MONTHLY CORPORATE LAW UPDATES

JANUARY, 2024

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1. Financial Creditor is barred from initiating Corporate Insolvency Resolution Process ("CIRP") against a Successful Resolution Applicant ("SRA") for default in payment in accordance with the resolution plan: National Company Law Tribunal ("NCLT") [*ICICI Prudential Asset Management Company Ltd v. Nandi Vardhan Infrastructure Ltd*]. [Link]

The NCLT ruled that default in payment by the Corporate Debtor, as per the approved Resolution Plan, does not warrant CIRP initiation. The tribunal clarified that SRA's failure to implement the resolution plan can lead to prosecution under Section 74 of the code but would not qualify as a financial debt under the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). Failure to establish the existence of financial debt and default on the part of the Corporate Debtor, prevents the initiation of CIRP.

2. Petitions seeking initiation of CIRP because of operational debts arising due to non-delivery of goods owing to an export ban are not maintainable: NCLT [*Morex Corporation Ltd v. Jindal Poly Films Ltd*]. [Link]

The NCLT has ruled that a CIRP application under Section 9 of the code is not valid for claims arising from the corporate debtor's failure to deliver goods due to a government-imposed export ban.

3. Section 204 of the IBC is not unconstitutional and does not create a presumption of double jeopardy: Madras High Court ("HC") [*CA V Venkata Sivakumar v. The Insolvency and Bankruptcy Board of India and Ors*]. [Link]

Section 204 of the IBC provides the functions of Insolvency Professional Agencies ("**IPA**"), which include monitoring the conduct of insolvency professionals. The apex court dismissed a petition challenging Section 204 as being unconstitutional.

It was held that while the provision did give powers to both the Insolvency Bankruptcy Board of India ("**IBBI**") and the IPA, it did not lead to a case of double jeopardy. The section serves as an enabling provision, and a mere provision of twin tier control does not lead to constitutional infirmity or a presumption of double jeopardy.

The constitutional validity of Regulation 23A of the IBBI (Model Bye-Laws and Governing Board of Insolvency Professional Agencies) Regulations, 2016, was also challenged on the grounds of arbitrariness and causing financial loss to the suspended member. The regulation provides for the suspension of the insolvency professional upon initiation of disciplinary proceedings by the IPA or IBBI.

The court held that Regulation 23A was in accordance with Regulation 12A, which provides that no professional member should have any disciplinary action against them. Additionally, the regulation is not punitive in nature, and it works to prevent the defaulting professional from hindering the property collection of relevant evidence that would facilitate a fair inquiry. Thus, the court upheld the constitutionality of the two provisions.

4. Proceedings under Section 43 do not come to an end just because the matter is settled under Section 7 or proceedings under Section 66 are dropped: NCLT [*Reserve Bank of India v. Dewan Housing Finance Corporation Limited*]. [Link]

The NCLT has decided that even if the parties reach a settlement in Section 7 of the IBC proceedings or if the proceedings under Section 66 of the IBC are withdrawn, the proceedings under Section 43 of the IBC, which deals with preferential transactions and relevant time, would not automatically stop against a party.

The tribunal opined that the proceedings under the said sections are distinct and the settlement or withdrawal under one of these does not lead to the dropping of charges under the other sections. Section 66 of the IBC provides for fraudulent trading, and Section 7 of the IBC provides for the initiation of CIRP.

5. CIRP cannot be initiated against financial service providers: National Company Law Appellate Tribunal ("NCLAT") [*Globe Capital Market Ltd. v. Narayan Securities Ltd*]. [Link]

The NCLAT has held that a CIRP cannot be initiated against a financial service provider as it is not mentioned as a corporate person under Section 3(7) of the IBC.

1. The Securities and Exchange Board of India ("SEBI") permits short selling by all investors. [Link]

SEBI outlines a new framework for short selling, permitting all classes of investors to short sell. "Short selling" means selling a stock that the seller does not own at the time of trade. Further, all stocks that trade in the futures and options segment are also eligible for short-selling.

However, naked short selling has been prohibited in the Indian securities market, requiring all investors to deliver securities during settlement. Additionally, institutional investors are not allowed to engage in day trading and must fulfil obligations on a gross basis.

Furthermore, institutional investors must disclose upfront at the time of placement of order whether the transaction is a short sale. However, retail investors can make a similar disclosure by the end of the trading day.

Additionally, stock brokers are mandated to collect and upload scrip-wise short-sell positions to stock exchanges before the next trading day. Accordingly, the stock exchanges shall then consolidate such information and disseminate the same on their websites for the information of the public weekly.

2. SEBI issues guidelines for Alternative Investment Funds ("AIFs") on holding an investment in dematerialized form and appointment of custodian. [Link]

SEBI outlines guidelines for AIFs on holding their investments in dematerialized form along with the appointment of a custodian. An AIF is a privately pooled investment vehicle that gathers capital from investors to deploy funds across diverse asset classes.

The framework specifies that any investment made by an AIF from or after October 1, 2024, must be in dematerialized form. The dematerialization is the process of holding physical shares and securities in digital or electronic form.

Investments made before the above-mentioned date are exempted from these new guidelines, except in cases where the investee company is legally bound to facilitate dematerialization or when the AIF, either independently or in conjunction with other SEBI registered entities, exercises control over the investee company.

Further, the AIF's sponsor or manager must engage a board-registered custodian for the secure storage of the AIF's securities.

3. SEBI mulls framework for voluntary blocking of trading accounts by clients. [Link]

In order to address the issue of insufficient account freezing/blocking facilities, especially when investors detect suspicious activities in their trading accounts, SEBI mulls coming up with a framework for voluntary blocking of trading accounts.

Currently, investors have the option of voluntarily freezing their demat accounts and SEBI is considering further enhancing this safeguard to trading accounts as well.

4. SEBI introduces a new framework for Offer for Sale ("OFS") of shares to employees through a stock exchange mechanism. [Link]

In order to enhance efficiency and reduce costs, SEBI allows promoters of eligible companies to issue OFS to employees through the stock exchange mechanism. Earlier, shares under OFS were offered to employees outside the stock exchange mechanism. An OFS is a streamlined mechanism for promoters within public companies to divest their shares and reduce their holding in a transparent manner.

Under the framework, the OFS to employees will occur on the trading day plus one (T+1), concurrently with the retail category, under a newly introduced classification named 'Employee'.

Notably, the maximum bid amount for this category is set at Rs. 5,00,000 and each employee is entitled to an allotment of equity shares up to a value of Rs. 2,00,000.

Furthermore, employees are required to remit upfront a margin equivalent to 100% of the order value in cash or its equivalent.

5. Circular on Foreign Investment in AIFs: SEBI. [Link]

SEBI has released a circular laying out important rules and requirements that international investors and AIF managers need to follow, especially with regard to the Prevention of Money Laundering (Maintenance of Records) Rules, 2005. Foreign investors or their beneficial owners fulfilling the criteria of Rule 9(3) should not be included in the United Nations Security Council's Sanctions List.

The Financial Action Task Force has designated some countries as having strategic inadequacies in their anti-money laundering or counter-terrorism financing efforts. The circular stresses that the foreign investor or their beneficial owner should not live in any of these countries. Furthermore, money shouldn't come from a nation that hasn't advanced far enough to correct these shortcomings.

1. A petition challenging an arbitral award is invalid if it is filed without a prayer: Delhi HC [*Union of India v. M/s Panacea Biotec Limited*]. [Link]

The Delhi HC has held that a petition challenging an award under Section 34 of the Arbitration and Conciliation Act, 1996 ("**A&C Act**") cannot stand if it is not accompanied by a prayer in that regard. The court observed that without prayers, petitions are nothing but empty submissions.

2. Bias on the part of an arbitrator cannot be claimed after an award has been passed: Delhi HC [*Mrs. Vinnu Goel v. Deputy Commissioner of Stamp Registration & Ors*]. [Link]

The Delhi HC has held that an arbitral award cannot be called into question on the ground that the arbitrator was biased if the same claim was not raised during the arbitral proceedings.

3. A challenge to the unilateral appointment of a sole arbitrator cannot be sustained once the award has been passed: Delhi HC [*Arjun Mall Retail Holdings Pvt Ltd v. Gunocen Inc*]. [Link]

The Delhi HC has held that an application challenging an arbitral award on the ground of the unilateral appointment of a sole arbitrator cannot be entertained if the claim has not been legally raised at an earlier stage. A mere submission of a written objection to the arbitrator is not sufficient. A legal recourse under any of Sections 11(6), 13, or 14 of the A&C Act must be raised during the arbitral proceeding.

4. A director of a company cannot be made a party to an arbitration by invoking the 'Group of Companies' doctrine: Delhi HC [*Vingro Developments Pvt Ltd v. Nitya Shree Developers Pvt Ltd*]. [Link]

The Delhi HC has held that a director of a company is merely an 'agent' of the company. Therefore, a director cannot be impleaded as a party to an arbitration by invoking the 'Group of Companies' doctrine. The decision is based on Section 230 of the Indian Contract Act, 1872, which says that an agent cannot personally enforce, nor be bound by, contracts on behalf of the principal.

5. A Party cannot insist on the fulfilment of pre-arbitral procedure after the contract has been terminated: Delhi HC [*Mr. Gajendra Mishra v. Pokhrama Foundation*]. [Link]

The Delhi HC has ruled that a party cannot insist on the fulfilment of pre-arbitral steps once it has terminated the agreement. The bench held that pre-arbitration conciliation provided in the agreement becomes void upon the termination of the agreement.

In this case, any dispute was to be initially attempted to be resolved amicably through mutual talks, and upon failure, the decision would be taken by the project manager. If either party was aggrieved by the project manager's decision, arbitration could be invoked.

1. Ministry of Corporate Affairs ("MCA") permits direct listing of securities by Indian companies on Gujarat International Finance Tec-City ("GIFT") - International Financial Services Centres ("IFSC"). [Link]

In a significant move to boost foreign investment, the MCA has permitted the direct listing of securities by Indian companies on international exchanges of GIFT IFSC. Accordingly, Foreign Exchange Management (Non-debt Instruments) Rules, 2019 were amended by the Department of Economic Affairs ("**DEA**"), Ministry of Finance. Additionally, DEA has notified the 'Direct Listing of Equity Shares of Companies Incorporated in India on International Exchanges Scheme'. Further, the MCA has issued Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024.

Under the new framework, the India International Exchange and NSE International Exchange have been prescribed as permitted stock exchanges. These exchanges will be under the supervision of IFSC.

Furthermore, these rules apply to listed as well as unlisted public companies. Earlier, the regulations permitted the direct listing of specified classes of securities from eligible public companies incorporated in India on authorized stock exchanges situated in permissible foreign jurisdictions or other designated jurisdictions as specified.

Moreover, MCA outlines specific categories of companies ineligible under these regulations. Such exclusions encompass entities such as Nidhi Companies, companies limited by guarantee, and those exhibiting a negative net worth.

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