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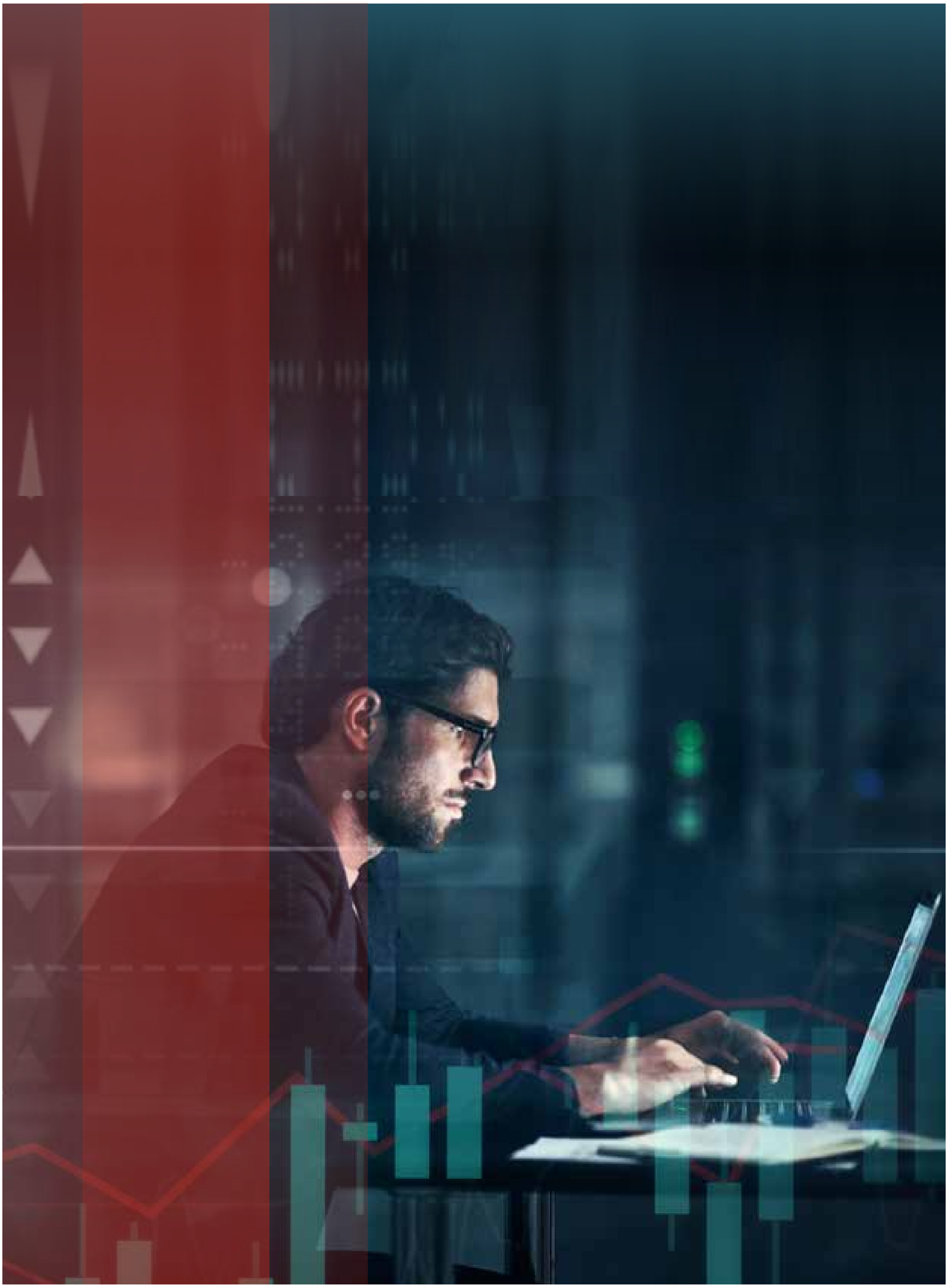
15 November 2024



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Reduction of securities premium by reduction of share capital or through scheme of arrangement?

Introduction.

Companies Act 2013, ('the Act'), the companies are allowed to issue shares of the company at a premium (i.e. at a price more than the face value of the shares). But in such case, the premium received on shares issued and allotted, cannot be credited to paid up share capital. Such amount then is credited to a separate reserve account called 'Securities Premium Reserve ('SP')' and is shown under the head 'Reserves and Surplus' on the liability side of the balance sheet[i].

Section 52 of the Act provides for creation and utilization of SP. Sub-section (1) of section 52[ii] of the Act states that, provisions of capital reduction shall apply to SP as if it is paid up capital for any purpose other than those specified in sec 52 whereas, definition of 'paid up share capital' as prescribed under clause 64 of section 2 of the Act[iii] does not include SP.

Therefore, there arises a question that, if a company wishes to reduce its SP only without reducing share capital, then can it do so under section 66 of the Act or it has to be done under a scheme of arrangement under section 230 of the Act? In this article, we shall try to find an answer to this question with the help of legal provisions and a judicial pronouncement.

Legal provisions.

Section 66 of the Act[iv] states that a company may reduce its share capital inter-alia without reducing or extinguishing any liability on shares. However, section 66 talks about reduction of capital and can SP be treated as capital of the company?

As discussed above, under clause (64) of section 2 of the Act, only the paid-up value of shares is considered as paid-up capital and since SP forms part of 'Reserves and Surplus', it is not a part of paid-up capital. However, if we refer to sub-section 1 of section 52, it clearly says that, provisions of capital reduction shall apply to SP as if it is paid up capital of the company. Therefore, exclusively for the purpose of capital reduction, SP can be considered as paid-up capital and be reduced by following the process of capital reduction.

Judicial pronouncement.

In the matter of capital reduction of Vetoquinol India Animal Health Private Limited ['the Company'], the Company was desirous of reducing SP of the Company against the accumulated losses. This matter was before Hon'able National Company Law Tribunal Mumbai bench ['Hon'able Tribunal'] for its approval for the said reduction as required under section 66(1) of the Act.

Hon'able Tribunal, vide its judgment dated January 25, 2023, confirmed that, sub-section (1) of section 52 of the Act equates the SP with paid up capital and therefore, provisions of the Act relating to capital reduction is applicable to reduction of SP against accumulated losses. Also, the articles of association of the Company allows reduction of SP in any manner permitted by law. Hence Hon'able Tribunal approved the proposed capital reduction of SP against accumulated losses which were not represented by the assets of the Company.

Conclusion.

Hence on the basis of legal provisions and the judicial pronouncement, it can be stated that, SP can be equated to paid up capital for the purpose of capital reduction and can be reduced by following the process provided by section 66. There is no need for the companies to go for scheme of arrangement under section 230 for reducing SP.

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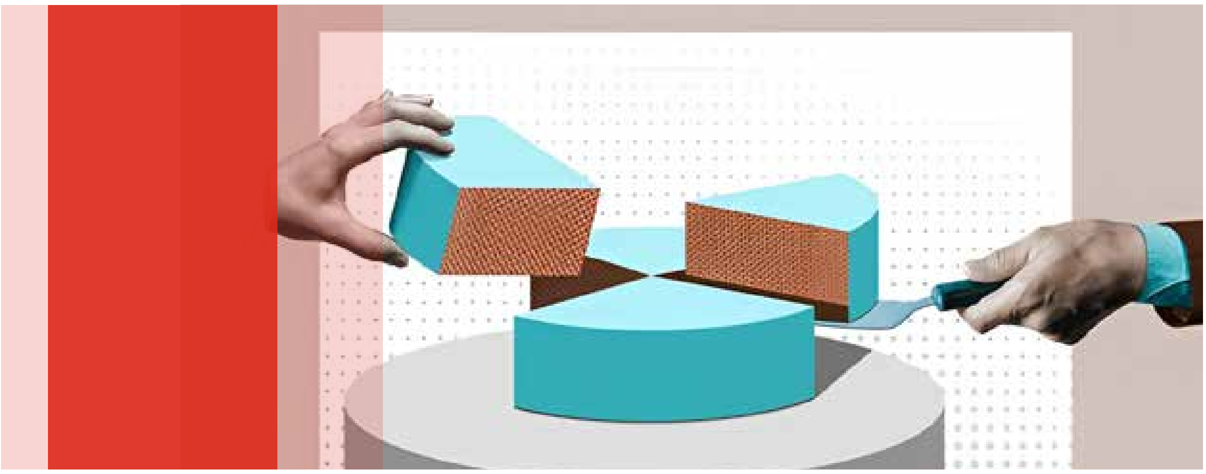
[i] Schedule III, Part B
[ii] 52. (1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.
[iii] (64) "paid-up share capital" or "share capital paid-up" means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid-up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;
[iv] 66. (1) Subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in, particular, may—
(a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or
(b) either with or without extinguishing or reducing liability on any of its shares,—
(i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or
(ii) pay off any paid-up share capital which is in excess of the wants of the company,
alter its memorandum by reducing the amount of its share capital and of its shares accordingly:



From Compliance to Strategy: How ESG Lowers IPO Risks for Indian Firms

As Indian companies increasingly tap into the capital markets through Initial Public Offerings (IPOs), aligning business strategies with Environmental, Social, and Governance (ESG) principles has emerged as a vital strategy—not just for compliance or ethical reasons, but for tangible financial benefits. The core purpose of this article is to explore how Indian companies can leverage strong ESG risk management practices to reduce IPO under-pricing, which can translate into lower costs and better investor confidence during their public listing. This analysis is particularly important as companies face growing scrutiny from investors prioritizing sustainability and corporate governance. We will outline actionable ESG strategies tailored for Indian firms preparing for IPOs, backed by global and domestic case studies that demonstrate the benefits of ESG integration in improving IPO outcomes.

Understanding ESG's Role in IPOs

A study examining 7,446 IPOs across 36 countries between 2008 and 2018 found a clear correlation between strong ESG risk management and reduced IPO under-pricing[i], particularly in countries with robust financial transparency and shareholder protections. Companies that manage ESG risks effectively reduce uncertainties related to environmental impact, corporate governance, and social responsibility, which lowers under-pricing and boosts investor confidence. For Indian companies, these findings highlight how integrating ESG into business strategies can not only enhance attractiveness to investors but also minimize post-listing market volatility. A recent survey revealed that 28% of institutional investors prioritize climate risk disclosure over financial disclosure[ii], reflecting the growing demand for precise, standardized ESG reporting. In fact, investments influenced by ESG considerations in the U.S. grew at a 14% compound annual rate from 1995 to 2020, reaching approximately $17 trillion by early 2020, according to the US SIF Foundation[iii].

Patagonia: A Case Study in ESG Leadership

Globally, companies like **Patagonia** have successfully integrated Environmental, Social, and Governance (ESG) principles into their core business strategies, demonstrating the financial and reputational benefits of doing so. Patagonia, an outdoor clothing and gear company, has been a pioneer in adopting sustainability practices. The company has implemented a closed-loop recycling system, significantly reducing its environmental impact by recycling old products into new items. Additionally, Patagonia has invested in renewable energy and maintained a strict supplier code of conduct that upholds labor and environmental standards

Patagonia's strong ESG framework not only positioned it as a leader in sustainability but also helped attract a dedicated customer base and investor trust. This commitment translated into enhanced financial performance and long-term growth. When Patagonia issued corporate bonds to fund its sustainability projects, investor confidence was high, leading to favorable pricing. By prioritizing ESG, Patagonia demonstrated how ethical business practices could mitigate risks and maximize opportunities in a rapidly changing global environment[iv].

Tata Steel: ESG Reporting and a Successful FPO in 2011

Tata Steel, an early adopter of ESG practices in India, began issuing sustainability reports in 2001, aligning with global standards like the Global Reporting Initiative (GRI). Over the years, the company has consistently demonstrated its commitment to environmental responsibility, social impact, and governance reforms. This long-standing focus on ESG played a crucial role in building investor trust and credibility. In **2011**, when Tata Steel conducted its ₹3,477 crore Follow-on Public Offering (FPO), its strong ESG framework helped reassure investors amidst concerns over the company's debt from the Corus acquisition. By showcasing its sustainable business practices and responsible governance, Tata Steel's well-established ESG reporting contributed to the success of the FPO, allowing it to raise necessary capital while maintaining market confidence.

Actionable ESG Strategies for Indian Firms Preparing for IPOs

As more investors prioritize sustainability, Indian firms preparing for IPOs can similarly benefit by embedding ESG into their corporate strategies. Sectors such as manufacturing, real estate, and energy, where environmental and social risks are high, can particularly benefit from adopting similar ESG frameworks. The Indian market is increasingly responsive to companies that demonstrate a long-term commitment to sustainability. As shown by Patagonia's success, this approach can lead to higher investor confidence, better market positioning, and ultimately, more favorable IPO outcomes. Here are some actionable ESG strategies for Indian firms gearing up for an IPO:

1. **Enhance ESG Risk Management**: Indian companies should start by identifying and addressing specific ESG risks related to their industries. For example, reducing carbon emissions in manufacturing, adopting clean energy in real estate, or improving governance in financial services can directly mitigate perceived risks. Investors value firms that manage their environmental footprint, contribute to social welfare, and enforce strong governance practices. By addressing these risks, companies can reduce uncertainties and strengthen their market appeal. ESG-related risks are important not just for companies in eco-sensitive sectors, but for all businesses across various industries. ESG encompasses not only environmental concerns but also governance and social responsibility.
2. **Prioritize Long-Term Sustainability**: Today's investors prioritize companies with a long-term vision for sustainability. Firms should align their ESG strategies with India's national sustainability goals, such as promoting renewable energy, fostering inclusive growth, or contributing to local community development. Highlighting how ESG initiatives contribute to long-term value creation positions companies as forward-thinking and resilient, attracting investors focused on sustainability-driven returns.
3. **Focus on Transparent ESG Reporting**: Aligning with frameworks like SEBI's Business Responsibility and Sustainability Reporting (BRSR) ensures that companies provide clear and standardized ESG disclosures. Transparent reporting not only builds investor trust but also reduces information asymmetry, allowing investors to accurately assess a company's long-term viability. Indian companies should offer both qualitative and quantitative data on their ESG performance to improve investor confidence.

Conclusion: Leveraging ESG for IPO Success in India

As the Indian capital market evolves, companies need to recognize that ESG is not just a regulatory requirement but a strategic advantage. Integrating strong ESG risk management into business strategies can significantly reduce uncertainties and improve investor confidence during IPOs. As seen in the case of Patagonia, embedding sustainability into core operations enhances a company's market reputation, drives long-term growth, and attracts capital from investors increasingly focused on sustainable investments.

For Indian companies, particularly in sectors like manufacturing, real estate, and energy, adopting similar ESG frameworks can result in better market positioning, reduced risk perception, and ultimately, more favorable IPO outcomes. By focusing on risk management, long-term sustainability, and transparent reporting, Indian firms can not only align with global best practices but also ensure a successful public listing in an increasingly ESG-conscious investment landscape.

The time is ripe for Indian firms to turn ESG from a regulatory box-ticking exercise into a powerful tool for financial and reputational growth, driving both IPO success and long-term value creation.

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[i] https://www.sciencedirect.com/science/article/abs/pii/S0929119921000341
[ii] Ilhan, E., Krueger, P., Sautner, Z., & Starks, L. T. (2023). Climate risk disclosure and institutional investors. *The Review of Financial Studies*, **36**(7), 2617–2650.
[iii] https://www.ussif.org/files/Trends%20Report%202020%20Executive%20Summary.pdf
[iv] Tong,H. (2023).The Importance of ESG in Corporate Strategy and Investment Decisions with Patagonia as an Example.Advances in Economics, Management and Political Sciences,25,88-94

Whether regulatory approvals would be considered as unpublished price sensitive information?

Background

Unpublished Price Sensitive Information ['UPSI'] is any event or information which when publicly available would affect the price of the securities of the company materially. Certain events or information undertaken by listed entities require approval of regulators or financial institutions or third-party approvals under contractual arrangement. These approvals are sometimes taken post approval of the transaction or event by members of the company in general meeting. Question that arises is whether the process of receipt of these approvals would be considered as UPSI even when it is already disclosed to members that the event or transaction is subject to approval?

Introduction

Regulatory approval in the nature of no objection certificate, regulatory approvals for launch of product, removal of sanctions on product produced in a factory etc. are required by the listed entity in a particular field in order to carry on a particular transaction or event. It always not confirmed or certain that the regulatory approvals would be received or not?

Non-receipt of regulatory approvals would lead to non-completion of transaction or events that are undertaken by the listed entity. This would certainly have a material impact on the listed entity and its share price consequently.

So even when the shareholders were made aware that a particular transaction or event is subject to regulatory approval or third-party approval, the receipt or rejection of approval will still be considered as UPSI as there is no certainty with respect to receipt of approvals.

Here are few cases where regulatory or third-party approvals were considered as UPSI.

A. **Adjudication order in the matter of PC Jeweller Ltd**[i]: In this case insiders traded in the shares of PC Jeweller when they were in possession of UPSI relating to withdrawal of buyback by board of directors of PC Jeweller as its lender State Bank of India had refused to give no objection certificate for going ahead with buyback. PC Jeweller had decided to buyback its shares which was subject to approval of principal lender State Bank of India. State Bank of India refused to give NOC to PC Jeweller. Pursuant to this PC Jeweller could not go ahead with buyback. This non-receipt of NOC was considered as UPSI by SEBI. SEBI held that this refusal by State Bank of India affected the change in capital structure of PC Jeweller. So even when shareholders were aware that PC Jeweller is going to undertake the buyback but it was subject to approval of SBI and hence non-receipt of NOC from State Bank of India was considered as UPSI[ii].

B. **Adjudication order in the matter of Shakti Pumps Ltd ['SPIL']**[iii]**:** In this case the SPIL had applied for permission to set up inhouse R&D facilities u/s 35(2AB) of Income Tax Act 1961. In this regard SPIL made an application to Income Tax Department for same. Prior to getting this recognition from Income Tax SPIL needed to get permission from DSIR. This permission was already received by SPIL. This entire process of obtaining recognition from Income Tax Department for setting up inhouse R&D facility was considered as UPSI by SEBI. SEBI considering this as UPSI had stated that getting recognition to set up inhouse R&D facility would help company avail fiscal incentives. This would materially impact financial position of the company. Hence the regulatory approval of Income Tax department was considered as UPSI[iv].

C. **Adjudication order in the matter of Suven Life Sciences Ltd[v]:** In this case the question was whether passing of clinical trials of a drug for public use would be considered as UPSI? In this regard SEBI held that when a medicine clears clinical trial it moves closer to be ready to be sold for commercial use in the market. Clinical trials approval is long drawn process. So even when market is aware that the drug is patented but the actual regulatory clearance of all three clinical trials would make the drug ready for commercial use. As passing of clinical trials involves considerable progress hence it would be considered as price sensitive information.[vi]

Conclusion

Regulatory approval pertaining to any nature of UPSI (viz. capital structure or launch of new product etc.) would be considered as UPSI even when members were aware that such regulatory approval is pending. Regulatory approval would allow the listed entity to either go ahead with the transaction or cancel the transaction. There is uncertainty whether the approval will be received or not. So once approval is received or rejected, till the time disclosure is made to stock exchange it will be considered as UPSI.

This article is published in Taxmann. The link to the same is as follows: https://www.taxmann.com/research/company-and-sebi/top-story/105010000000024723/whether-regulatory-approvals-would-be-considered-as-unpublished-price-sensitive-information-experts-opinion

This article is written by **Vallabh Joshi- Senior Manager- vallabhjoshi@mmjc.in**

[i] https://www.sebi.gov.in/enforcement/orders/may-2021/final-order-in-the-matter-of-insider-trading-in-the-scrip-of-pc-jeweller-ltd-_50111.html

[ii] "*I note that in terms of the disclosure made by the Company on May 10, 2018, the general public was made aware that the Company was going to buy-back upto 1,21,14,285 fully paid-up equity shares of the Company of Rs.10/- each at a price of Rs.350/- per equity share which was an unpublished price sensitive information within the meaning of Regulation 2(1)(n)(iii), as discussed in the previous para, as the said information was pertaining to the change in the capital structure of the Company. As the said decision of buy-back of shares by the Company was abandoned by the Company on July 13, 2018 when its board of directors decided to withdraw the buy-back offer, therefore, as a corollary, I find that the said information was also an unpublished price sensitive information within the meaning of Regulations 2(1)(n)(iii) of the PIT Regulations, 2015 as being an information pertaining to the change in capital structure of the Company. I find that as mentioned above, the said unpublished price sensitive information which has been identified as UPSI-II in the SCNs, came into existence on July 07, 2018 when the State Bank of India refused to give its NOC to the proposed buy-back of the Company and remained so till it was disclosed to the stock exchanges by the Company on July 13, 2018*".

[iii] https://www.sebi.gov.in/enforcement/orders/dec-2022/adjudication-order-in-respect-of-8-entities-in-the-matter-of-shakti-pumps-india-limited_65734.html

[iv] "*Pursuant to obtaining recognition and Registration of In-house R&D Units(RDI), SPIL had an option to avail Fiscal Incentives for Scientific research (FI). SPIL having DSIR recognition and concerned manufacturing facility applied for approval of In-house Research& Development facility u/s 35(2AB) of IT Act, 1961. The grant of 'Approval for In-house R & D facilities u/s 35(2AB) of Income Tax Act, 1961' was identified as UPSI by SEBI. SPIL received Certificate for In-house R & D Recognition from DSIR on March 27, 2018 which is pre-requisite to apply for benefit u/s 35(2AB) of Income Tax Act, 1961. Thus the UPSI period was considered from March 27, 2018 till disclosure of grant of approval by DSIR on October 10, 2018.*"

[v] https://www.sebi.gov.in/enforcement/orders/oct-2021/adjudication-order-in-respect-of-suven-life-sciences-limited-and-5-others-in-the-matter-of-suven-life-sciences-limited_53616.html

[vi] "62. *Considering the process followed and the time taken for clinical trials, the progression from one stage to the next cannot be taken for granted. Hence, I recognise that the change in stage of a clinical*

trial/completion of a phase of clinical trial is significant and hence price sensitive information. The successful completion of a phase of clinical trial in respect of a patented molecule or compound or chemical entity is a milestone which investors would reasonably be expected to factor while considering sale or purchase of shares of the Company….I note that clinical trials take considerable time and progress to the next stage indicates a material progress towards commercial use of the drugs. Every successful stage of clinical trials takes an NCE closer to market and hence is likely to have positive price impact. Therefore, I am of the view that information pertaining to progress of clinical trials in respect of the 3 clinical state compounds was price sensitive in nature…..

Performance evaluation of Additional Directors and Directors liable to retire by rotation

Provisions with respect to performance evaluation

Performance Evaluation is a periodic process which aids the management to assess the performance of the Individual directors and the board as whole which is then further aligned with the organizational goals.

Section 134 (3) (p) read with Rule 8 (4) of the Companies (Accounts) Rules, 2014 states the Board Report must include a statement indicating the manner in which the formal annual evaluation of the performance of the Board, its committees (where applicable) and of individual directors has been made. As per Section 178(2), the Nomination and Remuneration Committee of every listed company and any other class of public companies as may be prescribed by the Rules shall indicate the manner for the effective performance evaluation of the Board, the committees and individual directors. Further, the evaluation is conducted either by the Board, Nomination and Remuneration Committee or it could be done by an external agency.

In case of reappointment of independent director performance evaluation is mandatory. In the same way no time limit is prescribed for performance evaluation of individual directors other than independent directors.

In this write up we will check two instances when performance evaluation of an individual director should ideally be done.

Performance evaluation in case of Directors to retire by rotation

Section 152(6) of the Companies Act states that, unless the articles provide for retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company are those eligible to retire by rotation. The retiring director is eligible to be re-appointed at the same general meeting. and may be re-appointed, but the company may also appoint some other person in place of the retiring director.

It would be a good practice, where a retiring director offers himself for re-appointment as a director the performance evaluation of the retiring director is being done by the Nomination and Remuneration Committee. The same can then be recommended by the Nomination and Remuneration Committee to the Board and then the shareholders to make informed decision regarding the re-appointment.

In a recent case Mr. Samir Modi, executive director of Godfrey Philips India Limited being liable to retire by rotation at the annual general meeting of 2024. Mr Samir Modi offered himself for re-appointment at the AGM of 2024.

While considering his request for reappointment as a director liable to retire by rotation, Nomination and Remuneration Committee ['NRC'] of Godfrey Philips India Ltd did performance evaluation of Mr Samir Modi. On performance evaluation NRC did not recommend the reappointment of Mr Samir Modi. While recommending against NRC noted as follows, "*The Nomination and Remuneration Committee of the Company ("NRC"), at its meeting held on 7th August 2024 considered Mr. Samir Kumaar Modi's offer to be re-appointed as a director and his recommendation in this regard. In the course of detailed deliberations, the NRC considered various aspects, including Mr. Samir Kumaar Modi having placed himself on multiple occasions in situations of conflict with interest of the Company, his conduct in the meetings in the recent past (as recorded) being unbecoming of a Director, his concerted efforts to propagate a culture of disrespect for fellow Directors and Senior Officials of the Company, his levelling false allegations against fellow Directors* *and his deliberately taking inconsistent position on matters discussed in the meetings. The NRC also observed that Mr. Samir Kumaar Modi's overall conduct in the Board Meetings and outside is much against his fiduciary duties and responsibilities as an Executive Director of the Company instances of which are captured in the minutes of the meetings and are clearly reflected in the developments of the recent past. Accordingly, the NRC unanimously decided to recommend against his re-appointment as a director keeping in view the overall interest of the Company and its stakeholders. Thereafter, the Board at its meeting held on 7th August 2024 considered the recommendation of the NRC and after detailed discussions, unanimously decided to accept the same. The Board further decided that, subject to approval of the shareholders at the ensuing Annual General Meeting, the vacancy caused by the retirement by rotation of Mr. Samir Kumaar Modi be not filled by the Company for the time being*[1]." Pursuant to this member of Godfrey Philips India Ltd rejected appointment of Mr Samir Modi as a director liable to retire by rotation.

Performance evaluation in case of Additional Director

Section 161(1) of the Companies Act states that the Board is empowered by the articles to appoint any person (other than a person who fails to get appointed as a director in a general meeting) as an additional director at any time. Such a director shall hold office until the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever earlier.

On completion of tenure as an additional director an individual is subject to provisions of section 160 sub-section (1) of Companies act, 2013 for being appointed as a director. First proviso to section 160 sub-section (1) of Companies act, 2013 states that deposit of amount shall not apply in case the director appointment is recommended by NRC. So, while recommending an individual for the office of director NRC should not only consider his qualifications and experience but also undertake performance evaluation of the tenure during which he was acting as an additional director. The criteria here could be his attendance, involvement and contribution during the Board and committee meetings. The Nomination and Remuneration Committee can also consider the ability of the additional to bring his wisdom to the Board. This will come to the aid of the members to conclude whether the additional director to be elected as a director on the Board.

Conclusion

Performance evaluation shall be preferably undertaken at the time of appointment, re-appointment and in situations of retirement by rotation. Further, the evaluation done by the independent directors and their views on the same should be of utmost importance, reason being independent directors may not give an influenced opinion.

The views/ feedback of independent directors and the Nomination and Remuneration Committee should be considered by the board at the time of determining the action plan with respect to results of performance evaluation. This would go a long way in strengthening the board as the exercise would involve identifying the strength, weakness and accordingly determine the corrective mechanism.

This article is published in Taxmann. The link to the same is as follows:
https://www.taxmann.com/research/company-and-sebi/top-story/105010000000024715/performance-evaluation-of-additional-directors-and-directors-liable-to-retire-by-rotation-experts-opinion

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[1] https://www.godfreyphillips.co.in/public/storage/images/annual -report/2023-24/7711cd33ab4038e2fc22073d4533911f.pdf

Implications of not carrying out business activities as per Memorandum of Association (MOA)

Introduction

The provisions of section 186 of the Companies Act, 2013 (**Act**) states that a Company can not give loan to any person or body corporate exceeding 60% of its paid-up share capital, free reserves, and securities premium account, or 100% of its free reserves and securities premium account, whichever is more unless a special resolution has been passed at a general meeting. The challenge arises when a company, being a Financial Creditor (FC) or a Corporate Debtor (CD) under the Insolvency and Bankruptcy Code, 2016 (**IBC**), breaches this limit without the mandated special resolution.

Questions for Consideration

I. Whether the violation of section 186 of the Act prohibits a FC from invoking IBC against a CD (u/7 of IBC) despite having an established debt and default.
II. Alternatively, can the CD rely on non-compliance with section 186 of the Act as a shield against insolvency.

This article refers orders where the Tribunals have adopted two approaches while determining the admissibility of section 7 of IBC application despite existence of debt and establishment of default.

Analysis of the Law

A. **Debt not in accordance with provisions of applicable law is not legally enforceable debt:** In the matter of ***UKG Steels Private Limited v. Exotic Buildcon Private Limited***, UKG Steels Private Limited (FC) extended an inter-corporate loan to the Exotic Buildcon Private Limited the CD that exceeded 60% of the aggregate of its paid-up share capital and free reserves, as per its balance sheet. The FC neither made the disclosure of such inter corporate loan in its balance sheet nor it was able to submit a special resolution passed at the Extra- Ordinary General Meeting (EOGM) u/s 186 (3) of the Act. The loan agreement was also silent about the resolution passed by shareholders. FC filed a section 7 application under IBC against the CD .

HON'ABLE NCLT dismissed the application u/s 7 of IBC and stated that loan given by FC were ultra vires and loan advanced was not a legally enforceable debt. HON'ABLE NCLT further held that **loan given contrary to the limit prescribed under Section 186 of Companies Act, 2013 is an ultra vires act and is not a legally enforceable debt. CD enjoying the benefits of a FC's transgression, lacks standing to contest the breach and its ramifications.**

Similarly in the matter of ***Jambudwip Exports and Imports Limited v. UP Bone Mills Private Limited***. Jambudwip Exports and Imports Limited (FC/lender) initially provided funds as an advance for goods, subsequently the said advance was converted into an intercorporate loan by executing a Memorandum of Understanding (MOU). This amount exceeded the limit prescribed under section 186(2) of the Act, and the FC failed to obtain prior approval through a special resolution at a general meeting. Consequently, the HON'ABLE NCLT New Delhi dismissed the FC's petition, deeming the debt as unenforceable.

In a more recent matter of ***Proplarity Infratech Private Limited v. Sky High Technobuid Private Limited.*** The principal bench of HON'ABLE NCLT, Delhi (*now pending appeal*) adopted the similar view. It was alleged by Sky High Technobuild Private Limited the CD (borrower) that Proplarity Infratech Private Limited the FC (lender company) had extended the purported loan in excess of the limits set by section 186 without obtaining the necessary shareholder approval. HON'ABLE

NCLT ruled that in view of non-compliance with section 186 of the Act, granting of such a loan was an *ultra vires* act, and therefore not a legally enforceable debt.

B. Debt not in accordance with provisions of applicable law is not legally enforceable debt:

HON'ABLE NCLT Mumbai took a contrary view in the matter of ***Pegasus Assets Reconstruction Private Limited v. Whiz Enterprises Private Limited.*** The Whiz Enterprises Private Limited ['CD'] argued that its corporate guarantee should be deemed void in view of the provisions of section 186 of the Act as it exceeded the limits set out in the section 186 of the Act. The HON'ABLE NCLT emphasised that the CD was well aware of the fact that it was entering into a deed of corporate guarantee for the loan disbursed to the principal borrower (proprietary firm of the director of the CD). Further any belated attempt to interpose such objections to evade payment obligations or insolvency was unacceptable**.**

Similarly in the matter of ***India Bulls Commercial Credit Limited Vs Koshika Bioscience Private Limited at HON'ABLE NCLT Mumbai*** wherein the India Bulls Commercial Credit Limited ['FC'], gave loan to Pro Fin Capital Financial Services (Principal Borrower). The CD/respondent/guarantor-Koshika Bioscience Private Limited, gave a **corporate guarantee** to the FC in favour of Principal Borrower against the loan amount. As per the deed of guarantee submitted by the FC before HON'ABLE NCLT, the CD irrevocably and unconditionally agreed that the CD would pay the guaranteed amount stipulated in the guarantee deed without any delay to the FC as if the CD was a borrower. On failure of the principal borrower to repay the loan facility on time, an event of default occurred under the loan agreement. The CD argued that the guarantee issued was in violation of section 186 of the Act. The FC relied on the board resolution wherein it was stated that approval of members would be accorded in the general meeting. According to the Doctrine of Indoor Management it was presumed that the company must have complied with the relevant provisional requirements of the law. The HON'ABLE NCLT held that the FC **relied on the board resolution and argued that there is no violation of section 186 of the Companies Act, 2013**. Even if it was so, it may, at best be the procedural violation by the Company **which does not invalidate the guarantee issued by the CD.**

Hence to conclude it can be stated that when a CD admitted the acquisition of a loan or issuance of a corporate guarantee, subsequently leading to a default, it is estopped from evading its responsibility or resisting insolvency proceedings under the IBC merely on the technical grounds of non-compliance with Section 186 of the Act. Further HON'ABLE NCLT held that non-compliance to provisions of section 186 of the Act is merely a procedural violation and does not prejudice the claim of applicant FC. It is well settled legal principle based on Latin maxim *commodum ex injuria sua nemo habere debet*, which means that 'no party can take undue advantage of his own wrong'. After signing and issuing of the guarantee on behalf of the CD and after handing over a duly signed board resolution, the same director cannot wiggle out of it on any ground of anomaly or violation of provisions of the Companies Act, 2013 by the CD. Hence the corporate guarantee was valid and enforceable.

HON'ABLE NCLT Kolkata, in the matter ***EDCL Infrastructure Ltd. Vs. Urban Infraprojects Private Limited.*** –has adopted a similar view that Section 186(2) of the Companies Act, 2013 is a protection mechanism to the shareholders/ stakeholders of the Company so that the persons who are managing the company cannot and should not give loan in excess of limits prescribed which would be in excess of their capacity and could land the company in deep trouble in case of a default of the loan lent. It is not open for the CD to take shelter under such violations and refuse to repay money borrowed.

I. Whether the violation of section 186 of the Act prohibits a FC from invoking IBC against a CD (u/7 of IBC) despite having an established debt and default –

Loan given contrary to the limit prescribed u/s 186 of the Act is an ultra vires act and is not a legally enforceable debt. CD enjoying the benefits of a FC's transgression, lacks standing to contest the breach and its ramifications.

II. Alternatively, can the CD rely on non-compliance with section 186 of the Act as a shield against insolvency –

Section 186 of the Act cannot serve as a tool for Corporate Debtors to evade responsibility or resist insolvency when faced with a Financial Debt. According to Section 5(8) of the IBC, for a debt to qualify as Financial Debt, two crucial conditions must be met: (i) there must be a debt, including any interest, disbursed for the time value of money; and (ii) money must be disbursed from creditor to debtor. The essence of Financial Debt remains unaffected by any (in)fraction of Section 186.

The principles while determining the admissibility of a section 7 (IBC) application.

The Doctrine of Election and Estoppel –Those who consciously enjoy the advantages arising from a contract are barred from subsequently contesting its validity or enforceability. This is to ensure fairness and equity. Consequently, when a CD admits the acquisition of a loan or issuance of a corporate guarantee, subsequently leading to a default, it is *estopped* from evading its responsibility or resisting insolvency proceedings under the IBC merely on the technical grounds of non-compliance with section 186 of the Companies Act, 2013.

Doctrine of Indoor Management

The doctrine of indoor management implies that an outsider whose actions are in good faith and has entered into a transaction with a company can have a presumption that there are no irregularities internally and all the procedural formalities have been complied with. In cases where a CD defaults on a financial debt arising out of a loan exceeding the limits of section 186, Tribunal may attempt to invoke the doctrine of indoor management, claiming entitlement to presume that the FC adhered to internal procedures while extending the loan. (***India Bulls Commercial Credit Limited Vs Koshika Bioscience Private Limited, EDCL Infrastructure Ltd. Vs. Urban Infraprojects Private Limited)***

Further in cases like *Proplarity Infratech Private Limited v. Sky High Technobuid Private Limited, UKG Steels Private Limited v. Exotic Buildcon Private Limited and Jambudwip Exports and Imports Limited v. UP Bone Mills Private Limited* **it can be concluded that when the requirements of section 186 are not met the transaction itself is void ab initio and therefore** , granting of such a loan becomes an *ultra vires* act, and not a legally enforceable debt.

Conclusion

After taking note of all the above orders and principles we observe that the HON'ABLE HON'ABLE NCLT have adopted different views on account of non-compliance of section 186 –

One view is of treating the financial transaction as *ultra vires* and not enforceable, and the other view of treating a violation or breach on the part of the company extending the loan, security or guarantee should not allow the borrower to prevent itself free from its repayment obligations.

Setting aside financial transactions on this ground will lead to a situation where a borrower, can avoid its repayment liability, after obtaining financial assistance, by taking a plea of an internal non-compliance of section186 of the Act on the part of the lender goes against the very objective of the section, to protect the interest of the shareholders of a company.

Further, where a bank or financial institution obtains a third-party security or guarantee from a group company of the borrower and where such security provider or guarantor has not complied with section 186 of the Act, then in such a situation, if the guarantee or security transaction itself would be treated as void or *ultra vires* and unenforceable, it would lead to a situation of a party taking advantage of its own wrong. A corporate guarantor or security provider cannot be rewarded for its own breach of section 186 of the Act, by terming such a transaction as void or *ultra vires* on account of its own internal non-compliance.

This article is published in Taxmann. The link to the same is as follows:
https://www.taxmann.com/research/company-and-sebi/top-story/105010000000024718/implications-of-not-carrying-out-business-activities-as-per-memorandum-of-association-moa-experts-opinion

This article is written by **Esha Tandon- Deputy Manager- eshatandon@mmjc.in**

NEWS UPDATES FOR THE MONTH OF NOVEMBER 2024

Sr. No.	News Updates	Link & Brief Summary
	NEWS	
1	CFO hiring surges as India Inc ramps up financial leadership amid IPO boom and growth challenges	https://cfo.economictimes.indiatimes.com//news/strategy-operations/cfo-hiring-surges-as-india-inc-ramps-up-financial-leadership-amid-ipo-boom-and-growth-challenges/114975981
2	High time for internal audit to deep dive in to ESG issues	https://cfo.economictimes.indiatimes.com//news/esg/high-time-for-internal-audit-to-deep-dive-in-to-esg-issues/114968646
3	India's NFRA to review all 35 Standards on Auditing	https://www.theaccountant-online.com/news/nfra-review-standards-on-auditing/
4	Amendments to IBC, Companies Act on the cards	https://search.app/?link=https://www.financialexpress.com/business/banking-finance-amendments-to-ibc-companies-act-on-the-cards-3656358/&utm_source=dsdfns,sh/x/discover/m1/4
5	SEBI warns investors against unauthorised virtual trading, gaming platforms offering stock price-based advice	https://www.livemint.com/market/sebi-warns-investors-against-unauthorised-virtual-trading-gaming-platforms-offering-stock-price-based-advice-11730723767078.html
6	Sebi allows MFs to invest in overseas funds with exposure to Indian securities	https://legal.economictimes.indiatimes.com/news/regulators/sebi-allows-mfs-to-invest-in-overseas-funds-with-exposure-to-indian-securities/114955033
7	Indian crypto exchanges' futures trade with foreign peers may test FEMA limits	https://cfo.economictimes.indiatimes.com//news/governance-risk-compliance/indian-crypto-exchanges-futures-trade-with-foreign-peers-may-test-fema-limits/114928829
8	NFRA board to meet next week: Adoption of new audit rules on agenda	https://www.business-standard.com/economy/news/nfra-board-meeting-on-november-11-12-to-push-new-audit-standards-124110400845_1.html
9		https://economictimes.indiatimes.com/prime/money-and-markets/sebis-new-move-aims-to-limit-

	Sebi's new move aims to limit retail options traders. Will they pay heed?	retail-options-traders-will-they-pay-heed/primearticleshow/114914064.cms
10	Sebi proposes doubling the threshold for 'high value debt listed entities' to Rs 1,000 crore	https://cfo.economictimes.indiatimes.com//news/governance-risk-compliance/sebi-proposes-doubling-the-threshold-for-high-value-debt-listed-entities-to-rs-1000-crore/114881357
11.	Sebi proposes measures to promote ease of doing biz for Small, Medium REITs	https://legal.economictimes.indiatimes.com//news/regulators/sebi-proposes-measures-to-promote-ease-of-doing-biz-for-small-medium-reits/114787869
12	New rules on data protection likely to be notified soon	https://legal.economictimes.indiatimes.com//news/law-policy/new-rules-on-data-protection-likely-to-be-notified-soon/114761030
13	Gold taxation: Income tax laws for capital gains on gold have changed, know the new rules	https://cfo.economictimes.indiatimes.com//news/tax-legal-accounting/gold-taxation-income-tax-laws-for-capital-gains-on-gold-have-changed-know-the-new-rules/114736636
14	Filing Fee for Increased Share Capital Classified as Revenue Expenditure: ITAT Upholds AO's Decision	https://search.app/?link=https://www.taxscan.in/filing-fee-for-increased-share-capital-classified-as-revenue-expenditure-itat-upholds-aos-decision/450150/&utm_source=dsdfns,sh/x/discover/m1/4
15	NBFC growth to be hit due to rising unsecured loan stress	https://cfo.economictimes.indiatimes.com//news/nbfc-growth-to-be-hit-due-to-rising-unsecured-loan-stress/114568878
16	ICAI disciplinary action: 205 CAs penalized, but questions on nature of indiscipline, transparency remain	https://cfo.economictimes.indiatimes.com//news/tax-legal-accounting/icai-disciplinary-action-205-cas-penalized-but-questions-on-nature-of-indiscipline-transparency-remain/114492564

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VIEWS SHARED IN MEDIA BY MR. MAKARAND JOSHI - FOR THE MONTH OF NOVEMBER 2024

Sr. No.	Topic for Media Comment	Link
1.	SEBI's new rules for mutual funds, debt securities from Nov 1: What these mean for investors	Mandating UPI for bids up to ₹5 lakh will ease the process and draw more retail investors into the debt segment https://www.cnbctv18.com/personal-finance/sebi-new-rules-novemebr-1-mutual-funds-insider-trading-debt-securities-upi-investors-changes-19502064.htm