Between the lines...

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Highlights

I. Provisions of SICA to prevail over Companies Act even after a winding up order is passed: Supreme Court

The three-Judge Bench of the Supreme Court of India in the case of *Madura Coats Limited* (**"the Appellant"**) *vs. Modi Rubber Ltd.* (**the Respondent"**) *and Ors.,* decided on June 29, 2016, has observed that the winding up proceedings before the Company Court cannot continue after a reference has been registered by the Board for Industrial and Financial Reconstruction (**"BIFR"**) and an enquiry has been initiated under Section 16 of the Sick Industrial Companies (Special Provisions) Act, 1985 (**"SICA"**).

Company Court had passed winding up order against the Respondent and official liquidator was also appointed to take charge of the assets of the Respondent and to submit a report along with the inventory. The Board of Directors of the Respondent had passed a resolution to file a reference before the BIFR under the provisions of SICA and after due procedure, reference to BIFR was registered. It is pertinent to note that while the application for reference was sent to the BIFR before the winding up order was passed by the Company Court, the reference was actually registered with the BIFR after the winding up order was passed by the Company Court. Thereafter, BIFR sanctioned the rehabilitation scheme under SICA, also making provision for unsecured creditors (including the Appellant). Some payment was also made by the Respondent to the Appellant pursuant to an order of the Company Court.

The Division Bench of the Allahabad High Court (**"HC"**) had allowed the Special Appeal of the Respondent and had stayed further proceedings before the Company Court till a final decision was taken on the reference made by the Respondent to the BIFR. This decision of HC was under challenge before the apex Court.

The Supreme Court considered different situations that can arise in the interplay between the Companies Act and the SICA in the matter of winding up of a company, looking at its earlier rulings.

According to the Supreme Court, this appeal from HC decision was squarely covered by the primacy given to the provisions of the SICA over the Companies Act as delineated in its earlier rulings namely, *Real Value Appliances Ltd. v. Canara Bank* and *Rishabh Agro Industries Ltd. v. P.N.B. Capital Services Ltd*. The apex Court also took note of the subsequent developments in the case and the fact that the Appellant had participated before the BIFR and had taken its dues in terms of the rehabilitation scheme.

The Supreme Court observed that whatever may be situation, whenever a reference is made to the BIFR under Sections 15 and 16 of SICA, the provisions of SICA would come into play and they would prevail over the provisions of the Companies Act. Court affirmed the view taken by the HC in concluding that the winding up proceedings before the Company Court cannot continue after a reference has been registered by the BIFR and an enquiry initiated under Section 16 of SICA.

VA View

Adding to the significant rulings in the past by the Supreme Court on this issue, this is yet another judgment pronouncing its stance on the issue concerning primacy of SICA over the Companies Act in certain cases. By this ruling, the apex court has affirmed its ruling in the case of Tata Motors Ltd. v. Pharmaceutical Products of India Ltd, (2008) 7 SCC 619, making it clear that, different situations can arise in the process of winding up a company under the Companies Act but whatever be the situation, whenever a reference is made to the BIFR under Sections 15 and 16 of the SICA, the provisions of the SICA would come into play and would prevail over the provisions of the Companies Act and proceedings under the Companies Act must give way to proceedings under the SICA.

II. Minimize interference with arbitration process as that is the forum of choice: Delhi High Court Division Bench

The Delhi High Court (Division Bench) (**"the Delhi HC"**) in the case of *Mcdonald's India Private Limited* (**"McDonald"**) *vs. Vikram Bakshi* (**"Vikram"**) *and Ors.* (**collectively "the respondents**), decided on July 21, 2016, has observed that Courts should minimize interference with arbitration process, which is the policy discernible from the Arbitration and Conciliation Act, 1996 (**"Arbitration Act"**).

McDonald, Vikram and the McDonald's Corporation, U.S.A. entered into a joint venture agreement (**"JVA"**) for setting up and operating McDonald's restaurants initially within the National Capital Region of Delhi on a non-exclusive basis. Essentially, the agreement was between McDonald and Vikram and, McDonald's Corporation, U.S.A. was a confirming party. The Delhi HC referred to relevant clauses of the JVA and the major developments that took place after the execution of JVA. The crux of the dispute was that McDonald wanted to exercise call option under the JVA as Vikram ceased to be the Managing Director of a company incorporated pursuant to provisions of JVA (**"said company"**). The Company petition before the Company Law Board (**"CLB"**) came to be filed by Vikram and another alleging oppression and mismanagement against McDonald and seeking reinstatement of Vikram as the Managing Director of said company. An order was passed by CLB directing McDonald to maintain status quo over the shareholding, board pattern and right of call option. Thereafter, McDonald terminated the JVA and instituted arbitration proceedings in the London Court of International Arbitration. By an order of the Single Judge of the Delhi

High Court, McDonald was restrained from pursuing the arbitration proceedings until, inter alia, the status quo order passed by CLB was vacated.

The contention of the respondents was that arbitration proceedings at London would be vexatious and oppressive. Several case laws on this and related points were discussed by the Delhi HC. The Delhi HC observed that unless and until a party seeking an anti-arbitration injunction can demonstrably show that the arbitration agreement is null and void, inoperative or incapable of being performed, no such relief can be granted in the suit or as an interim measure therein. The Delhi HC was of the view that the finding of the learned single Judge that the arbitration agreement in the present case is incapable of performance or inoperative because of the pendency of the proceedings in the CLB was not sound. According to the Delhi HC, even if it was assumed that Part I of Arbitration Act was to apply, then also, because of the provisions of Section 8 of the Arbitration Act, the judicial authority was obliged to refer the parties to arbitration, as, the Delhi HC noted that, there is now a mandate to refer the parties to arbitration unless the court finds that prima facie no valid arbitration agreement exists.

The Delhi HC finally concluded that the circumstances of invalidity of the arbitration agreement or it being inoperative or incapable of being performed did not exist in this case and observed, *"Courts must be extremely circumspect and, indeed, reluctant to thwart arbitration proceedings. Thus, while courts in India may have the power to injunct arbitration proceedings, they must exercise that power rarely and only on principles analogous to those found in sections 8 and 45, as the case may be, of the 1996 Act."*

VA View

This ruling emphasis the objectives for which the Arbitration and Conciliation Act, 1996 was enacted. The Delhi HC has observed that courts should not frequently interfere with arbitration proceedings, except to the extent permissible under the applicable provisions of the Arbitration Act thereby ensuring speedy resolution of disputes which is an important facet of the arbitration process.

III. Amendments to the Companies (Share Capital and Debenture) Rules, 2014; the Companies (Incorporation) Rules, 2014 and the Companies (Accounts) Rules, 2014.

The Ministry of Corporate Affairs (**"MCA"**) issued the Companies (Share Capital and Debenture) Amendment Rules, 2016 (**"Amendment Rules"**) on July 19, 2016 which sets out various amendments to the Companies (Share Capital and Debenture) Rules, 2014 (**"Rules"**). The Rules, inter alia, contain procedure for issuance of shares, debentures, disclosures, filing requirements and other compliances relating thereto. The Amendment Rules modify rules with respect to, *inter alia*, issue of equity shares with differential voting rights, sweat equity, employee stock options, secured debentures, pricing requirements for issue of equity shares and other convertible securities.

On July 27, 2016, the MCA amended certain provisions of the Companies (Incorporation) Rules, 2014 (**the "Incorporation Rules"**) and the Companies (Accounts) Rules, 2014 by notifying the Companies (Incorporation) Third Amendment Rules, 2016 and the Companies (Accounts) Amendment Rules, 2016 respectively, with the aim of providing clarity to the rules and easing the process of incorporation as well as filing of financial documents.

The major amendments are summarised as under:

The Companies (Share Capital and Debenture) Amendment Rules, 2016

1. **Conversion rate under preferential allotment process**

   The Amendment Rules have done away with the requirement of shares allotted under preferential allotment to be fully-paid up at the time of allotment. Accordingly, now partly-paid securities can be allotted by means of a preferential issue.

   As per the Rules, in case of convertible securities issued by way of a preferential issue, companies had to determine the conversion price of such securities upfront. The Amendment Rules now allow companies to either determine the conversion price (i) upfront at the time of offering the convertible securities, or (ii) not later than 30 (thirty) days prior to the date when the holder of convertible securities becomes entitled to convert such convertible securities, based on a valuation report of a registered valuer issued not later than 60 (sixty) days prior to such date. Further, companies would have to choose one of the aforesaid options upfront at the time of offering the convertible securities. The Amendment Rules have offered flexibility to determine the conversion price of convertible securities.

2. **Relaxation of restriction on issue of equity shares with differential voting rights**

   The Amendment Rules allow companies defaulting in respect of (i) repayment of term loan or interest thereon, (ii) payment of dividend on preference shares, (iii) payment of statutory dues relating to employees or (iv) crediting amounts to Investor Education and Protection Fund, to issue equity shares with differential rights after 5 (five) years from the end of the financial year in which such default is rectified by the company.

3. **Secured Debenture issuance**

   The Amendment Rules have brought in the much awaited change by allowing creation of charge on the assets or properties of not only the company issuing secured debentures but also of such company's subsidiaries, holding or associate companies. This relaxation is to the extent of creation of charge on specific movable properties of such company's subsidiaries, holding or associate companies.

   The Amendment Rules also expressly permit companies willing to redeem their debentures before maturity to transfer amounts to the Debenture Redemption Reserve even if it may be in excess of the limits specified under the Rules.

4. **Relaxation to Start-ups for issuance of sweat equity and Employee Stock Option Plan ("ESOP"):**

   Start-ups (as recognised by the Department of Industrial Policy and Promotion) have been allowed to issue sweat equity shares up to 50% of their paid-up capital for the first 5 (five) years from the date of their incorporation as against the prevailing limit of 25% for other companies.

   Further, Start-ups have also been expressly permitted to issue ESOPs to their promoters, promoter group and to directors who hold more than 10% of the Start-up's equity shares for the first 5 years from the date of their incorporation whereas other companies are not permitted to do so.

The Companies (Incorporation) Third Amendment Rules, 2016

1. **Signing of memorandum and articles (Rule 13)**

   The amendment clarifies that typed or printed particulars by subscribers and witness to the memorandum and articles of association are permitted, if they are appended with the signature or thumb impression of the person furnishing the same.

2. **Publication of name by company (Rule 26)**

   Every company which has a website for business purposes or for any other purpose, has to publish its name, address of the registered office, the CIN (Corporate Identity Number), telephone number, fax number, e-mail and name of the person to be contacted in case of any query or grievance on the home page of the website.

3. **Alteration of Memorandum by change of name (Rule 29)**

   Under the Incorporation Rules, a company which has not filed its annual returns or financial statements or failed to pay or repay matured deposits or debentures or interest thereon is not allowed to change its name by altering its Memorandum of Association. However, such a company is now permitted to change its name, provided the company files the above mentioned documents and/or makes payment or repayment of matured deposits or debentures or interest thereon.

4. **Conversion of unlimited liability company into a limited liability company by shares or guarantee (Rule 37)**

   A new rule has been inserted which provides the procedure for conversion of unlimited liability company into a limited liability company by shares or guarantee.

The Companies (Accounts) Amendment Rules, 2016

1. **Manner of consolidation of accounts (Rule 6)**

   The companies which meet the following conditions do not have to fulfill the requirements of preparing consolidated accounts:

   i. If the company is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those who are otherwise not entitled to vote, have been intimated in writing and do not object to non-presentation of consolidated financial statements,

   ii. If the securities of the company are not listed or are not in the process of listing on any of the stock exchange, whether in India or outside, and

   iii. Its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which is in compliance with the applicable Accounting Standards.

2. **Companies required to appoint internal auditor (Rule 13)**

   A clarification has been inserted which states that an internal auditor can either be an individual, a partnership firm or a body corporate. Further, the ambit of “chartered accountant” or “cost accountant” is widened to

include even those who have not been in practice and by virtue of the amendment can now be appointed as an internal auditor.

VA View

The Companies (Share Capital and Debenture) Amendment Rules, 2016 enable start-ups to offer more incentives in terms of sweat equity and ESOP issue by relaxing the rules to an extent. The changes have in a way eased issuance of equity and debt. The operational difficulty in offering security while raising money by issuance of secured debentures has been facilitated. While the overall impact of the Amendment Rules is likely to be positive, the provision pertaining to the conversion price of convertible securities still remains ambiguous and more so when read in context of Foreign Direct Investment policy. The option allowed by the Amendment Rules may not necessarily benefit in case of foreign direct investment, since as per the extant Foreign Exchange Management Regulations, the price at the time of conversion or the conversion formula should not in any case be lower than the fair value worked out, at the time of issuance of such convertible security. There is need to sync the amendment provisions under the Companies Act with the FDI policy with respect to conversion price of convertible securities. Nevertheless, other companies sans foreign direct investment could still avail the benefit of exercising this option in case of preferential issue of convertible securities.

The Companies (Accounts) Amendment Rules, 2016 have eased the burden for some companies in respect of exemption from preparation of consolidated financial statements subject to fulfilment of certain conditions. A company can now appoint a chartered accountant or a cost accountant as its internal auditor, regardless of the fact that they are engaged in practice or not.

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