Between the lines...

May, 2020

VAISH ASSOCIATES ADVOCATES ESTD. 1971

NEW DELHI | MUMBAI | BENGALURU

Key Highlights

I. Rajasthan High Court: Approved resolution plan under IBC is binding on government authorities

II. Supreme Court: Foreign awards against fundamental policy of Indian law and basic concept of justice are not enforceable in India

III. Delhi High Court: Lockdown prima facie in nature of force majeure, interim relief granted

IV. Amendments to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019

I. Rajasthan High Court: Approved resolution plan under IBC is binding on government authorities

The High Court of Rajasthan (**"RHC"**) has, by its order dated April 7, 2020 (**"Order"**), held that an approved resolution plan under the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) is binding on government authorities and consequently quashed the notices seeking payment of excise duty and services tax issued by the Goods and Service Tax department to Ultra Tech Nathdwara Cement Limited, for the period before it took over M/s. Binani Cements Limited.

Facts

Brief facts of the case are that a company named M/s. Binani Cements Limited (**"Company"**) had suffered huge losses and was unable to repay its debts to its financial creditor, Bank of Baroda, who consequently filed an insolvency application under Section 7 *(initiation of CIRP by financial creditor)* of the IBC before the National Company Law Tribunal, Kolkata bench (**"NCLT"**). A Corporate Insolvency Resolution Process (**"CIRP"**) was then initiated by the NCLT in which Ultra Tech Nathdwara Cement Limited (**"Petitioner"**) was one of the resolution applicants.

After reviewing and comparing the resolution plans received, the Committee of Creditors (**"CoC"**) came to the conclusion that the resolution plan submitted by the Petitioner was the one that was best equipped to achieve the purposes of the IBC. The resolution plan dealt with the dues of all the creditors equitably and was superior in terms of recovery to the banks and other creditors as compared to the losses which all the creditors would have suffered in the event the Company had gone into liquidation.

The resolution professional collated claims of all operational creditors of the Company and verified the claim of the Central Goods and Service Tax Department **("Respondent")** and others, and earmarked an of INR 72.85 crores towards liabilities of excise duty and service tax. The resolution professional, also determined that the liquidation value of the Company was INR 2,300 crores which was lesser than its outstanding debt and thus, the liquidation value available to the operational creditors, including the Respondent, would be zero.

In a meeting of the CoC held on May 28, 2018, the resolution plan submitted by the Petitioner was approved unanimously and it was declared as being the successful resolution applicant. While considering the resolution plan, the NCLT duly approved the proportion/ distribution of payments to be made by the Petitioner to all the creditors.

Bank of Baroda, being a financial creditor, appealed against the said approved resolution plan before the National Company Law Appellate Tribunal (**"NCLAT"**). By order dated November 14, 2018, the NCLAT affirmed the aforesaid resolution plan approved by the NCLT. Subsequently, Bank of Baroda challenged the resolution plan affirmed by the NCLAT before the Supreme Court, which in turn affirmed the order of the NCLAT by an order dated November 19, 2018. Pursuant to receiving this final seal of approval of the resolution plan by the Supreme Court, the Petitioner took over the management and operations of the Company and the name of the Company was changed to M/s. Ultra Tech Nathdwara Cement Limited. The resolution plan was fully implemented and payments in the terms therein, were duly made to all the creditors, including the statutory creditors.

Despite the aforesaid, the Respondent raised numerous Goods and Service Tax (**"GST"**) demands on the Petitioner for the period from April 2012 to June 2017, including payment of interest up to July 25, 2017. Having made the full and final payment as proposed in the resolution plan, the Petitioner addressed a letter dated November 26, 2018 to the Respondent informing it of the payment by the Petitioner of all dues, as admitted by the CIRP, and reiterating that all remaining claims and proceedings stood extinguished in terms of the approved resolution plan.

Failing to get a positive response from the Respondent, the Petitioner approached the RHC through a writ petition filed under Article 226 of the Constitution of India seeking, *inter alia,* (a) quashing of the demand notices issued by the Respondent towards payment of excise duty and GST by the Petitioner for the period before it took over the Company, and (b) a restraint order against the Respondent from raising any further demands, or from proceeding with any coercive steps so far as dues incurred in relation to the period prior to the transfer date on which the Petitioner took over the Company pursuant to the CIRP.

Issues

(i) Whether the approved resolution plan under IBC is binding on government authorities, who did not have a right to vote or right of audience in the resolution plan approved by the COC.

(ii) Whether operational creditors like the Central Government and State Government to whom a debt in respect of the payment of dues arising under any law for the time being in force is owed, can raise claims after the resolution plan is approved by the adjudicating authority.

Arguments

Contentions raised by the Petitioner:

The Petitioner, *inter alia,* contended that the resolution plan submitted by the resolution professional attained finality only after approval by the CoC and hence, cannot be questioned in a court of law. It was further submitted that the financial creditors are given a precedence in the scheme of the IBC when the resolution plan is being finalized and the statutory and operational creditors have to make a sacrifice.

It was also contended that the approved resolution plan had been affirmed by the NCLAT by its order dated November 14, 2018 and thereafter by the Supreme Court by an order dated November 19, 2018, and thus, the Respondent had no jurisdiction to raise demands from the Petitioner for the period prior to the date on which the Petitioner took over the Company, especially after the resolution plan was finalized and approved.

Also, as per the amended Section 31 of the IBC, the approved resolution plan has to be made binding on the corporate debtor, its employees, members and all creditors including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force is owed. The Petitioner referred to the finance minister of India's clarification on the said amendment where it was stated that the amendment was evidently binding on the government of India and it is one of the ways in which the government is assuring that it will not raise any further claim after the resolution plan is approved.

The Petitioner also drew the RHC's attention to the averments made in the Special Leave Petition (**"SLP"**) filed by the Respondent before the honourable Supreme Court and it was urged that the judgment of the NCLAT approving the resolution plan wherein the Respondent's claim was curtailed and restricted at INR 72.85 crores was specifically challenged by the Respondent and that the same was rejected by the Supreme Court.

Contentions raised by the Respondent:

The Respondent contended that it was not heard by the CoC before finalizing the resolution plan and as such, it was not bound by the same. It was further contended that the mere summary rejection of the SLP preferred by the Respondent against the resolution plan would not foreclose the right of the department to raise its valid demands from the successful resolution applicant.

Observations of Rajasthan High Court

The RHC observed that, it was trite to note that as per the amended Section 31 of the IBC, the Central Government, State Government or any other local authority to whom a debt in respect of payment of dues arising under any law for the time being in force are owed, have been brought under the umbrella of the resolution plan approved by the adjudicating officer, which has been made binding on such government and local authorities.

The purpose of the IBC was salutary as it had been enacted to ensure that an industry under distress does not fade into oblivion and can be revived by virtue of the resolution plan. Once the offer of the resolution applicant is accepted and the resolution plan is approved by the appropriate authority, the same is binding on all concerned to whom the industry may be having statutory dues.

No right of audience is given in the resolution proceedings to the operational creditors, that is, the Central Government or the State Government, as the case may be. The reply given by the Finance Minister of India emphatically conveys that the revival of the dying industry is of primacy concern and to secure this objective, the government would be ready to sacrifice, leaving its interest finally in the hands of the resolution professional and the CoC, as the case may be.

The RHC also referred to the case of ***Committee of Creditors of Essar Steel India Limited through Authorised Signatory v. Satish Kumar Gupta and Others [2019(16) SCALE 319],*** where it was observed by the Supreme Court that: *"Section 31(1) of IBC makes it clear that once a resolution plan is approved by the Committee of Creditors it shall be binding on all stakeholders, including guarantors. This is for the reason that this provision ensures that the successful resolution applicant starts running the business of the corporate debtor on a fresh slate as it were. A successful resolution applicant cannot suddenly be faced with 'undecided' claims after the resolution plan submitted by him has been accepted as this would amount to a hydra head popping up which would throw into uncertainty amounts payable by a prospective resolution applicant who successfully takes over the business of the corporate debtor. All claims must be submitted to and decided by the resolution professional so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the corporate debtor."*- emphasis supplied.

The RHC observed that in light of the ratio of the above judgment and the stance of the finance minister before the upper house of the Parliament it was clear that the financial creditors have to be given a precedence in the ratio of payments when the resolution plan is being finalized. It is the financial creditors who are given the right to vote in the CoC whereas, the operational creditors, which are, commercial taxes department of the Central Government or the State Government, as the case may be, have no right of audience.

The purpose of the statute is clear that it intends to revive the dying industry by providing an opportunity to a resolution applicant to take over the same and begin the operation on a clean slate. Towards that purpose the evaluation of all dues and liabilities, as they exist on the date of finalization of the resolution plan, have been left in the exclusive domain of the resolution professional with the approval of the CoC.

In addition, from the two possible situations, one being liquidation and the other being revival, the Respondent would gain significantly in case of the latter since as per the assessed liquidity value, their dues have been assessed as nil, whereas as per the resolution plan with revival of the industry at the instance of the resolution applicant, their rights have been secured to the extent of INR 72 crores. Also, the amount of INR 72 crores assessed by the resolution professional in favour of the Respondent has already been deposited by the Petitioner.

Decision of the Rajasthan High Court

In disposing off the writ petition, the RHC held the view that the Respondent would be acting in a completely illegal and arbitrary manner while pressing for demands raised by the notices which are impugned in the aforesaid writ petition and any other demands which they may contemplate for the period prior to the resolution plan being finalized. The demand notices issued by the Respondent were ex-facie illegal, arbitrary and per-se could not be sustained. Accordingly, the impugned demand notices and any further demands pending as on the date of finalization of the resolution plan issued/ raised by the Respondent were to be quashed and struck down.

VA View:

While the High Court of Rajasthan has, in the present case, clearly held that a resolution plan approved by the CoC would be binding on all concerned parties, including government departments to whom statutory dues are payable by the corporate debtor, its view has not been upheld by some other courts.

A case in point in this regard is the matter of ***Electrosteel Steels Limited v. The State of Jharkhand [W.P.(T). No. 6324 of 2019 and analogous matters]*** that was subsequently decided by the High Court of Jharkhand (on May 1, 2020), in which it was held that a resolution plan, although approved by the adjudicating authority in favour of a resolution applicant, but not brought to the knowledge of the concerned government stakeholders, would run contrary to Section 31 of the IBC which provides that the approved resolution plan would be binding only on those stakeholders that were involved in the resolution plan.

Per contra, as per to the judgment of the Rajasthan High Court, Section 31 of the IBC clearly emphasizes that government authorities will be bound by the resolution plan approved by the CoC under the IBC, irrespective of whether they were involved in the resolution plan or had an audience before the CoC. This has further been buttressed by the finance minister's statement before the upper house of the Parliament, mentioning that the government is to make no further claim after a resolution plan has been approved. This principle has also been sustained by the Supreme Court in the form of dismissal of the special leave petition filed by the GST Department challenging the order of the NCLAT upholding the approved resolution plan.

Considering that the interpretation of Section 31 of the IBC in its current form is leading to divergent views on the requirement of resolution plans being binding on stakeholders who have not been informed of and involved in the resolution process,it is therefore imperative that necessary clarifications in this regard be introduced in the IBC itself to reduce the possibilities of contentious litigation arising as a consequence of divergent views taken by various High Courts.

II. Supreme Court: Foreign awards against fundamental policy of Indian law and basic concept of justice are not enforceable in India

The Supreme Court (**"SC"**) in the case of ***National Agricultural Co-operative Marketing Federation of India (NAFED) v. Alimenta SA*** *(decided on April 22, 2020)* held that foreign arbitration awards against NAFED is ex facie illegal, and in contravention of fundamental law, as no export without the requisite permissions was permissible and without the consent of the government, quota could not have been forwarded to next season.

Facts

The dispute arose forty years ago in the year 1980 over supply of groundnut to Ailmenta. NAFED, a government agent, and Alimenta had entered into a contract for supply of 5,000 tons of Indian groundnut.

Clause 14 – Prohibition of the contract reads as, *"In the event, during the shipment period of prohibition of export of* ***any other executive or legislative act by or on behalf of the Government of the country of origin*** *or of the territory where the port/s or shipment named herein is/are situate, or of blockade or hostilities,* ***restricting export, whether partially or otherwise, any such restriction shall be deemed by both parties to apply to this contract and to the extent of such total or partial restriction to prevent fulfilment whether by shipment or by any other means whatsoever and to that extent this contract of any unfulfilled portion thereof shall be extended by 30 days. In the event of shipment during the extended period still proving impossible by reason of any of the causes in this Clause, the contract or any unfulfilled part thereof shall be cancelled."***

For any export, NAFED required the express consent of the government and the transaction was also governed by covenants such as force majeure. Due to crop damage in Saurashtra, only 1900 tons could be supplied, and the rest of the contractually mandated amount was not supplied due to government restricted export policy and quota ceiling.

Alimenta treated NAFED's non-supply of commodity as a notice of default and initiated arbitration proceedings before the Federation of Oil, Seeds and Fats Associations (**"FOSFA"**), London, in February 1981. NAFED moved to the Delhi High Court for seeking a stay of the arbitration proceedings, various interim orders were passed by the Delhi High Court. Despite interim orders by the High Court of Delhi, the arbitral tribunal was constituted and FOSFA appointed an arbitrator for NAFED.

Eventually, the High Court of Delhi held that one order of supply was subject to arbitration while the other was relegated to a civil suit. Against the order of the High Court of Delhi, NAFED approached the SC. The SC also passed interim orders. The arbitral tribunal contravened even these interim orders and the arbitration proceeding proceeded before FOSFA and pursuant thereto arbitration award was passed in November 1989, holding NAFED liable to pay USD 4,681,000 as damages and interest.

Ailmenta moved to the Delhi High Court for enforcement, and NAFED objected to the award on the grounds of public policy. The Delhi High Court ruled against NAFED, and consequently an appeal was filed in the SC.

Issues

(i) Whether NAFED was unable to comply with the contractual obligation to export groundnut due to the Government's refusal.

(ii) Whether NAFED could have been held liable in breach of contract to pay damages particularly in view of Clause 14 of the agreement.

(iii) Whether enforcement of the award is against the public policy of India.

Arguments

The submissions of the counsel for NAFED were:

(i) The arbitral tribunal was constituted in violation of the Delhi High Court's order and thereby a nullity.

(ii) The tribunal was against the basic principles of natural justice, rule of fairness, and against public policy.

(iii) The contract between Ailmenta and NAFED was frustrated due to the prohibition imposed by the government.

(iv) The Delhi High Court in the order dated January 28, 2000 was wrong in awarding a further interest @18% p.a. on the awarded sum.

(v) The limitation to file the enforcement proceedings was not 3 years but was in fact 30 days as per the Limitation Act, 1963.

(vi) Alimenta could not have been given the benefit of interest as also the benefit of the exchange rate.

(vii) The date of USD decree conversion into Indian Rupees.

The submissions of the counsel for Ailmenta argued that the interference allowed in a foreign award is limited and the award is not contrary to public policy.

Observations of the Supreme Court

The SC referred to Section 32 of the Indian Contract Act, 1872 which deals with 'contingent contracts' and provides for contingencies upon happening of which the contract cannot be carried out, and the consequences thereof. It held that a possible prohibition on export having been specifically envisaged, it was a contingent contract, and once that contingency arose, that is, the refusal to allow NAFED to export the commodity, the contract was required to be cancelled.

The SC also distinguished Section 32 from Section 56 of the Indian Contract Act, which deals with 'frustration' of a contract and applies where an agreement becomes impossible to perform at a future date on account of an unforeseen exigency not provided for in the agreement. In this case, the court held that the principle of frustration did not apply given the wordings of Clause 14 of the FOSFA and the contract dated January 12, 1980 explicitly provided for the event preventing NAFED from performing its obligations.

The SC also observed that there was no permission to export commodity of the previous year in the next season, and the Government declined permission to NAFED to supply. Thus, it would be against the fundamental public policy of India to enforce such an award, as any supply made then would contravene the public policy of India relating to export for which permission of the Government of India was necessary.

The SC also referred to the settled principles in ***Renusagar Power Company Limited v. General Electric Company [1994 Supp. (1) SCC 644]*** **("Renusagar")** in which the apex court held that "the enforcement of a foreign award would be refused on the ground that it is contrary to public policy if such enforcement would be contrary to: (i) fundamental policy of Indian law; or (ii) the interests of India; or (iii) justice or morality."

The SC also observed the ruling in ***Vijay Karia v. Prysmian SA*** *(decided on February 13, 2020)* that the fundamental policy of Indian law, as has been held in Renusagar, must amount to a breach of some legal principle or legislation which is so basic to Indian law that it is not susceptible of being compromised. "Fundamental Policy" refers to the core values of India's public policy as a nation, which may find expression not only in statutes but also time-honoured, hallowed principles which are followed by the courts.

Decision of the Supreme Court

The SC set aside the arbitral award on the grounds of being contrary and violative of Indian public policy.

VA View:

This decision puts to rest a forty-year-old dispute which reinforces the doubt foreign companies may have in the judicial process of Indian courts. The decision of the apex court in Renusagar gave a narrow scope to the challenge of a foreign arbitral award. The sanctity of foreign awards has been respected in subsequent judgements as well.

The observations of the SC in this case although pertains to the provisions of the Foreign Awards Act, 1961 and therefore may be fact specific, however, given the contractual terms and the facts that transpired then, the SC rightfully applied the provisions of the contract act in holding that the contract (especially Clause 14) which was executed was a contingent contract and held that the award is in violation of public policy.

III. Delhi High Court: Lockdown prima facie in nature of force majeure, interim relief granted

The Delhi High Court (**"DHC"**) has, in the case of ***M/s. Halliburton Offshore Services Incorporated v. Vedanta Limited and Others*** *(decided on April 20, 2020)* temporarily injuncted Vedanta Limited (**"Vedanta"**) from encashing bank guarantees issued on behalf of Halliburton Offshore Services (**"Halliburton"**) as the lockdown due to Covid-19 would prima facie amount to force majeure.

Facts

Vedanta and Halliburton entered into an agreement dated April 25, 2018 for the integrated development of three blocks to drill petroleum wells. In terms of the said contract, various performance, liquidated damages and advance bank guarantees were furnished by Halliburton. The above order was filed in an application filed under Section 9 *(interim measures, etc., by court)* of the Arbitration and Conciliation Act, 1996 whereby Halliburton sought to restrain Vedanta from encashing the bank guarantees provided to Vedanta.

Issue

Whether the delay in the performance due to the Covid-19 induced lockdown can be condoned.

Arguments

The counsel for Halliburton argued that even though the contractual obligations have been substantially performed, the delay in performance of the remaining portion was not complete owing to a complete lockdown, on industrial activities as well as on movement of persons in the country, including, specifically, the state of Rajasthan consequent to the Covid-19 pandemic. It was argued that Halliburton was unavoidably handicapped in performing the contract as performance of the contract required travel of persons from overseas, as well as workmen from various parts of the country.

The counsel appearing for Vedanta argued that in law, the only ground on which invocation of a bank guarantee can be stayed, is the existence of egregious fraud, for which purpose reliance was placed on ***U. P. Cooperative Federation Limited v. Singh Consultants and Engineers (Private) Limited*** *(dated November 19, 1987)* and ***Svenska Handelsbanken v. Indian Charge Chrome*** *(dated January 24, 1994).* It was further emphasised that the contract envisaged work to be carried out by Halliburton in three wells, to be completed on January 16, 2019, March 16, 2019 and June 16, 2019 respectively and that the delay has been unconscionable, and has never been condoned, either expressly or impliedly. It was argued that Halliburton is merely seeking to piggyback and reap benefits of the Covid-19 crisis that had befallen the country.

It was further argued that the project, being an oil well, stood specifically exempted from the lockdown, as imposed by the Government, by circular dated March 26, 2020, of the Government of India. As a rejoinder to the above point, the counsel for Halliburton stated that the abovementioned exemption would not apply to Halliburton as it was not engaged in the production of oil as such, but was engaged in drilling of the wells.

Observations of the Delhi High Court

The DHC further stated on analysis of various decisions by courts, that egregious fraud is well encapsulated as one of the two grounds on which invocation of an unconditional bank guarantee may be injuncted, the second ground is of irretrievable or irreparable injury. The decision of the Supreme Court in ***Standard Chartered Bank Limited v. Heavy Engineering Corporation Limited*** *(decided on December 18, 2019)* was discussed, where it was held that:

"The settled position in law that emerges from the precedents of this Court is that the bank guarantee is an independent contract between bank and the beneficiary and the bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable one. The dispute between the beneficiary and the party at whose instance the bank has given the guarantee is immaterial and is of no consequence. There are, however, exceptions to this Rule when there is a clear case of fraud, irretrievable injustice or special equities. The Court ordinarily should not interfere with the invocation or encashment of the bank guarantee so long as the invocation is in terms of the bank guarantee."

It was then concluded by the DHC that the above mentioned case of ***Standard Chartered Bank Limited v. Heavy Engineering Corporation Limited*** held that the existence of irretrievable injustice and special equities, as distinct circumstances would justify an order of injunction. It was observed that there appears to be no gainsaying the proposition that where "special equities" exist, the court is empowered, in a given set of facts and circumstances, to injunct invocation, or encashment, of a bank guarantee.

It was also observed that the counsel for Halliburton had limited his prayer to an injunction continuing up to the expiry of one week from the end of the Covid-19 related lockdown as had the lockdown not intervened, Halliburton would have been able to complete the work assigned, which was viewed as a limited amnesty by the DHC.

Decision of the Delhi High Court

The DHC declared an *ad-interim* stay on the invocation and encashment of the bank guarantees till the date of the next hearing and directed Vedanta to ensure that the guarantees remained live until then.

VA View:

The DHC correctly stated that the devastation, human, economic, social and political, that has resulted as a consequence of the Covid-19 pandemic and subsequent lockdown, is unprecedented. However, it is important to note that this is not a blanket injunction and will be applicable only till the next hearing.

The principle, however is more important than the facts especially since activities regarding oil and petroleum are, in general, exempt from the rigors of the lockdown.

The DHC rightly appreciated that the facts of the activities in question require manpower and travel. Therefore, we can expect similar cases in the future, especially where bank guarantees are being/ going to be invoked, where if the facts prove that there was no possible way to complete the terms of a contract, similar relaxations will be given, unless otherwise directed by the Honourable Supreme Court.

IV. Amendments to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019

The Ministry of Finance has on April 22, 2020 and April 27, 2020 published the Foreign Exchange Management (Non-debt Instruments) Amendment Rules, 2020 (**"Amendment Rules"**) and the Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules, 2020 (**"Second Amendment Rules"**) respectively to amend the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (**"NDI Rules"**).

Foreign Exchange Management (Non-debt Instruments) Amendment Rules, 2020

The Amendment Rules have come into force due to the current Covid – 19 pandemic and is to curb the opportunistic takeover/acquisition of Indian companies.

Prior to the amendment of the NDI Rules, foreign investment was permitted under automatic route for countries such as China, Hong Kong, etc., unless the sectoral policy prescribed for approval. However, with the Amendment Rules, an entity of a country, or beneficial owner of an investment from a country, which shared its land border with India, shall invest in an Indian company only with the prior approval of the government. The Amendment Rules also require the approval of the government where foreign investment in form of transfer of ownership of any existing or future foreign direct investment results in the beneficial ownership or investment from a country, which shared its land border with India.

The countries falling within the ambit of these Amendment Rules are Afghanistan, Bangladesh, Bhutan, China, Myanmar, Nepal and Pakistan. It is unclear whether Hong Kong and Taiwan would be seen to be covered within the ambit of the Amendment Rules.

Beneficial Ownership Deconstructed:

The NDI Amendment Rules do not define the term beneficial ownership. Therefore, the concerned parties would have to rely on the Companies (Significant Beneficial Owners) Rules 2018 and/or the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (**"PMLA Rules"**) to apply the threshold for being a beneficial owner. However, both the Rules define the term differently as the threshold under the Companies Act for significant beneficial ownership is a person who holds indirectly, or together with direct holdings, at least 10% of the shares or voting rights of the share; or has the right to receive or participate in at least 10% of the total distributable dividend, or any other distribution, in a financial year; or who exercises significant influence or controlin any manner other than through direct holding alone whereas under PMLA Rules, in case of a company, it is ownership of or entitlement to at least 25% of shares or capital or profits of the company or who has the right to appoint majority of the directors or control management or policy decisions; in case of partnership firm, incorporated associations or body of individuals, it is 15% of the capital or its profits, and in case of a trust, it is at least 15% of interest in the trust.

The government should clarify the meaning of beneficial ownership at the earliest. In the absence of a clarification, it is implied that any foreign investment, whether direct or indirect, from such countries will require approval of the government.

It is also not clear whether the Amendment Rules would apply to rights issue, bonus issue, and whether even rights issue and bonus issue would require government approval.

Foreign Portfolio Investment **("FPI")**:

A question that arises is whether FPI, that is, an investment which is less than 10% of the equity capital of a listed company would be impacted by the Amendment Rules. Presently, it appears that the Amendment Rules do not apply to FPI investment.

Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules, 2020

Renunciation of Rights

Section 62 of the Companies Act, 2013 states that at the time of a rights issue, an existing shareholder has the right to renounce the shares offered to him or any of them in favour of any other person.

The Central Government has omitted the explanation of Rule 7 and introduced Rule 7A which states that in the event a person resident in India renounces their right to equity shares to a person resident outside India, then the pricing guidelines specified under the NDI Rules are to be abided by the issuing company.

The explanation to the NDI Rules provided that a person resident outside India was permitted to invest in equity instruments (other than share warrants) issued by an Indian company as a rights issue that were renounced by the person to whom such equity instruments were offered to. However, there was no pricing guidelines that were provided for the same. Thus, before the Second Amendment Rules, the following was to be complied with:

1. in case of a listed Indian company, the rights issue to persons resident outside India shall be at a price determined by the company; and
2. in case of an unlisted Indian company, the rights issue to persons resident outside India shall not be at a price less than the price offered to persons resident in India;

This led to many entities taking advantage of the lacuna and many foreign investors acquired equity instruments issued by an Indian entity for a cheaper price. This is commonly known as a designed rights issue.

Thus, the Central Government has endeavored to plug this loophole through the Second Amendment Rules. Therefore, post the enforcement of the Second Amendment Rules, the issue price of the shares subscribed by a person resident outside India pursuant to the renunciation would be as follows:

1. in case of an unlisted company, the price should not be less than fair value computed as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with the Securities and Exchange Board of India (**"SEBI"**) or a practicing Cost Accountant; and
2. in case of a listed company, the pricing shall not be less than price arrived as per applicable SEBI guidelines. If renunciation of shares is treated as rights issue then the pricing can be done as rights issue pricing guidelines. However, if shares issued pursuant to renunciation were to be treated as separate from rights issue, then the price should be determined in such a situation as there are no relevant SEBI guidelines dealing with pricing of

shares issued pursuant to preferential issue. Considering that as per presently applicable SEBI regulations there is no differentiation on pricing of shares issued pursuant to renunciation, it appears that the former approach is better and if that is the case, it may be concluded that there is no impact of this amendment to subscription of renunciation of rights shares by the shareholders in a listed company.

If the renunciation is in favour of Non-resident Indian (**"NRI"**) or an Overseas Citizen of India (**"OCI"**) and the shares proposed to be acquired on non-repatriation route, then in such a situation the NRI or OCI may acquire the shares at the rights issue price as pricing restrictions are not applicable to investment on non-repatriation basis.

If the renunciation shares are to be acquired by foreign venture capital investor (**"FVCI"**), then in our view pricing guidelines would not apply as pricing guidelines are not applicable to shares issued to FVCI.

The Second Amendment Rules are silent about a situation where a non-resident renounces the rights shares in favour of another non-resident and hence it is open to interpretation as to whether pricing guidelines as per the Second Amendment Rules will have to be complied with in such a situation.

Another interesting question that arises is where a non-resident renounces the rights shares in favour of a Foreign Owned and Controlled Company Incorporated in India (**"FOCC"**) or whether FOCC renounces the rights shares in favour of another FOCC, will such FOCC (renunciation) also have to comply with pricing guidelines as per the Second Amendment Rules for subscription to shares to be acquired pursuant to renunciation.

<u>Liberalization of foreign investment in insurance intermediaries</u>

The Central Government has increased the cap for FDI in insurance intermediaries from 49% to 100%. Insurance intermediaries would be insurance brokers, insurance consultants, corporate agents, third party administrators among others. This amendment comes as a relief to many, as persons not resident in India may now invest 100% in insurance intermediaries, provided they would be verified by the Insurance Regulatory and Development Authority of India (**"IRDAI"**). It is noted that the sectoral cap for insurance companies still remains at 49%.

Foreign investors wanting to hold majority shareholding in an insurance intermediary shall comply with the following conditions, as per the Second Amendment Rules:

(i) be incorporated as a limited liability company under the provisions of the Indian Companies Act, 2013;

(ii) at least one from among the Chairman of the Board of Directors or the Chief Executive Officer or Principal Officer or Managing Director of the insurance intermediary shall be a resident Indian citizen;

(iii) shall take prior permission of the **IRDAI** for repatriating dividend;

(iv) shall bring in the latest technological, managerial and other skills;

(v) shall not make payments to the foreign group or promoter or subsidiary or interconnected or associate entities beyond what is necessary or permitted by the Authority;

(vi) shall make disclosures in the formats to be specified by the **IRDAI** of all payments made to its group or promoter or subsidiary or interconnected or associate entities; and

(vii) composition of the Board of Directors and key management persons shall be as specified by the concerned regulators.

It has been further clarified that where an entity like a bank, whose primary business is outside the insurance area, is allowed by IRDAI to function as an insurance intermediary, the foreign equity investment caps applicable in that sector shall continue to apply, subject to the condition that the revenues of such entities from the primary (non-insurance related) business must remain above 50% of their total revenues in any financial year.

Amendment to Single Brand Retail Trading (**"SBRT"**)

The amendment made under SBRT is clarificatory in nature. It states that the sourcing norms shall not be applicable up to three years from the commencement of business. Commencement of business earlier only included opening of the first store, but post the amendment it also includes first store or an online retail store, whichever would be earlier.

Divestment by FPI

On breach of investment limit by FPI, FPI has an option to divest or reclassify their investment as FDI. Now the divestment or reclassification is subject to additional conditions, if any, specified by SEBI and the Reserve Bank of India (**"RBI"**) in this regard. No conditions have been specified so far. However, given the amendment SEBI/RBI may specify further conditions.

Contributors:

Ajita Patnaik, Drushan Engineer, Ishita Mishra, Mahim Sharma and Rhea Sethi.

Disclaimer:

While every care has been taken in the preparation of this Between the Lines to ensure its accuracy at the time of publication, Vaish Associates, Advocates assumes no responsibility for any errors which despite all precautions, may be found therein. Neither this bulletin nor the information contained herein constitutes a contract or will form the basis of a contract. The material contained in this document does not constitute/substitute professional advice that may be required before acting on any matter. All logos and trade marks appearing in the newsletter are property of their respective owners.

© 2020, Vaish Associates Advocates
All rights reserved.

Contact Details :

www.vaishlaw.com

NEW DELHI
1st, 9th & 11th Floor
Mohan Dev Bldg. 13 Tolstoy Marg
New Delhi - 110001, India
Phone: +91-11-4249 2525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI
106, Peninsula Centre
Dr. S. S. Rao Road, Parel
Mumbai - 400012, India
Phone: +91-22-4213 4101
Fax: +91-22-4213 4102
mumbai@vaishlaw.com

BENGALURU
105-106, Raheja Chambers,
#12, Museum Road,
Bengaluru 560001, India
Phone: +91-80-40903588 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com