CORPORATE LAWS
Case Law Update

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IBC – CASE – 1

In the matter of *Times Innovative Media Limited (Appellant) vs. Pawan Kumar Aggarwal (Liquidator/Respondent no.1) and Anr.,* at National Company Law Appellate Tribunal (NCLAT) New Delhi dated 19 September 2024

Facts of the Case

- An application was filed u/S 9 of the Insolvency and Bankruptcy Code, 2016 (IBC) for initiating the Corporate Insolvency Resolution Process (CIRP) against Brand Connect Communications (India) Private Limited (CD). The CIRP commenced with an order dated 27 March, 2018.
- In the CIRP of the CD, the claim of Times Innovative Media Limited - the Appellant was admitted as an Operational Debt and the claim of ex-director respondent no. 2 was admitted as an Unsecured Financial Debt.
- By an order dated 28 January 2019, the National Company Law Tribunal (NCLT) directed for liquidation of the CD.
- In the stakeholders' consultation meeting, the liquidator informed that as per section 53 of the IBC, respondent no. 2 of the CD would get priority over the appellant in the distribution of the liquidation estate.
- An objection was raised by the appellant claiming priority in payment of its operational debt over the payment to ex-director- respondent no. 2 who was an unsecured financial creditor. The objection of the appellant was that in the distribution u/s 53 of IBC priority should not be given to a related party.
- The objection of the appellant was rejected by the liquidator vide its communication dated 3 September 2021.
- The NCLT vide order dated 24 April 2024, held that the appellant who is an operational creditor cannot be given any preference over the debt of the unsecured financial creditor. It was also held that Section 53 of the IBC does not envisage any difference between unsecured financial creditors and related party unsecured financial creditor.
- Aggrieved by this order an appeal was filed at National Company Law Appellate Tribunal (NCLAT).

Arguments of the Appellant

- The ex-director- respondent no. 2 of the CD, being a related party cannot be given priority in the distribution of

proceeds of liquidation assets of the CD, ahead of the appellant/operational creditor.

- The ex-director - respondent no. 2 of the CD had to be treated as an equity shareholder and a related party of the CD, and therefore, he was not entitled to a priority in the waterfall mechanism under section 53 of the IBC, as he wears was a promoter/director/equity shareholder and a financial creditor. Therefore, he ought to be considered under the head of an equity shareholder.
- Reliance was placed on ***J.R. Agro Industries P. Limited vs. Swadisht Oils P. Ltd.***- and the judgment of the Hon'ble Supreme Court in ***Arun Kumar Jagatramka vs. Jindal Steel and Power Limited & Anr.*** as well as the judgment of the Hon'ble Supreme Court in ***M.K. Rajgopalan vs. Dr. Periasamy Palani Gounder & Anr.*** where in it is submitted that a related unsecured debtor has to be treated differently in the waterfall mechanism from the unrelated unsecured creditors and the operational creditor. Operational Creditor debt has to be given priority over debt of related party unsecured creditor.

Arguments of the Respondent 1 (Liquidator)

- The inclusion of the ex-director -respondent no. 2 of the CD as an unsecured financial creditor in the list of stakeholders was never challenged. The objection was raised only after the stakeholders' consultation meeting.
- The ex-director-respondent no. 2 of the CD had advanced the loan on 2 February, 2011 and thereafter, he resigned as a director on 1 October, 2013 thus, the ex-director-respondent no. 2/of the CD would not fall within the ambit of a related party of the CD.
- Section 53 of the IBC does not envisage any difference between an unsecured financial creditor, i.e., the appellant/ operational creditor and a related party unsecured financial creditor, i.e., the ex-director/respondent no. 2/of the CD.
- Section 53(1) of the IBC provides that liquidation assets shall be distributed in the order of priority as enumerated therein. In the order of priority, financial debts owed to unsecured creditors are at Clause (d). Clause (f) deals with any remaining debts and dues. The operational debt of the appellant falls under clause (f). Thus, on a plain reading of section 53(1), it is clear that financial debts owed to unsecured creditors ranked higher than the debt of operational creditors.
- The Hon'ble Supreme Court in ***Swiss Ribbons Private Limited and Anr. vs. Union of India and Ors.*** had occasion to consider section 53 of the IBC. The Hon'ble Supreme Court held that there is an intelligible differentia between the financial debts and operational debts. The reason for differentiating between financial debt and operational debt was noticed and differentiation was upheld. The Bankruptcy Law Reforms Committee Report also highlighted the importance of financial debt and dues of unsecured financial creditors were kept higher than the remaining debts within which operational debt now formed.
- The definition of 'financial debt' as contained in Section 5(8) of IBC does not indicate any exclusion of financial debt which is reflected by any transaction with the CD by the related party.

- When a financial debt is extended by the related party the consequence for such creditor is captured in section 21 of IBC. As per section 21(2) of IBC, a financial creditor if it is a related party of the CD shall not have any right of representation, participation or voting in a meeting of the CoC. Further, by virtue of Section 29A, related party may incur any of the disqualifications under Section 29A. With respect to filing of the claim as per Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations 2016, the claim by the financial creditors can be filed as per regulation 18 **Scheme of regulations 2016 does not indicate that the related party is excluded from filing a claim.**

Arguments of the Respondent No. 2 (supporting the case of the liquidator)

- The loan was advanced by the ex-director -respondent no. 2 of the CD in 2011 to 2012, which loan had been partly repaid by the CD.
- The financial debt of the ex-director-respondent No. 2 of the CD was admitted and he was treated as an unsecured financial creditor, which was never challenged.

Held

- Financial debts owed to unsecured creditors rank higher than debts of operational creditors. The appellant/ operational creditor cannot claim any priority in the distribution of the assets of the CD as compared to the unsecured financial creditor, who was the appellant/ex-director in the present case.
- The Operational Creditor which is the appellant in this case cannot claim any priority in the distribution of assets of the CD as compared to unsecured financial creditor and the appeal was dismissed.

Companies Act — Case 2

In the matter of *HT Media Ltd And Anr vs. Regional Director & Ors,* NCLAT principle bench New Delhi, order dated 12 March, 2024

Facts of the Case

- A composite scheme of amalgamation was proposed for the merger of Digicontent Ltd., Next Mediaworks Ltd (NMW) and HT Mobile Solutions Ltd (HTMS) transferor companies, with HT Media Ltd (Transferee company/ Appellant).
- Scheme of a merger of these companies was provided in the scheme in different parts: Part D of the composite scheme dealt with the amalgamation of the HTMS with HT Media (Transferee company), Part B dealt with the amalgamation of Digicontent with the Transferee Company and Part C dealt with the amalgamation of NMW with the Transferee Company.
- The said scheme was presented before the Hon'ble National Company Law Tribunal ['NCLT'] Delhi and Mumbai for its approval and through its first motion order, ordered Digicontent Ltd, NMW, HTMS and Transferee company ['Amalgamating companies'] to call meetings of their respective shareholders and creditors. Accordingly, the Amalgamating companies called the requisite meetings and notified other authorities like the Regional Director and Income Tax authority etc. about the proposed scheme.

- The scheme stood approved qua HTMS and Transferee company with requisite majority shareholders and creditors. However, the scheme was not approved by the requisite majority of public shareholders of Digicontent Ltd as well as the requisite majority of public shareholders of NMW.
- Thereafter, the Transferee company moved the second motion under sections 230 to 232 seeking sanction of the scheme with respect to HTMS and Transferee company, that is sanction of part D of the scheme.
- However, the Hon'ble NCLT, New Delhi dismissed the application of the second motion on the ground that the other two parties viz. Digicontent Ltd. and NMW had rejected the proposed scheme, and it was difficult to comprehend how the approval can be granted to the scheme which involves all the three companies.
- Therefore, the appellants are before NCLAT for obtaining approval for a specific part of the composite scheme.

Contentions of Transferee company

The schemes were separable as per provisions of the composite scheme of the amalgamation filed viz Annexure-2, annexed with the appeal.

Reliance is placed on Clause No. 1.2.2 of the scheme and further, Clause 23.1 of the scheme, as under:

"*1.2.2. Notwithstanding, anything contained in this Scheme, if for any reason any Part of this Scheme being Part B or Part C or Part D of the Scheme is found to be unviable or unworkable qua the relevant Transferor Company or cannot be effected together with other Parts of the Scheme in a consolidated manner including on account of non-approval of the Scheme by the Appropriate Authority or by requisite majority of the shareholders of the relevant Transferor Companies, the same shall not, unless decided otherwise by the Boards of the Transferee Company and other Transferor Companies, affect the validity or implementation of the other Parts of this Scheme. For the avoidance of doubt, it is hereby clarified that each part of this Scheme being Part B or Part C, or Part D, are severable and can be made effective independently along with the applicable clauses of this Scheme as contained in Part A, Part E and Part F of this Scheme, subject to Clause 22 of this Scheme. It is further clarified that for the purpose of Part A, Part E and Part F of this Scheme, the term Transferor Company or the Transferor Companies shall be construed accordingly. 23.1. In the event any of the sanctions and approvals as referred to in Clause 22 of the Scheme is not obtained or complied with or satisfied, or, if for any other reason, any Part of this Scheme cannot be implemented, such Part of this Scheme shall automatically stand revoked, cancelled and be of no effect, save and except in respect of any act or deed done prior thereto as is contemplated hereunder, or as to any rights and liabilities which might have arisen or accrued pursuant thereto, and which shall be governed and be preserved or worked out as is specifically provided in the Scheme or as may otherwise arise in law. It is hereby clarified that the non-receipt of approvals, as mentioned above, shall not, unless decided otherwise by the Boards of the relevant Transferor Companies and Transferee Company, affect the validity or implementation of the other Parts of this Scheme*".

Ld. Sr. Counsel for the Appellant submitted that the scheme was structured in a manner the shares of HTMS held by the shareholders will be swapped with those of the transferee Company based on a pre-determined ratio, except for the shares of the transferor company held by the transferee company which shares are intended to be cancelled. It is pertinent to note the share swap ratio as determined by the registered valuer for the respective Parts B, C and D are completely distinct and independent of one another.

Respondent's contentions: The income Tax Department and Regional Director gave no objections for the partial acceptance of the scheme.

Held

- We have gone through the order of Hon'ble NCLT Mumbai and Delhi, and it doesn't discuss if the scheme of amalgamation was separable as pointed out in clauses no. 1.2.2 and 23.1 (supra). The impugned order is completely silent on these clauses.
- Section 231(1) (b) of the Companies Act 2013 duly empowers the Hon'ble NCLT to exercise discretion to "give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement". The Hon'able NCLT was thus duly vested with sufficient powers under the Companies Act, 2013 to even partly sanction the scheme.
- Reliance was also placed on '***Rama Investment Company Pvt. Ltd. vs. Ankit Mittal***' wherein vide order dated 07.09.2022 in Civil Appeal Nos. 2022-2023/2022 the Hon'ble Supreme Court was pleased to set aside the order of this Tribunal and confirm the scheme of amalgamation in part as approved by the Ld. NCLT.
- In the aforesaid circumstances, while setting aside the impugned order dated 23.02.2023 we direct the Hon'able NCLT, New Delhi Bench to revisit the application of the second motion in the light of the observations made by this Hon'able Tribunal above and after considering the observations/ clarifications of Regional Director, may dispose of the petition in accordance with law within six weeks from the date of communication of this order.
- Appeal and pending applications stand disposed of.

SEBI — Case 3

The Securities Appellate Tribunal ('SAT') Order in the Matter of Remsons Industries Limited

Facts of The Order

1. The Remsons Industries Limited ('Appellant') is a Company registered under the Companies Act, 1956. The Appellant is engaged in the manufacturing of auto products like control cables, gear shifters etc.
2. The National Stock Exchange ('NSE') vide email dated January 11, 2022, had called upon the Appellant to clarify with regard to the disclosure of Related Party Transactions as required under Regulation 23(9) of the Securities Exchange Board of India (Listing Obligation and Disclosure Requirement) Regulations ('SEBI LODR Regulation') for the quarter ended September 30, 2021.
3. In reply, *vide* email dated January 11, 2022, the Appellant sought to clarify that Regulation 23 of the SEBI LODR Regulations is not applicable to the

Appellant as the Appellant is exempted under Regulation 15(2) of the LODR Regulations.

4. The reason of said exemption as mentioned was that, the paid-up equity share capital of the Appellant was ₹ 5.71 crores and Company's net worth was ₹ 31.36 crores and as per Regulation 15 of SEBI LODR Regulations, a listed entity having paid-up equity share capital not exceeding ₹ 10 crores **and** net worth not exceeding ₹ 25 crores, **is exempt from compliance of corporate governance provisions under various Regulations including Regulations 23 of SEBI LODR**.

5. Further the learned Advocate on behalf of Appellant submitted that the Appellant had paid the penalty amount of ₹ 12,04,200 under protest and had sought for a direction for a refund of the same as the Appellants paid up share capital is less than ₹ 10 crore hence Appellant is entitled for exemption under Regulation 15 of the SEBI LODR.

6. The respondents in the present matter are NSE, SEBI and the Bombay Stock Exchange ('BSE').

Charges Levied

Issue involved in this appeal is the applicability of provisions of related party transactions (i.e. Regulation 23 of SEBI (LODR) Regulations to Appellant Company?

Submissions on Behlaf of The Appellant

1. <u>The appellant is entitled for exemption under Regulation 15 of the SEBI LODR Regulation:</u>

   On behalf of the Appellant, it was submitted that the Appellant is a listed entity having net worth of ₹ 31.36 crore as on March 31, 2021. Further, it was submitted that the Appellant had paid-up share capital less than ₹ 10 crore. Further, it was submitted that Regulation 15 of the SEBI LODR Regulation it was submitted that a listed entity having paid-up equity share capital not exceeding ₹ 10 crores and net worth not exceeding ₹ 25 crores, is exempt from compliance of corporate governance provisions under various Regulations including Regulations 23 of SEBI LODR Regulation. Hence the submission of the Appellant was that since the Appellants paid up capital is less than ₹ 10 crores they are entitled for exemption under Regulation 15 of SEBI LODR Regulations.

<u>Contentions on behalf of the Respondents</u>

1. <u>The appellant is entitled for exemption under Regulation 15 of the SEBI LODR Regulation:</u>

   Advocate for the Respondent contended that compliance with the corporate governance provisions must be strictly construed because they shall have far-reaching consequences in the securities market. It was further submitted that on a plain reading of Regulation 15(2)(a) of SEBI LODR Regulation it was clear that in order to seek exemption from compliance with corporate governance a listed entity has to satisfy both the conditions (viz. the share capital must not exceed ₹ 10 crores and the net worth should not exceed ₹ 25 crores.)

   The paid-up share capital of the Appellant company as of March 31, 2021 was ₹ 5.71 crores and the net worth of the company was ₹ 31.36 crores as certified by the independent Chartered Accountant.

   Advocate for the Respondent further submitted that in ***'Durrani Abdullah***

Khan vs. State of Maharashtra ['(2017), 4 AIR Bom R 300 decided on May 5, 2017'] it was held that if the use of word 'and' conjunctively unintelligible result, the court has the power to read the word 'or' as 'and; and vice versa to give effect to the intension of the legislature.

Further, it was contended that it is settled that words of a statute are to be understood in their natural and ordinary sense and according to their grammatical meaning. The learned Senior Advocate for the Respondent hence contended that one of the two conditions namely net worth of the Appellant admittedly exceeds ₹ 25 crores therefore Appellant is not entitled for any exemption.

Held

Hon'ble SAT held that plain reading of the second proviso to sub-regulation (2) of regulation 15 states as follows:

"*15(2) The compliance with the corporate governance provisions as specified in regulations 17, [17A,] 18, 19, 20, 21,22, 23, 24, [24A,] 25, 26, 27 and clauses (b) to (i) and (t)] of sub-regulation (2) of regulation 46 and para C, D and E of Schedule V shall not apply, in respect of –*

(a) [a] listed entity having paid up equity share capital not exceeding rupees ten crore and net worth not exceeding rupees twenty five crore, as on the last day of the previous financial year:

***Provided** that where the provisions of regulations 17 to 27, clauses (b) to (i) and (t) of sub-regulation (2) of regulation 46 and para C, D and E of Schedule V become applicable to a listed entity at a later date, it shall ensure compliance with the same within six months from such date:'*

***Provided further** that once the above regulations become applicable to a listed entity, they shall continue to remain applicable till such time the equity share capital or the net worth of such entity reduces and remains below the specified threshold for a period of three consecutive financial years"*

On reading the second proviso to sub-regulation (2) of regulation 15 it is clear that the exemption shall continue to remain applicable till the equity share capital or the net worth of the entity reduces below the specified threshold. This means when the corporate governance provisions become applicable to a listed entity, they shall continue to remain applicable till either the equity share capital falls below ₹ 10 Crores or net worth reduces to less than ₹ 25 Crores. Thus, by reading the proviso, the intent of the legislature becomes clear that the Regulations shall be applicable upon happening of both contingencies and remain as such, till one of the conditions reduces below the specified threshold. Hence it was held that since the paid-up equity share capital is less than ₹ 10 crores, the corporate governance provisions do not apply to the Appellant.

Order

Appeal allowed holding that the corporate governance provisions are not applicable to the Appellant as the paid-up equity capital is less than ₹ 10 Crores.

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