CORPORATE LAWS
Case Law Update

CS Makarand Joshi

IBC – CASE – 1

In the matter of *Mitsubishi Heavy Industries Limited (Appellant) vs. Punj Lloyd Limited (Respondent) and Others* at National Company Law Appellate Tribunal (NCLAT) 9 August 2024

Facts of the Case

- In 2015, a contract was entered between Indian Oil LNG Private Limited (IOLPL) and Mitsubishi Heavy Industries Limited (the appellant) on 15 September 2015. The appellant subcontracted parts of the work to Punj Lloyd Ltd. (Respondent No. 1/Corporate Debtor/CD).
- As per the contract's general conditions, the Corporate Debtor (CD) was required to provide an unconditional and irrevocable Bank Guarantee as security for proper and timely performance of the obligations. A Performance Bank Guarantee worth approximately ₹ 47.7 Crores was issued by the State Bank of India in favor of the appellant.
- The agreed mechanical completion date under the contract with CD was 23 March 2018, but the appellant issued a Mechanical Completion Certificate with a completion date of 31 January 2019.
- On 8 March 2019, the Corporate Insolvency Resolution Process (CIRP) was initiated against CD before the National Company Law Tribunal (NCLT).
- On 30 October 2019, the appellant invoked the Performance Bank Guarantee due to fundamental breaches of the contract, including delays in achieving mechanical completion and failure to inspect and repair leakage in the LNG Tank during the defect liability period.
- On 13 November 2019, the Resolution Professional (RP) of CD filed an application before the NCLT, seeking directions under Section 14 of the Insolvency and Bankruptcy Code, 2016 (IBC) to restrain the appellant from encashing the Performance Bank Guarantee.
- *NCLT referred to the NCLAT judgment in C&C Construction Ltd. vs. Power Grid Corporation of India Limited (26 July 2021), where it was held that the moratorium period under Section 14 of the IBC does not cover performance bank guarantees.*

- On 27 May 2022, NCLT directed the liquidation of the CD as a going concern.
- Despite this, the RP's application to restrain the appellant from encashing the Performance Bank Guarantee was allowed by an order dated 30 October 2023, against which this appeal has been filed.

Arguments of the Appellant

- The Performance Bank Guarantee (PBG) issued by the State Bank of India in favor of the appellant was irrevocable and unconditional.
- The CD had agreed to complete the work by the mechanical completion date, but there was a 10-month delay. During the defect liability period, the appellant sent emails to CD to inspect leakage in the LNG tank, but these requests were refused, resulting in a breach of contract by CD.
- As a result, the appellant was forced to invoke the PBG on 30 October 2019.
- The RP filed an application on 13 November 2019, seeking to restrain the appellant from encashing the PBG. However, the application was not maintainable because:
  - NCLT lacked jurisdiction to determine the legality of the PBG invocation or adjudicate contractual disputes between the appellant and CD.
  - The PBG is an independent contract, and courts should not interfere with its invocation except in exceptional circumstances, which did not exist in this case.
- Since the bank guarantee was unconditional and irrevocable, the appellant was not required to prove losses at the time of invocation. The appellant had valid claims due to:
  - Delay in mechanical completion.
  - Failure to cure defects during the defect liability period
- The Defect Liability Period was 30 months from the mechanical completion date or 24 months from the issuance of the completion certificate. During this period, the CD was required to conduct searches, tests, or trials to determine the cause of any defect.
- The NCLT's order restraining the appellant from encashing the PBG was without jurisdiction.
- The PBG has been explicitly excluded from the moratorium under Section 14 of the IBC, following an amendment by Act 26/2018 effective 6 June 2018.
- As such, the moratorium under Section 14 of the IBC did not apply to the PBG, and the appellant was fully entitled to invoke the PBG even after the insolvency proceedings against CD which began on 8 March 2019.
- In similar cases within the same CIRP, the NCLT rejected applications filed by the RP seeking to restrain the invocation of guarantees by IOCL and GAIL, but in this case, the NCLT allowed the RP's application, resulting in an inconsistent ruling.
- The NCLT was aware that the issue was pending before the NCLAT in the case of C&C Construction Ltd., which was decided on 26 July 2021, confirming

that the moratorium period under Section 14 does not cover performance bank guarantees, meaning the RP's application should have been rejected.

Arguments of the Respondent

- NCLT had ample jurisdiction to adjudicate the application filed by the RP regarding the bank guarantee.
- NCLT previously considered similar applications filed by the RP in cases involving IOCL, GAIL, and Triveni-Mersens and passed orders on the issues related to bank guarantees, indicating that the appellant cannot now claim that NCLT lacks jurisdiction.
- The orders passed by NCLT in the IOCL, GAIL, and PLL cases were not overturned by the NCLAT, and the Triveni-Mersens order applied directly to this case. In the Triveni-Mersens case, NCLT held that once a Mechanical Completion Certificate is issued, the bank guarantee should be discharged.
- Even if the bank guarantee was termed unconditional and irrevocable, this did not mean the appellant could invoke it arbitrarily or outside the scope of contractual provisions. Any claim during the Defect Liability Period should have been quantified and communicated to the Corporate Debtor (CD) with sufficient evidence, which the appellant failed to do.
- As per Clause 7.1.2, once a Mechanical Completion Certificate is issued, the contractor is no longer responsible for that part of the work, unless there is damage caused by the CD's ongoing activities.
- In this case, the Mechanical Completion Certificate was issued on 3 September 2018, so the CD could not be held responsible for the alleged leakage. The invocation of the bank guarantee could lead to asset stripping of the CD.
- The argument that the bank guarantee is not an asset of the CD should be rejected, as the State Bank of India extended the bank guarantee based on the CD's collateral. If the bank guarantee was wrongfully invoked, the State Bank of India would claim the same from the CD as a creditor, causing the CD to suffer the ultimate loss.
- NCLT has jurisdiction to examine all aspects related to bank guarantee invocation, including factual aspects. Given the special equities in favor of the CD, the bank guarantee should not have been invoked, as doing so would cause irretrievable injury to the CD.

Held

- NCLAT referred the following cases:
  - ***State Bank of India vs. V. Ramakrishnan & Anr.***
  - ***Himadri Chemical Industries Ltd. vs. Coal Tar Refining Co.***
  - ***Standard Chartered Bank vs. Heavy Engineering Corporation Limited & Anr.***
- *It was noted that the issue regarding the invocation of performance bank guarantees during the moratorium period is well-established in law. Also noted that the definition clarifies that "Security Interest" does not include PBG. Effective from June 6, 2018, Section*

14(3) explicitly excludes security in a contract of guarantee from the provisions of Section 14(1) of the IBC. It is well settled that Section 14 does not affect the right of a beneficiary to invoke a bank guarantee during the moratorium. The disputes between the beneficiary and the party who requested the bank guarantee are immaterial and do not affect invocation. Invocation of a bank guarantee may only be restrained on the grounds of irretrievable injury and special equity.

- NCLT did not allow the application filed by the Resolution Professional (RP) based on exceptions highlighted by the Supreme Court in Standard Chartered Bank. Instead, NCLT stated that the appellant failed to prove any fault on the part of the CD or quantify its claim.
- NCLT allowed the application on the grounds that the appellant did not prove a default of contract by the CD.
- According to the Supreme Court in *Standard Chartered Bank*, disputes raised by the contractor regarding the invocation of an unconditional and irrevocable bank guarantee are not to be considered.
- The NCLT erred by allowing the application to restrain the appellant and other banks from invoking the bank guarantee, rendering its order unsustainable. The appeal was allowed, overturning the NCLT's decision.

CASE – 2 SEBI

WRIT PETITION IN THE HIGH COURT OF JUDICATURE AT BOMBAY IN THE MATTER OF DR. PRADEEP MEHTA

Facts of The Order

1. The present writ petition deals with two petitions filed under Article 226 of the Constitution of India. The first Petition No.1590 of 2021 is filed by Dr. Pradeep Mehta ('Petitioner') and the second Petition (Writ Petition No. 2228 of 2021) is filed by his son Neil Pradeep Mehta. Dr. Pradeep Mehta and Neil Pradeep Mehta are collectively referred to as 'Petitioners'.

2. In both the writ petitions the reliefs prayed for are quite similar, which pertain to challenging the action of the Bombay Stock Exchange ('BSE') and the National Stock Exchange ('NSE') under the directives of the Securities and Exchange Board of India ('SEBI') to freeze the Demat Accounts of the Petitioners.

3. Respondents in the matter are- Respondent 1-Union of India, Respondent 2-Securities and Exchange Board of India, Respondent-3 Bombay Stock Exchange Ltd. Respondent 4-National Stock Exchange Ltd., Respondent 5-Central Depository Services (India) Ltd.('CDSL'), Respondent 6- National Securities Depository Ltd. ('NSDL') Collectively referred to as respondents. Collectively referred as 'Respondents'.

4. The challenge raised in the petition was with regards to the freezing of the "demat account" of the Petitioners by the respondent no. 6 – NSDL under the regulations/orders of the SEBI merely for the reason that at one time Petitioner happened to be one of the promoters

of a company. Neil Pradeep Mehta held a demat account along with his father Dr. Pradeep Mehta, who was the second holder and his demat account was also freezed.

5. The Petitioner was a medical practitioner, and he had one of the investments made in a company named Shrenuj & Company Limited ('Shrenuj/ the Company') which was promoted in the year 1989 by his father-in-law.

6. In 2016, the Petitioner learnt that there was some litigation in regard to the affiliate of Shrenuj in Hong Kong. It was learnt that Shrenuj was facing financial issues and due to this, Shrenuj could not file its financial results as per the SEBI Regulations.

7. Thereafter on March 2, 2017, respondent no. 3 – BSE issued a letter to Shrenuj in regard to non-submission of financial results under Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('SEBI LODR') inter alia stating that the Company had not submitted to BSE and NSE its quarterly financial results for the period ended in December 2016, and hence, the company was liable to pay a fine of ₹ 1,84,000/. Shrenuj submitted reply vide its letter dt. March 20, 2017, to the BSE and NSE.

8. In the month of March 2017, the Petitioners, received a monthly statement of demat account and found that some of the shares in their demat account maintained with the Stock Holding Corporation of India Limited ('SHCIL') were frozen.

9. NSDL by communications dated March 23, 2017, and April 13, 2017, freezed the demat account of the Petitioner applying Circular No. CIR/CFD/CMD/12/2015 dated November 30, 2015 and Circular No. SEBI/HOCFD/CMD/CIR/P/2016/116 dated October 26, 2016 ('SEBI Circulars'). The NSDL freezed not only the Petitioner's shareholding in Shrenuj & Company but also in ITC Limited.

10. Meanwhile, Shrenuj addressed a letter dated September 27, 2017, to the BSE stating the reasons as to why the company could not submit the quarterly financial results since the quarter ended on June 30, 2016.

11. The Petitioner also addressed a detailed letter dated January 4, 2018, to the SEBI stating that he was never in any direct or indirect control of Shrenuj, and that he never held any post in the company; that he was unaware of the company had allegedly violated the (LODR) Regulations.

12. The Petitioner had appealed before the Securities Appellate Tribunal ('the Tribunal'/'SAT') and an order was passed by the Tribunal dtd April 18, 2018 disposing Petitioner's appeal and directing BSE and NSE to dispose of representation made by the Petitioner's.

13. Pursuant to the order dated April 18, 2018 passed by the Tribunal, Respondent no. 4 - NSE replied to the said representation of the Petitioner by its letter dated May 11, 2018 *inter alia* stating that in accordance with the SEBI circulars which prescribed for SOP, trading is suspended in the securities of Shrenuj, as Shrenuj had defaulted in the filing of its quarterly financial results with the BSE and NSE for the quarters ending on June 2016, September 2016 and December 2016. A fine of ₹ 25,10,815/- also came to be imposed on Shrenuj.

14. Respondent no. 3/BSE replied to the said representation of the Petitioner by its letter dated May 15, 2018, stating that it is not in a position to issue instructions to de-freeze the Petitioner's securities except in accordance with the SEBI circulars and further advised the Petitioner as a promoter to insist upon Shrenuj to comply with the applicable requirements at the earliest.

15. The Petitioner on such backdrop, addressed an e-mail dated May 5, 2021, to the NSDL making a grievance that the action to freeze the Petitioner's demat account and the securities held by him was wholly illegal.

16. NSDL responded to such e-mail by its letter dated June 1, 2021, directing the petitioner to approach BSE and NSE for clarification in regard to the freezing of his account.

17. Lastly, the Petitioners, through advocates addressed a detailed notice dated June 7, 2021, to respondent no. 2 – SEBI setting out its grievances and requesting to immediately take steps to defreeze the Petitioner's demat accounts and the securities held by him. There were an exchange of letters between the parties, however, there was no response from the respondents. Therefore, the Petitioner filed the present petition.

Charges Levied

Freezing of the demat account of the Petitioner who was also a promoter of a listed company Shrenuj, along with his son Neil Mehta's demat account who was joint holder, was it legal and valid in law?

Submissions on Behalf of The Petitioner

1. **<u>Freezing of Demat Accounts & Lack of fair procedure:</u>**

On behalf of the Petitioner, it was submitted that Dr. Pradeep Mehta's demat accounts were frozen by NSDL at the direction of SEBI due to his status as a promoter of Shrenuj & Co. Limited, a company facing financial and compliance issues. The Petitioner claimed that this was in contravention of section 11 of the SEBI Act 1992. Despite having no control over Shrenuj' s operations, his demat account was frozen, including shares unrelated to Shrenuj.

Further, it was submitted that particularly Section 11(4)(e) of the SEBI Act grants SEBI the power to attach bank accounts or property, including demat accounts, for a maximum period of 90 days in cases involving violations of the SEBI Act or its regulations. However, the freezing of a demat account may not be justified in this case, especially if the Petitioner is not directly liable for the actions of the company involved.

It was argued on behalf of the Petitioner that no notice or opportunity for a hearing was provided before the action was taken, violating principles of natural justice. Petitioner further stated that his connection with Shrenuj was limited to being listed as a promoter due to his family relation with the company's founder, and he was unaware of this until his accounts were frozen. He emphasized that he had sold most of his shares in Shrenuj, reducing his holding to below 0.01% by 2016.

2. **Legal Challenges to SEBI's Circulars & Compensation Claims:**
The Petitioner challenged SEBI's authority to issue circulars that resulted in penalties or the freezing of accounts, arguing these were ultra vires (beyond the legal authority of SEBI under the SEBI Act). Dr. Mehta sought the quashing of SEBI regulations and circulars related to these actions, stating they unjustly penalized investors for company failures. The Petitioner sought compensation of ₹ 1 crore each from BSE, NSE, CDSL, and NSDL for illegally freezing his accounts, damaging his reputation, and preventing him from trading in shares.

Arguments by the Respondents

Reply affidavits were filed on behalf of respondents as follows:

1. **SEBI** - The affidavit states that the Petitioner's demat accounts are frozen in pursuance of the Circulars dated November 30, 2015, and October 26, 2016, issued by SEBI which prescribe the 'Standard Operating Procedure', for suspension and revocation of trading of specified securities, detailing the manner in which the exchanges shall deal with non-compliance or contravention of SEBI LODR regulations 2015. It is hence contended that the issuance of impugned Circulars dt. November 30, 2015, and October 26, 2016, is well within the powers of SEBI under Regulations 97, 98, 99 and 102 read with Regulation 101(2) of SEBI (LODR) Regulations 2015. Further, it mentioned that SEBI has wide powers under sec. 11 of the SEBI Act to protect the interests of the investors in securities and to promote the development of and to regulate the securities market. Bye-Laws of the Stock Exchanges inter alia mandate that every listed Company shall comply with the conditions of the Listing Agreement as prescribed from time to time by such Stock Exchanges and/or SEBI and shall be liable to pay such fine(s) as may be prescribed by such Stock Exchanges and/or SEBI for non-compliance of the Listing Agreement or any of the SEBI Regulation dealing with the listing. It was thus contended by the Respondents that the actions taken by respondent nos. 3 to 6 are in consonance with the SEBI (LODR) Regulations 2015 and the aforesaid circulars of SEBI. It was next stated that respondent no. 3 and 4 issued directions to respondent no. 5 and 6 to freeze the demat account of the Petitioners under the aforesaid statutory mechanism.

It was also stated that the freezing of the demat account of the Petitioners is also a consequence of Compulsory Delisting of Shrenuj, under the provisions of the SEBI (Delisting of Equity Shares) Regulations, 2009 ('Delisting Regulations 2009') read with SEBI circular dt. September 7, 2016. It is thereafter stated that Regulation 29 of the Delisting Regulations 2009 itself envisages that the respective recognized stock exchanges shall monitor compliance with the provisions of these regulations and shall report to the Board any instance of non-compliance which comes to their notice. It was further stated that as a result of the compulsory delisting of the securities of Shrenuj, NSDL informed the Petitioner on August 8, 2018, that the Petitioner's account was "Suspended for Debits" in accordance with the Circular dated September 7, 2016.

SEBI further stated that the power to regulate has been delegated to the

recognised Stock Exchanges by the Parliament by virtue of Section 9 of the Securities Contract Regulation Act, 1947 ['SCR Act'] to include the power to levy fees, fines, and penalties. SEBI further stated that if Petitioner is aggrieved by the actions taken by the Stock Exchanges, then under Section 23 of the SCR Act, the statutory remedy lies before the Tribunal.

SEBI further submitted that if the Petitioner is aggrieved by the orders dated April 18, 2018 and September 4, 2018, passed by the Tribunal, then the remedy would lie before the Supreme Court pursuant to Section 15Z of the SEBI Act. Hence the petition is not maintainable.

2. **BSE -** The primary contention urged in the reply affidavit was in regard to the non-compliance of the SEBI (LODR) regulations by Shrenuj, which is stated to have resulted in its compulsorily delisting from the platform of stock exchanges and freezing of the demat account of the promoter and promoter group of the Shrenuj. It is stated that the Petitioner's demat account was frozen on account of non-compliance with the provisions of the SEBI (LODR) Regulations for two consecutive quarters by Shrenuj. Respondent No. 3 contends that the Petitioner had never objected of being classified as a "promoter" until the freezing of his demat account. Further stated that the Petitioner's demat account was frozen in July 2018, hence, the cause of action to file any proceeding had accrued to the Petitioner in the year 2018, however, the Petitioners approached the court in the July/September 2021, that is after 3 years of delay.

   It is next stated that the Petitioner challenged the freezing of the Demat Account in an appeal filed before the Securities Appellate Tribunal, which was disposed of by an order dated April 18, 2018, directing Respondent-BSE to dispose of the representation made by the Petitioner dated January 4, 2018, within 4 weeks therefrom. Accordingly, respondent no. 3-BSE disposed of the Petitioner's representation by its communication dated May 15, 2018, inter alia recording that the Petitioner was a promoter of Shrenuj, hence, the consequences of freezing of the demat account of Shrenuj applied to the Petitioner.

3. **NSE –** Reply affidavit filed by the NSE stated that the appropriate remedy is available to the Petitioner against the order dated May 11, 2018, passed by respondent no. 4, freezing the demat account of the Petitioner lies before the Securities Appellate Tribunal, and the remedy in respect of the order dated September 4, 2018, of the Securities Appellate Tribunal lies before the Supreme Court.

4. **CDSL-** Reply affidavit filed by CDSL mentioned that Petitioner holds no demat account maintained with respondent no. 5, yet the Petitioner has made monetary claims against respondent no. 5. Therefore, the Petitioner's claim for compensation does not arise and be dismissed.

5. **NSDL-** Reply affidavit filed by NSDL stated that NSE addressed emails to NSDL and directed for freezing of certain other securities held by the promoter/promoter group entities of certain listed entities (which included Shrenuj) on account of non-compliance, by such listed entities with the provisions of the "SEBI (LODR) Regulations". It is stated that

accordingly, NSDL initiated an ISIN level freeze in respect of shares of ITC Limited, based on the directions received from NSE. It is further stated that thereafter, on July 9, 2018, BSE informed NSDL that trading notices had been issued by BSE for compulsory delisting of certain companies from the trading platform of the exchange w.e.f. July 4, 2018. BSE also shared a list of such companies along with other details and directed NSDL to freeze all demat accounts of such promoters as per the SEBI Circular dated September 7, 2016. Accordingly, based on PANs of promoter/promoter group of compulsorily delisted companies as received from BSE, the Petitioner's account was marked as 'Suspended for Debit' until further instructions from BSE/SEBI and the same was communicated to the Petitioner vide letters dated August 8, 2018.

It is next stated that NSDL also received an email communication dated August 7, 2018, from NSE forwarding a list of companies which had been compulsorily delisted w.e.f. August 8, 2018. It is hence stated that NSDL acted on the instructions of NSE and BSE and implemented a freeze on the demat accounts of promoters of companies, that have been compulsorily delisted in which Shrenuj was one such company and the Petitioner, was disclosed as a promoter of the company. It is next stated that NSDL, as a depository, acts only on the instructions received from SEBI/stock exchanges and is not involved in the decision-making process relating to the freezing of any individual's demat accounts. It is further stated that as the Petitioner was named as a promoter of Shrenuj, in due compliance with the directions of the stock exchanges, NSDL had initiated a freeze on the demat accounts of the Petitioner.

Decisions by Hon'ble High Court of Bombay

1. **<u>Freezing of Demat Accounts & Lack of fair procedure</u>:**

   The Hon'ble Bombay High Court stated that with respect to the freezing of the demat account, the Hon'ble Bombay High Court is of the view that action against the Petitioner is taken only for the reason that, when such company was formed in the year 1989, the Petitioner was one of the promoters of the company.

   Further, any coercive action in respect of one's property is required to be taken in accordance with law and after complying with the basic principles of natural justice. No show cause notice or a prior opportunity of a hearing was granted to the petitioner before the letters dated March 23, 2017, and April 13, 2017, were addressed to the SHCIL by NDSL, freezing not only the petitioner's shares in Shrenuj but also the other shareholding of the petitioner in ITC Limited. For such reason, the impugned action on the part of NSDL is required to be held to be brazenly illegal, unreasonable, and arbitrary.

2. **<u>Legal Challenges to SEBI's Circulars & Compensation Claims</u>:**

   The Hon'ble Bombay High Court clarified that SEBI's circulars from September 7, 2016, and October 26, 2016, did not provide legal authority to freeze the demat accounts of promoters for shares they hold in companies other than the one that violated compliance rules. Paragraph 2.2 of the October

circular, which allowed for freezing shares in other companies based on quarterly calculated liabilities, was found to be beyond SEBI's legal powers as outlined in the SEBI Act. The Hon'ble Bombay High Court stated that such drastic actions, like freezing someone's demat account, have serious civil consequences and must be based on substantive law, not just circulars. Furthermore, SEBI should have provided the promoter with a chance to be heard before freezing their account, as required by the principles of natural justice. The Hon'ble Bombay High Court concluded that SEBI's actions were illegal, arbitrary, and violated constitutional protections under Articles 14 (equality before the law), 21 (right to life and personal liberty), and 300A (protection of property rights), as circulars cannot override statutory law or the SEBI Act. The Hon'ble Bombay High Court stated that circulars cannot have an overriding effect on the statutory provision under which it is issued and cannot be implemented in defiance of principles of natural justice. The Hon'ble Bombay High Court examined SEBI's authority to freeze the demat accounts of promoters and referred to Regulation 98(1)(c) and (d) of the SEBI (LODR) Regulations, 2015. These regulations state that if a listed company violates SEBI rules, actions like imposing fines, suspending trading, or freezing the holdings of promoters in that company can be taken. However, the Hon'ble Bombay High Court pointed out that these actions should only apply to the promoter's holdings in the specific company that violated the rules. In this case, SEBI and NSDL froze the Petitioner's other shareholdings (e.g., in ITC Limited), which the court found to be unjust and illegal since the Petitioner's role as a promoter was limited to Shrenuj, the defaulting company. The Hon'ble Bombay High Court also emphasized that the Petitioner was simply a shareholder of Shrenuj, and no evidence was provided to show that he had an active role in managing the company or in its non-compliance with SEBI regulations. As a result, freezing the Petitioner's other assets could not be justified. The freezing of shares beyond those related to the defaulting company was deemed arbitrary, illegal, and without legal basis.

Conclusion

The Hon'ble Bombay High Court found SEBI's actions unjust because they were based on an outdated and irrelevant classification of Dr. Mehta as a 'promoter'. The Hon'ble Bombay High Court further stated that decisions were taken without following due process or providing a reasoned order and were disproportionate in their impact on Petitioner's other investments. The Hon'ble Bombay High Court also held that SEBI had overstepped its legal authority in issuing the circulars that led to the freeze. The Petitioners lost valuable trading opportunities to deal with his property as entitled to him under Article 300A of the Constitution of India.

Held

1. Freezing of the demat account of the Petitioners was declared to be illegal and invalid.

2. The Petitioners shall be free to deal with all his shares as held in the Demat accounts in question.

3. The SEBI/BSE/NSE are directed to jointly pay to the Petitioners cost of ₹ 80 lakhs within a period of two weeks from the date of passing of this judgement.

CASE – 3 Companies Act

In the matter of the scheme of Azim Premji Trust Services Private Limited and its respective shareholders - NCLT Bengaluru Bench order dated 4th September 2024.

Facts of the case

- The **Azim Premji Trust Services Private Limited** (hereinafter called as Petitioner company), has filed a second motion application under sections 230 read with sections 18 and 66 of the Companies Act 2013 ('the Act'), before NCLT to obtain its approval for conversion of a company limited by shares into company limited by guaranty without share capital.
- As per the petition, the objectives of the Petitioner company are to carry on the business to undertake the office of and act as the trustee, judicial trustee, fiscal agent, represent fiduciary, intermediary, administrator, manager, registrar, paying agent, adviser, agent of attorney of or for any person or persons, company, corporation, Partnership, Limited Liability Partnerships, association, institution and all other natural and artificial person etc.
- The NCLT Bengaluru Bench through its order dated 18th October 2022 in the first motion application, allowed the dispensations of shareholder meetings and meetings of secured and unsecured creditors. Also, the NCLT ordered the petitioners to give a public notice in newspapers and to give notice of the proposed scheme to all the regulators and call for their objections if any. The scheme got approved by the shareholders of the Petitioner company.
- Accordingly, the Registrar of Companies (ROC) and the Regional Director (RD) have raised some objections to the said conversion.

ROC/RD's ('Respondent's')

- In view of section 4(e) of the Act, in respect of a company having share capital each subscriber/shareholder should hold a minimum of one share. Therefore, the power to reduce the capital under section 66 of the Act cannot be exercised by the company to reduce the paid-up equity capital of the company from ₹ 1,00,000 to zero. Such a proposal is contrary to the provisions of Section 66 of the Act.
- Section 18 of the Act permits a company of any class registered under this Act may convert itself as a company of other class under this Act by alteration of memorandum and articles of the company in accordance with the provisions of this Chapter. This Petitioner company has been registered as a company limited by shares. Therefore, the company limited by shares can be converted into a company limited by guarantee only in accordance with the chapter II of the Act and Rules made there under.
- Rules made under chapter 2 of the Act, (i.e. companies (Incorporation) rules 2014) provide for the conversion of a company limited by guarantee into a company limited by shares but does not talk about the conversion of a company

limited by shares into a company limited by guarantee. Therefore, a scheme under section 230 of the Act cannot propounded as short circuit mechanism substituting the power of the Central Government to prescribe rules relating to the conversion of a company Limited by Shares into a Company Limited by Guarantee.

Petitioner company's contentions

- The scheme approved by the shareholders envisages converting the company limited by shares to a company limited by guarantee without capital. Hence the requirement of holding a minimum one share as provided in Section 4(1)(e) of the Act is not applicable after such conversion. Company limited by guarantee without capital is permitted as per Section 4(1)(d) of the Act,
- Under sub-section 68 of Section 2 of the Act, a Private Company need not have share capital at all. Table B to Schedule 1 of the Act also permits the Memorandum of Association of a Company Limited by Guarantee not to have any share capital at all. The Scheme does not result in the Petitioner Company being without Members, which alone is not permitted under the provisions of the Act.
- Conversion of company limited by shares into company limited by guarantee without capital is not barred by any provision of the law and it is expressly permitted under section 18 of the Act.
- Submissions only state that the Regional Director or the ROC do not have such powers, it does implicitly concede that the Tribunal is empowered to permit the Scheme. It is a settled position that Section 230 of the Act is a complete code in itself and sanctioning the Scheme of the Petitioner company is well within the plenary powers conferred upon the Tribunal.
- While there is a restriction to the Tribunal permitting a scheme under sub-section 10 of Section 230 in case of buyback of shares unless such buyback is in accordance with Section 68 of the Act, there are no such restrictions on the Tribunal's powers for sanctioning the scheme under any other Section.
- A scheme of compromise or arrangement may involve an increase, consolidation, or sub-division of shares or reduction of share capital or reorganization of the capital in any manner. Therefore, changing the characteristic of the capital from equity shares to guarantee and consequent change in the character of the company into a company limited by guarantee without capital as sought by the Petitioner company under the Scheme cannot be deemed to be impermissible under Section 230 of the Act. The proposed Scheme cannot be considered as a short-circuit mechanism.
- The Petitioner company acts as a Trustee of philanthropic trusts, a company limited by guarantee is more suitable as it will ensure that no property rights are created while discharging the fiduciary responsibilities of a Trustee.

Held

- The ROC has conveniently ignored the provision of Section 4(1)(d) read

with Section 2(21) of the Act, in which the definition of a company limited by guarantee is given and it has been provided as to what will be stated in the Memorandum of such company. Thus, the restrictions cited by the ROC in the report is relying on the Section 4(1)(e) and Section 66 of the Act are not in respect of a company limited by guarantee without capital; whereas considering the provision of Section 4(1)(d) read with Section 2(21) of the Act, there is no such requirement that the Company should hold at least a minimum of one share if it is a Company limited by guarantee. Thus, this objection is not legally tenable.

- It is a fact that such a conversion as requested by the Petitioner has been duly incorporated under Section 18 of the Act which expressly allows such conversion.
- Rule 39 of the Companies (Incorporation) Rules, 2014 has been notified for "Conversion of a Company Limited by guarantee into a company limited by shares". However, no rules have been prescribed so far for allowing the conversion in the reverse direction, from the Company limited by shares into a company limited by guarantee.
- Merely because the rules have not yet been notified for the conversion of the company limited by shares into a company limited by guarantee, it does not mean that such conversion cannot be allowed when it is allowable under the provisions of Section 18 of the Act. This is covered within the scope of 'arrangement' between the company and its members,
- In view of the facts and circumstances of the case, we are of the considered opinion that the conversion as requested by the Petitioner company is liable to be allowed under the provisions of Section 230 of the Act read with Section 18 and Section 66 of the Act and read with Rule 11 of the NCLT Rules, 2016.
- Accordingly, the scheme of arrangement in question as annexed at Annexure – A is approved and from the Appointed Date, the Petitioner company will be a company limited by guarantee without share capital. While approving the Scheme, it is clarified that this order should not be construed as an order in anyway granting exemption from payment of any stamp duty, taxes, or any other charges, if any, and payment in accordance with law or in respect of any permission/compliance with any other requirement which may be specifically required under any law.
- As requested by the Petitioner company, the following directions are issued:

  1. With effect from the appointed date, the Memorandum of Association of the Petitioner company henceforth shall be in the form of Table-B of Schedule I of the Act or such other form as may be applicable.
  2. With effect from the appointed date the Articles of Association of the Petitioner company henceforth shall be in the form of Table-H of Schedule I of the Act or such other form as may be applicable.

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