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MMJCINSIGHTS

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Non-compliance with provisions of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ['ICDR Regulations']

SEBI vide its circular dt: 19 August, 2019 prescribed penalties for non-compliance with certain provisions of ICDR Regulations. This Circular prescribes penalty that can be levied by Stock exchange for:-

(I) delay in completion of bonus issue,
(ii) for not completing the conversion of convertible securities and allotting shares within 18 months from date of allotment of convertible securities,
(iii) not making an application for trading approval within seven working days from the date of grant of listing approval, and
(iv) not making an application for listing in case of further issue within a period of 20 days.

For all these violations SEBI Circular dt: 19 August, 2019 provided for levy of penalty on per day basis till the compliance is done.

Now SEBI vide its circular dt: 23 November, 2021 SEBI has partially modified its Circular dt: 19 August, 2019.
SEBI has now added a clause which states as follows, *"The Stock Exchanges may deviate from the provisions of the circular, wherever the interest of the investors are not adversely affected, if found necessary, only after recording reasons in writing"*

Vide this partial modification **SEBI empowered Stock Exchanges** to **deviate from the provisions of this circular** in the **interest of investors** by giving reasons in writing for same.

So now the question arises as to **what powers stock exchanges have** pursuant to this Circular dated 23 November, 2021?

As per SEBI Circular dt: 19 August, 2019stock exchanges are empowered to:-

i. issue notice to non-compliant listed entities to ensure compliance, and
ii. collect fines as per this circular within 15 days.

Also if any listed entity was unable to pay fine then stock exchanges were empowered to initiate appropriate action under Regulation 298 of ICDR Regulations. Regulation 298 of ICDR Regulations empowers Stock Exchange to initiate action in accordance with their bye-laws after giving notice in writing.

As per the SEBI Circular dt: 23 November, 2021 SEBI has stated that stock exchanges may deviate from the provisions of this circular, but SEBI has also added the conditions for deviation like:-

- The deviation should be appear necessary.
- The interest of investors should not be adversely affected by the deviation
- The reasons for deviation should be recorded in writing

So the question that arises is whether stock exchange can deviate only with respect to enforcement actions to be taken (including recovery of penalty) OR can stock exchanges also reduce the per day fine that is prescribed? This maybe seen in the days to come when stock exchanges decide to deviate in any case in accordance with this circular !!!

SEBI circular can be accessed at below link:
https://www.sebi.gov.in/legal/circulars/nov-2021/non-compliance-with-certain-provisions-of-sebi-issue-of-capital-and-disclosure-requirements-regulations-2018_54130.html

SEBI Circular 19 August, 2019:
https://www.sebi.gov.in/legal/circulars/aug-2019/non-compliance-with-certain-provisions-of-sebi-issue-of-capital-and-disclosure-requirements-regulations-2018-icdr-regulations-_43941.html

Minimum review items while approving Related Party Transactions

SEBI had recently amended the provisions with regard to related party transactions in SEBI (LODR) Regulations 2015. Also SEBI vide its circular dt: 22 November, 2021 has prescribed disclosure obligations on listed entities for entities which have listed their specified securities (equity shares and securities convertible into equity shares) while placing Related Party Transactions ("RPT") for approval before the Audit Committee and / or members of the entity. A draft proposal in this regard was released by SEBI in the form of Report of the Working Group on Related Party Transactions on 20 January, 2020. This reportput forth a view that while the responsibility of approving RPTs is placed on the Audit Committee which has a majority of independent directors, at present, however, there is no specific requirement of minimum information that should be provided to the Audit Committee while seeking approval for a proposed related party transaction. This Report also mentioned that while company management would be expected to provide all relevant information regarding an RPT to the Audit Committee and to the members to evaluate the same, it would be prudent to specify in the LODR Regulations, the minimum information to be provided to the Audit Committee and to the members in relation to any RPT for which approval is being sought.

Till now Rule 15 of Companies (Meetings of Board and its Powers, Rules 2014 – (the Rules)) read with Section 188 of Companies Act, 2013(the Act) prescribes minimum items that should be given to Board of Directors and to the members for approval of Related Party Transactions. Now SEBI has additionally prescribed some minimum items that needs to be reviewed by Audit Committee and disclosures to be provided to members for approval of Related Party Transactions. This Circular dated 22 November, 2021 will become effective from 1 April, 2022.

This raises an ambiguity that whether the disclosures will be required for approvals to be sought post 1 April, 2022 OR even for those RPTs which are entered post 1 April, 2022 but approvals would have already been sought before 1 April, 2022?

It is recommended that for the omnibus approval being sought at the upcoming Audit Committee Meeting in next quarter, these minimum items be placed before members of Audit Committee - as the approval will be for transactions to be entered post 1 April, 2022.

The list of minimum items are divided in three parts:

I. Minimum items to be placed before Audit Committee for approval of all Related Party Transactions
II. Minimum additional items to be placed for approval of Related Party Transactions relating to loans, inter-corporate deposits, advances or investments
III. Minimum items to be disclosed in explanatory statement attached to Notice sent to members for seeking approval of Related Party Transactions

I. Minimum items to be reviewed by Audit Committee for approval of Related Party Transactions:

a. Type, material terms and particulars of the proposed transaction;
b. Name of the related party and its relationship with the listed entity or its subsidiary, including nature of its concern or interest (financial or otherwise);
c. Tenure of the proposed transaction (particular tenure shall be specified);
d. Value of the proposed transaction;
e. The percentage of the listed entity's annual consolidated turnover, for the immediately preceding financial year, that is represented by the value of the proposed transaction (and for a RPT involving a subsidiary, such percentage calculated on the basis of the subsidiary's annual turnover on a standalone basis shall be additionally provided)
f. Justification as to why the RPT is in the interest of the listed entity;
g. A copy of the valuation or other external party report, if any such report has been relied upon;
h. Percentage of the counter-party's annual consolidated turnover that is represented by the value of the proposed RPT on a voluntary basis;
i. Any other information that may be relevant
j. The audit committee shall also review the status of long-term (more than one year) or recurring RPTs on an annual basis.

The above lists of items are not exhaustive. If it is necessary for any particular RPT, the listed entity can provide any additional data for review of Related Party Transactions. If a particular RPT is covered under Section 188 of the Act also then while placing the same before Board of Directors as per Rule 15 of the rules r/w Section 188 of the Act,in addition to above data details pertaining to any advance paid or received for the contract or arrangement, if any, the manner of determining pricing and other commercial terms, both included as part of contract and not considered as part of the contract and all relevant factors that have been considered and rationale for not considering the same also needs to be placed before the Board of Directors.

II. Minimum items to be placed for approval of Related Party Transactions relating to loans, inter-corporate deposits, advances or investments

a. details of the source of funds in connection with the proposed transaction;
b. where any financial indebtedness is incurred to make or give loans, inter-corporate deposits, advances or investments,
i. nature of indebtedness;
ii. cost of funds; and
iii. tenure;
c. applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured; if secured, the nature of security; and
d. the purpose for which the funds will be utilized by the ultimate beneficiary of such funds pursuant to the RPT.

III. Minimum items to be provided to shareholders for approval of Related Party Transactions

a. Information required to be provided in explanatory statement as per the Act.
b. A summary of the information provided by the management of the listed entity to the audit committee as specified in point I above;

c. Justification for why the proposed transaction is in the interest of the listed entity;
d. Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary, the details specified under point II above; (The requirement of disclosing source of funds and cost of funds shall not be applicable to listed banks/NBFCs.)
e. A statement that the valuation or other external report, if any, relied upon by the listed entity in relation to the proposed transaction will be made available through the registered email address of the shareholders;
f. Percentage of the counter-party's annual consolidated turnover that is represented by the value of the proposed RPT, on a voluntary basis;
g. Any other information that may be relevant.

Format of half-yearly disclosure of Related Party Transactions to stock exchanges

SEBI had, vide an amendment on 8 May, 2018, inserted Regulation 23(9) in SEBI LODR Regulations which prescribed a new disclosure requirement with regard to related party transactions to stock exchanges on a half-yearly basis starting from half year ending 31 March, 2019, in the format prescribed under relevant accounting standards.Thereafter BSE & NSE had vide their circulars dated 6 September, 2021prescribed a separate format of this disclosure requirement with effect from the half year ending 30 September, 2021.

Now,SEBI has, vide this circular dated 22 November, 2021, prescribed the format of this disclosure. Since this Circular is applicable from 1 April, 2022 onwards, it appears that this half yearly disclosure to be given for the half year ending 31 March, 2022 shall be as per the revised format. This format is different from the format prescribed by the above-mentioned BSE & NSE Circulars.

Hence, it will be very important to see whether the stock exchangesamend their above-mentioned circular and adopt the format prescribed by SEBI OR whether they expect the listed entities to submit the details of RPTs as per the format prescribed by them as well as the format prescribed by SEBI!!!

SEBI Circular dt: 22 November, 2021 can be accessed at below mentioned link:
https://www.sebi.gov.in/legal/circulars/nov-2021/disclosure-obligations-of-listed-entities-in-relation-to-related-party-transactions_54113.html

Is KMP defined under Materiality Policy?

The term Key Managerial Personnel (KMP) is defined under the Companies Act, 2013 (the Act), SEBI Listing Obligations and Disclosure Regulations (LODR) and under the SEBI Issue of Capital and Disclosure Regulations (ICDR).

The term KMP under the Act and the SEBI LODR covers Managing Director (MD), Chief Executive Officer (CEO), Whole-time Director (WTD), Chief Financial officer (CFO) and Company Secretary (CS) as KMP. Moreover, the power has been given to the Board of Directors (Board) to designate additional people who are in whole –time employment of the Company and not more than one level below the directors as KMPs.

However, when a Company pursue for an Initial Public offer (IPO), the ICDR regulations also get triggered. KMP as per ICDR covers the following:

- Members of the core management team other than board,
- Management Team one level below executive director,
- Functional heads,
- KMPs as per the Companies Act and
- Any person whom the issuer company declares KMP

So, a person for eg Head of Human Resource (Functional head) would a KMP as per SEBI ICDR but not as per the Companies Act or LODR.

The listed entity is required to make disclosure of events/information to stock exchange under regulation 30 of LODR which are material in the opinion of Board and that includes any changes in KMP. Further, the listed entity is also required to determine the criteria of materiality to disclose material events/information.
Interestingly, the difference **in the definition of a KMP under the LODR leads to a situation wherein a resignation of a person listed as a KMP in the draft document need not mandatorily be disclosed to the stock exchanges post listing**.

Recently, in one of the case of start-up which got listed through IPO – didn't announce the resignation of Co-founder and the head of supply at the time of IPO and was also termed as the KMP under the DRHP and was questioned by stock exchange for non-disclosure.

The KMP provided in the prospectus are generally key people in the organisation which may or may not be on board and their exit need not be mandatorily disclosed to the stock exchange post listing. Their exit may affect the public at large and price sensitive. These start-up may face allegations from the stock exchanges as to why the disclosure was not provided. They can avoid such situations and allegations**by setting the grounds as to which KMP from the prospectus is material for the listed entity and any change from those would be informed to stock exchange.**

Book Debt V. Loan – in context of Sec. 185

Sec. 185 regulates giving loans by any Company (public or private) directly or indirectly, **including any loan represented by book debt**, to any director of the company or entities in which such director is interested.
Whether all book debts of a company can be termed as loan? Let's discuss in this article.

Let us understand Meaning of Loan and Book Debt First.

Oxford English Dictionary defines **Loan** as "something the use of which is allowed for a time, on the understanding that **it shall be returned or an equivalent given** ; esp., a sum of money lent on these conditions and usually with interest."

Cambridge dictionary defines **Book Debt** as, "**money that a company has not yet received from customers who owe it money, as recorded in the company's accounts."**

Once we understand the meaning, next question comes to mind is "How to decide Whether a transaction is a loan or not?"

The Bombay High Court in "*Pennwalt India Ltd. v. RoC"* held that **to ascertain whether a transaction is a loan or not, surrounding circumstances, relationship and character of the transaction and the manner in which parties treated the transactions will have to be considered.**

For better understanding we can take an example, say "A Limited" supplies goods to "B Limited" wherein "X" is a Common director and "A Limited" generally provides period of 60 days for payment against supplies. The payment from "B limited" is pending for last 6 months and "A limited" continues to supply further goods without giving any reason for disproportionate time provided so.

In case any such type of transactions is occurring in your company, there are chances of allegation of Sec. 185 violation.

Point to be considered here is While Checking Compliance of Section 185, do we check Book Debts which are outstanding for disproportionately high period...

MANU/MH/0006/1987

Holding of General Meeting through VC or OAVM is here for more extended period!

- **Annual General Meeting (AGM)**

  Ministry of Corporate Affairs (MCA) vide Circular dated 8 December, 2021 allowed Companies to conduct their AGM through Video Conferencing (VC) or Other Audio Visual Means (OAVM) upto 30 June, 2022. However the extension is subject to fulfilment of requirements stated in Circular No. 20/2020 dated 5 May, 2020.

  Further, it is clarified that it should not be construed as conferring any extension of time for holding AGM by Companies under the Companies Act, 2013 (the Act).

  It is imperative to note that, the extension upto 30 June, 2022 is given for conducting AGM through VC/OAVMonly and the due date for holding of AGM is not extended.

  Failure to adhere timelines shall cause legal action under the appropriate provisions of the Act.

  MCA, further vide circular dated 14 December, 2021has clarified the ambiguous situation created by circular dated 8 December, 2021. It states that the companies which are proposing to organise AGMs in 2022 (due in the year 2022) can be conducted through VC or OAVM upto 30 June, 2022

- **Extra- Ordinary General Meeting (EGM)**

  MCA vide Circular dated 8 December, 2021 allowed Companies to conduct their EGM through VC or OAVM or transact items through postal ballot upto 30 June, 2022 subject to fulfilment of requirements of applicable circulars dated 8 April, 2020 and 13 April, 2020.

If the Corporate Debtor is a MSME - not necessary for the promoters to compete with other Resolution Applicants to regain the control of the Corporate Debtor.

In the matter of Mr.C Raja John (Appellant) being promoter / suspended Director of the Corporate Debtor of Spring Field Shelters Pvt. Ltd (Corporate Debtor) vsMr. R. Raghavendran being Resolution Professional(Respondent)and others order passed by National Company Law Appellate Tribunal (NCLAT) at Chennai dated 1December 2021.

Facts of the Case:

- An application was filed against Spring Field Shelters Pvt. Ltd – Corporate Debtor (CD) for initiation of Corporate Insolvency resolution Process (CIRP) under the Insolvency and Bankruptcy Code, 2016 (IBC/Code)
- The application was admitted by the National Company Law Tribunal (NCLT) and CIRP was initiated on 12 February, 2020
- Committee of Creditors (CoC) fixed the minimum eligibility criteria in relation to submission of Resolution Plan.
- Mr. C Raja John (Appellant) being promoter/suspended Director of the Corporate Debtor also submitted the resolution plan on the ground that the Corporate Debtor is an MSME and the Appellant is eligible to participate in the Resolution Plan.
- However, the Resolution Professional (RP) rejected the plan on two grounds.
    - The Appellant does not meet the eligibility norm of prescribed the Networth of Rs.2 Crores by the COC u/s 25(2)(h) of the IBC.
    - The Director Identification Number (DIN) of the Appellant is under default and not eligible as per Section 29(A)(e)of the IBC.
- NCLT considered the view of RP and rejected the application of the appellant for the resolution plan.
- Aggrieved by the order, an Appeal was filed by the appellant at NCLAT.

Arguments by the Appellant:

- Contented that without considering the reasons and the documents submitted by the Appellant, the NCLT rejected the Application and upheld the order passed by the RP.
- Further, w.r.t first ground i.e. not able meet the eligibility norm of prescribed the Networth of Rs.2 Crores by the COC u/s 25(2)(h) of the IBC- it was submitted that the Appellant has invested all his life earnings and properties worth Rs.10.5 Crores in the company.
- Also contended that the Appellant has also provided the collateral security of his only housefor the loan raised by the Corporate Debtor amounting Rs.1.75 Crores and the cost of the land of the Corporate Debtor is worth Rs.4.05 Crores. Thestated investment and the properties can be considered as net worth of the Appellant and requested the RP to consider the resolution plan submitted by the Appellant.
- Further, on second ground, submitted that the status of the DIN 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 neither considered by the RP nor by NCLT.
- The criteria prescribed cannot be made applicable to the CD since the CD is an

MSME Enterprise as per the Certificate issued by the Government of Tamil Nadu, Department of Industries and Commerce dated 28 May 2013 and subsequently, the certificate was also issued by the Government of India Ministry of Micro, Small and Medium (MSME) Enterprises, recognizing the CD as Micro Enterprise vide Certificate dated 19 December,2020. Hence, the status of the Corporate Debtor is an MSME.

- Reliance was placed on the judgement 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)(e) of the Code. Further,it was held that it is not necessary for the CoC to find out whether the Resolution Applicant is ineligible in terms of Section 29(A) or not.

Arguments by the Respondent:

- The criteria w.r.t net worth of the prospective Resolution Applicants to submit the Resolution Plan as per IBC is within the purview of the CoC.
- Further, the Appellant was disqualified as Director therefore, he is not eligible as per Section 29(A)(e) of the Code.
- Further, the eligibility criteria has to be complied with at the time of presenting the application and no order was obtained from the ROC in respect of removing the name of the Appellant from the list of Default Directors.
- Appellant filed an application before the Ministry of Micro, Small and Medium Enterprises and availed a certificate dated 19 December 2020 with regard to the status of the CD as Micro Enterprise subsequent to the initiation of CIRP against the CD, therefore the same has not been considered.
- The Commercial Wisdom of COC cannot be interfered by relaxing the minimum eligibility criteria as fixed by the COC.

HELD:

- The amendment to Section 240-A of the IBC was made with the intention to encourage the Promoters of MSME and allowed the Promoters of MSME to file Resolution Plan, which is viable, feasible and fulfills other criteria as laid down by the Code
- NCLAT held that if the CD is MSME, it is not necessary for the Promoters to compete with other Resolution Applicants to regain the control of the Corporate Debtor.
- Further, held that keeping in view of the object of the Code ***Maximization of the Value*** of the ***Assets*** of Corporate Debtor is to be kept in mind in achieving its object. To give an opportunity to regain the control of the Corporate Debtor, the Management/Promoters/Erstwhile Directors of the Corporate Debtor being an MSME, not necessary to compete with other Resolution Applicants.
- It is made clear that the Appellant does not fall under the category of 29A(e) of the Code in view of the directions of the Hon'ble High Court of Madras, whereby the Hon'ble High Court of Madras set aside the disqualification of the Appellant.
- The RP wasdirected to consider the Resolution Plan of the Appellant being erstwhile Director/Promoter of the Corporate Debtor.

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