CORPORATE LAWS
Case Law Update

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Companies Act – Case 1

In the matter of Rajiv Sharma (Petitioner) Versus Registrar of Companies (ROC), Mumbai (Respondent), Bombay High Court order dated 9th February 2024.

Facts of the case.

- Mr. Rajiv Sharma (hereinafter called petitioner) gave consent to act as director of Local Search Solutions Private Limited (hereinafter called as company) on 14th August 2020. However, the operations of the company never commenced and the company never filed form INC-20A for commencement of business under section 10A of the Companies Act 2013 (the Act).
- As a result, the petitioner submitted his resignation from the position of director of the company on 24th August 2021 and the same was taken on record by the board through circular resolution dated 1st September 2021.
- In spite of taking the resignation on record and after continuous follow-up from the petitioner, the company did not take any steps to inform the ROC about the resignation through form DIR-12. Also, the petitioner himself could not intimate the ROC about his resignation by filing form DIR-11 for the reason that the company had not filed form INC-20A.
- On observing that no steps are being taken by the company for the updation of records, the petitioner himself wrote a letter dated 12th July 2022 to the ROC Mumbai informing him about the petitioner's resignation and his inability to file the form.
- On receipt of a complaint from the petitioner, the ROC wrote to the company asking for clarification about the said complaint. But the letter sent to the company returned undelivered and hence ROC did not take the petitioner's resignation on record.
- As a result, the petitioner has filed the present writ petition before the Bombay High Court praying:

  a) The Hon'ble Court may be pleased to issue a Writ of Mandamus or any other appropriate Writ or direction directing the ROC to remove the name of Petitioner as a Director of the Company with effect from 1st September, 2021 i.e. the date of resignation;

  b) The Hon'ble Court may be pleased to issue a Writ of Mandamus or

any other appropriate Writ or direction directing the Respondent No. 1 to initiate appropriate action/ steps against Respondent No. 4 for default in complying with the provisions of the Companies Act, 2013 regarding the resignation of the Director."

Petitioner's contentions

The petitioner contended that:

- The consent to act as director was given during COVID period.
- After incorporation, the company never commenced its business
- The company took the resignation of the petitioner on record by passing a resolution but made no efforts to file the form with ROC in spite of follow-up by the petitioner.

Respondent's contentions

- The company had not fulfilled some of the compliances required to be made under the provisions of the Act more particularly under Sections 10A, 12, 92, 137 and 96 thereof.
- The Directors are in default as per Section 166(3) of the Act.
- Both the directors of the Company, including the petitioner were in default for having not complied with the provisions of Rule 12A of the Companies (Appointment and Qualification of Director) Rules, 2014, by not submitting form DIR-3 within the prescribed time period
- The contention of the Petitioner is not valid as the Company has not filed Form INC - 20 as per the provisions of Section 10A of the Act and as a result form DIR-11 and Form DIR 12 cannot be filed. Hence the Petitioner cannot claim relief on the basis that his resignation was not communicated to the Respondent through Form DIR-11 and DIR-12 due to failure on the Petitioners part to file the necessary forms relating to the commencement of business.
- It is the responsibility of the Directors of the Company to file all the necessary forms as per the provisions of the Act, and since both the Directors have defaulted in filing the commencement of business, the Company and its Directors are not capable of filing any other forms.

Held

- It appears to be not in dispute that the company never commenced its business, there were hence defaults in undertaking various compliances.
- The petitioner tendered his resignation by the letter dated 24th August 2021, which was during the pandemic period, which was duly noted by the Board of Directors and a resolution to that effect was also passed.
- It appears that, however, what had remained on the part of the company, was to make necessary compliances with the ROC, so that the records of the ROC qua the company stand updated inter alia also in regard to the resignation of the petitioner. As the business of the company itself did not commence such compliances had remained to be undertaken.
- Insofar as the legal position is concerned, by virtue of sub-section (2) of Section 168, the resignation of a

director shall take effect from the date on which the notice is received by the company, which in the present case was on 24th August 2021 and which stood confirmed by the resolution of the board of directors of the company dated 1st September 2021.

- Hence, by operation of law, the petitioner ceased to be a director of the company with effect from 1st September 2021. If this be the position the law would bring about, then certainly it would be an obligation on the ROC to give effect to such legal position in its records, and more particularly when an intimation to that effect was received from the petitioner.

- In our opinion, although certain compliances on the part of the company, as noted by us hereinabove were necessary, however, in the peculiar facts of the present case, it is clear that the company itself did not commence its business, as also the other director being a foreign director did not take any steps in that regard. Added to this was the Covid-19 pandemic period during which such compliances could not be made. All these circumstances ought not to weigh against the petitioner, for deletion of his name as a director from the record of the ROC.

- Except for certain forms not being filled by the company within the prescribed time, there does not appear to be any other gross default or illegality or any other justifiable reason for the ROC to give effect to the resignation of the petitioner, in the official records, as maintained by him. This is fortified from the contents of the reply affidavit of the official respondents which categorically state that even the explanations/comments and/or compliances as demanded by the ROC from the company were reported to be not answered by the company. This was a default on the part of a non-functional company. Thus, this is clearly a case where the company itself was stillborn.

- In the light of the above discussion, the petition needs to succeed, it is accordingly allowed in terms of prayer clause (a).

- It is clarified that, however, in regard to any other compliances and/or defaults of respondent No.4-company, it is open to the ROC to take appropriate actions as the law may mandate.

Case: 2 SEBI

Final Order in the matter of Vedanta Ltd regarding non-payment of dividend to Cairn UK Holdings Limited

Facts of the order

1. Securities Exchange Board of India had received a complaint dtd. April 13, 2017 against Cairn India limited ('CIL'/Noticee No 1) (now known as Vedanta limited) alleging non-payment of dividend of ₹ 340.64 crores to Cairn UK holdings limited ('CUHL') .

2. This dividend was in respect of 18,41,25,764 equity shares owned by CUHL in CIL.

3. On September 14, 2017, the Securities Exchange Board of India ('SEBI') disposed of the complaint on the ground that the unpaid dividend was handed over by the company to the Income-tax authorities and, therefore, it would not be appropriate for SEBI to take any further action and, accordingly, closed the complaint.

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4. CUHL being aggrieved by the disposal of the complaint filed an appeal against SEBI's order dtd. September 14, 2017. Securities Appellate Tribunal ('SAT') allowed the appeal and disposed of the appeal directing SEBI to reconsider the complaint of the appellant and pass appropriate orders.

5. Thereafter SEBI reconsidered the matter and by the impugned order dtd December 26, 2019 held that the violation of section 127 of the Companies Act 2013 and regulation 4(2)(c) of SEBI (Listing Obligation and Disclosure Requirement), Regulations ('LODR Regulations') by CIL was not established and accordingly rejected the complaint of CUHL.

6. CUHL thereafter preferred another appeal before SAT against SEBI communication dtd December 26, 2019 wherein SAT *vide* order dtd on July 5, 2022 held that as the dividend was not paid by CIL to CUHL within the stipulated time period it was a prima facie violation of Section 127 r/w section 124 of the Companies Act 2013. SAT also commented that relevant documents were not considered by SEBI.

7. Against this SAT verdict, SEBI preferred an appeal with the Hon'ble Supreme Court of India wherein the Supreme Court vide order dated October 14, 2022 extended the time for completing the enquiry by a period of six months from the date of the order and disposed the said appeal.

8. Thereafter, SEBI carried out an investigation to ascertain whether CIL had violated the provisions of the Companies Act, 2013, LODR Regulations by withholding the dividends payable to CUHL during the period January 22, 2014 to June 20, 2017 (Investigation period/'IP').

9. In its investigation, SEBI observed that the dividend was declared by the board of directors of CIL during the financial years 2013-2014, 2014-2015, 2015-2016, 2016-2017. But such dividend was not paid to the CUHL.

10. It transpired that the Income-tax department had initiated assessment proceedings against CUHL on January 22, 2014 and passed a provisional attachment order under section 281B of the Income-tax Act, 1961.

11. The provisional attachment order mentioned that: '*So far as the receivables by Cairn UK Holdings Ltd in the books of Cairn India Limited are concerned the Principal Officer of Cairn India Limited is directed not to remit/pay any amount to Cairn UK Holdings Ltd.*'

12. The provisional attachment order was extended from time to time and expired on March 31, 2016. As a result of the attachment order, the dividend could not be released by CIL to the CUHL.

13. However, even after the expiry of the attachment order on March 31, 2016, there was no embargo upon CIL from not releasing the dividend in favour of the CUHL.

14. In this regard, it was found that certain correspondence had taken place between CIL with the income-tax authorities with regard to the release of the dividend and with regard to the effect of the attachment order.

15. After receipt of the income tax department's letter dated March 31, 2016, CIL wrote letters dtd. September 22, 2016, January 31, 2017 and March

27, 2017 to the income tax department seeking clarification on the release of dividends to CUHL.

16. Income tax authorities internal communication dated March 01, 2017 inter-alia stated "...So far as the payment of the dividend is concerned, it is a matter between the company (CIL) and its shareholder (CUHL). This office presently has no role to play in this matter. In spite of aforesaid, dividend was not paid. Thereafter income tax authorities issued a recovery notice dated June 16, 2017, directing CIL that if any amount is due from them or held by them for or on account of CUHL, the same has to be transferred to the income tax department. Accordingly, the amount of dividend due to CUHL (i.e. ₹ 666.53 crore) till June 2017 was transferred by CIL to the income tax department on June 19 & 20, 2017 in terms of the said directions.

17. Thereafter on February 14, 2022 the income tax department declared that the assessment order against CUHL stands nullified.

18. Accordingly, the tax demand of CUHL of ₹ 10,247 crore was nullified by the income tax department subsequent to amendment in retrospective tax laws in 2021 and a refund of ₹ 7,975 crores was made by the income tax department to CUHL against the recoveries made by way of dividend and sale of shares of Vedanta. Accordingly, CUHL received the said dividend amount by way of this settlement on February 24, 2022.

19. SEBI observed that CIL declared a dividend, however, it failed to pay the dividend to CUHL within the timelines prescribed in Section 127 of the Companies Act, therefore, the CIL has to pay simple interest at the rate of eighteen percent per annum on the dividend due to CUHL for the period there was delay in payment of the dividend to CUHL.

20. SEBI also observed that Noticee No 2 to 11 were aware that the Noticee No. 1 owed a substantial amount of dividend to CUHL which was being kept in abeyance and clarifications were being sought from the income tax department. The Noticee No. 2 to 11 (as mentioned below in tabular format) were aware of the failure on the part of Noticee No. 1 to distribute dividends in the manner and within the period prescribed in section 127 of the Companies Act. Hence Noticee no. 2 to 11 have also violated applicable laws:

Noticee No	***Name***	***Designation***
2	Mr. Navin Agarwal	Chairman/Non-Executive Chairman DOC*- CIL merged with Vedanta effective 11.04.2017
3	Mr. Tarun Jain	Whole-Time Director/Non-Executive Director DOC- CIL merged with Vedanta effective 11.04.2017
4	Mr. Thomas Albanese	Whole-Time Director & Chief Executive Officer
5	Mr. GR Arun Kumar	Whole-Time Director & Chief Financial Officer
6	Ms. Priya Agarwal	Non-executive director

Noticee No	*Name*	*Designation*
7	Mr. K Venkataramanan	Independent director
8	Ms. Lalita D Gupte	Independent director
9	Mr. Aman Mehta	Independent director
10	Mr. Ravi Kant	Independent director
11	Mr. Edward T Story	Independent director

21. Based on the investigation Show cause notice('SCN') was sent to all the Noticee and SEBI observed in the investigation that even after the expiry of the provisional attachment order issued by the income tax department on March 31,2016 and CUHL repeatedly claiming the dividend, CIL along with other Noticees didn't take steps to pay dividend to CUHL hence violated applicable laws.

Charges levied

Noticee No. 1 to Noticee No. 11 were alleged to have violated section 127 of the Companies Act, Regulation 4(1)(g) and 4(2)(c) of SEBI LODR Regulations 2015.

Common submission were submitted by Noticee No 1, 2, 4-6, 8, 10, 11 (together addressed as Noticees)

Contention by Noticee's:

1) CUHL has not approached SEBI with clean hands

- Noticees contended that CUHL was well aware that CIL did not withhold payment of dividend as a free agent of its own free accord and was only following instructions of the income tax department.
- Noticees further stated that CUHL had filed a complaint dt. April 13, 2017, on SCORES portal alleging non-payment of dividend by CIL and along with it has also approached arbitration proceedings which was going on between CUHL and the Government of India prior to and at the time of the complaint dated April 13, 2017.
- Further between April 2016 and June 2017, CUHL pursued various legal avenues, including appeals before the International Arbitral Tribunal and the Income Tax Appellate Tribunal ('ITAT'), regarding the release of dividend by the Government of India. Despite CUHL's efforts, the ITAT upheld the tax demand by the Income Tax Department ('ITD') on March 9, 2017. Subsequently, the ITD demanded tax payment from CUHL by June 15, 2017, and issued a garnishee order on June 16, 2017, directing CIL to transfer CUHL's dividend amount to the ITD. As a result, CIL transferred ₹ 666.53 Crore of CUHL's dividend to the ITD on June 19 and 20, 2017.
- Hence Noticees contended that CUHL was actively pursuing the matter against the Government of India before the Arbitral Tribunal and was also anticipating recovery of tax demand upheld by ITAT, CUHL had also filed a complaint

on SCORES without disclosing crucial details of adjudication of the dividend matter in the Arbitration and existence of ITAT order against CUHL.

2) **Section 127(a) of the Companies Act- Dividend was not paid on account of operation of law and Section 127(c) of the Companies Act- Dispute Regarding Right to Receive Dividend**

- Noticees contended that ITD vide letter dated March 31, 2016, marked to CIL, prohibited CUHL from creating a charge on its assets without previous permission from the ITD.
- Noticees further contended that ITD also restricted any other person to create a charge or part with possession by any mode of transfer whatsoever without prior approval of ITD. The language of the said letter was similar to the attachment order issued by ITD previously. Thus, CIL could not have parted with the assets of CUHL unless ITD permitted for the same. Hence Noticees complied with section 127(a) of the Companies act 2013.
- Noticees contended that CIL was being penalized for having complied with the order from ITD.
- Noticee pointed out that Section 127(c) of the Companies Act 2013 isn't restricted to disputes solely between the company declaring dividends and the shareholder expecting them. The provision doesn't specify that the dispute must be solely between the company and the shareholder.

3) **Non payment of dividend was on the basis of regulatory and public authority**

- Noticees contended that section 127(e) of the Companies Act states that dividends may not be paid if the default is not the fault of the company.
- Noticees further contended that the ITD did not provide a clear response that could have absolved CIL of its obligation to pay dividends, nor had CUHL obtained a decree or order confirming its entitlement to dividends.
- Noticees further contended that right to receive dividend was similar to the feature of free transferability of shares of a listed company. Shareholding of CUHL in CIL was put under freeze by NSDL during April 01, 2016 till February 23, 2018, date of direction from ITD. Similar to NSDL, CIL kept a freeze on pay-out of dividends to CUHL. As no action had been taken against NSDL for freeze of shares during the said period, therefore, no action should be taken against CIL.

4) **Directors cannot be held liable for non-payment of dividend**

- Noticees contended that even if CIL was held to be in default, the directors cannot be roped in merely due to their designation. In absence of precise roles of directors in the alleged violations, the directors cannot be held responsible for alleged violation.
- Noticees further contended that directors aren't in charge of the daily running of the company.

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Even if they know about some conversations between the company and tax authorities, it doesn't mean they're responsible for paying dividends. Directors' main job was to give advice and oversee the company's big picture plans, not to handle day-to-day tasks.

- Further Noticees contended that Noticee no. 6 to 11, being independent directors at CIL were not involved in the company's day-to-day operations. Independent directors are supposed to guide and support the company that hires them. They also help improve the company's reputation and make sure it follows rules, but they're not responsible for running things every day.

5) All Similarly placed shareholders were treated similarly

- The Noticees had submitted that the SCN had alleged violation of Regulation 4(2)(c)(i) of LODR Regulations which was a principle to be applied in interpreting rest of LODR Regulations and cannot be a charging provision.

SUBMISSION BY SEBI

1) CUHL has not approached SEBI with clean hands

- SEBI stated that the Noticee No 1, 2, 4 to 6, 7, 8 and 10 & 11 had submitted that the arbitration proceedings covered the issue of dividends, which is connected to the tax demand from the ITD. When CUHL settled its dispute with the Indian government, the issue of delayed dividend payment had also ended. CUHL filed claims between April 2016 and June 2017, seeking directions from the arbitration tribunal to release dividends from CIL. The tribunal did not address the delay in dividend payments by CIL to CUHL. The tribunal ruled that the matter of dividend release was between CIL and CUHL, and it had no jurisdiction to intervene. The Indian government clarified that it had not instructed CIL to withhold dividends from CUHL. Therefore, SEBI was of the view that the arbitration tribunal did not rule on the delay in dividend payment by CIL to CUHL.

2) Section 127(a) of the Companies Act- Dividend was not paid on account of operation of law and Section 127(c) of the Companies Act- Dispute Regarding Right to Receive Dividend

- SEBI stated that Noticee no. 1, 2, 4-6, 7, 8, and 10-11 claimed that CIL was advised by tax authorities to withhold dividends, but there was no evidence to support this. The tax authority denied giving such advice, and there was no record of the Revenue Secretary instructing CIL to withhold dividends. Even after the tax authority's order expired on March 2016, CIL continued to hold back dividend payments to CUHL until June 2017.
- Therefore, SEBI was of the view that Noticee No. 1 violated Section 127 of the Companies Act, Regulation 4(1)(g) and 4(2)(c) of LODR Regulations.

3) Non payment of dividend was on the basis of regulatory and public authority

- SEBI stated that Noticee No. 1, 2, 4-6, 7, 8, and 10-11 had argued that CIL's freeze on dividend payments to CUHL was similar to NSDL's freeze on CUHL's shares. However, SEBI was of the view that the circumstances regarding CIL and NSDL were different, so they can't be compared. The tax authority's order restricting dividend payments to CUHL had expired on March 2016, but restrictions on share transfers continued. Therefore, CIL cannot claim parity with NSDL.
- SEBI pointed out that Noticees also argued that CUHL's grievance about not receiving dividends from CIL was already settled. However, SEBI was of the view that the arbitration proceedings didn't address the delay in dividend payments, and CIL's reasons for withholding dividends were based on its own interpretation, as no direct instructions were received from the tax authority. Therefore, CUHL's grievance wasn't fully settled by the arbitration proceedings.

4) Directors cannot be held liable for non-payment of dividend

- SEBI submitted here that the audit committee meeting of CIL was held on February 9, 2017 and in that meeting it was noted that CIL was seeking clarification from the ITD regarding the release of dividends due to CUHL. Noticee No. 3, along with others, attended this meeting. The minutes were later presented to the Board of Directors on March 30, 2017, attended by Noticee No. 2, 3, 6, 9, and 11.
- Further SEBI submitted that during a subsequent Board meeting on May 15, 2017, the CEO i.e. Noticee no mentioned efforts to obtain formal communication from the ITD before releasing funds, as there was a demand on CUHL post ITAT order due by June 15, 2017. This meeting was attended by Noticee No. 2, 3, 4, 5, 7, 8, and 10.
- Hence SEBI concluded by mentioning that Noticee No. 2 to 11, being responsible for the affairs of Noticee No.1, and also were party to the decision to withhold dividend payments to CUHL after March 31, 2016. Their omission to release dividends was seen as consent to the decision. Therefore, Noticee no. 2 to Noticee no 11 were held responsible for the violations committed by Noticee No. 1.

5) All Similarly placed shareholders were treated similarly

- SEBI noted that Regulation 4(2)(c)(i) of LODR Regulations was part of Chapter II of LODR which provides for principles governing disclosures and obligations of listed entity. Such principles are required to be followed by the listed entity while making disclosures and discharging its obligations. In case of failure to follow or abide by such principles, the listed entity is liable to be attended with necessary directions or penalty or prosecution in accordance with the gravity of the violation.

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- In the present case, the SCN had called upon the Noticee(s) to show cause as to why necessary directions in the exercise of power under Section 11(1), 11(4), 11B(1) of the SEBI Act should not be issued against them for violation of Section 127 of the Companies Act, 4(1)(g) and 4(2)(c)(i) of LODR Regulations. Further SEBI noted that CIL had failed to make payment of dividend to CUHL after cessation of restraint on payment of dividend on March 31, 2016. CIL made payment of dividend to other shareholders when there was no restraint on release of dividend.
- In view thereof, SEBI was of the opinion that CIL failed to treat CUHL at part with other shareholders in respect of payment of dividend. Accordingly, SEBI established that CIL violated Regulation 4(1)(g) and 4(2)(c)(i) of LODR Regulations.

Penalty

a) Noticee No. 1 to pay to CUHL ₹ 77,62,55,052/- (Rupees Seventy Seven Crore Sixty Two Lakh Fifty Five Thousand and Fifty Two Only) i.e. simple interest @ 18%per annum for delayed payment of dividend, due and payable by Noticee No. 1 to CUHL, within 45 days from the date of this order;

b) The Noticee No. 2 to 5 were, restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of Two Months, from the date of coming into force of this order;

c) The Noticee No. 6 to 11 were restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of One Month, from the date of coming into force of this order.

Case: 3 IBC

In the matter of M/s EPC Constructions India Limited through its Liquidator *Mr. Abhijit Guhathakurtha (Petitioner/Financial Creditor) vs. M/s Matix Fertiliser and Chemicals Limited (Respondent/Corporate Debtor)* at National Company Law Tribunal at the Kolkata Bench dated 26 July 2023.

Facts of the case

- M/s. EPC Constructions India Limited, the Petitioner and Financial Creditor (EPC/FC), infused an amount of ₹ 250,00,00,000 (Rupees Two Hundred and Fifty Crores) as sub-debt into the capital of M/s. Matix Fertiliser and Chemicals Limited, the Corporate Debtor (Matix/CD). In exchange for this infusion, 25,00,00,000 (Twenty-Five crore) Cumulatively Redeemable Preference Shares (CRPS) were issued to EPC with a face value of ₹ 10 (Rupees Ten) each. These shares carry a cumulative dividend of 8% every year, payable at par after 3 (three) years.
- The EPC filed an application under section 7 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) to initiate a Corporate Insolvency Resolution Process (CIRP) against the CD due to default in redemption and

payment of ₹ 310 Crore (Rupees Three Hundred and Ten Crore Only). This amount became due and payable upon the maturity of 25 Crore CRPS with a face value of ₹ 250 crores since 26 August, 2018. Additionally, it includes dividends on the ₹ 250 Crore principal amount at a rate of 8% per annum until the entire amount is realized.

- The EPC submitted that the liability of ₹ 310 Crore arose pursuant to a contract dated 29 July 2010 (as amended from time to time). For each year that the CRPS remained unpaid, an interest of ₹ 20 Crore was added. Therefore, the claim of ₹ 310 Crore represented the sum of three years' unpaid dividends along with the principal amount of ₹ 250 Crore. According to the terms, this amount would continue to accrue until the CRPS were redeemed.

- Further, after the CRPS became due and payable, EPC through then RP issued a letter to CD, *inter alia*, calling upon CD to plan for redemption on the due date and arranged for remittance of redemption proceeds, including dividend, aggregating to ₹ 310 Crore.

- In response, the CD admitted liability for the CRPS redemption proceeds but requested an adjustment of this liability against its purported claim submitted in the CRPS of the FC. After adjusting the redemption proceeds of ₹ 310 Crore against the submitted claim, the CD asserted that the dues towards CRPS would become NIL. The CD did not dispute, in any manner whatsoever, that the redemption proceeds were not due and payable; rather, the liability was categorically admitted.

  A demand notice was issued to the CD claiming an amount of ₹ 632.71 Crore. This amount comprised ₹ 310 Crore, representing the redemption amount due on the maturity of the CRPS, and ₹ 322.71 Crore, representing outstanding receivables for services rendered by EPC.

- The CD disputed the amounts on the grounds of vulnerable economic conditions and non-completion of the assigned tasks.

- Due to the CD's default in payment of the redemption amount of CRPS, EPC filed a petition under Section 7 of the IBC seeking to initiate a Corporate Insolvency Resolution Process (CIRP) against the CD.

Arguments of the Petitioner – EPC

- The amount due from CD to EPC falls within the definition of debt as defined under Section 3(11) of the IBC. The issuance of 25 Crore Preference Shares by the CD against a portion of the outstanding receivables, amounting to ₹ 250 Crore, due to be paid to EPC under the Subject Contracts, constituted an infusion by EPC into the CD, akin to a loan, with redemption due after 3 years. Therefore, the aforementioned debt was undisputedly classified as a financial debt under Section 5(8)(f) of the IBC.

- It was argued that the said financial debt was an admitted liability in the books of account of the CD as recent as the Financial Year 2020-21. Therefore, the non-payment of the aforementioned financial debt, which had become due and payable, amounted to default as defined under Section 3(12) of the IBC.

- While the CRPS dues of ₹ 310 Crore were never disputed by the CD, the

remaining balance amount of ₹ 322.72 Crore, which continued to remain outstanding, was neither acknowledged nor paid by the CD. In a high-handed and potentially fraudulent manner, the CD refused to acknowledge the liability towards the balance amount, and astonishingly, this balance was miraculously wiped off from the books of accounts. This action caused significant losses not only to the Applicant but also to all stakeholders of EPC/FC, which was under liquidation.

- Reliance was placed on the following judgements:
  - *Preference shares are a 'financial debt' having 'commercial effect of borrowing' in terms of Sec. 5(8) (f) of the IBC* - ***HDFC Ventures Trustee Company Limited vs. Kakade Estate Developers Private Limited.***
  - *IBC is a complete code - Judgments passed in the context of the Companies Act, 2013 or 1956 cannot be relied upon to infer the purport, meaning and ambit of provisions contained in the Code* - ***Moser Baer Karamchari Union vs. Union of India and Gujarat Urja Vikas Nigam Limited vs. Mr. Amit Gupta and Ors***
  - *Balance sheets and financial statements are mandatory to be filed by a company, and therefore, the entries made therein qua admission and liability of debt ought to be considered - Juxtaposed to the arguments that statutory provisions of the Companies Act should not be looked into, the following decisions were referred to* - ***Asset Reconstruction Company (India) Limited vs. Bishal Jaiswal and Ors.,***
- It was argued that the petition u/s 7 of IBC was maintainable at the instance of a preference shareholder and FC fall under 'financial debt'.
- The argument put forth by the CD, stating that once the debt is converted into shares, it leads to the extinguishment of debt and loses its character, is contrary to law and inapplicable in the case of redeemable preference shares. Unlike equity shares, redeemable preference shares are liable to be redeemed or repaid.
- To counter the contention of the CD that it has no obligation to redeem preference shares because it hasn't made any profit or declared dividends, and thus redemption of CRPS is barred by Section 55 of the Companies Act, 2013 (the Act) – it was highlighted that the Section 55 of the Act merely outlines the manner in which preference shares can be redeemed, namely, out of the profits of the company or out of the proceeds of a fresh issue of shares made specifically for the purpose of such redemption. It does not absolve the CD from its obligation to redeem preference shares.
- The contention of the CD that CRPS was in the nature of investment, and hence, not a 'financial debt' is a position contrary to the IBC.

Arguments of the Respondent - CD

- There was never any financial debt advanced by the EOC to them. The transaction between the parties was a contract under which the EPC was

obligated to construct a green field fertiliser complex and handover the same to the respondent after completing installation, commissioning and issue final acceptance certificate. Therefore, the receivables of the CPC if any, from the respondent, at the highest, would be an Operational Debt under the IBC.

- The argument posited against the allegation made by the EPC, asserting that the respondent failed to redeem the CRPS on the maturity date, thereby constituting a default in payment of financial debt, is fundamentally flawed. Section 55 of the Act explicitly states that preference shares can only be redeemed by a company utilizing profits available for dividend distribution or from fresh equity raised specifically for the purpose of redeeming the preference shares. At the pertinent time, they neither recorded profits nor raised fresh equity for redemption purposes. Consequently, there existed no obligation on them to redeem the CRPS issued to the EPC. Without such an obligation, the EPC cannot reasonably claim that the respondent was in default.
- The respondent vide letter dated 7 December, 2018 categorically denied any liability to redeem the CRPS since the respondent has not earned any profit in the immediately preceding and the current financial year, rather, it had accumulated losses of ₹ 589.46 Crore.
- Reliance was placed on the following judgements:
  - *Once a Debt is converted into shares, it leads to the extinguishment of liability and loses the character of Debt - It is a settled position of law that once a debt has been converted into shares, it irrevocably loses all characteristics of debt*
    - ***Commissioner of Income Tax-V vs. Rathi Graphics Technologies Limited***
    - ***Canara bank vs. IBRCL Limited***
    - ***Anup Jhunjhunwala vs. Adea Powerquips Private Limited***
    - ***Karnataka State Financial Corporation vs. Namasthe Exports Private Limited***
  - *A Preference Shareholder is not a creditor or financial creditor of a Company*
    - ***Radha Exports vs. KP***
    - ***Aditya Prakash Entertainment Private Limited vs. Magikwand Media Private limited***
    - ***Lalchand Surana vs. M/s Hyderabad Vanaspathu Ltd.***
    - ***State Bank of India vs. Alstom Power Boiler Ltd***
    - ***Hindustan Gas & Industries Ltd. vs. Commissioner of Income Tax***
  - There was no obligation to redeem preference shares when the company has not made any profit and dividend had not been declared.
    - ***Roop Kumar vs. Mohan Thedani***
    - ***Rajasthan State Industrial Development & Investment***

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Corpn. vs. Diamon & Gem Development Corpn. Ltd

— Accounting Standards and entries in the balance sheet cannot override the contract between the parties - ***Union of India vs. Assn. of Unified telecom Service Providers of India and other judgements***

— ***I&B Code, is a complete code in itself - Innoventive Industries Ltd. vs. ICICI Bank***

- It was highlighted that the Preference Shareholder is also a Shareholder - The preference shareholder has all the rights of an equity shareholder and in addition thereto has certain preferential rights to share in the profits available for dividend and for return of capital in priority to that of an equity shareholder. Preference Shares' are not defined, or described or discussed in the IBC which itself will demonstrate that a claim based on non-redemption of 'Preference Shares' cannot form the basis of a claim under Section 7 of IBC.
- It was also highlighted that there is no absolute entitlement to redeem a preference share. This is primarily due to the fact that any redemption of preference shares outside the provisions outlined in Section 55 of the Act would constitute preferential treatment to shareholders over the company's creditors, thus violating the law. This contravention includes the stipulations of the waterfall mechanism under Section 53 of the IBC, which expressly prohibits such preferential actions. When paid out of profits, the lenders/ financial creditors are not affected, which highlights that CRPS is not a debt.
- It was further contended that the amount claimed represents an investment rather than a debt, despite exhibiting the commercial characteristics of borrowing. The assertion is that the EPC's claim does not qualify as a debt, let alone a financial debt.
- The classification of CRPS as a financial liability in the respondent's balance sheet, done to adhere to the classification norms of Ind AS, does not automatically equate to the liability under CRPS being considered a financial debt under the IBC. Hence, relying on the respondent's balance sheets to argue the existence of a financial debt is misguided and legally incorrect.

Held

- After analysing in detail whether a preference share is an instrument having the commercial effect of borrowing and after examining the definition of equity and preference share capital u/s 43 of the Act - it was observed that a preference shareholder has a preferential right to —
  — A share in the profits of the company that are available for dividend; and
  — Return of capital of the company in priority to equity shareholders in the event of the company's liquidation.
- The NCLT also examined Sections 2(55) and 47 of the Act - which defines voting rights of preference and equity shareholders and observed that:
  — Both equity and preference shareholders are members of a company and therefore the Petitioner who was issued

25,00,00,000 (twenty-five crore) CRPS too is a member of the Corporate Debtor;

— Preference shareholders are also entitled to enjoy voting rights in every resolution placed before the company.

- The NCLT noted that a preference shareholder cannot step into the shoes of a creditor and examining the Section 55 of the Act which defines the issue and redemption of preference shares and observed that:

  — Preference shares can only be redeemed out of (a) the profits of the company which would otherwise be available for dividend; or (b) the proceeds of a fresh issue of shares made for the purpose of such redemption;

  — Preference shareholders cannot be paid unless the company fully discharges its debt obligations;

  — Thus, non-redemption of preference shares does not result in preference shareholders becoming creditors or the carrying value of preference shares and dividends becoming a debt.

- CRPS are in the nature of an investment and not a debt unless it becomes redeemable, as it is not obligatory for a company to pay a dividend to preference shareholders since a dividend is usually a part of the profit that the company shares with its shareholders. Thus, unless the company earns profits, no dividend is payable against CRPS.

- NCLT also examined Sections 3(11) and (12) of the IBC which defines debt and default respectively, and accordingly observed that if payment against CRPS is not due, no liability can arise; and the necessary corollary would be that unless CRPS is payable, non-payment against CRPS cannot be termed as a default.

- Further, NCLT also observed that a perusal of the Balance Sheet of the CD for 2018-19 and 2020-21 manifests losses incurred by the CD. As such, since the dividend is not payable out of losses and unless the CRPS becomes redeemable, it cannot be termed as a debt, much less a financial debt, which is the *sine qua non* for a petition u/s 7 of the IBC to be maintainable.

- The NCLT summarized the fundamental difference between raising of capital through debt instruments and *via the* issuance of shares. The decision is a classic example of the doctrine of literal interpretation while construing statutes. Section 55 of the Act squarely covers the position that preference shares can only be redeemed out of the profits of the company available for dividend or through the issuance of fresh shares. This decision removes the ambiguity surrounding the issue concerning the treatment of preference shareholders, and conclusively holds that non-redemption of preference shares does not result in preference shareholders becoming creditors.

- NCLT dismissed the petition filed u/s 7 of the IBC on the ground of maintainability.

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