LEY BOLETIN

New Bankruptcy Ordinance: Preventing 'Willful Defaulters' from chasing their own assets – Pros & Cons!

Introduction

Insolvency and Bankruptcy Code, 2016 (**Code**) was enacted when public sector banks and financial institutions in India were helpless chasing their over-stressed accounts in largely protracted legal battles. Some of the recent statistics suggests that the total stressed loans which also include non-performing assets and standard assets are currently growing at an alarming rate and the situation could worsen further by March 2018.

In the midst of rising stressed loans in banking system which poses a systemic risk to the country's economic growth and the concerns that a defaulting promoter could grab back control of the company that is under insolvency at the cost of banks taking a severe haircut, the Union Government on November 23, 2017 amended the Code by pronouncing the Bankruptcy Code (Amendment) Ordinance, 2017 (**Ordinance**). The Ordinance amends various sections of Code and inserts two new provisions in terms of Sections 29A and Section 235A respectively providing the eligibility criteria for a 'resolution applicant'. Resolution applicant is the person who proposes an insolvency resolution plan in a bankruptcy scenario. The Ordinance also provides a monetary penalty for violating the provisions of the Code where no specific penalty has been prescribed.

Purpose

The primary purpose of the Ordinance is to prevent certain categories of persons including the promoters of defaulting companies going through insolvency proceedings and their holding companies, subsidiaries and associate or related parties to be a 'resolution applicant' who are (a) undischarged insolvent; (b) has been a willful defaulter under the RBI guidelines; (c) being convicted for any offence bearing punishment exceeding two years; (d) disqualified directors under the companies act; (e) who have their accounts classified as non-performing for a year or more as per the RBI framework; or (f) those who have provided guarantee in respect of a corporate debtor under the bankruptcy resolution or liquidation process initiated as per the Code.

The Ordinance specifically empowers the Committee of Creditors or COC to reject a resolution plan, which is submitted before the pronouncement of Ordinance but is yet to be approved and where the resolution applicant is not meeting the test of eligibility criteria stated above. Further, the Ordinance expressly prohibits sale of any immovable property, movable property and actionable claims of the corporate debtor by a liquidator to any person who is not eligible to be a resolution applicant. Thus idea is to prohibit fraudulent and dishonest promoter and their connected persons or entities from participating in the insolvency resolution process.

Implications - Pros & Cons

The key objective of Ordinance is to put in place appropriate safeguards to prevent the promoters who are willful defaulters from misusing the Code for personal gains. The Ordinance provides for a robust diligence framework enabling the COC to make proper assessment of the solvency, integrity and credibility of a resolution applicant before approving a resolution plan keeping in view the scale, complexity, viability and feasibility of a resolution plan to avoid entry of frivolous applicants. Approval of any insolvency resolution plan by COC now requires 75 percent voting consent of the financial creditors. In this regard, recent decisions of Hyderabad and Mumbai bench of NCLT respectively are notable. The Hyderabad bench in November last month in [1]*K. Sashidhar v. Kamineni Steel & Power India Pvt. Ltd.* held that while exercising its discretion NCLT being the adjudicating authority has power to approve the resolution plan even though it had received the support of less than 75% of the financial creditors in value; on the other hand Mumbai bench in [2]*ICICI Bank Limited v. Innoventive Industries Limited* questioned the jurisdiction of NCLT in interfering a decision taken by the COC. The stand taken by Mumbai bench appears to be more rationalistic due to the literal as well as the purposive intent behind the legislation. Besides, the Ordinance aims to protect the insolvency

[1] http://nclt.gov.in/Publication/Hyderabad_Bench/2017/Others/285.pdf
[2] http://nclt.gov.in/Publication/Mumbai_Bench/2017/Others/2053.pdf

resolution process from any impurity or intoxication which had recently been seen in the matter of *Synergies Dooray* where the corporate debtor company got merged with a related party while Edelweiss ARC as a lender undertook nearly a 95% haircut on its recovery. The Ordinance prescribes penalty for violation of the Code which will ultimately prove to be a deterrence for frivolous applicants participating in the resolution process.

Whilst the Ordinance calls for a stringent examination on defaulters and non-compliant participants, there are few serious concerns on the adverse economic implications of Ordinance. To a large extent the Ordinance makes process to qualify as a resolution applicant arbitrary in the hands of the lenders even though they are mandated to follow the RBI guidelines for such determination. Due to its stringent qualifying criteria, the Ordinance disqualifies majority of the domestic and international aspirants from participation in the bidding process. This has the potential to further weaken an already depressed financial value of any resolution plan. Also, lack of clarity on retrospective or prospective implementation of the Ordinance brings substantial procedural uncertainty in the resolution process and makes it a subject matter of long drawn court battles and disputes between the parties. There are serious concerns in qualification criteria for bidders from foreign jurisdiction where the comprehensive eligibility conditions prescribed under the Ordinance may not be existing at all. The Ordinance eliminates a fundamental aspect that the promoter being the owner knows the real value of his business and if assets are sold to the same promoter, then they will generate higher value for the lenders compared to a new bidder who may consider it to be an unknown asset and therefore a risky proposition desiring a higher discount. The Ordinance also ignores the fact that every promoter may not be a willful defaulter or fraudster and a non-performing asset may be the end result of cyclical nature of business, market situation, government policies or for the reasons which are beyond any promoters' control.

Conclusion & the Way Forward

The Code is still at the nascent stage and will need suitable adaptations before it gradually settles down. The basic premise on which the Code is designed is to distinguish genuine business failure from willful default or fraud, as all business failures are not fraud. The preamble of the Code suggests that its purpose is to maximize value of assets of insolvent persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders. The Ordinance goes against this principle by viewing the business failure and fraud with the same lenses. The need of hour is to define the term willful default and fraud in a scientific manner. Hopefully these concerns will be addressed, once the Ordinance is tabled in the ongoing winter session of the parliament.

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Oppression and Mismanagement - Does the law need a revamp?

Sudden ouster of Mr. Cyrus Mistry late last year as the Chairman of Tata Group and the subsequent oppression and mismanagement petition filed by the Mistry group against the Tatas before NCLT has brought into foray, the intense debate and interpretative approach towards provisions dealing with oppression and mismanagement under the statute, i.e. Sections 241, 242 and 244 of the Companies Act, 2013 ('**Act**'). The Mumbai bench of National Company Law Tribunal ("**NCLT**") had dismissed the petition and also the Mistry Group's request for a waiver of the shareholding requirement to bring in the suit of oppression and mismanagement against Tata Sons. Further, on appeal by Mistry Group before National Company Law Appellate Tribunal ("**NCLAT**"), NCLAT ruled that Mistry Group's petition did not meet the requirements of maintainability under section 244 of the Act, however, it exercised its discretionary power to grant a waiver on certain "exceptional circumstances", and allowed the action to proceed on its merits before the NCLT.

The surrounding legal provisions of the Act on this aspect suggest that any member of a company can make an application for seeking relief to the NCLT in case of oppression and mismanagement, subject to certain prescribed eligibility criteria. Law prescribes that in case of a company having a share capital, at least one hundred members or members constituting one-tenth of total number of its members, whichever is less, or members holding at least 10% of issued share capital of the company, can file an application with NCLT alleging oppression and mismanagement. NCLT is also empowered to grant waiver in case any of the above criteria are not met by the applicant. Moreover, the term 'share capital' under the Act includes both equity and preference share capital.

Just to recap, in Tata-Mistry tussle, the Mistry group held 2.17% of the total issued share capital of Tata Sons Limited, which was equivalent to 18.37% of the equity share capital of the company. Moreover, the Mistry Group comprised two members out of a total of 51 members in the company. The crux of the issue was whether the 10% requirement stipulated in the Act ought to have been satisfied by taking into account the entire issued share capital of the company (comprising of both equity and preference) in which case the Mistry Group falls below the threshold, or whether it should take into account only the equity share capital of the company (in which case the Mistry Group satisfies the requirement).

On this issue, both NCLT and NCLAT provided a literal and narrow interpretation to the eligibility criteria, and held that the scope of expression "issued share capital of the company" ought to take into account both equity and preference shares. However, on the issue of grant of waiver, NCLAT exercised its judicial discretion liberally since the Act was silent on this aspect; it gave due importance to the fact that in the concerned case, only two shareholders strictly met the shareholding qualifications and the Mistry Group's interests in Tata Sons was enormous in monetary terms, and hence, such petition should not be rendered as frivolous. NCLAT observed that it would be unfair and inequitable to rule Mistry Group's petition non-maintainable on the shareholding linked eligibility criteria, and thereby it qualifies to be "exceptional circumstances".

On analysing the orders passed by both NCLT and NCLAT, an argument may be made that the existing legal provisions surrounding oppression and mismanagement warrants a serious revisit. While certain numerical threshold may be required to prevent frivolous lawsuits that may be brought by resentful shareholders, thereby hindering the day to day operations of a company, however, an intelligible differentiation should be created considering the nature and class of shareholders as opposed to treating all members on the same footing. Such demarcation is also essential to mitigate the scope of judicial discretion by tribunals on grant of waiver, thereby making the position of law more exhaustive and less ambiguous in future.

In this context, reference may be made to Indian Accounting Standard (IndAS) 32, which construes preference shares as debt, unless they are compulsorily convertible. The rationale behind such specification is that as long as such shares are not converted or convertible into equity shares, the holders of such shares stand in the same footing as that of other creditors since a fixed or assured

return shall be distributed to such holder without him taking any equity risks in the company. This position is substantially different from that of equity shareholders who infuse funds in a company with no assured or fixed return and also carries equity risk. Hence, corporate governance matters and conduct of affairs of a company so as to allege any oppression or mismanagement are much more relevant and critical from an equity holder's perspective as opposed to holder of redeemable preference shares. Since the provisions in relation to oppression and mismanagement are provided to protect minority shareholders' interests against the brute force of majority, the law should be interpreted in a more beneficial manner against a strict literal, technical and narrow approach. Though it is a disquieting drift from the jurisprudential position vis-à-vis interpretation of a statute of this nature, the same may be warranted to curb abuse by majority shareholders and to provide a mechanism to minority shareholders to assert their rights against majority.

Thus, while prescribing the numerical threshold for maintainability of such petition, the redeemable preference shares should be kept out of the equation and should not be construed as share capital, since they do not have an intrinsic interest in day to day affairs of the company. Otherwise, the very purpose of protecting minority in the company will become redundant. Having such a literal interpretation may lead to a conflicting or absurd situation sometime, when an equity holder holding 26% of equity shares can block special shareholder resolutions (those requiring consent of more than 75% of equity holders) wherein such resolutions are significant vis-à-vis constitution/restructuring of a company and crucial corporate governance matters, he cannot seek relief for oppression and mismanagement in case affairs of a company are conducted prejudicial to its interests.

Moreover, there is a conscious departure in the legislative intent of Companies Act, 1956 which only addressed public interest or interest of the company while assessing a claim of oppression and mismanagement; however, the Companies Act, 2013 expands the scope of such assessment to any class of shareholders, debenture holders and creditors and so the threshold of 10 % should also be looked at from this aspect.

Though the law seeks to obtain an appropriate balance between minority protection and the avoidance of frivolous or vexatious litigation, the construct of numerical shareholding threshold in case of oppression and mismanagement should be revisited in order to protect the genuine interests of minority shareholders against the tyranny of majority. Till the time the legislature brings such reforms in the present laws, the tribunals shall have the onus to direct the jurisprudence towards a more balanced approach.

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New FDI Regulations - Key Changes Impacting Stakeholders

The Reserve Bank of India ("**RBI**") vide its notification dated November 7, 2017 has taken another step to simplify one of the most seminal regulations governing foreign investment in India namely Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 ("**New FEMA Regulation**"). Summarized below are key changes introduced by the New FEMA Regulation which may have lasting impact on the various stakeholders.

1. *Capital Vs Capital Instruments - anomaly removed*. Under Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ("**Erstwhile FEMA Regulation**") the term 'capital instrument' was not defined. *Instead,* the Erstwhile FEMA Regulation referred to the term 'capital' which always meant equity shares, preference shares, convertible preference shares and convertible debentures, however, excluded share warrants from its ambit. On the other hand, the Consolidated FDI Policy of 2017 issued by Department of Industrial Policy and Promotion, Government of India on August 28, 2017 ("**FDI Policy**"), included 'warrants' as part of definition of term 'capital'. Therefore, some sort of uncertainty prevailed in usage of term 'capital'. The New FEMA Regulation has overcome this anomaly by expressly defining the term 'capital instruments' including the term 'share warrants' issued by an Indian company within the said definition.

2. *Can share warrants be issued by only listed companies to a foreign investor*? The Erstwhile FEMA Regulation and FDI Policy, had suggested an inclusive definition of 'warrant' which always meant share warrants issued by an Indian company in accordance with the provisions of the Companies Act, 2013. However, the New FEMA Regulation defines the term 'share warrants' to mean those issued by an Indian company in accordance with the regulations issued by the Securities and Exchange Board of India ("**SEBI**"). Interestingly, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 governs the issuance of share warrants issued or to be issued by listed Indian companies. Therefore, going by the stricter interpretation of the definition of 'share warrants' as referred in the New FEMA Regulation, it appears that now only listed Indian companies may issue share warrants to a person resident outside India or non-resident. A clarification on this aspect of new law by RBI may be warranted.

3. *FDI Vs FPI – Reclassification.* One of the most pivotal change brought out by the New FEMA Regulation is the distinction laid out between the type of investment made by non-resident namely Foreign Direct Investment ("**FDI**") and Foreign Portfolio Investment ("**FPI**"), a change suggested in Dr. Arvind Mayaram Committee's report in June 2014. The said report characterized FDI as sort of lasting interest or a long term relationship having significant degree of influence. The said report suggested that typically, ownership of 10 percent or more of the ordinary shares / voting power signifies this relationship. On the other hand, FPI is characterized by portfolio investment that is distinctive from FDI because of the nature of the funds raised, representing largely anonymous relationship between the issuers and holders, and the degree of trading liquidity in the instruments.

New FEMA Regulation has implemented the key recommendations made in the said report. The New FEMA Regulation now defines the term 'FDI' to mean investment through capital instruments by non-resident (i) in an unlisted Indian company; or (ii) in 10% or more of the post issue paid up equity capital on a fully diluted basis of a listed Indian company. However, the said definition is prospective in nature and does not apply to existing FDI investments which do not meet the 10% threshold as per the aforesaid definition. On the other hand, term 'FPI' has now been defined to mean any investment made by non-resident through capital instruments only pertaining to listed Indian companies and where such investment is less than 10% of the post issue paid-up share capital on a fully diluted basis or less than 10% of the paid up value of each series of capital instruments of such listed Indian company.

Therefore, in case of a listed Indian company, if the foreign investment is made within the aforesaid limit of

less than 10% then, the said investment will be termed as FPI and if the said foreign investment exceeds to 10% or more then, the same FPI will be re-classified as FDI and all provisions as applicable to FDI will be applicable on such foreign investment including the reporting requirements as applicable to an Indian company for FDI investment in FC-GPR. Therefore, it appears that non-resident may hold foreign investment in a particular Indian company either as FDI or FPI (but not both). Conversely, it also suggests that FDI investor who proposes to invest less than 10% in a listed Indian company can make such investment only as FPI investor and thereby it may need to seek FPI registration with SEBI before making such investment. A clarification on this aspect of new law by RBI is desirable.

4. *Can right shares be issued by an unlisted Indian company to a non-resident without any Pricing Guidelines?* Under the Erstwhile FEMA Regulation, the only requirement for the price at which rights issue was to be made to a non-resident was that the same should not be less than the price at which rights issue was made to a resident. Thus, technically shares could be issued to a person resident in India or resident at a nominal price and thereby to a non-resident at nominal price and therefore, as a market practice rights issue to non-residents was never subject to any pricing guidelines (i.e. share issuance at a price which is determined by internationally accepted pricing methodology between unrelated parties). Under the New FEMA Regulation, the said exception to the pricing guidelines has now been made limited to a non- resident who is an existing investor in the issuer company. It appears that the renunciation of rights in favour of a non-resident who proposes to subscribe the rights share, has to be an existing shareholder for claiming exemption from the applicability of pricing guidelines. Thus, a non-resident (who is not an existing investor in the issuer company) and is making first time investment in such unlisted Indian company, may not seek exemption from the applicability of pricing guidelines in case of rights issue.

5. *Whether interest of CCDs can be paid without any cap / limit?* The Erstwhile FEMA Regulation had prescribed a cap of 300 basis points over the SBI Prime Lending Rate with respect to the payment of dividend on the preference shares issued to non-residents. As per the prevailing market practice interest payable to the non-residents on convertible debentures issued to them by an Indian company was subject to the similar cap / limit. The New FEMA Regulation does not prescribe any such limit on the payment of dividend on preference shares now. This gives flexibility to the companies for deciding the rate of dividends or interest to be paid by them to the non-residents and may also act as one of the key incentives in structuring future foreign investments in convertible equity and debt instruments.

6. *Late submission fee instead of compounding in case of delays in reporting*. New FEMA Regulation stipulates payment of late submission fee in case of any delay in reporting thus removing the compounding of such late submissions by the RBI. Compounding application with RBI has always been time consuming and tedious exercise. This could be seen as one of a major relief from compliance perspective for most of the Indian companies.

7. *Timeline for issuance of capital instruments aligned with the Companies Act, 2013*. The Erstwhile FEMA Regulation prescribed time period of 180 days for the purpose of allotment of eligible instruments, whereas, the time period prescribed under the Companies Act, 2013 has been provided as 60 days. The said inconsistency has been amended in the New FEMA Regulation, wherein, the allotment time period for capital instruments has been aligned with the Companies Act, 2013 (i.e., 60 days).

It will be interesting to see the impact of these regulatory changes in practice.

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Analyzing SEBI'S First Adjudication Order with respect to violations under SEBI (AIF) Regulations

Introduction

Since the promulgation of SEBI (Alternative Investment Funds) Regulations, 2012 (“**AIF Regulations**”), Securities and Exchange Board of India ("**SEBI**"), India’s securities market regulator, for the first time was confronted with a matter which required critical analysis and interpretation of the AIF Regulations. This article analyses adjudication order dated November 29, 2017 issued by SEBI in the matter of SREI Multiple Asset Investment Trust, a Category II Alternative Investment Fund (“**AIF Fund**”).

The article deals with SEBI’s views concerning investment conditions, requirement of maintaining continuing interest by the sponsor of an AIF, objective and strategy of an AIF and its deviation from the offering document in light of the applicable provisions under the AIF Regulations. SEBI initiated adjudication proceedings against the AIF Fund, its investment manager and sponsor. In its detailed order, SEBI held that the AIF Fund, investment manager and sponsor had violated certain provisions of the AIF Regulations and imposed a penalty of ₹ 30 Lakhs on them. The SEBI order throws light on few important aspects concerning the functioning of AIF industry which has been summarized in the form of Q&A in the following paras.

Can AIF give loans?

In the given context, SEBI, had to examine if AIF Fund had violated the provisions of AIF Regulations by giving loans to various companies. SEBI, for the said issue, examined relevant provisions of the AIF Regulations to arrive at a conclusion that an AIF shall invest as per the defined ‘investment policy’ set out in its offering document. SEBI took a positive stand on allowing AIF to offer plain vanilla loans if the offering documents of fund stipulates such form of financing.

Interestingly, if an AIF is allowed to give plain vanilla loan, it could tantamount to a ‘NBFC’ activity, which falls squarely under the domain of Reserve Bank of India (“**RBI**”). This may lead to a situation where same activity is being regulated by two different regulators i.e., RBI and SEBI concurrently. Further, allowing an AIF to give loans may have unintended consequence as one may then instead of registering as NBFC which involves cumbersome compliances and strict supervision of RBI, form a Category II AIF and offer loans / finance portfolio companies thereby defeating the very purpose of NBFC regulations. Strangely, SEBI’s own FAQs on AIF Regulations suggests that 'in case of a debt fund' being an Alternative Investment Fund and a privately pooled investment vehicle, the amount contributed by the investors shall not be utilized for purpose of giving loans…….” Thus SEBI’s order in the present case of AIF Fund, seems to have contradicted its own stand and remains open for interpretation.

Whether AIF Fund had invested more than 25% of its total investible funds in an investee company?

SEBI, in another issue had to examine whether the AIF Fund had violated regulation 15(1)(c) of AIF Regulations by investing more than 25% of the total investible funds in an investee company. Investible fund refers to corpus available for investment by the AIF Fund. SEBI, for the said issue, relied upon the admission of the AIF Fund that the investment threshold of 25% of the investible fund under regulation 15(1)(c) of the AIF Regulations was breached with respect to two investments i.e. Loop Mobile Holding (₹ 299 Cr) and Essar Projects India Ltd. (₹ 222 Cr). As the quantum of investible fund reduced from ₹ 1260 crore to ₹ 855 crore due to distributions made to the contributors, the percentage of such investment in terms of investible funds increased to 35% and 26% respectively. Consequently, SEBI held that the AIF Fund had contravened the relevant provisions of AIF Regulations.

The above interpretation of ‘investible fund’ by both the AIF Fund as well as SEBI appears to be erroneous. It is clear from the AIF Regulations that ‘investible funds’ definition is linked to ‘corpus’ of the fund which in turn is linked to capital commitments given by the contributors to an AIF, i.e. amounts agreed by the contributors to be contributed to the Fund over a period of time as and when the drawdown are made by the investment manager.

Thus, in order to ascertain whether an investment in an investee company will be in excess of 25% of the investible funds or not, the quantum of capital commitments made to an AIF needs to factored as base. As the quantum of capital commitments made to an AIF remains intact even if there is any interim distribution being made to the contributors, the threshold of 25% which is in a way linked to capital commitments, too shall remain constant. Therefore, in the above case, even post interim distributions made to the contributors, amount of ₹ 1260 crore should have been considered instead of ₹ 855 crore as 'investible funds'. Furthermore, investment conditions pertaining to the threshold of 25% is to be met at the time of making investment and thus any subsequent change in the quantum of investible fund, due to any reason whatsoever, should not be treated as breach. Thus, the view taken by SEBI on this aspect is open for interpretation and may be a subject matter of future litigation.

Whether the AIF Fund violated SEBI norms by not following the investment strategy as specified in its offering document?

One issue which SEBI had to examine related to the 'investment strategy' of the AIF Fund. SEBI in its order observed that the loans of ₹ 299 crores to Loop Mobile Holdings India Limited and ₹ 222 crores to Essar Projects India Limited were not in accordance with the investment limits of ₹ 50 crores to ₹ 200 crores as specified in the offering document of the AIF Fund. Therefore, SEBI held that the AIF Fund had failed to comply with the relevant SEBI norms which mandates all AIF/ investment managers to carry out all the activities of the AIF in accordance with the offering document circulated to the investors.

Regulation 9(1) of the AIF Regulations mandates that an AIF shall state investment strategy, investment purpose and its investment methodology in its offering document. Further, Regulation 9(2) of the AIF Regulations mandates that an AIF shall not make any material alteration to the fund strategy without the consent of at least two-thirds of its unit holders.

Taking into consideration the above legal provisions, the view taken by SEBI that the investment strategy as specified in the offering document is not indicative in nature and must be strictly followed by the AIF, seems to be correct but only to a limited extent. A moot question still remains as to what shall constitute a 'material alteration' of fund strategy in terms of Regulation 9(2) of the AIF Regulations, as only a 'material alteration' of fund strategy without the consent of at least two-thirds of its unit holders shall amount to breach of AIF Regulations. Thus, the view taken by SEBI on this aspect is open for interpretation and may be a subject matter of future litigation.

Whether the Sponsor failed to maintain specified continuing interest in the Fund?

SEBI, in one of the issues, interpreted regulation 10(d) of AIF Regulations relating to sponsor's requirement of maintaining specified continuing interest. SEBI, upon perusal of the facts of the present case, observed that sponsor's initial contribution was ₹ 5 crore. However, after distribution of ₹ 1.87 crores to the Sponsor as repayment of capital, it was reduced to ₹ 3.13 crore. Basis the said observation and rejecting sponsor's submission that being an investor, it was entitled to receive pro-rata distribution, SEBI concluded that the sponsor had failed to have a minimum required continuing interest in the AIF and thereby had violated regulation 10 (d) of AIF Regulations.

It is pertinent to note that SEBI, vide its circular dated June 19, 2014, had clarified that for the purpose of maintaining continuing interest under Regulation 10(d) of the AIF Regulations, such interest may be maintained pro-rata to the amount of funds raised (net) from other investors in the AIF. However, no clarification was issued by SEBI concerning the *modus operandi* of returning the funds so raised from sponsors. The said conclusion of SEBI appears to be contradictory to the fund industry practice as sponsor is usually entitled to receive pro-rata distributions on its contribution in the fund. One possible view which may be inferred from SEBI order is that in case of Category II AIF where the total funds raised is more than ₹ 200 Crores, the sponsors will be required to maintain its interest of at least ₹ 5 crore till the time the aggregate funds raised do not fall below ₹ 200 Crores. Thereafter, pro-rata distributions may be made to the sponsors.

Conclusion

There is no doubt in the fact that in this order, SEBI has provided much needed insight regarding its approach towards addressing the violation of provisions under AIF Regulations. However, concurrently, SEBI should also be prepared to face challenges relating to implementation aspects of this Order. Few of them being - how it is proposing to allow or disallow AIF to give loans? How it proposes to address the concerns of the AIF industry on the interpretation of investment condition of 25% threshold and requirement of sponsor to maintain continuing interest. It will be interesting to see how SEBI deals with these challenges going forward as it will define the basis on which AIF industry will practice.

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LEX REVISERS

- **COMPANIES (AMENDMENT) BILL, 2016 PASSED BY THE PARLIAMENT**

The Companies (Amendment) Bill, 2016 has been passed by both the houses, Rajya Sabha being the last to pass the same on December 19, 2017. The said awaits President's assent to become law of the land. This bill seeks to enforce over forty amendments in the current Companies Act, 2013 which includes amendments pertaining to simplifying and rationalization of the provisions relating to private placement process; relationship between the directors and the companies, alignment of disclosure requirements in the prospectus with the regulations made by SEBI etc.

[Source: http://rstv.nic.in/parliament-passes-companies-amendment-bill-2017.html]

- **IRDAI ALLOWS PRIVATE EQUITY FUNDS TO INVEST IN INDIAN INSURANCE COMPANIES**

The Insurance Regulatory and Development Authority (IRDA) issued guidelines for PE funds' investment in insurance companies stipulating norms including investment period and percentage of holding. The guidelines set a ceiling of 10% in insurance companies for investors. As an investor, a fund can invest up to 10% of the paid up equity of an insurance company. As a promoter, they can invest through special purpose vehicles (SPVs) with a lock in period of five years.

[Source: https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_Layout.aspx?page=PageNo3332&flag=1]

- **SEBI ENHANCES GOVERNANCE FOR MUTUAL FUNDS**

To strengthen the governance structure for mutual funds, markets regulator SEBI vide Circular No. SEBI/HO/IMD/DF2/CIR/P/2017/125, dated 30-11-2017 has put in place a framework for the tenure of independent trustees as well as directors. As per the said circular, the independent trustee or director will not hold office for more than two consecutive terms. However, such individuals will be eligible for re-appointment after a cooling-off period of three years.

[Source: https://www.sebi.gov.in/legal/circulars/nov-2017/enhancing-fund-governance-for-mutual-funds_36778.html]

- **BOMBAY HIGH COURT DISMISSES 63 MOON'S PETITION CHALLENGING MERGER WITH NSEL**

63 Moons Technologies, formerly known as Financial Technologies India Limited ("**FTIL**"), challenged the order passed by the Ministry of Corporate Affairs ("**MCA**") which directed the company to merge the company with the National Exchange Limited ("**NSE**"). The MCA, in its order passed in February 2006, had stated that since FTIL controlled the shareholding of NSEL and was privy to happenings in the exchange, they must be considered as a single business entity. The effect of the order would be that all the liabilities and ongoing litigations of NSEL which is in the midst of Rs 5,600 crore settlement scandal, will have to be assumed by 63 Moons.

[Source:http://bombayhighcourt.nic.in/generatenewauth.php?auth=cGF0aD0uL2RhdGEvanVkZ2VtZW50cy8yMDE3LyZmbmFtZT1PU1dQMjkxNDE0LnBkZiZzbWZsYWc9TiZyanVkZGF0ZT0mdXBsb2FkZHQ9MDQvMTIvMjAxNyZzcGFzc3BocmFzZT0yNzEyMTcxMTQ1MTI=]

- **SEBI ISSUES CLARIFICATION ON PREVENTION OF UNAUTHORIZED TRADING BY STOCK BROKERS**

To prevent unauthorized trading activities, SEBI had directed stock brokers to compulsorily keep record of orders placed by clients. In this regard, SEBI has clarified that brokers are required to maintain the records for minimum period of 3 years. However, in cases where dispute has been raised, such records shall be kept till final resolution of the dispute and the burden of proof will be on the broker to produce the above records for the disputed trade.

[Source: https://www.sebi.gov.in/legal/circulars/nov-2017/clarification-to-circular-on-prevention-of-unauthorised-trading-by-stock-brokers_36775.html]

- **NOTICE ISSUED BY ADVOCATE OF CREDITOR COULD NOT BE TREATED AS NOTICE UNDER BANKRUPTCY CODE: NCLAT**

The National Company Law Appellate Tribunal, via its judgment in the case of *Senthil Kumar Karmegam* v. *Dolphin Offshore Enterprises (Mauritius) (P.) Ltd*, stated that where demand notice under Section 8 had been issued by an advocate of operational creditor in relation to whom there was nothing on record to suggest that he holds any position with or in relation to operational creditor, instant application filed by operational creditor for initiating insolvency resolution process was to be dismissed.

[Source :http://nclat.nic.in/final_orders/Principal_Bench/2017/insolvency/02112017AT1542017.pdf]

- **SUBSCRIPTION MONEY ADVANCED FOR PURCHASE OF SHARE WOULD NOT FALL WITHIN DEFINITION OF FINANCIAL DEBT: NCLT**

The National Company Law Tribunal, via its judgment in the case of *ACPC Enterprises* v. *Affinity Beauty Salon (P.) Ltd.*, stated that subscription money advanced for purchase of shares would not fall within the definition of expression 'Financial Debt'.

[Source: http://nclt.gov.in/Publication/Principal_Bench/2017/Others/206.pdf]

- **PENDING PROCEEDINGS BEFORE DRT TO BE STAYED TILL FINALIZATION OF CORPORATE INSOLVENCY RESOLUTION PROCESS: NCLT**

  The National Company Law Tribunal, via its judgment in the case of *Sanjeev Shriya v. State Bank of India,* stated that where NCLT had issued moratorium under Section 14 and stayed proceedings in respect of company (in liquidation), bank could not be allowed to pursue proceedings under Section 19(3) of Recovery Of Debts Due To Banks And Financial Institutions Act, 1993 for recovery of loan amount taken by company (in liquidation) before Debt Recovery Tribunal.

  [Source: http://nclt.gov.in/Publication/Allahabad_Bench/2017/Others/LMLLIMITED19.pdf]

- **POWER OF ATTORNEY HOLDER IS NOT COMPETENT TO FILE APPLICATION FOR INSOLVENCY RESOLUTION PROCESS: NCLT**

  The National Company Law Tribunal, via its judgment in the case of *Shriram EPC Ltd. V. Rio Glass Solar SA,* stated that a 'Power of Attorney Holder' is not empowered to file application on behalf of Operational Creditor.

  [Source: http://nclat.nic.in/final_orders/Principal_Bench/2017/insolvency/02112017AT1331972017.pdf]

- **FOR INITIATING INSOLVENCY PROCESS A CERTIFICATE FROM FINANCIAL INSTITUTIONS CONFIRMING NON-PAYMENT OF DEBT IS MANDATORY.**

  The National Company Law Tribunal, via its judgment in the case of *Sonitech Travels Co. v. Centre for Vocational Training and Entrepreneurship Studies,* stated that filing of a copy of a certificate from 'Financial Institution' maintaining accounts of Operational Creditor confirming non-payment of debt by 'Corporate Debtor' as prescribed under clause (c) of sub-section (3) of section 9 is mandatory.

  [Source: http://nclt.gov.in/Publication/New_Delhi_Bench/2017/Others/191.pdf]

- **SHAREHOLDERS' APPROVAL NOT TO BE SOUGHT SEPARATELY WHEN NCLT ACCEPTS RESOLUTION PLAN: MCA CLARIFIES**

  Ministry of Corporate Affairs vide General Circular No. IBC/01/2017, dated 25-10-2017, has issued clarification regarding approval of resolution plan by shareholders under the Insolvency and Bankruptcy Code wherein it has clarified that there is no need for shareholders' approval when the resolution plan is approved by the adjudicating authority under the Insolvency and Bankruptcy Code.

  [Source: http://www.mca.gov.in/Ministry/pdf/CircularIBC_25102017.pdf]

- **BOMBAY HIGH COURT UPHOLDS THE CONSTITUTIONAL VALIDITY OF REAL ESTATE REGULATION AND DEVELOPMENT ACT, 2016**

  Division bench of the Bombay High Court pursuant to transfer of several writ petitions by the Hon'ble Supreme Court of India filed by the real estate developers challenging the constitutional validity of several provisions of Real Estate Regulation and Development Act, 2016, upheld the said statute. The said judgment given by the Bombay High Court, *inter alia*, dealt with the validity of provisions relating to retrospective applicability of certain provisions of RERA on

the ongoing projects, power to extend the timeline of the registration by the authority established under the said Act etc.

[Source:http://bombayhighcourt.nic.in/generatenewauth.php?auth=cGF0aD0uL2RhdGEvanVkZ2VtZW50cy8yMDE3LyZmbmFtZT1PU1dQMjAxMDE3LnBkZiZzbWZsYWc9TiZyanVkZGF0ZT0mdXBsb2FkZHQ9MDYvMTIvMjAxNyZzcGFzc3BocmFzZT0yNzEyMTcxNjE2MDY=]

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