CASE LAW UPDATE

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IBC

EPC CONSTRUCTIONS INDIA LIMITED - APPELLANT VS. MATIX FERTILISERS AND CHEMICALS LIMITED – RESPONDENT

In the matter of *EPC Constructions India Limited - Appellant vs. Matix Fertilisers and Chemicals Limited – Respondent* at National Company Law Appellate Tribunal – New Delhi- dated 9 April 2025

Facts of the case

- EPC Constructions India Limited - the Appellant executed an EPC contract with Matix Fertilisers and Chemicals - Respondent/Corporate Debtor (CD) for setting up a fertilizer complex on 11 December 2009.

- A resolution dated 30 July 2015 was passed by the appellant giving consent to make investments up to ₹ 400 Crores into 8% Cumulative Redeemable Preference Shares (CRPS) of ₹ 10/- each of CD in one or more tranches.

- CD in consequence allotted 25,00,00,000 8% CRP Shares of ₹ 10/- each to the appellant and Essar Projects (India) Limited (earlier name of the Appellant) in terms and conditions mentioned therein. The CRPS were renewable within three years.

- National Company Law Tribunal (NCLT) initiated a Corporate Insolvency Resolution Process (CIRP) against the appellant by order dated 20 April 2018. The appellant issued a letter on 28 August 2018 to the CD asking for redemption of CRPS including dividend, aggregating to ₹ 310 Crore.

- The CD sent a reply dated 24 August 2018 informing that liability towards redemption of CRPS along with cumulative dividend, aggregating to ₹ 310 Crores had been adjusted against the claim which CD had against the appellant.

- CD submitted a claim in the CIRP of Appellant of ₹ 377.87 Crores, information of which was also sent on 5 June 2018 for adjustment of total liability of CRPS against the aforesaid claim.

- The Resolution Professional of the appellant also wrote a letter on 27 October 2018 to the CD claiming the debt which included the amount of ₹ 250 Crores towards investment in CRPS with a dividend of ₹ 60 Crores totalling to ₹ 310 Crores.

- The Liquidator of the appellant moved an application before the NCLT seeking leave under Section 33 of the Insolvency and Bankruptcy Code, 2016 (IBC/Code) for proceeding for recovery of the debt of the appellant.

- Consequently, an application u/s 7 of the IBC was filed by the Liquidator of the Appellant on 25 April 2022 against the CD claiming a default amount of ₹ 250 Crores + ₹ 60 Crores totalling to ₹ 310 Crores.

- NCLT rejected the application and observed that:

  – The CRPS were not due and payable, hence, no default could be established.

  – That CRPS were not a financial debt under IBC unless and until they become due for redemption.

  – In the absence of any debt due to the appellant and non-existence of default on the part of the respondent, the application filed u/s 7 of the IBC was held to be not maintainable.

- An appeal was filed with the National Company Law Appellate Tribunal (NCLAT) challenging the above order of the NCLT.

Arguments of the Appellant

- The CRPS were allotted by the respondent in lieu of the existing debt which was owed to the appellant. The respondent had acknowledged the liability to the extent of ₹ 310 Crores and sought to adjust this amount against the outstanding dues payable to the respondent.

- The transaction under which the CRPS were allotted was a commercial transaction and was considered as financial debt having a commercial effect of borrowing, The NCLT committed an error in rejecting the application filed by the appellant u/s 7 of IBC.

- It was submitted that the conversion of the outstanding amount into subordinated debt was undertaken at the request of the respondent. The CD had expressly communicated to the appellant that it had raised equity funds, which would be specifically earmarked for the repayment of the appellant's subordinated debt.

- The nature of the transaction serves as the basis for determining the classification of the debt. In the present case, it is evident that the transaction involved financial debt, as demonstrated by the allotment of CRPS. These shares carried an 8% dividend obligation and were redeemable, indicating a debt-like feature. The time value of money was also clearly reflected in the transaction. Under the IBC, this transaction fully meets the criteria for the commercial effect of borrowing, thereby qualifying as financial debt.

- In the Audited Financial Statement for the financial year 2016-17 of the CD - CRPS were shown as its liability which proves that the respondent owed a financial debt.

- The appellant, after three years from the issuance of CRPS, was entitled to redeem them. Having written to the respondent requesting payment of the redemption amount along with the applicable dividend, the respondent incurred a financial debt. Therefore, the NCLT erred in rejecting the Section 7 application.

Arguments of the Respondent

- The appellant submitted that CRPS is capital and is not a financial debt owed by the CD to the appellant. The outstanding amount which was payable to the appellant under the contract by the CD having been converted into CRPS the debt extinguished. After debt is converted into shares, debt or liability losses the character of debt.

- Further, the terms 'preferential share' and 'investment' have been defined under the Companies Act, 2013 (Act), hence, relevant provisions of the Act, have to be looked into to find the nature of debt and claim under the CRPS.

- The CRPS can only be redeemed as per Section 55 of the Act - out of the profit of the Company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

- The CD did not earn any profit in the relevant year so as to preferential shares could not have been redeemed nor any amount was available towards the fresh issue of shares for redeeming the preferential shares. No payment could have been made in the preferential shares as no amount was due nor any default could said have been committed.

- The appellant filed a petition u/s 7 of the IBC based on CRPS worth ₹ 250 crores. The nature of debt has to be found out from the transaction which culminated in 25 Crore CRPS. The CRPS is not a financial debt. The legislature is fully conversant of the law which it enacts. The legislature was well aware with the concept of preferential shares, debentures and in Section 5(8)(c) expression 'debentures' has been used but there is no mention of preferential shares. The legislature was fully aware that a preferential shareholder is not a financial creditor.

- A written contract between the parties must be interpreted on its terms alone and any other evidence to interpret the same, must be excluded. There is no obligation to redeem preference shares when the company has not made any profit, and dividend has not been declared. IBC is a complete code; hence, the financial debt has to be proved as per the provisions of the IBC.

Held

- Section 2(37) of the IBC, 2016 provided that words and expressions used but not defined in IBC but defined in other statutes including the Act shall have meaning respectively assigned to them in those acts. Certain provisions of the Act, which are relevant to find out the nature of the preferential shares allotted to the Appellant need to be noticed. The Act defines 'shares' as well as 'debentures' in Section 2(84) and 2(30) of the Act.

- Section 43 of the Act deals with 'Kinds of Share Capital'. Share Capital is equity share capital or preference share capital. Section 55 on which reliance has been placed by learned counsel for the respondent deals with 'Issue and Redemption of Preferential Shares'. The proviso to Section 55 provides that no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption.

- In the present case, the respondent consistently argues that after the allotment of CRPS to the appellant, the respondent company neither declared any dividend nor earned enough profit to redeem the preference shares. If the CRPS allotted to the appellant could not be redeemed, no debt would have become due. The NCLT concluded that since the preference shares were not redeemable and the company had neither earned profit nor issued fresh shares to facilitate such redemption, there was no default on the part of the respondent. Therefore, the NCLAT fully concurs with the NCLT's finding that no default existed on the respondent's part, and thus, the Section 7 application could not be admitted.

- Placing reliance of the judgment passed by the Hon'ble Supreme Court *in **Global Credit Capital Ltd. and Anr. vs. Sach Marketing Private Limited and Anr.**, NCLAT observed held that for determining the nature of the debt, the real nature of the transaction has to be looked into.*

- In the present case, although CRPS were allotted to the appellant, there was no Share Subscription and Shareholders Agreement between the parties, nor were the CRPS subject to any conditions that would categorize the transaction as financial debt.

- The NCLAT was of the view that preferential shares being part of the preferential share capital of the Company should not transfer any debt to initiate any Section 7 proceeding.

- Further, the Company has not earned any profit nor any dividend having been declared, no redemption was permissible by the statutory provision, hence, no debt was due on the basis of which Section 7 application could be filed by the appellant. There was also no material that any proceeds of a fresh issue of shares made for the purpose of such redemption was available.

- The NCLAT, thus, fully endorses the finding of the Adjudicating Authority that there did not exist any default. It, thus, does not find any merit in this appeal. The appeal was dismissed.

SEBI

FOODS AND INNS LIMITED

In the matter of *Foods and Inns Limited* dated 13 March 2025

Facts of the Case

- Securities and Exchange Board of India (SEBI) invested in trading activities of Foods and Inns'(FIL/Company) of during the Investigation Period (IP) from 1 July 2022 to 30 November 2022, which revealed that FIL failed to have a properly documented Code of Conduct as mandated under Regulation 9(1) read with Schedule B of SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations).

- The following was alleged by SEBI that:

  i. The Code of Conduct submitted by FIL during the investigation, titled as 'Code of Ethics for Directors and Senior Management' (Code of Ethics) was formulated under SEBI Listing Obligations and Disclosure Requirements Regulations (LODR), 2015, rather than the PIT Regulations 2015.

  ii. FIL's Code of Ethics did not define 'Designated Persons', and the same was made applicable to 'Officers' which defined to include all directors of FIL; senior management of FIL; all employees serving in the roles of finance, tax, accounting, purchase, treasury, internal audit, financial analyst and investor relations; all disclosure committee members; and all members of the senior management of subsidiaries of FIL. As such, it was noted that the aforesaid code of ethics did not apply to promoters of the company.

  iii. The code of ethics included only certain aspects on insider trading; it drew reference to PIT Regulations. It stipulated that the officers and their relatives should not derive any benefit or assist others to derive any benefit from the access to and possession of insider information; that the officers shall abstain from trading in securities of FIL during the closure of the trading window; and that the officers should follow the pre-clearance procedure for trading. However, it did not prescribe the procedure or format for seeking pre-clearance or the thresholds above which requirement of seeking pre-clearance should apply or the timeframe within which trades that had been pre-cleared had to be executed. Further, any stipulation in respect of contra trades was also not contained in the Code of Ethics.

- As Mr. Milan Dalal, Managing Director (MD) of FIL (Noticee 1) and Mr. Moloy Saha, Chief Executive Officer (CEO) of FIL (Noticee 2), (collectively referred to as Noticees) were directly responsible for ensuring the code's formulation and compliance and a Show Cause Notice was issued by SEBI to them.

Charges Levied

- The code lacked essential elements such as the identification of designated persons, pre-clearance procedures, execution timelines, and contra-trade restrictions, all of which are crucial for preventing Insider trading. Consequently, the Noticees were alleged to have failed to formulate the Code of Conduct as required under Regulation 9(1) read with Schedule B of PIT Regulations.

Contentions by the Noticees

- **Acted in Good Faith**: Noticees have contended that the company acting in good faith, believed its existing 'Code of Ethics' and 'The code of Practices and Procedures for Fair Disclosure of Unpublished Price Sensitive Information' were sufficient to ensure compliance with the PIT Regulations in spirit. However, upon receiving SEBI's query by SEBI about the Company Code not being compliant with PIT Regulations corrective actions were taken.

- Noticees acted in good faith belief, and believed they were in compliance with regulations. FIL contended that they proactively engaged with SEBI and took corrective actions before and after the issuance of the SCN.

- **Technical Lapses:** Order in the matter of SEBI Vs Cabot International Capital Corporation (Appeal No. 7 of 2001 in SEBI Appeal No. 24 of 2000) was quoted wherein it was stated that technical lapses without *mala fide* intent should not attract penalties.

- **SCN did not allege insider trading or misuse of UPSI**: The SCN did not allege insider trading or misuse of UPSI and that there was no fraudulent activity, investor harm, or unjust enrichment.

- **Selective Issuance SCN:** As per regulation 9(1) responsibility is on the Board of Directors but the SCN was issued to specific individuals -MD & CEO instead.

- **Remedial measures:** Noticee has sought for leniency by contending that SCN's objective is remedial, not punitive, and since the company has taken corrective actions, a penalty should not be levied.

Contentions of SEBI

- **Acted in Good Faith:** The argument of 'good faith' is not a valid defense, as the regulatory requirement in this regard is quite explicit and the non-compliance is objectively verifiable.

- **Technical Lapse:** Regulatory compliance is a legal obligation, not a discretionary practice. FIL only adopted a compliant Code of Conduct after SEBI's intervention in October 2024 and subsequently in January 2025. The delay in compliance reflected a failure in regulatory adherence rather than proactive governance, and could not be treated as a technical lapse. While corrective actions may be considered as mitigating factors under Section 15J of the SEBI Act, they do not negate past noncompliance. Moreover, the Cabot case does not grant blanket immunity for all regulatory breaches but applies only to violations which are technical, venial and bona fide mistakes. The violation by the Noticees was not merely technical or venial lapse but an ongoing violation leading to fundamental regulatory failure that weakens the framework of Insider Trading prevention, making enforcement ineffective. The compliance was essential for preventive compliance to safeguard market integrity. The above referred judgment did apply to the said matter.

- **Regulation 9 (1) of PIT** -Code submitted by FIL during the investigation i.e., Code of Ethics for Directors and Senior Management did not fulfill the mandate of Regulation 9(1) of PIT Regulations which explicitly mandates a listed company to establish a Code of Conduct to regulate, monitor and report trading by its designated persons and immediate relatives of designated persons. This code must adhere to the minimum standards set out in Schedule B of the Regulations to ensure compliance with the prescribed framework.

- No insider trading violation was alleged, Regulation 9(1) mandates preventive compliance irrespective of whether insider trading occurs- The absence of direct harm does not absolve a company of its regulatory obligations. Failure to implement a proper Code of Conduct creates systemic risks and undermines the regulatory framework. Therefore, the noticees contention in this context was not accepted.

- Regulation 9 (1) explicitly states that the Board of Directors shall ensure that the chief executive officer or managing director of the listed company must formulate the Code of Conduct- explicitly states the same.

- **Selective Issuance SCN**: The contention of selective issuance of SCN to the Noticees is untenable, as regulations place a direct statutory obligation on these executives to ensure that the Code of Conduct is formulated. Further, though the regulation also mandates that the Board of Directors shall ensure that these executives should have fulfilled their obligation; other board members are not part of the present proceedings, hence their role in the violation is outside the purview of these adjudication proceedings.

- **Remedial measures post SCN do not erase past violations** -Timely compliance of the provisions by the listed company is essential for the efficient working of the securities market.

- **Hon'ble Supreme Court Order, *SEBI vs. Shriram Mutual Fund*** was quoted by SEBI wherein the Hon'ble Supreme Court of India held that "In our considered opinion, the penalty is attracted as soon as the contravention of the statutory *obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant. A breach of a civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether contravention must be made by the defaulter with guilty intention or not."*

Penalty

SEBI imposed a monetary penalty of ₹ 2,00,000/- each on the two Noticees with the amount payable within 45 days of the receipt of this order.

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