CASE LAW UPDATE

CS Makarand Joshi

Companies Act 2013

M/S. BANWARI LAL ARORA & SONS VERSUS M/S. S. R. FOILS & HYGIENE PRIVATE LIMITED NATIONAL COMPANY LAW TRIBUNAL (NCLT)

In the matter of *M/S. Banwari Lal Arora & Sons versus M/s. S. R. Foils & Hygiene Private Limited National Company Law Tribunal (NCLT)* -New Delhi Bench, dated 19th May 2023.

Facts of the case

- Banwari Lal Arora & Sons ('hereinafter referred to as Applicant') registered partnership firm had advanced a sum of ₹ 58,70,000- to S. R. Foils & Hygiene Private Limited (hereinafter referred to as Respondent),
- The advance was given in consideration for the supply of various categories of aluminum foil papers by the Respondent.
- The Respondent did supply a significant portion of goods amounting to ₹ 52,57,879 during the period from 19 July, 2018 to 26th November, 2018.
- A balance value of goods amounting to ₹ 6,12,121 was not delivered. In spite of repeated emails from the applicant asking for delivery of goods or refund of money, neither the goods were delivered, nor was the money refunded within 365 days.
- Therefore, the Applicant filed a petition before Hon'ble NCLT under section 73(4) of the Companies Act 2013 (the Act), praying that the pending amount of ₹ 6,12,121 be treated as a deposit and the Respondent company should be ordered to refund the same with interest thereon.

Arguments of the Applicant

- The Applicant filed a company petition under section 73(4) of the Act, seeking a direction for the Respondent to repay the outstanding amount of ₹ 6,12,121/-along with interest amounting to ₹ 2,40,589/-.
- Their primary argument was that the outstanding amount constituted a "deposit" within the meaning of the Act, and the Companies (Acceptance of Deposits) Rules, 2014, and therefore, the company was obligated to refund it.

- The goods corresponding to the outstanding amount were not supplied and the advance effectively transformed into a deposit that should be repaid.

- As per rule 2(1)(c)(xii)(a) of Companies Acceptance of Deposits rules 2014, the amount received by the company in the course of business as advance for the supply of goods or services can be treated as a deposit if it lies in the books of the company for more than 365 days.

Arguments of the Respondent:

- The Respondent did not appear before NCLT despite multiple hearings. Therefore, they did not present any formal arguments or defense in the NCLT proceedings.

- However, NCLT inherently considered the legal position of advances received for goods/services which implicitly forms the defense against the applicant`s claim of it being deposited.

Held

- Rule 2(1)(c)(xii)(a) of Companies Acceptance of Deposits Rules 2014, states that the advance received by the company is not treated as a deposit if it is allocated or appropriated against identified or specified goods or services within 365 days of acceptance. It is not necessary for the company to actually deliver the goods or services within 365 days. Moreover, a company may actually supply goods/materials/services ordered at its convenience as long as the advance received by it is set aside for such goods or services within 365 days.

- It is a trite law that an advance given for a particular purpose cannot be treated as a deposits. A mere monetary advance given without any purpose but intended to be refunded, with or without interest, would still be a deposit. However, if money is received as an advance against any purpose, it is an advance and not a deposit. Only advances that are received without any purpose will amount to a "deposit".

- As per the facts of the case, the fact is itself unconditionally admitted by the applicant that the advance was made towards the supply of various categories of aluminum foil papers.

- Having regard to the conspectus of facts and circumstances, the Tribunal was satisfied that the advance sum disbursed to the Respondent is appropriated for the supply of various categories of home foils in pursuance of which the goods were duly supplied to the Applicant.

- A mere perusal of the e-mail dated 28 November 2015, clearly mentioned that the advance money was already appropriated towards the Aluminum Foil as mentioned in the e-mail dated 28 November 2018.

- Hence, the said advance of ₹ 6,12,121/- could not be qualified to be a deposit under Section 2(31) of the Act read with Rule 2(1)(c)(xii)(a) of the Companies (Acceptance of deposits) Rules, 2014 and other relevant provisions of the act as the amount had been appropriated within a period of 365 days from the date of receipt of advance. Resultantly, the Company's petition stood dismissed.

SEBI

V. SHANKAR VS. SECURITIES AND EXCHANGE BOARD OF INDIA

Order of the Hon'ble Securities Appellate Tribunal in the matter of *V. Shankar vs Securities and Exchange Board of India.*

Background of the Case

V. Shankar ['Appellant'] was a Company Secretary in Deccan Chronicle Holdings Ltd ['DCHL'] for two years during 2009-2011. SEBI conducted an investigation in the script of DCHL. SEBI conducted an investigation in the scrip of DCHL and issued a show cause notice (SCN) to the Promoter director and Appellant on August 3, 2017 alleging that, the promoter director had **understated the outstanding loans** and interest in finance charges etc., in the annual reports for the year 2008-2009, 2009-2010 and 2010-2011 and being a signatory to the public announcement made by the company for the buyback of its equity shares without having adequate free reserves, Appellant had not exercised due diligence and care in authenticating public announcement of DCHL which lead to **misleading the investors/shareholders.**

Securities Exchange Board of India (SEBI) later held that the **company/promoters and directors had knowingly contributed in the dissemination of factually incorrect and distorted information relating to the annual financial statements of the company to the public in their annual reports**. SEBI found that the company carried out a buyback of its equity shares which were more than 25% of the total paid-up capital limit during the financial year 2011-2012 without having adequate free reserves and had thus misled the investors and shareholders about valuation and free reserves of the company. SEBI penalized DCHL, its directors, and promoters for violation of sections 68 and 77A of the Companies Act, 1956 read with Regulations 3 and 4 of the SEBI (PFUTP) Regulations, 2003 and Section 12A of the SEBI Act.

SEBI held that the Appellant liable for signing financial statements that were misleading. The appellant made an appeal to the Hon'ble Securities Appellate Tribunal against SEBI's adjudication order. Hon'ble Securities Appellate Tribunal vide its order dated November 1, 2022 reversed SEBI's order dated March 22, 2022, stating that the Appellant was not liable for the misrepresentation of financial information leading to misleading investors or for re-examining the veracity of certified accounts and that his responsibility was to only comply with Regulation 19 (3) of SEBI (Buyback of Securities) Regulation, 1998. Against this order of Hon'ble Securities Appellate Tribunal dated November 1, 2022. SEBI appealed to the Hon'ble Supreme Court, seeking to reinstate its original decision.

Hon'ble Supreme Court held as follows, "*Regulation 19(3) of the SEBI (Buyback of Securities) Regulations 1998 requires the company to nominate a compliance officer and an investors' service centre. The purpose of the nomination is twofold, namely (i) to ensure compliance with the buyback Regulations; and (ii) to redress the grievances of investors. There is a patent error on the part of the Tribunal in interpreting the Regulations. The Tribunal held that the role of the respondent, who was a Company Secretary, compliance officer, was limited to redressing the grievances of investors. In arriving at the finding, the Tribunal relied upon the latter part of Regulation 19(3) which dealt with redressal of the grievances of investors. The crucial point*

which had been missed by the Tribunal was that the compliance officer was also required to ensure compliance with the buyback regulations. Since the interpretation which had been placed by the Tribunal on the interpretation of 19(3) was contrary to the plain terms of Regulation 19(3), SAT impugned decision and remitted the proceedings back to the Tribunal for consideration of the facts afresh in the light of the interpretation which had been placed above on the provisions of Regulation 19(3)". The matter was again heard by SAT and SAT vide its order dt: May 5, 2025, exonerated the Appellant from the charge of misleading investors due to lack of doing due diligence.

Charges levied

Violation of section 68, 77A of Companies Act, 1956; section 12(a), (b)and (c) of SEBI Act 1992 and regulation 3(a), (b), (c), (d); regulation 4(1), (2), (f), (k) and (r) of SEBI (PFUTP) regulations, 2003 under section 15HA of SEBI Act.

Argument of the Appellant

- **Scope of Compliance Officer's Duty:** The appellant contended that his role as a Compliance Officer was to ensure procedural compliance and disclosures, not necessarily to independently verify the veracity of the company's financial accounts, especially those certified by statutory auditors. He contended that his role was to ensure timely filings and adherence to stipulated procedures for buyback, not to re-examine the accuracy of the underlying financial data that would typically be certified by auditors.

- **"Officer in Default" Definition:** The appellant's counsel delved into the definition of "Officer in Default" under Section 5(f) of the Companies Act, 1956. They argued that for a person to be held liable under this definition, they must be "charged by a Board with the responsibility of complying with that provision." In this case, for a Section 77A violation (buyback), the Appellant disputed that he was not specifically charged with the responsibility of verifying the company's reserves or the accuracy of its financial position relevant to the buyback.

- **Reliance on Certified Accounts:** Appellant argued that Company Secretary or Compliance Officer would typically rely on the audited or certified accounts provided by the finance department or statutory auditors for compliance purposes, especially concerning financial positions like free reserves.

- **Reliance on Oversight Mechanisms:** Mr. Shankar asserted that he was entitled to rely on the multiple tiers of oversight over the financial statements by competent bodies entrusted with this duty under the Listing Agreement. These included the Audit Committee, the Board of Directors, the statutory auditors, and the CEO/CFO. He argued that his role as Company Secretary did not extend to independently verifying the accuracy of the financial statements that had already been vetted by these higher authorities.

- **Limited Role in Buyback Process:** The appellant contended that his role in the buyback offer was limited to authenticating the contents of the balance sheet and the offer document, once approved by the Board of Directors. He argued that he was not required to inquire into the veracity of the buyback offer documents or its legal compliances before authenticating and signing them. He distinguished his role from that of

a Merchant Banker, who is specifically required to vet the disclosures related to buybacks.

- **No Independent Duty to Verify Financials:** Mr. Shankar argued that as a Company Secretary, his primary duty was related to compliance and secretarial functions, not the independent verification of the financial soundness or accuracy of the financial statements, which is the responsibility of the Board and the auditors.

- **Distinction from Promoters/Directors:** He emphasized that the primary responsibility for the accuracy of financial statements and the legality of corporate actions like buybacks lies with the promoters and directors who are involved in the decision-making process and have a deeper understanding of the company's financial affairs.

- **Regulation 19(3) of SEBI (Buyback of Securities) Regulations, 1998:** The appellant likely argued, as later noted by the Supreme Court in SEBI's appeal, that Regulation 19(3) which requires the company to nominate a compliance officer, should be interpreted in the context of ensuring compliance with the buyback regulations and redressing investor grievances, and not as imposing a duty to independently verify the financial basis of the buyback

SEBI's Arguments before Hon'ble Securities Appellate Tribunal

- **Reliance on certified accounts:** SEBI argued that V. Shankar, as the Company Secretary and a signatory to the public announcement for the buyback, had a duty to diligently examine liabilities when concerned with the buyback, even when relying on unaudited results. SEBI implied that V. Shankar should have known about the NCDs/loans, which would have been in DCHL's books, regardless of the accounts being certified.

  SEBI also contended that V. Shankar's claim of not attending Board Meetings where accounts were approved and not being invited to meetings was contradicted by his admission in reply to the SCN that he "assisted the conduct of the board of director meeting," suggesting he had a role in the process.

- **Scope of compliance officer's duty**: SEBI emphasized that V. Shankar's role as a Compliance Officer under Regulation 19(3) of the Buyback Regulations obligated him to ensure compliance with the buyback regulations, not just to redress investor grievances.

  SEBI maintained that he was obligated to diligently examine liabilities when concerned with the buyback based on unaudited results and that his argument of not being in charge of accounts was irrelevant as he had a duty to check NCDs/loans when signing the public announcement. According to SEBI, Sections 77A read with Section 5 of the Companies Act, 1956, and Regulation 19(3) and (8) of the Buyback Regulations made him responsible for ensuring compliance.

- **"Officer in Default" Liability:** SEBI argued that V. Shankar's failure to follow basic aspects of his role, given his experience, indicated active involvement in the fraud. Knowledge of loans taken would be known to a Company Secretary through preparing Board Minutes and maintaining the Register/Index of Debentures. SEBI concluded that

V. Shankar was equally liable for the fraudulent Public Announcement and his actions indicated willful default, making him an "Officer in Default." SEBI's case against V. Shankar primarily rested on the contention that he, as the Compliance Officer and Company Secretary, was an "Officer in Default" under the Companies Act, 1956, and thus liable for the company's alleged violations related to a buyback scheme.

Hon'ble Securities Appellate Tribunal Findings and Reasoning

Hon'ble Securities Appellate Tribunal thoroughly examined the AO's order and V. Shankar's arguments.

- **Lack of Specificity in Charges:** Hon'ble Securities Appellate Tribunal found that SEBI's charges against V. Shankar were not "clear and unambiguous." It noted that SEBI merely stated the Appellant was a signatory and "misled the investors" without pointing out any specific action or violation on his part. The Hon'ble Securities Appellate Tribunal stressed that a clear charge is essential when consequences are likely to be met.

- **Unfounded Presumption:** The Hon'ble Securities Appellate Tribunal critically analyzed the SEBI adjudicating officer's presumption that the Company Secretary/Compliance Officer "ought to have re-examined the veracity of the certified accounts." Hon'ble Securities Appellate Tribunal unequivocally held that "Such a presumption is without any legal foundation and therefore the impugned order is unsustainable in law." This is a key ruling, delineating the scope of a Compliance Officer's responsibility and pushing back against an overly broad interpretation of their duties to scrutinize audited financials.

- **Interpretation of "Officer in Default":** While the Hon'ble Securities Appellate Tribunal acknowledged Section 5(f) of the Companies Act, it implicitly upheld the principle that liability as an "Officer in Default" requires being "charged by a Board with the responsibility of complying with that provision." The AO's order failed to establish this specific responsibility for V. Shankar in the context of the alleged financial irregularities related to the buyback's accounting aspects.

The Hon'ble Securities Appellate Tribunal allowed the appeal and set aside the order dated March 22, 2022, passed by the Adjudicating Officer of SEBI. ■

"All differences in this world are of degree,
and not of kind, because oneness is the secret of everything."

Swami Vivekananda