 in this regard and Respondent was not informed of any concerns in relation to the ICDs granted by FHL/ FHsL. The loan outstanding as on June 2015 from the Borrower Companies was signed off by the previous auditor and subsequently repaid duly in the next quarter, which again did not contribute to any reason for suspicion by this Respondent. The closing balances for the quarters of the financial year 2016-17 were also nil, indicating that all ICDs had been realised duly, along with interest. Thus, there was no reason for this Respondent to be suspicious of any transactions of FHL/ FHsL which were carried on from the past and those which continued thereafter.

3. **Show Cause Notice is based on certain facts that Statutory Auditor is not required to examine:** Charges under Show Cause Notice are levied based on matters and certain documents that a statutory auditor is not required to examine as a part of the audit/limited review process – and documents of third party borrowers referred to in the Show Cause Notice were not part of the books of account of FHL and FHsL and were not available to the auditors in the course of their audit or limited review viz. bank statements of Borrower Companies and alleged ultimate beneficiaries. SEBI has relied on facts that were never available to this Respondent at the time when it had conducted the audit of FHL/FHsL. Noticee further submitted that SEBI has not provided any facts suggesting that he was aware of any matters that could have impacted his audit opinion pursuant to the statutory audit or limited review report(s) for the relevant quarters, (i.e., matters that have been unearthed by the investigation in connection with the inter-corporate deposits ("ICDs") and that this Respondent chose to suppress such facts.

Conclusions made by SEBI

1. **Securities and Exchange Board of India ('SEBI') does not have jurisdiction to go into questions of negligence and non-adherence of Standards of Auditing ('SAs'):** SEBI stated that it agrees with the submissions of the Noticee that SEBI is not the authority statutorily mandated or equipped to evaluate the role of an auditor in the ordinary course of the latter's business. SEBI further submitted that even if there be any non-compliance of any standards of auditing by an auditor, the same shall squarely fall under the regulatory domain of ICAI, an institution created under a statute of the Parliament exclusively for the purpose of regulating the practice of charted accountancy and auditing in India. Further SEBI stated that SEBI Act, 1992 empowers SEBI to take

any such measure as it deems fit for regulation, protection and development of the securities market in India. The legislative, executive and quasi-judicial powers of SEBI under the SEBI Act are all aimed towards the fulfilment of the aforementioned mandate of SEBI. The disciplinary jurisdiction of SEBI under the statue extends to all the intermediaries in the securities market and to any person associated with the securities market. There are judicial rulings to the effect that the phrase 'Person Associated with the Securities Market' would include all and sundry those have something to do with the securities market [***Karnavati Fincap Ltd. And Anr. vs SEBI, (1996) 87 Comp Cas 186 Guj***]. So, it becomes clear that any action or omission of any person which has a direct and substantive relation to the securities market and can reasonably be expected to have an impact on the securities market, would come under the disciplinary jurisdiction of SEBI, besides being amenable to the jurisdiction of any other sectoral regulator. SEBI further stated that Hon'ble Bombay High Court in ***Price Waterhouse & Co. and Ors. vs. SEBI [2010 (103) SCL 96 (Bom***)] held that even an auditor of a company can be brought under the ambit of the SEBI (PFUTP) Regulations, if the fraud committed by it can be established from the evidence. Therefore, in the present case, it cannot be held that only because the Noticee was an auditor, he shall not come under the disciplinary/ penal jurisdiction of SEBI. Rather, the correct position would be that if it can be established from the available evidence that the Noticee had indeed aided the alleged fraudulent scheme of utilization of the funds of FHL for the benefit of its erstwhile promoters, then he shall be amenable to the disciplinary/ penal jurisdiction of SEBI as a person directly or indirectly associated with the securities market. Thus, this preliminary issue in the present case is involved with the merits of the case and cannot be adjudicated independent of the merits of the case.

2. Noticee submitted that he is not involved in Fraud:

a. SEBI has not evaluated the procedures followed by this Respondent against the relevant SAs and guidance notes before sending the Show Cause Notice: SEBI stated that from the investigation report of SEBI it can be seen that the Noticee had refused to sign unqualified unaudited financial information of FHL Group (which included FHsL) pending clarity on recoverability of the ICDs, which were not repaid as contracted on September 30, 2017. Subsequently on February 6, 2018, the Noticee vide an email to the then Audit and Risk Management Committee of FHL, requested to conduct an investigation on the matters pertaining to the issue and repayment of the ICDs. SEBI stated that it is important to note that these actions were taken by the Noticee even prior to February 9, 2018, the date on which Bloomberg had published an article inter alia alleging that the promoters of FHL, had siphoned off around USD 78 million from the company, and stated that the Noticee (and his firm) refused to sign off on the company's second-quarter results until the funds

were accounted for or returned. Thereafter, on the request of the Noticee, the then Audit and Risk Management Committee of FHL appointed an external independent law firm to conduct an investigation, inter alia, into the alleged issues concerning the ICDs. Subsequently, on February 28, 2018, the Noticee had issued a disclaimer of conclusion reports for the quarters ended September 30, 2017 and December 31, 2017. The report of the Noticee issued for the financial year ended March 31, 2018 was qualified with requisite disclosures in relation to the ICDs. Thereafter, on August 13, 2018, reported the issue relating to the outstanding ICDs to the Ministry of Corporate Affairs, similar to reporting under section 143(12) of the Companies Act, 2013. I note that all these steps were taken by the Noticee even prior to the publication of the Forensic Audit Report commissioned by SEBI and this conduct of the Noticee do not indicate any mala fide with respect to its engagement with FHL/FHsL.

b. ***No reason for Noticee to be suspicious of any transactions of FHL/FHsL:*** SEBI stated that nowhere in the investigation report it has been alleged that the Noticee had colluded or connived with the management of FHL/ FHsL in any manner to wilfully misrepresent the financial status of the said companies. It has been noted in the investigation report that till December 2015, the ICDs were being regularly repaid by the Borrower Companies. Thus, the Noticee is correct in his submissions that at the point in time when he/his firm had started the auditing exercise for FHL/FHsL, there was no reason for an auditor to be alarmed with respect to the grant of the ICDs.

3. **Show Cause Notice is based on certain facts that Statutory Auditor is not required to examine:** In this regard SEBI submitted that investigation has recorded that it was from June 2016 to June 2017 quarter (i.e., over 5 quarters) that Best/Fern/Modland did not make any actual repayment of loan/ ICDs to FHsL and despite the same receipts of repayment was shown by FHL/FHsL. FHsL was observed to have artificially inflated its profits by ₹ 473 Crore over a period of 5 quarters. SEBI further submitted that it was also observed in the investigation that the structured rotation of funds and the rollover of loans were employed by FHsL to hide its real financial position. SEBI further stated that for this alleged act of suppression of material facts and creation of an elaborate scheme to conceal the actual financial status of the company, it is FHsL that has been prima facie held to be responsible in the investigation of SEBI and no allegation has been leveled against the Noticee for arranging/ aiding the said structured transactions and/or rotation of funds or rollover of loans. The only allegation against the Noticee is that it could have found out this elaborate fraudulent scheme of FHL/FHsL had it applied due diligence. SEBI in this regard stated that it is the case of the Noticee is that it could not have detected the aforesaid rotation of funds without *inter alia* having access to the bank account statements of the Borrower

Companies in order to understand that there were insufficient funds with the Borrower Companies, which was never available to him as he was not auditing the Borrower Companies. It is also not the case of SEBI that the Noticee had access to the bank account statements of the Borrower Companies. SEBI further noted that there is a possibility that despite reasonable efforts put in by an auditor in compliance with the extant standards of auditing; a material misstatement might remain undetected in the financial statement of an entity which is being audited. SEBI relied on ruling of Hon'ble Bombay High Court in ***Tri-Sure India Ltd. vs A.F. Ferguson and Co. and Others [1985 SCC OnLine Bom 342 : (1987) 61 Comp Cas 548]*** in this regard.

Penalty

Matter disposed off without penalty. **SEBI's concluding remarks,** "The relevant standards of auditing and the relevant judicial pronouncements do not hold the auditors liable or responsible for a fraud perpetrated by the management of a company if it can be established that the auditor(s) had not colluded/connived with the management in the perpetration of the fraud. Even if it is assumed that there has been a breach of a particular standard of accounting by the Noticee in this case as alleged, in the absence of any material to establish knowledge/collusion/connivance of the Noticee with such fraudulent scheme, the Noticee cannot be brought under the disciplinary/ penal jurisdiction of SEBI.

Cases referred:

SEBI

- ***Tri-Sure India Ltd. vs A.F. Ferguson and Co. and Others [1985 SCC OnLine Bom 342 : (1987) 61 Comp Cas 548]***
- ***Price Waterhouse & Co. and Ors. vs. SEBI [2010 (103) SCL 96 (Bom)]***
- ***Karnavati Fincap Ltd. And Anr. vs SEBI, (1996) 87 Comp Cas 186 Guj]***
- ***W.P. Nos. 5249 & 5256 of 2010 [Price Waterhouse & Co. & Ors. vs. SEBI & Ors.]***

IBC – (1)

Lotus City Plot Buyers Welfare Association (Appellant) vs. Three C Homes Private Limited and Others (Respondent) – in the order dated 8 July, 2021 passed by the National Company Law Appellate Tribunal (NCLAT) New Delhi

Facts the Case

- Mr. Arun Kumar Sinha – Financial Creditor and a home buyer-initiated insolvency proceedings against the M/s Three C Homes Private Limited - Corporate Debtor on 6 September 2019 u/s 7 of the Insolvency and Bankruptcy Code (IBC). The Committee of Creditors (CoC) constituted of homebuyers (creditors in a class) of the Corporate Debtor.
- Pursuant to publication of the invitation for expression of interest by the resolution professional, only one resolution plan, i.e. by M/s Ace Infracity Developers Private Limited, was put for consideration before the CoC. The CoC consisting 100% of homebuyers approved the resolution plan by a majority vote and upon CoC's approval of the resolution plan, the resolution professional (RP) approached the National Company Law Tribunal (NCLT).
- Certain homebuyers being financial creditors in a class led by Mr. Sandeep

Goel, moved the to NCLT by way of an application under Section 60(5) of IBC, seeking corrective measures in accordance with the law, whilst expressing their dissent towards the approval of a non-compliant resolution plan. They even highlighted the substantive and procedural irregularities on the part of RP, authorised representative and the resolution applicant during Corporate Insolvency Resolution Process (CIRP).

- NCLT weighed the objections raised by the dissenting financial creditors aka home buyers and made the following observations, on four aspects:

  1. ***The Resolution Plan is in violation of Section 30(2)(b) of IBC, as there is no provision regarding payment to the dissenting financial Creditors in a class as required under the IBC.***

     — NCLT held that IBC has not provided for a mechanism whereby creditors within a Class can be entitled to the guaranteed sums under Section 30(2)(b), under the heading of dissenting financial creditors, owing to the specific scheme of voting for creditors in a Class

     — The NCLT observed that the individual vote of creditor is not taken into account while deciding the final stance of the entire Class, and therefore the final vote represents the vote of each and every member of the Class.

     — This objection was rejected by NCLT.

  2. ***The treatment of Homebuyers by the resolution applicant was inequitable, unjust and highly objectionable.***

     — In the present case, the liquidation value for the corporate debtor was estimated at around ₹ 480.70 Crores, against which the resolution plan approved by the CoC provided for only an amount of ₹ 180.34 Crores. Even, against the sum of ₹ 180.34 Crores, the resolution applicant was obliged to bring in only ₹ 95 Crores by way of fresh infusion of funds, spread over a period of 2 years, and the rest ₹ 85 Crores was to be contributed by the financial creditors, i.e. homebuyers themselves

     — NCLT while examining the viability and suitability of the resolution plan found that that there is a huge difference of 80.23% between the actual liquidation value for the corporate debtor and the amount of funds being proposed by the resolution applicant by way of fresh infusion.

     — This objection was upheld by NCLT.

  3. ***The Resolution Plan was not in compliance of the provisions of the Code and specifically the amended Regulation 16A (9) of the CIRP Regulations, 2016, which came into force on 7 August 2020.***

     — The resolution professional contended that the notice for

the CoC meeting was issued before the amendment was introduced and placed reliance on the position that every statute or amendment is to apply prospectively, unless it is stated to be retrospective.

— However, NCLT held that since the amendment relates to a provision concerning procedure, an amendment in procedural law always has retrospective effect unless there is a specific provision barring its retrospective operation.

— NCLT also noted that even after the introduction of the amended regulation coming into force on 7 August, 2020 three meetings of the CoC were conducted thereafter and the amended procedure was not followed. Resultantly, no effective participation was to be found of the authorised representative of the homebuyers in the voting process conducted for the approval of the resolution plan.

— The objection was upheld by NCLT

4. ***The Resolution Plan was found to be in violation of Regulation 38(3) (a) of the CIRP Regulations, as it fails to demonstrate facts that addresses the 'cause of default'.***

— NCLT observed that the proposed socio-economic arrangement in the resolution plan, to deal with the cause of default' being Yamuna Expressway Development Authority's (YEIDA) everlasting dispute with farmers belonging to the vicinity of the corporate debtor's project 'Lotus City' & 'Park space', were unilateral and unsustainable.

— The resolution plan sought to address the cause of default' by way of developing the adjoining village 'Salarpur' and also developing community facilities in consolation with YEIDA and local panchayat by investing ₹ 15 Crores for such development, to satisfy the demands of farmers. The resolution plan overlooked the fact that YEIDA and other authorities failed to support the corporate debtor when the farmers were creating a law and order problem and at the outset, YEIDA had raised a demand of ₹ 71.66 Crores to be paid by the corporate debtor. Consequently, the Farmers will not forego their claim in exchange of a meagre sum to develop the adjoining village, and hence the Resolution Plan fails to address the cause of default'.

- NCLT rejected the resolution plan and with directions to the resolution professional to file an appropriate application seeking liquidation order of the corporate debtor at the earliest.
- An appeal was then filed u/s 61 of IBC, at NCLAT by the appellant.

Arguments of the Appellant
The Appellant contended that:

- NCLT did not consider the quantum of debt due to allottees as after giving the possession of plots to allottees, the debt due to allottees would stand satisfied and the quantum which shall be paid by the resolution applicant to Ex-management.
- The resolution plan had been approved with a 62.9% voting share which would be considered as 100% as per Section 25A(3A) of the Code in favour of the 'resolution plan'.
- The decision of the CoC in respect of commercial issues cannot be challenged by the NCLT.

Arguments of Respondent
The Respondent contended that:

- RP in this case has not submitted the 'compliance certificate' as required under the Code.
- The RP in the 3rd CoC meeting has requested for the formation of a sub-committee to appraise and validate the resolution plan which is contrary to the provisions of the Code. Section 25(2)(i) of IBC mandates that the resolution professional shall represent all the plans at the meeting of the CoC.
- Resolution Applicant is acquiring the Corporate Debtor is less than 1/5th of the Liquidation value of the Corporate Debtor.

Held

- NCLAT observed that there is a difference of CoC where they are 'Banks' and 'Institutional lenders 'as members, while the CoC in the Homebuyers is not so expert in finance and related valuations. Hence, CoC in case of the commercial organisations will have a different perspective and expertise while in case of Real Estate projects where the CoC are totally comprising of homebuyers may not have the same expertise and perspective. Although, in case of Homebuyers provisions exist for Authorised Representatives but even he cannot be equated with the expertise the banking professional will have.
- Also noted that while the Resolution Plan will generally provide a higher value than the liquidation value but in case of Real Estate Project may not be always feasible and homebuyers are in dire need of getting their homes at the earliest However, in this case certain reconciliations are required that what is the actual realisable value which the homebuyers are getting whether it is below liquidation value or above liquidation value.
- NCLAT stated that liquidation is the last resort and this programme of homebuyers needs some calibration and proper evaluation.
- Accordingly, the matter was remanded to NCLT and a liquidation order was set aside with a direction to review the programme in full along with the relevant provisions of the code and regulations.

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