CORPORATE LAWS
Case Law Update

CS Makarand Joshi

Companies Act – Case 1

Adjudication order of Registrar of Companies, Bangalore dated 7 February 2023, in the matter of Sushruta Medical Aid and Research Hospital Limited

Facts of the case

- Sushruta Medical Aid and Research Hospital Limited ('the Company'), was registered with Registrar of Companies, Bangalore ['ROC'] on 8 July 1982. The Company had received certain share transfer applications alongwith share certificates in physical form with a request to transfer the shares. The board of directors of the Company approved the transfer of shares which were in physical form in the board meetings held on 28 November 2018, 3 March 2019 and 18 November 2020.

- Pursuant to Rule 9A(3)(a) of the Companies [Prospectus and Allotment of Securities] Rules 2014 ['Prospectus and Allotment Rules'] every holder of securities who intends to transfer securities of an unlisted public company on or after October 2, 2018 shall get such securities dematerialized before the transfer. The Company being an unlisted public company, Rule 9A(3)(a) of Prospectus and Allotment Rules was applicable to it. Accordingly, transfer of shares of the Company should have been done only if the shares were in dematerialized form. Hence it can be seen that the transfer of shares done by the board of directors three times as mentioned above is in violation of rule 9A(3) of Prospectus and Allotment Rules.

- The Company made a *suo-motto* application to ROC for adjudication of the non-compliance.

Company's contentions

- The contention of the Company was that the Company has taken steps to facilitate the dematerialization of shares by taking an International Security Identification Number ('ISIN'). The Company further stated that after the above three instances of transfer of shares, the Company has not approved any further transfer of shares in physical mode.

ROC's contentions

- ROC stated that transfer of shares in physical mode is not in compliance with Rule 9A(3)(a) of Prospectus and Allotment Rules. Further, the Company has defaulted in permitting the transfer of shares in physical form in all three board meetings as mentioned above. In

ML-759

the context of penalty, ROC stated that the Company is a public company and not covered under the definition of a small company and therefore, section 446B of the Companies Act, 2013 shall not be applicable in this case.

Penalty

- Since Rule 9A of of Prospectus and Allotment Rules does not prescribe any penalty for non-compliance, the penalty is imposed under section 450 of the Act.

Sr. No.	*Penalty Imposed upon*	*Amt*
1.	Company (for all 3 Board Meetings)	30,000
2.	Whole-time Director (for the first 2 board meetings where he was director)	20,000
3.	Managing Director (only for the last board meeting where he was director)	10,000

Companies Act – Case 2

ROC Bangalore adjudication order dated 22 February 2023, in the matter of Lululemon Services Private Limited

Facts of the case

- Lululemon Services Private Limited ('the Company'), is a subsidiary of Lulu US Holding LLC and was registered with the Registrar of Companies – Karnataka ('ROC') on 22 March, 2021.
- The Company appointed Mr. Gareth Daniel James Pope, as an additional director of the Company on 28 February, 2022.
- Mr. Gareth Daniel James Pope attended his first board meeting as an additional director of the Company on 22 March, 2022. In the said board meeting, Mr. Gareth Daniel James Pope missed to disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals in form MBP-1 which was required under sub-section (1) of section 184 of the Companies Act, 2013. Mr. Gabreth Daneil James Pope, the additional director made the disclosure in MBP-1 as was required under section 184(1) on 13 May 2022 (i.e., the second board meeting attended by him as additional director).
- As per section 184(1) of the Companies Act, 2013 every individual shall at the first board meeting where he participates as a Director shall give a disclosure of his concern or interest in any company or companies or bodies corporate or firms or other association of individuals in the manner as may be prescribed. Rule 9(1) prescribes as follows: *Every director shall disclose his concern or interest in any company or companies or bodies corporate [including shareholding interest], firms or other association of individuals, by giving a notice in writing in Form MBP-1.* Since an individual is required to give disclosure of concern or interest in the first board meeting in which he participates as a director, the disclosure given on 13 May 2022 was a delayed disclosure resulting in non-compliance of section 184(1) of the Act read with Rule 9(1) of the Companies [Meetings of Board and its Powers] Rules, 2014. Hence the Company filed a *suo-moto* application for adjudication of the said non-compliance.

Defaulting Director's contentions

- Mr. Anup Kumar, authorized representative of Mr. Gareth Daniel James Pope submitted that his client

ML-760

had attended his first Board meeting on 22 March, 2022 but had missed to make a disclosure of interest [MBP-1]. It was submitted that such non-compliance of section 184(1) read with Rule 9(1) of the Companies [Meetings of Board and its Powers] Rules, 2014 was inadvertent. On identifying the default it was made good and the additional director accordingly made the disclosure of his concern or interest in MBP-1 in the board meeting dated 13th May, 2022. Further, it was submitted that the concerned additional director was not a director in any other Indian company other than the **Lululemon Services Private Limited.**

ROCs Contentions

- The disclosure of concern or interest in any company or companies or bodies corporate, firms, or other association of individuals has to be given at the first board meeting wherein the individual participates as a director. Even if MBP-1 is submitted in next board meeting it is in violation of Section 184(1) read with Rule 9(1) of Prospectus and Allotment Rules. In the context of levying penalty ROC stated that the Company being a subsidiary of foreign entity Lulu US Holding LLC cannot be considered as a small company and hence for levying penalty provision of section 446B of the Act cannot be applied. Hence penalty was levied under section 454(3) of the Companies Act, 2013 for violation of section 184(1) of the Companies Act, 2013.

Penalty

- The ROC levied a penalty on the concerned director amounting to ₹ 1,00,000/- for the delay in disclosing the interest in other entities in form MBP-1.

SEBI Case I

Securities and Exchange Board of India Adjudication order in the matter of Metropolitan Stock Exchange of India Ltd.

Facts of the case

1. Metropolitan Stock Exchange of India Limited (hereinafter referred to as ‘MSEI/Noticee 1’) is a recognized stock exchange of India. During the period July 20, 2019 - July 02, 2021, the Securities and Exchange Board of India (“SEBI”) had received various complaints against MSEI, wherein, irregularities in working of the management of MSEI were alleged. In view of the said complaints received during 2019-2021, *vide* letter dated June 09, 2021 and July 09, 2021, SEBI had advised MSEI to appoint a reputed forensic auditor to conduct the audit of MSEI covering the allegations.

2. SEBI further advised the Governing Board of MSEI to take suitable action on the observations in Forensic Audit Report (“FAR”) against the entities/persons found to be involved in the malpractices, if any, and to submit the ATR to SEBI within 15 days from the date of FAR.

3. Accordingly, MSEI appointed Ernst & Young LLP (“EY”) as a forensic auditor to conduct a forensic audit. EY submitted its report to the Chairman of MSEI, *vide* email dated November 11, 2021.

4. Subsequently, Chairman, MSEI, *vide* its email dated March 02, 2022 submitted the Action Taken Report (“ATR”) to SEBI and also submitted clarification as sought by SEBI.

5. Based on the adverse findings of the forensic auditor comments/ATR,

SEBI observed certain violations of provisions of, *inter-alia*, of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "SEBI Act"), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, (hereinafter referred to as "LODR Regulations"), Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (hereinafter referred to as "SECC Regulations"), Securities Contract (Regulation) Act, 1956 (hereinafter referred to as "SCRA"), Securities Contracts (Regulations) Rules, 1957 (hereinafter referred to as "SCRR")

Charges levied

1. MSEI ('Noticee no. 1') has violated Regulation 33(1) of the SECC Regulations read-with Regulation 4(1)(a) of LODR Regulations pertaining to principles governing disclosures and obligations to be observed by a listed entity/recognized stock exchange) and clauses 25-26 of Indian Accounting Standard-1 ('Ind AS 1') (pertaining to main principles governing accounting policies and stating that information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.)

Contentions by Noticee no. 1

1. **SEBI lacks jurisdiction to assess violation of accounting standards**
   a. Noticee no. 1 contended that jurisdiction to examine an entity's compliance with accounting standard vests with the National Financial Reporting Authority ('NFRA') and not SEBI. Noticee no. 1 further argued that SEBI cannot proceed against Noticee no. 1 for violation of provisions of the SECC Regulations/LODR Regulations, unless the NFRA has conclusively determined non-compliance with AS-1. It needs to be noted that Noticee contended that he has not violated AS-1 but SEBI had levied a charge for violation of Ind AS-1. In support of this contention, Noticee no. 1 quoted the judgment of the Hon'ble Supreme Court in ***Arun Kumar and Ors. vs. Union of India [(2007), 1 SCC 732]***. In this case it was held that by erroneously assuming the existence of jurisdictional facts, no authority, such as SEBI in the instant matter, can confer upon itself jurisdiction which it otherwise does not possess. Hon'able Supreme Court quoted as follows: "*A "jurisdictional fact" is a fact which must exist before a Court, Tribunal or an Authority assumes jurisdiction over a particular matter. A jurisdictional fact is one on the existence or non-existence of which depends jurisdiction of a court, a tribunal or an authority. It is the fact upon which an administrative agency's power to act depends. If the jurisdictional fact does not exist, the court, authority or officer cannot act. If a Court or authority wrongly assumes the existence of such fact, the order can be questioned by a writ of certiorari. The underlying principle is that by erroneously assuming the existence of such jurisdictional fact, no authority can confer upon itself jurisdiction which it otherwise does not possess." From the above decisions**, it is clear that existence of "jurisdictional fact" is sine qua non for the exercise of power. If***

ML-762

the jurisdictional fact exists, the authority can proceed with the case and take an appropriate decision in accordance with law. *Once the authority has jurisdiction in the matter on the existence of "jurisdictional fact" it can decide the "fact in issue" or "adjudicatory fact" A wrong decision on "fact in issue" or on "adjudicatory fact" would not make the decision of the authority without jurisdiction or vulnerable provided essential or fundamental fact as to the existence of jurisdiction is present.*" (Emphasis Supplied)

2. MSEI has not prepared financial statements on going concern basis

- Noticee no. 1 contended that MSEI financial reports had been prepared in compliance with AS-1. Noticee no. 1 further stated that 'Going Concern as per AS-1' is a fundamental assumption and a specific disclosure is required only if this assumption is not followed. Noticee no. 1 was continuously contending that he had not violated AS-1 but SEBI had levied a charge for violation of Ind AS-1.

- MSEI had provided the statutory auditor with the plans and various other steps taken/being taken by them in this regard, forming the basis of such assumption in September 2021. Under such circumstances, an absence of financial projections to support the going concern assumption in the management's representation is not a violation of the AS-1. Considering that MSEI is currently a business operation, it is submitted that it was a valid assumption to make that MSEI is running on a going concern basis.

Submissions by Adjudicating Officer

1. SEBI lacks jurisdiction to assess violation of Accounting Standards

- SEBI stated that Noticee no. 1 has challenged the jurisdiction of SEBI with regard to the examination of compliance with accounting standards, considering the existence of a specialised statutory authority National Financial Reporting Authority ("NFRA") to monitor and enforce the compliance with accounting standards and auditing standards. In response to this SEBI contended that SEBI is not stepping into the shoes of NFRA for determining the non-compliance with accounting standards by the exchange, instead SEBI is placing its reliance upon the report prepared by a reputed forensic accounting expert, in this case EY, and as per the said report the "Auditors" of the Noticee No. 1 have expressed a qualified opinion on the preparation of the books of accounts on going concern basis. Further, if non-compliance or non-adherence with a particular standard of accounting and financial disclosure is going to have an impact on the functioning and operation of the stock exchange or may adversely affect the interest of any stakeholders, in that case, SEBI has every right to look into such issues and violations pertaining to such issues considering the consequential impact on stakeholders and securities market. In this regard, SEBI placed reliance on the

judgment of NFRA dated March 29, 2023, passed under Section 132 of the Companies Act, 2013 and NFRA Rules, 2018 in respect of a complaint made by Brigadier Vivek Chhatre against Mahindra Holidays Resorts India Limited (MHRIL), wherein it was held that:

"3 ……… The SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, (LODR hereafter), require the listed companies like MHRIL to prepare and disclose information in accordance with applicable standards of accounting and financial disclosure. The relevant accounting standards, known as Indian Accounting Standards or Ind AS, have been notified by the Central Government in 2015. All listed companies including MHRIL are required by law to follow the Ind AS in preparing their accounts….

29 ……. In the present context, it is desirable for the CODM of MHRIL to take note of the international developments and practices and also adopt a proactive stance in its disclosures, taking a cue also from the SEBI LODR that expects the entities to follow the disclosure norms in letter and spirit…."

In view of the above and the placing reliance on the aforesaid order of NFRA the contention raised by Noticee 1 is not valid. The judgment of ***Arun Kumar and Others vs. Union of India and Others [(2007) 1 SCC 732]***, as referred by Noticee 1 is factually distinguished from the present case.

2. MSEI has not prepared financial statements on going concern basis

a. SEBI submitted that the statutory auditor of MSEI had made qualifications in his audit report to MSEI for the financial years 2019-2020 and 2020-2021 referring to the findings in the FAR. The audit report for 2019-2020 and 2020-21 stated that the statutory auditor is unable to comment on the aspects relating to preparation of accounts on going concern basis and not making provisions for impairment of GST Credit and MAT Credit Entitlement along with other adjustments, if any, that will be arising if accounts are not prepared on going concern basis. The statutory auditor had stated below mentioned reasons for making such qualifications:

a) Preparation of financial statements on going concern basis despite of incurring significant losses in current and preceding periods

b) Business volumes are not sufficient

c) No clarity on increasing revenue and making profits

d) Non-achievement of projected revenues

e) Consideration of GST Credit (INR 4171 Lakh in FY 2019-20 and INR 4328 lakhs in FY 2020-21) and MAT Credit Entitlement (INR 186 Lakh in FY 2019-20 and FY 2020-21) as recoverable treating the company as a going concern.

ML-764

b. SEBI stated that Noticee 1 in its reply had contended that financial statements of MSEI have been prepared in compliance with AS-1 and Noticee 1 had provided the statutory auditor with the plans and various other steps taken/ being taken by them in this regard, forming the basis of such assumption in September 2021. In this regard, SEBI replied that the allegation levelled against Noticee no. 1 is w.r.t. violation of Ind AS 1 which is broader than Ind AS-1. SEBI stated that with respect to going concern, Ind AS 1 prescribes as follows:

a) *For preparation of financial statements, management shall assess an entity's ability to continue as a going concern.*

b) *Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading or has no realistic alternative but to do so*

c) *However, in cases, where an entity does not have a history of profitable operations and ready access to financial resources,*

d) *management may need to consider a wide range of factors relating to current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.*

By assessing Notice 1's replies with the requirements of Ind AS 1, SEBI stated that in management representation made by Noticee no. 1, in accordance with the requirements of LODR Regulations as well as Ind AS 1, to the statutory auditor for FY 2019-20 does not contain any financial projections with respect to future funding, revenue, costs etc. Though Noticee 1 *vide* its email dated July 20, 2023 has stated that there is a reduction in losses, as compared to previous years, but it can be seen that Noticee 1 is still incurring losses and in line with the letter dated January 25, 2022 submitted by Noticee 1 to SEBI on Noticee 1's future prospects to close and/or merge with some other exchange. Further SEBI stated that the subsidiary of Noticee 1 has no viable plan and also has no incentive to improve performance. Further trading volumes of Noticee 1 have declined significantly from July 2021 and Noticee 1 does not have the required leadership and managerial talent to turn it around and take it to the next level by significantly improving business and implementing new initiatives. SEBI further stated that, from the letter dated January 25, 2022 written by the Chairman of Noticee 1 to SEBI, on future prospects to close and/or merge with some other exchange, the net worth of Noticee 1 has been continuously eroding and if exchange's net worth falls below ₹ 100 crores it needs to be closed down.

c. In view of the same, and in accordance with the qualifications made by the Auditor of Noticee 1,

in its Audit Report, SEBI concluded that Noticee 1 has not complied with the Clause 25-26 of Ind AS 1 and therefore violated the provisions of Regulation 33(1) of the SECC Regulations read with Regulation 4(1) of the LODR Regulations and Clause 25-26 of Ind AS 1.

Penalty

SEBI levied a penalty on Noticee 1 for violation of Regulation 33(1) of SECC regulations read with Regulation 4(1) of LODR Regulations and Clauses 25-26 of Ind AS 1 under section 15A(b) of SEBI Act read with 23A(a) of SCRA – ₹ 2,00,000/-

In this CTC Summary we are only discussing violations concerning the Indian accounting standards and SEBI LODR regulation by MSEI ('Noticee').

IBC Case 1

In the matter of *Mr. Mayur Suchak - Appellant vs. Catalyst Trusteeship Limited – Respondent-1 Renaissance Indus Infra Private Limited Respondent-2 at National Company Law Appellate Tribunal (NCLAT) dated 23 May, 2023.*

Facts of the Case

- M/s Renaissance Indus Infra Private Limited the Corporate Debtor (hereinafter referred as the CD) and Altico Capital India Limited (hereinafter referred to as Altico) entered and executed term sheet for a loan amount of ₹ 650,00,00,000/- (Rupees Six Hundred and Fifty crores) on 11 June 2018.
- In terms of the above Debt Term Sheet, executed between Altico and CD, Altico had agreed to subscribe to the Non-Convertible Debentures (NCDs) amounting to ₹ 390,00,00,000/- (Rupees Three hundred and Ninty crores) pursuant to which, an amount of ₹ 280,00,00,000/- (Rupees two hundred and eighty crores) had been disbursed.
- On 21 June 2018, the Debenture Trustee Appointment Agreement was executed where Vistra ITCL (India) Limited was appointed as the Debenture Trustee (hereinafter referred as Debenture Trustee).
- Further, a Debenture Trustee Document (DTD) was executed on 26 June 2018 between the CD, Promoters (Mr. Mayur Suckak and Ms. Dipti Suchak) and Debenture Trustee under which 390 unlisted, secured, redeemable non-convertible debentures of ₹ 390,00,00,000/- (Rupees Three hundred and Ninty crores) were issued by the CD.
- An Assignment Agreement dated 4 March 2021 was issued by Altico in favour of - Catalyst Trusteeship Limited - Financial Creditor - Assignee (hereinafter referred to as FC).
- Altico as the debenture holder transferred all the rights under the Debentures along with all underlying security interest and rights created by the CD and the other obligations in connection with the debentures, together with the debentures to the FC.
- Pursuant to the execution of the Assignment Agreement dated 4 March 2021, the NCDs were transferred to the account of the FC.
- On 13 July 2022, the Debenture Trustee issued a demand notice to the CD to make outstanding payments due to the FC. However, CD failed to make payment.

ML-766

- On failure to make payment, CD committed events of default as per DTD and therefore the FC issued an Acceleration and Enforcement Notice dated 26 July 2022. No response was given by the CD.

- The FC filed a section 7 application under the Insolvency and Bankruptcy Code, 2016 (IBC) against the CD on 29 July 2022. Notice was issued in the Company Petition.

- Along with the reply an I.A. was also filed by the CD on 26 November 2022 challenging the maintainability of the company petition.

- National Company Law Tribunal (NCLT) *vide* order dated 21 March 2023 admitted the application filed u/s 7 of IBC against the CD on the following grounds:

  — *The Inter Creditor Agreement dated 26 June 2018, the finance parties were intended to collectively mean (a) Debenture Trust Deed (b) Debenture Holders' and (c) any agent of the Debenture Trustee as may be appointed by the Debenture Trustee from time to time. Further Clause 5.6 of the Agreement further clearly stated that all or any of the finance parties would be entitled to bring a suit or other legal proceedings or to take or to instruct the Debenture Trust Deed to take any steps for enforcement of the security created in its or their respective favor for the realization of its respective security interests created under the Debenture document. This also showed that it was not necessary that only the Trustees were competent to launch the legal proceedings. Rather any of the financial parties including the Debenture Holders/assignee could initiate the proceedings for the Enforcement of the security interests created by the Debenture Documents*

- The National Company Law Tribunal (NCLT) vide order dated 21 March 2023 admitted the application filed u/s 7 of IBC against the CD.

- Aggrieved by the order, an Appeal had been filed by the Suspended Promoter & Director of the CD.

Question before the NCLAT: Is the Catalyst Trusteeship Limited ie., the Financial Creditor/Assignment Holder entitled to file an application u/s 7 of the IBC or only the Debenture Trustees, i.e. Vistra ITCL India Limited could file such an application.

Arguments of the Appellant

- As per the DTD as well as the Enforcement Notice, proceedings against the CD can be initiated only by the Debenture Trustee.

- The FC in its reply suppressed various vital documents.

- The DTD read with Inter-Creditor Agreement clearly provided that it was only the Debenture Trustee who was legally entitled to take any action or declare default against the CD either by itself or jointly with the Debenture Holder.

- The FC invoked Enforcement Notice dated 26 July 2022 which notice was contrary to the terms of the Inter-Creditor Agreement. The FC/ Assignee has no locus standi to invoke proceedings u/s 7 of IBC without the prior consent of other lenders.

- The appellant also highlighted the clauses of the DTD Inter-Creditor

Agreement which depicted that the assignment holder had no locus standi in initiating proceedings against the CD which NCLT failed to appreciate.

Arguments of the Respondent

- It was submitted that the Appellant had not disputed the debt and default committed by the CD.
- CD failed to issue any reply to the Demand Notice or the Acceleration and Enforcement Notice.
- The appointment of the Debenture Trustee does not detract or in any manner prejudice the rights of the Debenture Holders to take legal action.
- Notice of payment default dated 13 July 2022 had been issued by the Debenture Trustee on the instructions of FC. Hence, the CD cannot raise any grievance regarding the locus standi of the FC.
- The CD had no privity to the Inter-Creditor Agreement. The other creditor i.e., Clearwater Capital Singapore Fund V Private Limited had also filed its own section 7 application against the CD.
- As per the clauses of the Inter-Creditor Agreement, the rights of each Creditor to avail necessary legal proceedings had been preserved.
- Assignment Agreement categorically records that all rights, entitlements, and claims of the original Debenture Holder have been transferred to the Assignment Holder.
- In the appeal filed by the Appellant, they had also made a statement that they propose to give a fresh offer to the assignment holder for settlement, but no steps were taken by the Appellant in that regard.
- Debt and default being admitted; the NCLT has rightly admitted the Section 7 application under IBC.

Held

- NCLAT after looking into the different clauses of the Debenture Trust Document and Inter-Creditor Agreement, made clear that the Financial Creditor was fully entitled to issue Acceleration Notice.
- The argument of the Appellant that action must be taken by the Debenture Trustee loses its significance.
- Also highlighted the fact that other creditor i.e. Clearwater Capital Singapore Fund V Private having already initiated action under Section 7 of IBC, both the creditors are unanimous in taking action against the CD.
- The submission of the Appellant that there was no majority opinion of the Financial Creditor to take action under the Debenture Trust Document against the CD loses its significance. Furthermore, Clause 9.8 begins with the words "*Notwithstanding anything to the contrary contained in this Deed....*". Clause 9.8, thus has an overriding effect which reserves rights in lender to take all action and seek remedy as available.
- **NCLAT held that the locus standi of a debenture holder to file a section 7 application could not be challenged based on the independent right available to debenture trustees to initiate such proceedings.**
- The Appeal was thus dismissed.

ML-768