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LEX NOVUS
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GURUGRAM ▪ MUMBAI

October - December 2017

EDITORIAL

On behalf of the entire team of SB Partners, here's wishing you a very Happy New Year!

In the last quarter, the notable highlight has been the amendment of the Insolvency and Bankruptcy Code, 2016 ("**Code**"), in terms of which, promoters of stressed companies are not allowed to bid for their own assets. In addition to the aforesaid, the Code is now also made applicable to partnership firms, proprietorship firms, personal guarantors, and other individuals.

In another important development in Insolvency law, the National Company Law Tribunal ("**NCLT**") has held that a discretion is given to the Adjudicating Authority to approve the Resolution Plan and that the requirement of obtaining consent of 75% of the Committee of Creditors is not mandatory.

In addition to the foregoing, this issue of 'Lex Novus' also focuses on other key regulatory developments in the previous quarter in the spheres of Banking and Finance, Capital Markets and Corporate Laws, which includes the formulation of new rules and regulations such as the Companies (Registered Valuers and Valuation) Rules, 2017, and the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017.

We hope you find this edition of *Lex Novus* informative and insightful.

IN THE NEWS

RBI GUIDELINES

- **NEW REGULATIONS FOR INVESTMENT BY PERSONS RESIDENT OUTSIDE INDIA**

The Reserve Bank of India ("**RBI**") vide notification dated November 07, 2017 has introduced the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 ("**Regulation**"). The same have been released in suppression of notification no. FEMA 20/2000-RB and notification no. FEMA 24/2000-RB dated May 03, 2000.

The aforesaid Regulation contains various provisions, *inter alia*, pertaining to investments by persons resident outside India, such as restrictions on receiving investment; permission for making investment(s); acquisition of shares; issue of shares or convertible notes; pricing guidelines; taxes and remittance of sale proceeds; reporting requirements and prohibited activities.

A few salient features include:

(a) *Permission for making investment by a person resident outside India:*
Any such investment shall be subject to entry routes, sectoral caps, or investment limits. Investment by a Foreign Portfolio Investor, an Overseas Citizen, a Foreign Venture Capital Investor, a citizen of Bangladesh or Pakistan, an entity incorporated in Bangladesh or Pakistan, etc., is permitted subject to certain restrictions and compliances.

(b) *Reporting Requirements:*
Reporting of investment in India by a person resident outside India shall be made in forms such as ARF, FC-GPR, FLA, FC-TRS, ESOP, DRR, CN, etc.

(c) *Prohibited Activities:*
Investment by a person resident outside India is prohibited in:

(i) Lottery business including Government/ private lottery, online lotteries;

(ii) Gambling and betting including casinos;

(iii) Chit funds;

(iv) Nidhi Company;

(v) Trading in Transferable Development Rights;

(vi) Real estate business or construction of farm houses;

(vii) Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes;

(viii) Activities/ sectors not open to private sector investment, e.g. (a) Atomic energy and (b) Railway operations; and

(ix) Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract for lottery business and gambling and betting activities.

(d) *Taxes and Remittance of Sale Proceeds:*
All transactions shall be undertaken through banking channels in India and subject to payment of applicable taxes and other duties/ levies in India. Further, any remittance of sale proceeds of an Indian security held by a person resident outside India shall only be made in accordance with the Regulation and conditions specified in respect thereto.

- **ARC'S EXEMPTED TO HOLD MINIMUM 26% SHAREHOLDING IN BORROWER COMPANIES**

Under the Securitization Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 ("Guidelines"), every Reconstruction Company ("**RC**") is required to frame a policy, duly approved by its board of directors for conversion of debt into shares of the borrower company. The shareholding of the RC as per Guidelines shall not exceed 26% of the post converted equity of the borrower company.

RBI pursuant to its circular dated November 23, 2017 has now exempted Asset Reconstruction Companies ("**ARCs**") from the requirement of holding minimum 26% shareholding in any company, subject to the following conditions:

(a) The ARC has a minimum of Rs. 100 Crores as 'net owned funds' on an ongoing basis;

(b) At least half of the board of directors of such ARC comprises of independent directors;

(c) The board of directors of the ARC has adopted a policy for conversion of debt into equity; and

(d) The equity shares acquired by the ARC are valued on a monthly basis.

The extent of shareholding post conversion of '*debt*' into '*equity*' shall be in accordance with the Foreign Direct Investment limit, applicable to any specific sector.

BANKING AND FINANCE

- **INSOLVENCY AND BANKRUPTCY CODE AMENDED**

With an aim to further strengthen the insolvency resolution process, the Insolvency and Bankruptcy Code ("**Code**") has been amended by way of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, dated November 23, 2017 ("**Ordinance**"), to inter alia, include prohibition on certain persons from submitting resolution plans, who on account of their antecedents, may adversely impact the credibility of the insolvency resolution process.

The salient features of the Ordinance are as follows:

(a) A new Section 29A has been inserted which makes the following persons ineligible to submit a resolution plan for any company, if such person, or another person jointly with such person, or any person who is a promoter or in the management or control of such person:

(i) is an un-discharged insolvent;

(ii) is a wilful defaulter in accordance with the RBI guidelines;

(iii) whose account is classified as a non-performing asset ("**NPA**") for one year or more and has failed to make payment of overdue amounts including interest thereon and charges relating to the NPA before submission of the resolution plan;

(iv) has been convicted of an offence punishable with imprisonment for two (2) years or more;

(v) has been disqualified to act as director under the Companies Act, 2013;

(vi) has been prohibited by SEBI from trading in securities or accessing the securities market;

(vii) has indulged in preferential transaction or undervalued transaction or fraudulent transaction in respect of which an order has been made by the adjudicating authority under the Code;

(vii) has executed an enforceable guarantee in favour of a creditor, in respect of a corporate debtor undergoing a corporate insolvency resolution process or liquidation process under the Code;

(ix) any connected person who meets any of the criteria mentioned above. Connected person means a promoter or one in management or control of the resolution applicant, or a person who shall be the promoter or in management or control of corporate debtor during the implementation of the resolution plan, or the holding company, subsidiary company, associate company or related party of the above referred persons.

(b) Any resolution plan submitted before the Ordinance came into effect shall come under the purview of Section 29A and if a resolution applicant is ineligible under Section 29A to submit such resolution plan, that resolution plan shall be rejected, and where no other resolution plan is available, the resolution professional shall be required to invite a fresh resolution plan.

(c) The scope of the Code has been expanded to now include personal guarantors to corporate debtors, partnership firms and proprietorship firms, and individuals other than personal guarantors.

(d) The Ordinance amends Section 25(2)(h) to invite prospective resolution applicants to submit resolution plans provided they fulfill the criteria laid down by the resolution professional with the approval of the Committee of Creditors ("**CoC**"). Further, Section 30(4) of the Code has been amended to explicitly obligate the CoC to consider feasibility and viability of the resolution plan in addition to such conditions as may be specified by the Board before approving any resolution plan.

(e) The Ordinance amends the definition of '*Resolution Applicant*' to mean a person who individually, or jointly with any other person, submits a resolution plan to the resolution professional pursuant to an invitation made by the resolution professional under Section 25(2)(h) of the Code.

(f) The liquidator is now restrained from selling property of the corporate debtor to any person who is ineligible to be a 'resolution applicant' pursuant to Section 29A of the Code.

- **INSOLVENCY RESOLUTION PROCESS FOR CORPORATE PERSONS AMENDED**

The Insolvency and Bankruptcy Board of India ("**IBBI**"), vide Notification dated December 31, 2017, has amended the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("**Regulations**").

Following are the notable amendments to the Regulations:

(a) The definition of dissenting financial creditor has now been amended to mean a financial creditor who voted against the resolution plan or abstained from voting for the resolution plan, approved by the committee.

(b) Regulation 35 of the Regulations, dealing with Liquidation Value now mandates that the resolution professional shall provide the liquidation value to every member of the committee in electronic form. Further, each member, interim resolution professional and resolution professional are required to keep such liquidation value confidential and not use such information to cause an undue gain or undue loss to itself or any other person.

CAPITAL MARKETS

• MORE ENTITIES PERMITTED TO ISSUE DEBT SECURITIES UNDER THE IFSC GUIDELINES

The Securities and Exchange Board of India (International Financial Services Centres) Guidelines, 2015 ("**Guidelines**"), have been formulated with a view to facilitate and regulate financial services relating to securities market in an International Financial Services Centre set up under the Special Economic Zones Act, 2005.

Under the Guidelines, a company incorporated in India and a company incorporated in a foreign jurisdiction are eligible to issue debt securities.

SEBI has now amended the definition of Issuer, pursuant to its notification dated November 14, 2017, to mean:

(a) A new Section 29A has been inserted which makes the following persons ineligible to submit a resolution plan for any company, if such person, or another person jointly with such person, or any person who is a promoter or in the management or control of such person:

(b) an entity incorporated in a foreign jurisdiction, provided such entity is permitted to issue securities outside the country of its incorporation or establishment or place of business as per the laws and regulations of its country of incorporation, jurisdiction or its constitution; or:

(c) any supranational, multilateral or statutory organization/institution/agency provided such organization/institution/agency is permitted to issue securities as per its constitution.

• REPORTING REQUIREMENTS FOR FPI INVESTMENT IN HYBRID SECURITIES

SEBI vide its circular dated November 15, 2017 has now introduced a new category of reporting for investments by foreign portfolio investors ("**FPI**") in hybrid securities.

Earlier, FPI investments were classified as either '*debt*' or '*equity*' depending on the type of the security in which the FPIs transacted. Now, FPIs are permitted to invest in REITs and InvITs, which are classified as hybrid securities.

The aforesaid hybrid securities were not reflected in the daily FPI net investment data or the monthly/fortnightly FPI Assets Under Custody data. Therefore, a third category termed as "Hybrid Security" has now been created for the purpose of capturing and disseminating FPI investment data in hybrid securities.

SEBI has further required the depositories (NSDL and CDSL) to put in place necessary systems for the daily reporting by the custodians of the FPIs and disseminate on their websites, the value of assets (in form of debt, equity and hybrid securities) under control by FPIs.

CORPORATE LAWS

• SHAREHOLDERS' APPROVAL NOT REQUIRED FOR SANCTION OF RESOLUTION PLAN UNDER THE INSOLVENCY AND BANKRUPTCY CODE

Under the Insolvency and Bankruptcy Code, 2016 ("**Code**"), the resolution professional is required to examine each resolution plan and confirm that such plan does not contravene any applicable law in force. Further, Section 31(1) of the Code states that if the Adjudicating Authority is satisfied that if any '*resolution plan*' as approved by the committee of creditors is in compliance of applicable law, it shall by order approve such resolution plan which shall be binding on the

corporate debtor and its employees, members, creditors, guarantors and other stakeholders involved in the resolution plan.

Clarifications have been sought by stakeholders on whether approval of '*shareholders*' of the corporate debtor is required for a resolution plan at any stage during the process of its consideration as laid down under Sections 30 and 31 of the Code.

It has been clarified by the Ministry of Corporate Affairs ("**MCA**") vide the circular dated October 25, 2017, that there is no requirement of obtaining approval of shareholders of the corporate debtor, at the time of examination and finalization of the resolution plan, and on approval of the plan by the Adjudicating Authority.

- **COMPANIES (REGISTERED VALUERS AND VALUATION) RULES, 2017**

MCA has notified October 18, 2017, as the date on which the provisions of Section 247 of the Companies Act, 2013 ("**Act**") shall come into force.

In terms of the aforesaid Section 247, if the property, stocks, shares, debentures, securities or goodwill or any other assets ("**Assets**") or net worth of a company or its liabilities are required to be valued under the provision of the Act, it shall be valued by a person having such qualifications and experience and registered as a valuer in such manner, on such terms and conditions as may be prescribed and appointed by the audit committee or in its absence by the board of directors of such company.

The MCA has also notified the Companies (Registered Valuers and Valuation) Rules, 2017 ("**Rules**"), which will come into force retrospectively from October 18, 2017.

The salient features of the Rules are as follows.

(a) *Eligibility criteria for individuals:*

A person shall be eligible to be a registered valuer if he, inter alia, is

(i) a member of a Registered Valuers Organization ("**RVO**");

(ii) is recommended by the RVO of which he is a valuer member for registration as a valuer;

(iii) has passed the valuation examination within three years of the date of making an application for registration and possesses the qualifications and experience as specified in the Rules.

(b) *Eligibility criteria for partnership entities and companies:*

No partnership entity or company shall be eligible to be a registered valuer if:

(i) it has been set up for objects other than for rendering professional or financial services, including valuation services;

(ii) where such applicant is a company, it is not a subsidiary, joint venture or associate of another company or body corporate; or

(iii) if three or all the partners or directors, of the partnership entity or company, as the case may be, are not registered valuers.

(c) *Compliance with standards:*

The registered valuer shall comply with the valuation standards as per (i) internationally accepted valuation standards, and (ii) valuation standards adopted by any RVO. The Central Government is yet to notify the valuation standards.

(d) *Report of the valuer:*

The report of the valuer shall state matters such as background information of the asset being valued, inspections and/or investigations undertaken, procedures adopted in carrying out the valuation and valuation standards followed,

restrictions on use of the report, if any, and caveats, limitations and disclaimers to the extent they explain or elucidate the limitations faced by valuer. However, such limitations, caveats and disclaimers shall not limit his responsibility for the valuation report.

(e) *Penalty for contravention:*

If the valuer contravenes the provision of the Section or the rules made thereunder, the valuer shall be punishable with fine of Rs. 25,000 to Rs. 1,00,000. Further, if a valuer has been convicted, he shall be liable to refund the remuneration received by him to the company and pay for the damages to the company or to any other person for loss arising out of incorrect or misleading statements of particulars made in his report.

IN THE COURTS

- **CONSENT OF M AJORITY SHAREHOLDERS UNDER IBC NOT MANDATORY**

In the matter of *K. Sashidhar v. Kamineni Steel & Power India Pvt. Ltd.,* the Hyderabad Bench of National Company Law Tribunal ("**Tribunal**") on November 27, 2017, approved the resolution plan approved by only 66.67% of the Committee of Creditors ("**CoC**").

FACTS

Kamineni Steel & Power India Pvt. Ltd. ("**Corporate Debtor**") filed a company petition under Section 10 of the Insolvency and Bankruptcy Code, 2016 ("**Code**"), seeking to initiate corporate insolvency resolution process of itself.

The resolution professional conducted 9 meetings of the CoC, and after such meetings, the resolution plan was approved by only 66.67% of the CoC.

ISSUE

Whether it is mandatory to obtain 75% votes of the CoC, for approval of a resolution plan under the Code.

CONTENTION

It was the contention of the resolution professional that he had followed all extant provisions of the Code and thus the resolution was in accordance with law and that it may be approved by the Tribunal. The resolution professional gave the following reasons for his contention:

(a) The resolution professional relied on the observation of NCLT Mumbai Bench in the matter of Raj Oil Mills Ltd and Edelwise Asset Reconstruction Company Limited, wherein it observed that the use of the word '*may*' in Section 22 of the Code (appointment of resolution professional by CoC) had prescribed a jurisdiction to deal with the issue of percentage of voting share depending on the facts and circumstances of each case.

(b) Further, the resolution plan aimed to pay the operational creditors in a staggered manner after payment to financial creditors in the usual course of business.

(c) He also contended that liquidation is a time consuming process and realization of assets will take 2-3 years, by which time the valuation will deplete and as per the opinion of majority lenders, it may not fetch more than the payment proposed to be made under the one time settlement envisaged under the resolution plan.

(d) Further, the dissenting financial creditors shall be paid pursuant to Regulation 38(c) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016.

HELD

The Tribunal held that the requirement of obtaining 75% votes of the CoC is not mandatory, and the Tribunal gave the following reasons:

(a) In the Code, at various places the words "*may*" and "*shall*" are used. Section 30(4) states that the CoC may approve the resolution plan by a vote of not less than 75% of voting shares of the financial creditors. Further, under Section 31 it is provided that "*if the adjudicating authority is satisfied …*" Therefore, even though the CoC may approve a resolution plan with not less than 75% of the voting share, a discretion is given to the Adjudicating Authority to approve the Resolution Plan.

(b) The Tribunal was of the view to approve the resolution plan since a majority of the lenders had approved the plan. Further, Section 30(4) merely states that the resolution plan may be approved by a vote of *not less than 75%*. Since the Code is a new legislation, the percentage has to be read with various circulars issued by Reserve Bank of India ("**RBI**").

OBSERVATION

The Tribunal observed that:

(a) The adjudicating authority cannot act mechanically and can't assess the threshold of 75% of the voting shares based on arithmetic calculations and it has to take into consideration various circulars/guidelines issued by RBI from time to time and social obligations cast on government to create employment. The Tribunal observed that it is its duty to examine the issue in a macro perspective so as to balance the interest of all stakeholders such as employees, creditors, economy, rural development. Maximization of value of assets and balancing interest triumphs over liquidation and recovery.

(b) The main preamble of the Code is resolution of corporate debtor rather than liquidation. The functioning of the three dissenting banks prima facie does not adhere to preamble of the Code and initiatives of government/RBI in restructuring bad loans.

(c) A paramount duty is cast upon the adjudicating authority that while approving the resolution plan, the authority has to exercise his judicious mind in the facts and circumstances of a specific case.

- **MORATORIUM UNDER IBC NOT APPLICABLE IF PROCEEDINGS DO NOT ENDANGER CORPORATE DEBTOR'S ASSETS**

In the matter of *Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd.,* the High Court of Delhi ("**Court**"), on December 11, 2017, held that proceedings under Section 34 of the Arbitration and Conciliation Act, 1996 ("**Act**"), for setting aside the arbitral award (in the nature of a money decree) passed in favour of the corporate debtor by the arbitral tribunal did not attract the provisions of Section 14 of the Insolvency and Bankruptcy Code, 2016 ("**Code**").

FACTS

An arbitral award in the nature of a pure money decree was awarded in favour of Jyoti Structures Ltd. ("**Corporate Debtor**"), in a dispute between the Corporate Debtor and Power Grid Corporation of India Ltd. ("**Petitioner**"). Subsequently, the petitioner filed a petition challenging the award under Section 34 of the Act.

During the pendency of the proceedings under Section 34 of the Act, an application was filed by a financial creditor of the Corporate Debtor under Section 7 of the Code, before the National Company Law Tribunal, Mumbai ("**NCLT**"), seeking initiation of the corporate insolvency resolution against the Corporate Debtor and by an order dated July 04, 2017, the NCLT admitted such application and declared a moratorium in terms of Section 14 of the Code.

ISSUE

Whether the petition challenging the award is liable to be stayed on account of the moratorium declared under Section 14(1)(a) of the Code.

CONTENTION

The Corporate Debtor contended that if the proceedings were stayed, the Corporate Debtor would be unable to execute the award given in its favour for an extended period till the moratorium exists and would be unable to recover its dues.

HELD

The Court held that the proceedings before it under Section 34 of the Act would not be hit by the embargo of Section 14(1)(a) of the Code for the following reasons:

(a) Proceedings do not mean '*all proceedings*';

(b) Moratorium under Section 14(1)(a) of the Code is intended to prohibit debt recovery actions against the assets of corporate debtor;

(c) Continuation of proceedings under Section 34 of the Act which do not result in endangering, diminishing, dissipating or adversely impacting the assets of corporate debtor are not prohibited under Section 14(1)(a) of the Code;

(d) The use of narrower term '*against the corporate debtor*' in Section 14(1)(a) makes it evident that Section 14(1)(a) is intended to have restrictive meaning and applicability;

(e) The Act draws a distinction between proceedings under Section 34 (objections to the award) and under Section 36 (enforceability and execution of the award). The proceedings under Section 34 are a step prior to the execution of an award. Only after determination of objections under Section 34, the party may move a step forward to execute such award and in case the objections are settled against the Corporate Debtor, its enforceability against the Corporate Debtor shall be covered by moratorium of Section 14(1)(a) of the Code.

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