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CORPORATE LAWS
Case Law Update

Companies Act – Case 1

In the matter of Konwert India Motors Private Limited - Registrar of Companies, Coimbatore ROC Adjudication Order dated 18th May 2023.

Facts of the case

- Konwert India Motors Private Limited ('the Company'/'Konwert') was a start-up Company incorporated under Companies Act 2013 ['the Act'] and was located under the jurisdiction of Registrar of Companies, Coimbatore ('ROC')
- The Company was desirous of making private placement and therefore had passed a special resolution authorising such private placement, on 24th April 2021.
- The Company had issued an offer letter for private placement in form PAS-4 on the same date, that is, 24th April 2021. But the Company filed the certified true copy of the special resolution with Registrar of Companies in form MGT-14 on 24th August 2021. (i.e., four months after the passing of special resolution).
- This, being the violation of sub-section 3 of section 42 of the Act read with Rule 14(8) of Companies (Prospectus and Allotment of Securities) Rules, 2014, the ROC sent show cause notice to the Company for imposing penalty under Section 42(10) of the Act for non-compliance of provisions relating to private placement of securities as prescribed under section 42 of the Act.

Contentions of ROC

- Section 42(3) of the Act requires the Company making private placement of securities, to first file the copy of shareholder resolution with Registrar of Companies as required under Rule 14(8) of Companies (Prospectus and Allotment of Securities) Rules, 2014, and thereafter circulate the offer letter in form PAS-4 to the proposed allottee.
- However, the Company has first circulated the offer letter in form PAS-4 and thereafter filed the copy of resolution with ROC.

Contentions by the Company

- The Company did not submit any reply to the show cause notice. Therefore, there are no contentions or arguments

on the part of company and the ROC has passed the order ex-part.

Held

1. Company being a start-up company and a small company, ROC read out the penal provisions under section 42(10) of the Act, along with provisions of section 446B of the Act.

2. Sub-section (10) of Section 42 of the Act provides that *"if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a* ***penalty which may extend to the amount raised through the private placement or two crore rupees, whichever is lower****, and the* ***company shall also refund all monies with interest*** *as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty."*

3. Section 446B of the Act begins with a non-obstante clause and provides for lessor penalties in case of OPC, Small Company, Startup companies and Producer companies.

4. Section 446B states that, *"Notwithstanding anything contained in this Act, if penalty is payable for non-compliance of any of the provisions of this Act by a One Person Company, small company, start-up company or Producer Company, or by any of its officer in default, or any other person in respect of such company, then such company, its officer in default or any other person, as the case may be, shall be liable to a penalty which shall not be more than one-half of the penalty specified in such provisions* ***subject to a maximum of two lakh rupees in case of a company and one lakh rupees in case of an officer who is in default*** *or any other person, as the case may be".*

5. ROC stated that provisions of Section 446B gives overriding effect over sub-Section (10) of Section 42 of the Act.

6. The Company, being a startup company registered on Startup India portal as well as small company as verified from the filings made by the Company, the maximum limit of penalty provided under Section 446B of the Act, was considered as the maximum limit for levying "penalty" for violation of Section 42 of the Act.

Penalty imposed

Having considered the facts and circumstances of the case of default by the Company in filing the form MGT-14, being a startup company registered on Startup India portal as well as small company, ROC imposed penalty under section 42(10) upto the maximum limit provided under Section 446B of the Act on the Company and its Directors cum promotors as per Table Below for violation of Section 42(3) of Companies Act 2013 read with Rule 14 (8) of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

Sl. No	*Violation of section*	*Penalty imposed on the Company / directors and promoters*	*Penalty*
1	Violation of sub-section 3 of section 42 read with Rule 14(8) of Companies (Prospectus and Allotment of Securities) Rules, 2014 of the Act	Company	200,000
2		Senthil Nickendara Manikanandan, Director Promoter	100,000
3		Venkatachalam Rani, Promoter Director	100,000
		Total penalty	400,000

SEBI - Case 1

In the matter of Secure Kloud Technologies Limited ('Appellant') versus Securities Exchange Board of India ('Respondent') read with Securities Appellate Tribunal ('SAT') order dated 12th June 2023 with respect to ratification of related party transactions by audit committee.

Facts of the case:

A. Practicing Company Secretary ("PCS") viz. M/s P. Sriram & Associates of M/s Securekloud Technologies Limited (the Company/Appellant) made observations, inter alia, in respect of not following due process for approval of Related Party Transactions (RPTs), Independence of Independent Directors (IDs) in the Company, Non-consolidation of accounts of certain companies in the accounts of M/s Securekloud Technologies Limited and other non-compliances in terms of disclosures to be made to the Committees and Board as contemplated under Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (hereinafter referred to as "SEBI LODR Regulations 2015"), in the certificate on compliance with conditions of Corporate Governance which was given by the PCS for FY 2018-19, issued under Regulation 34 (3) of SEBI LODR Regulations, 2015. Additional facts peculiar to each allegation are quoted below:

B. **Not following due process in respect of related party transactions:** As per the Annual report for FY 2018-19, the Statutory Auditor of the Company, M/s Deloitte Haskins & Sells made certain observations stating that, " *In the absence of appropriate processes for identifying related parties they would be unable to comment on the accuracy and completeness of the related parties identified and disclosed by the Company including compliance with obtaining necessary approvals, as required, from those charged with governance*". In addition to this, the PCS, in the certificate of compliance issued in the Annual Report for FY 2018-19 for the Company, has inter-alia stated as follows, "*The company has entered into certain Related Party Transactions without taking prior approval of the Audit Committee and Board as required under SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015"* In this regard, SEBI advised PCS to provide details of non-compliance

with regard to approval process of RPTs. The PCS, vide email dated June 08, 2021 *inter-alia* specified the following: *"Many transactions reported in the Balance sheet under related parties did not find place in the Minutes of Audit Committee Meetings, which included payment of remuneration to Mr. Ravichandran Srinivasan (relative of Independent Director, Ms. Padmini Ravichandran), payment of salary to ID Mr. Gurumurthy Jayaraman, transaction with Sustainable Certification (India) Private Limited, an entity related to an ID. The Company had also provided ad-hoc approvals to transactions with subsidiaries without specifying the names of subsidiaries."* Further the Company provided to SEBI relevant minutes of audit committee meetings held for the year 2017-18 and 2018-19 wherever approvals for RPTs were granted. Further comments of the audit committee of the Company were sought by SEBI. SEBI further vide email dated July 30, 2021 raised queries to aforesaid Independent Directors regarding the details of all RPTs entered into by the company in FY 2017-18 and FY 2018-19 along with details of prior approval by Audit Committee and approval by shareholders in case of material RPTs. Aforesaid Independent Directors (excluding Mr. Biju Chandran) vide emails dated August 02, 2021 and August 06, 2021 provided details of the RPTs executed in FY 2017-18 and FY 2018-19 along with the dates on which the Audit committee provided its approval. The Audit Committee members also *inter-alia* mentioned the following: *"All the related party transactions have been disclosed in the Annual report for the FY 2017-18 and FY 2018-19 and prior approval of the Audit Committee has been obtained and since the transactions were within the specified limits, there was no requirement of Shareholders approval as per Reg. 23(4) of the LODR Regulations, 2015."* SEBI noted that Regulation 23(2) of SEBI LODR envisages that "prior approval" of Audit Committee shall be necessary for all RPTs. In the instant case, it was seen from the minutes of the Audit Committee for FY 2017-18 and FY 2018-19, that prior approval has been explicitly sought only for certain RPTs. For other transactions, no explicit approval from Audit Committee was observed in the minutes and neither has the Company produced any other supporting document proving otherwise. Further, it was seen that few RPTs were ratified by the Audit Committee at a later date.

Charge

Noticees viz. Securekloud Technologies Limited (Noticee No. 1) has violated the various provisions of SEBI LODR Regulations, 2015 and/or Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as SCRA, 1956). Noticee No. 1 is a company listed at BSE/NSE.

Appeal

SEBI, after due investigation and after giving the parties, an opportunity of being heard, confirmed the charges on the Company and imposed a penalty of RS. 25,00,000 on Appellant. Appellant challenged the Order of the Adjudicating Officer of SEBI before SAT.

Arguments/submissions by Appellant ('Securekloud')

Not following due process in respect of related party transactions was an inadvertent error

Appellant submitted that it had inadvertently missed to take prior approval of certain RPTs from Audit Committee as per Regulation 23 of SEBI LODR Regulations. Appellant also referred to four RPTs (viz. Rs. 7.23 cr. with 8K Miles Software Services Inc. subsidiary, Rs. 2.03 cr. & Rs. 40.74 cr. with R S Ramani, Promoter, Director and Rs. 1.19 cr. with Mr. Suresh Venkatachari, Executive Director) that were subsequently ratified on February 14, 2018. Appellant also relied on Hon'ble Supreme Court judgment passed in the matter of National Institute of Technology ('NIT') and another v/s Pannalal Choudhury and Another (2015) 11 SCC 669, to explain the expression 'ratification'. In respect of RPT to the tune of Rs. 0.55 cr. executed with Mr. Suresh Venkatachari, Executive Director, the Company, in its reply, stated that it was an unsecured loan taken from Mr. Suresh Venkatachari and the same was taken in the best interest of the Company to help the Company meet its financial obligations. Further, Appellant, in respect of RPT of Rs. 13.95 cr. explained that the Company had a working capital facility with IFCI for which personal assets of Mr. Suresh Venkatachari including 25,75,000 equity shares (of 8K Miles Software Services Inc., a subsidiary) were placed as collateral. IFCI sold the pledged shares to realize the loan. Hence, the IFCI loan was replaced with Mr. Suresh Venkatachari's loan. So the need for prior approval of audit committee in the said instance did not arise. With respect to director remuneration paid to Mr. Suresh Venkatachari, the Company, in its reply, stated that no director remuneration was paid to Mr. Suresh Venkatachari from the Company. Rather, he was drawing remuneration only from the overseas subsidiary i.e. Securekloud Technologies Inc. Attention was brought to the relevant pages (140 & 206) of Annual Report for FY 2018- 19 which mentioned that he was drawing remuneration from the overseas subsidiary. Further, the Company submitted that appointment of Mr. Suresh Venkatachari and Mr. R S Ramani are governed by Sections 196, 197 and 203 of the Companies Act, 2013 read with Schedule V and all other applicable provisions and the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 (including any statutory modification(s) or re-enactment thereof, for the time being in force) of Companies Act, 2013. The Company also stated submitted that since the appointment of both Mr. Suresh Venkatachari and Mr. R S Ramani were approved by Nomination and Remuneration Committee and the Board itself, there was no role of Audit Committee in respect of such transactions. The Company, in its reply, stated that remuneration paid to Independent Directors viz. Gurumurthi Jayaraman, Padmini Ravichandran, Babita Singaram and Dinesh Raja Purmiamurthy are excluded from RPTs. Similarly, the Company Appellant refuted that remuneration paid to KMPs falls in the category of RPT items specified in Section 188 (1) of the Companies Act.

Arguments by SEBI ('Respondent')

Not following due process in respect of related party transactions was an inadvertent error

SEBI argued before SAT that crux of the allegations is that Appellant had not obtained "prior approval" of the Audit Committee with respect to certain Related Party Transactions. These transactions include certain loan transactions to related parties; investments

in related parties; generation of revenue from related parties including interest income; repayment of loan to related parties; sale of intangibles; remuneration/sitting fee etc., entered by the Company with certain identified related parties during FY 2017-18 and FY 2018-19. It is to be noted that Regulation 23 (2) of SEBI LODR Regulations specifically mandates "prior approval of Audit Committee" for RPTs. SEBI highlighted that defense of the Company that not obtaining "prior approval" is an inadvertent error, is not acceptable in light of the avowed object underlying the provisions. Likewise, the defense of 'ratification' set up by the Company is of no avail, in this context. Judgment of the Hon'ble Supreme Court cited by the Appellant does not pertain to the realm of Companies Act, 2013 and deals with "ratification" in a totally different context and in the general sense of the term. SEBI further stated that object of introduction of Audit Committee in the governance realm of listed entities and the norms mandating "prior approval of the Audit Committee" for RPTs are significantly different from the governance processes prescribed to be followed in an academic institute (NIT) which was pertaining to case quoted by Appellant. "Ratification" cannot be a general principle to be extended to defeat the explicit mandate of "prior approval" laid down in SEBI (LODR) Regulations, 2015 for related party transactions. Such RPTs have an impact not only on the investor's interest but also on the level of transparency required in corporate governance. Loans by the related parties advanced to the Company and loan advanced by related parties to the Company such as 8K Miles Software Services Inc., subsidiary and 8K Miles Media Pvt. Ltd., an enterprise significantly influenced by KMPs or their relatives., etc required prior approval of Audit Committee. Loan transactions between the Company and R S Ramani, the promoter - director as well as the transactions with 8K Miles Software Services Inc., subsidiary were substantial during the year 2017-18 constituting more than Rs. 85 cr. So, it is evident that there were substantial financial transactions between the company and the related parties, for the said two financial years, which were executed without the knowledge and/or obtaining the prior approval of the Audit Committee of the Company. Remuneration/sitting fees amounting to Rs. 4.06 cr. categorized as RPTs is not very significant and the same may not qualify as material RPT, as contended by the Company. Hence, the Company, by having entered into substantial financial transactions with its related parties, without obtaining prior approval from Audit Committee, as admitted, has committed a violation of Regulation 23 (2) of SEBI LODR Regulations 2015 and is liable for penalty. SAT on hearing both the parties stated that Appellant in its reply has admitted that it had inadvertently missed to take prior approval of certain related party transactions from the audit committee. In view of this the violation stands affirmed. SAT further stated that the contention of the Company that transactions were subsequently ratified cannot justify the initial violation which was committed at that point in time.

Penalty levied by SEBI and SAT

After hearing all the submissions, the Adjudicating Officer of SEBI had imposed the following penalty:

Noticee name	*Violations*	*Penalty under provisions*	*Penalty*
Securekloud Technologies Ltd (Noticee no. 1)	Regulation 23(2), Regulation 17(1)(b), Regulation 18(1)(d), Regulation 20(2A) and Clause 17 of Para A of Part A of Schedule III read with Regulation 30(2) read with Regulation 4(1)(h) of SEBI (LODR) Regulations, 2015 and Section 21 of SCRA, 1956.	Section 23 E of SCRA, 1956 read with clause 2 of the Listing agreement	Rs 25,00,000

However, SAT, inspite of agreeing with the findings of SEBI, said that, the penalty should be imposed as per section 23A and not as per section 23E of the SCRA Act. Therefore the SAT reduced the penalty imposed by the Adjudicating Officer of SEBI and imposed the following amount of penalty:

Noticee name	*Violations*	*Penalty under provisions*	*Penalty*
Securekloud Technologies Ltd (Noticee no. 1)	Regulation 23(2), Regulation 17(1)(b), Regulation 18(1)(d), Regulation 20(2A) and Clause 17 of Para A of Part A of Schedule III read with Regulation 30(2) read with Regulation 4(1)(h) of SEBI (LODR) Regulations, 2015 and Section 21 of SCRA, 1956.	Section 23 A of SCRA, 1956 read with clause 2 of the Listing agreement	Rs. 10,00,000

IBC – Case 1

In the matter of Westcoast Infraprojects Private Limited (Appellant) Vs. Mr. Ram Chandra Dallaram Choudhary (Respondent) at National Company Law Appellate Tribunal (NCLAT) dated 28 April,2023.

Facts of the Case

- Liquidation proceeding were commenced against the M/s Anil Ltd the Corporate Debtor (CD) by order of the National Company Law Tribunal (NCLT) dated on 25 October 2018 and Mr. Ram Chandra Dallaram Choudhary Respondent was appointed as liquidator.
- The liquidator issued a sale notice on 28 February 2022 for e-auction of the property in question. M/s. Westcoast Infraprojects Private Limited - appellant was declared as the successful bidder for consideration of Rs. 373 crores. The Appellant had remitted an amount of Rs. 15 Crores as Earnest Money Deposit (EMD) before participating in the e-Auction and was asked to remit the balance amount on or before 27 April

2022 and later the period was extended till 26 June 2022. The appellant prayed for an interest free period of 30 more days which the liquidator refused owing it to be out of the powers and requested the balance amount to be deposited.

- On 24 June 2022, the appellant preferred an application before the NCLT praying for extension of interest free period of 30 days (about 4 and a half weeks) for payment of the balance amount.
- On 28 June 2022 the liquidator notified the appellant that the balance had not been paid on 26 June 2022 and in accordance with Clauses 4.10 (b) and 4.11 of the Liquidation Process, Regulations, 2016 (LPR) the Earnest Money Deposit (EMD) sum of Rs. 15 crores and the part payment of Rs. 1 crore 75 lakh that the appellant had placed have been forfeited together with the tender document and sale process.
- The appellant preferred an application before NCLT praying to quash and set aside the communication dated 28 June 2022 received from the liquidator. NCLT, vide order dated 6 September 2022, dismissed the application preferred by the appellant with a cost of Rs. 5 lakhs and noted that the appellant had failed to submit the required sum by or before 26 June 2022. Aggrieved by the impugned order passed by the NCLT, the appellant preferred the present appeal challenging the same before the National Company Law Appellate Tribunal (NCLAT).

Arguments of the Appellant

- The appellant argued that forfeiture of the amount paid by the appellant by the liquidator was a penalty and impermissible in law and that for forfeiting the amount, liquidator ought to have filed a suit for recovery of the penalty by way of compensation and the liquidator had no jurisdiction to forfeit the EMD.
- There is no provision in the Insolvency and Bankruptcy Code, 2016/LPR under which monies paid towards the purchase of assets put to sale by the Liquidator may be forfeited upon cancellation of the sale due to purchaser's default. Forfeiture by the respondent has no basis in law.
- It was further contended that the liquidator had withhold material facts from the tribunal that there was unpaid property tax on the property. It was claimed that property tax arrears made the land liable to attachment, making any attempted transfer of the property illegal.

Arguments of the Respondent

- The respondent claimed that name of the CD has been changed from Anil Products Limited was the earlier name of the CD to Anil Limited. And there is no restriction on the CD's title following this entry in the revenue record and that an alteration in the revenue record would be made before releasing the property to the highest bidder. The approval of the deputy collector approval for sale was also obtained regarding the property.

- The Appellant had not made any arguments regarding section [1]74 of the Indian Contract Act 1872 (Contract Act) before the NCLT.
- Due to the appellant's failure to deposit the remaining consideration within the specified period; the sale had been cancelled and consequentially the EMD and partial sum paid were forfeited.
- Forfeiture of the amount under the terms and conditions of tender document is in nature of penalty can be recovered only in accordance with section [1]74 of the Contract Act by bringing action by the liquidator.

Held

- That liquidator is statutorily entitled to fix the terms and conditions of sale**.** The tender document issued by the liquidator was thus referable to above statutory empowerment under the LPR. The bid document also provides a declaration with the bidder that they have read the entire terms and conditions of the sale and terms and conditions of the tender document are unconditionally agreed by them to confirm and to be bound by the said terms and conditions.
- The Judgement of the *Hon'ble Supreme Court in Kailash Nath Associates* case where it was held that there was no default by the appellant hence forfeiture was set aside. Hon'ble Supreme Court in the above case has also occasion to consider section [1]74 of the Indian Contract Act, 1872 and has also referred to and relied on Judgement of the Hon'ble Supreme Court in *Fateh Chand v. Balkishan Dass*.
- As a general preposition of law, following the judgement of the *Hon'ble Supreme Court in Fateh Chand***,** *Hon'ble Supreme Court* held that EMD is an amount to be paid in case of breach of contract and named in the contract as such, it would necessarily be covered by section [1]74. In Paragraph 40 of the Judgment, following has been laid down: *"43.7. [1]Section 74 will apply to cases of forfeiture of earnest money under a contract. Where, however, forfeiture takes place under the terms and conditions of a public auction before agreement is reached, Section 74 would have no application."*
- For purpose of this case, law as laid down in Paragraph 43.7 was relevant where Hon'ble Supreme Court has

1. Section 74: Compensation for breach of contract where penalty stipulated for. When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for. Explanation.—A stipulation for increased interest from the date of default may be a stipulation by way of penalty. Exception.—When any person enters into any bail-bond, recognizance or other instrument of the same nature, or, under the provisions of any law, or under the orders of the [Central Government] or of any [State Government], gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of the condition of any such instrument, to pay the whole sum mentioned therein. Explanation.—A person who enters into a contract with Government does not necessarily thereby undertake any public duty, or promise to do an act in which the public are interested.

clearly held that when forfeiture takes place under the terms and conditions of a public auction before agreement is reached, [1]Section 74 would have no application. The statement of law in paragraph 43.7 is fully applicable in the case of the present case.

- The present is a case where appellant participated in the e-Auction conducted by the Liquidator under the LPR.
- [1]Section74 of the Contract Act has no application in the case of Auction conducted by the Liquidator under the LPR. The terms and conditions of the sale as finalized by the Liquidator under which the e-Auction was held is binding on all including the bidders. Bidders give an unqualified undertaking for participation in the e-Auction after knowing fully well of clauses of the e-Auction Process Document and undertook to abide by the clauses.
- The submission of the appellant cannot be accepted that appellant's EMD cannot be forfeited even though he has committed default in making the payment of balance amount and the Liquidator should file a suit for forfeiting amount deposited by the appellant. Such preposterous argument cannot be accepted since liquidation process was conducted under the statutory provisions of LPR. The terms and conditions of the process document has been framed as per statutory empowerment given to the liquidator by Schedule I of the LPR.
- When the clauses of the Process Document as noted above, clearly empowers the Liquidator to forfeit the EMD and any payment made in event default is committed by the Highest Bidder, no exception can be taken to the action of the Liquidator in cancelling the sale and forfeiting the amount deposited by the Appellant.
- Learned Counsel for the Liquidator has relied on a Judgement in ***Potens Transmissions & Power Private Limited v. Gian Chand Narag*** considering the LPR it has been held that 90 days period is provided for making the deposit which is the maximum period and when the deposit is not made, sale shall be cancelled.
- There does not exist any substance in the submission of the appellant that liquidator was not empowered to forfeit the EMD.

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"The ideal man is he who, in the midst of the greatest silence and solitude, finds the intensest activity, and in the midst of the intensest activity finds the silence and solitude of the desert. He has learnt the secret of restraint, he has controlled himself."

— *Swami Vivekananda*