Newsletter

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Editor's note

Dear Readers,

I am pleased to share with you our newsletter for the month of April, 2024, which covers significant legal and regulatory developments.

The recent judicial pronouncements made by various High Courts across India are notable and collectively underscore the evolving jurisprudence surrounding arbitration in India. Following a recent case, the Calcutta High Court delineated the necessity of a clear and explicit arbitration agreement between parties emphasizing on precision and specificity in drafting arbitration provisions to avoid ambiguity.

Recent judgments and rulings by various judicial bodies in India have significantly influenced the interpretation and application of the Insolvency and Bankruptcy Code (IBC). Notably, the National Company Law Appellate Tribunal (NCLAT), New Delhi and the Allahabad High Court have rendered decisions that bear substantial implications on the insolvency resolution process. While, the NCLAT, New Delhi held that extending the timeline does not amount to a modification of the resolution plan's terms the Allahabad High Court's ruling clarified the scope of moratorium under Section 14 of the IBC.

In a recent ruling, the Hon'ble Supreme Court of India has provided significant clarity on the interpretation of the term 'person' as delineated in the Consumer Protection Act of 1986 which not only clarifies the scope of its applicability but also reinforces the overarching objective of providing robust protection to consumers in the modern marketplace.

The Reserve Bank of India (RBI) has recently introduced a series of directives that encompass a range of areas, from loan agreements to foreign exchange transactions, and are indicative of the RBI's commitment to fostering a robust and resilient financial ecosystem. With the adoption of principles from the Basel Committee on Banking Supervision (BCBS), the RBI's Guidance Note underscores the importance of operational risk management and resilience across regulated entities. By providing a principle-based approach, the RBI seeks to ensure smooth implementation while catering to the diverse nature and risk profiles of financial institutions. Further, RBI's criteria for transitioning Small Finance Banks to Universal Banks by setting stringent conditions related to performance, net worth, and asset quality facilitate a smooth transition while safeguarding the interests of stakeholders.

The Securities and Exchange Board of India (SEBI) has recently introduced several amendments and relaxations to regulatory frameworks, enhancing ease of compliance, promoting efficient risk management, and fostering a conducive environment for investors and market participants.

SEBI's notification of amendments to AIF Regulations provides AIFs with greater flexibility in managing unliquidated investments during the dissolution period. Further, SEBI's framework for AIFs to create encumbrances on equity holdings of investee companies aims to facilitate fund-raising activities while ensuring prudent risk management. Furthermore, steps taken by SEBI in promoting investor protection, and fostering a conducive environment for the Indian capital markets showcase their proactive approach towards enhancing regulatory efficiency.

In this edition we have also included an article, "Deciphering the Distinction: Supreme Court Ruling on Financial Debt Vs. Operational Debt under the Insolvency and Bankruptcy Code, 2016' which delves into the crucial distinction between financial debt and operational debt under the Insolvency and Bankruptcy Code, 2016 (the Code) and analyzes a recent landmark ruling by the Hon'ble Supreme Court in the case of Global Credit Capital Limited & Anr. v. Sach Marketing Private Limited & Anr. This article is authored by our Principal Associate, Nishtha Arora and Associate, Srishti Bansal.

I hope you will find this edition useful.

Best wishes,

Rajesh Narain Gupta

Founder & Chairman,
SNG & Partners

A. ARBITRATION & CONCILIATION ACT, 1996:

1. **Calcutta High Court: 'A certified copy of the original agreement duly attested by the Notary Public is sufficient to fulfill the requirement of S. 8(2) of the Arbitration Act'**

The High Court of Calcutta, while allowing a revision petition filed under Article 227 of the Constitution of India by the petitioner, challenging the order dated 7th July 2015 passed by the learned Civil Judge vide which it rejected the application filed by the present petitioner/defendant filed under Section 8 with Section 5 of the Arbitration and Conciliation Act, 1996, held that the petitioner/defendant filed the certified copy of the original agreement duly attested by the notary public which in terms of the law cannot be said to be a not duly certified copy of the original agreement as required under the provision of the Act.

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2. **Tripura High Court: It is the duty of parties to the Agreement to refer any of their disputes to Arbitrator**

The division judge bench of the Tripura High Court held that the language of Section 8 of the Arbitration & Conciliation Act, 1996 is very clear, and it casts upon an obligation upon the parties to the agreement to refer any of their disputes to the Arbitrator.

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3. **Calcutta High Court: 'Mere communication of a decision to go to Arbitration cannot be construed as an Arbitration Agreement between parties u/S. 7 of the Act'**

The High Court of Calcutta, while disposing of a review application filed by the Applicant seeking review of an order dated 1 December 2022 passed under section 11(6) of the Arbitration and Conciliation Act, 1996, held that an arbitration clause cannot be deemed to have been incorporated by way of a subsequent circular unless it is specifically referred to and included in the original agreement between the parties.

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4. **'Explanation for delay usual and stereotypical'; Allahabad High Court dismisses appeal seeking setting aside of arbitral award after four years**

The Allahabad High Court, while rejecting an appeal challenging the arbitral award after more than four years observed that the period of filing of application under Section 34 against the arbitral award is 90days with a grace period of 30 days, whereas the appellants had approached the Commercial Court after a delay of 4 years and 9 months.

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B. INSOLVENCY AND BANKRUPTCY CODE (IBC)

1. NCLAT, New Delhi: Extension of time does not amount to modification of resolution plan

The NCLAT, Principal Bench, New Delhi opined that that the National Company Law Tribunal ("NCLT") has jurisdiction to grant extension of timeline in making the payment in a Resolution Plan and the view of the NCLT that granting of extension of the timeline is modification of the terms of the Resolution Plan is not a correct view.

Further, for extension of timeline it is not necessary that committee of creditors ("CoC") should express its concurrence, only then the NCLT can exercise its jurisdiction. Granting extension of time in payment as per Resolution Plan for implementation of the Resolution Plan, appropriate jurisdiction is always vested with the NCLT to pass appropriate order.

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2. Allahabad High Court : Moratorium u/S. 14 prohibiting the proceeding u/S. 138/141 N.I. Act not applicable only against the corporate debtor and not against the natural persons

The Allahabad High Court held that on commencement of the insolvency resolution process, the moratorium u/s 14 of IBC prohibiting the proceeding u/s 138/141 Negotiable Instruments Act, 1881 will be applicable only against the corporate debtor and not against the natural persons like the directors of the company for their vicarious liability.

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3. NCLT, Kolkata: Application for seeking orders relating to meeting of shareholders in scheme of arrangement between ITC Limited and ITC Hotels Limited Allowed

The NCLT, Kolkata Bench allowed application preferred for orders and directions with regard to meetings of shareholders and creditors in connection with the Scheme of Arrangement between ITC Limited (Demerged Company) and ITC Hotels Limited (Resulting Company).

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C. MINISTRY OF CORPORATE AFFAIRS (MCA)

1. Supreme Court: Definition of 'person' as provided in the Consumer Protection Act 1986 is inclusive and not exhaustive

The Hon'ble Supreme Court expounded that the definition of 'person' as provided in the Act of 1986 is inclusive and not exhaustive. Consumer Protection Act, being a beneficial legislation, a liberal interpretation has to be given to the statute.

The very fact that in the Act of 2019, a body corporate has been brought within the definition of 'person', by itself indicates that the legislature realized the incongruity in the unamended provision and has rectified the anomaly by including the word 'company' in the definition of 'person'.

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D. RESERVE BANK OF INDIA (RBI)

1. Key Facts Statement (KFS) for Loans & Advances

To harmonize the instructions on Key Facts Statement (KFS) for Loans & Advances and to enhance transparency and reduce information asymmetry on financial products being offered by different regulated entities, the following has been advised:

a. Definitions

(i) Key Facts: Key Facts of a loan agreement between Regulated Entities ("RE")/a group of REs and a borrower are legally significant and deterministic facts that satisfy basic information required to assist the borrower in taking an informed financial decision.

(ii) Key Facts Statement: Key Facts Statement (KFS) is a statement of key facts of a loan agreement, in simple and easier to understand language, provided to the borrower in a standardised format.

(iii) Annual Percentage Rate: Annual Percentage Rate (APR) is the annual cost of credit to the borrower which includes interest rate and all other charges associated with the credit facility.

(iv) Equated Periodic Instalment: Equated Periodic Instalment (EPI) is an equated or fixed amount of repayments, consisting of both the principal and interest components, to be paid by a borrower towards repayment of a loan at periodic intervals for a fixed number of such intervals; and which result in complete amortisation of the loan. EPIs at monthly intervals are called EMIs.

b. A standardized format has been given for the REs to provide KFS to all prospective borrowers to help them take an informed view before executing the loan contract.

c. KFS shall be provided with a unique proposal number and shall have a validity period of at least 3 working days for loans having tenor of 7 days or more, and a validity period of 1 working day for loans having tenor of less than 7 days.

d. KFS will also include a computation sheet of annual percentage rate (APR), and the amortisation schedule of the loan over the loan tenor. APR will include all charges which are levied by the RE.

e. Any fees, charges, etc. which are not mentioned in the KFS, cannot be charged by the REs to the borrower at any stage during the term of the loan, without explicit consent of the borrower.

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2. Guidance Note on Operational Risk Management and Operational Resilience

The Guidance Note has been prepared based on the Basel Committee on Banking Supervision (BCBS) principles documents. It adopts a principle-based and proportionate approach to ensure smooth implementation across REs of various sizes, nature, complexity, geographic location and risk profile of their businesses.

The Guidance Note is applicable to the following REs:

- All Commercial Banks;
- All Primary (Urban) Co-operative Banks/State Co-operative Banks/Central Co-operative Banks;
- All All-India Financial Institutions (viz., Exim Bank, NABARD, NHB, SIDBI, and NaBFID); and
- All Non-Banking Financial Companies including Housing Finance Companies.

The Guidance Note has been built on 3 pillars Prepare and Protect; Build Resilience and Learn and Adapt. The 3 Pillars contain 17 principiles as attached in the Annexure to the Note.

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3. Fair Practices Code for Lenders – Charging of Interest

RBI came across instances wherein the lenders resorted to certain unfair practices in charging of interest such as:

a. Charging of interest from the date of sanction of loan or date of execution of loan agreement and not from the date of actual disbursement of the funds to the customer. Similarly, in the case of loans being disbursed by cheque, instances were observed where interest was charged from the date of the cheque whereas the cheque was handed over to the customer several days later.

b. In the case of disbursal or repayment of loans during the course of the month, some REs were charging interest for the entire month, rather than charging interest only

for the period for which the loan was outstanding.

c. In some cases, it was observed that REs were collecting one or more instalments in advance but reckoning the full loan amount for charging interest.

To ensure transparency and fairness, all REs are directed to review their practices regarding mode of disbursal of loans, application of interest and other charges and take corrective action, including system level changes, as may be necessary, to address the issues.

The circular comes into effect immediately.

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4. Voluntary transition of Small Finance Banks to Universal Banks

RBI has prescribed a criteria for Small Finance Banks ("SFBs") to transition to Universal Banks with the objective of bringing clarity.

The criteria is as follows:

a. scheduled status with a satisfactory track record of performance for a minimum period of five years;
b. shares of the bank should have been listed on a recognised stock exchange;
c. having a minimum net worth of 1,000 crore as at the end of the previous quarter (audited);
d. meeting the prescribed CRAR requirements for SFBs;
e. having a net profit in the last two financial years; and
f. having GNPA and NNPA of less than or equal to 3 percent and 1 percent respectively in the last two financial years.

Conditions have also been provided for shareholding pattern.

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5. Limits for investment in debt and sale of Credit Default Swaps by Foreign Portfolio Investors (FPIs)

Investment limits for the financial year 2024-2025:

a. The limits for FPI investment in government securities (g-secs), state government securities (SGSs) and corporate bonds shall remain unchanged at 6 per cent, 2 per cent and 15 per cent respectively, of the outstanding stocks of securities for 2024-25.
b. As hitherto, all investments by eligible investors in the

'specified securities' shall be reckoned under the Fully Accessible Route (FAR).

c. The allocation of incremental changes in the g-sec limit (in absolute terms) over the two sub-categories – 'General' and 'Long-term' – shall be retained at 50:50 for 2024-25.

d. The entire increase in limits for SGSs (in absolute terms) has been added to the 'General' sub-category of SGSs.

The aggregate limit of the notional amount of Credit Default Swaps sold by FPIs shall be 5 per cent of the outstanding stock of corporate bonds. Accordingly, an additional limit of ₹2,54,500 crore is set out for 2024-25.

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6. Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) (Amendment) Regulations, 2024

The following amendment has been introduced in the Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2015:

a. In sub-regulation (F)(1) of Regulation 5 of the Principal Regulations, the existing provision shall be substituted by the following, namely:

"Subject to compliance with the conditions in regard to raising of External Commercial Borrowings (ECB) or raising of resources through American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) or through direct listing of equity shares of companies incorporated in India on International Exchanges, the funds so raised may, pending their utilisation or repatriation to India, be held in foreign currency accounts with a bank outside India."

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7. Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) (Amendment) Regulations, 2024

The following amendment has been introduced in the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019:

a. Regulation 3.1

The following has been inserted:

X. Schedule XI	A. Mode of Payment
(Purchase or Subscription of Equity Shares of Companies Incorporated in India on International Exchanges Scheme by Permissible Holder)	(1) The amount of consideration for purchase / subscription of equity shares of an Indian company listed on an International Exchange shall be paid, - (i) through banking channels to a foreign currency account of the Indian company held in accordance with the Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2015, as amended from time to time; or (ii) as inward remittance from abroad through banking channels. Explanation: The proceeds of purchase / subscription of equity shares of an Indian company listed on an International Exchange shall either be remitted to a bank account in India or deposited in a foreign currency account of the Indian company held in accordance with the Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2015, as amended from time to time.

	B. Remittance of sale proceeds The sale proceeds (net of taxes) of the equity shares may be remitted outside India or may be credited to the bank account of the permissible holder maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

b. Regulation 4

Substituted the original provision with:

"LEC(FII): (i) The Authorised Dealer Category I banks shall report to the Reserve Bank in Form LEC (FII) the purchase / transfer of equity instruments by FPIs on the stock exchanges in India.

(ii) The Investee Indian company through an Authorised Dealer Category I bank shall report to the Reserve Bank in Form LEC (FII) the purchase/subscription of equity shares (where such purchase / subscription is classified as Foreign Portfolio Investment under the rules) by permissible holder, other than transfers between permissible holders, on an International Exchange."

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8. Unauthorised foreign exchange transactions

RBI has come across instances of unauthorised entities offering foreign exchange (forex) trading facilities to Indian residents with promises of disproportionate/exorbitant returns. It is also observed that these entities are providing options to residents to remit/deposit funds in Rupees for undertaking unauthorised forex transactions using domestic payment systems like online transfers, payment gateways, etc.

A need is felt for greater vigilance to prevent the misuse of banking channels in facilitating unauthorised forex trading.

Therefore, Authorised Dealer Category-I ("AD Cat-I") banks are advised to be more vigilant and exercise greater caution

in this regard. As and when AD Cat-I banks come across an account being used to facilitate unauthorised forex trading, they shall report the same to the Directorate of Enforcement, Government of India, for further action, as deemed fit.

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9. Dealing in Rupee Interest Rate Derivative products - Small Finance Banks

Until now, Small Finance Banks were allowed to use only Interest Rate Futures (IRFs) for the purpose of proprietary hedging.

To expand the avenues for hedging interest risk in balance sheet and commercial operations more effectively, it has been now decided to allow Small Finance Banks to deal in permissible rupee interest rate derivative products for hedging interest rate risk.

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10. Hedging of Gold Price Risk in Overseas Markets

Resident entities were permitted to hedge their exposure to price risk of gold on exchanges in the International Financial Services Centre (IFSC) recognised by the International Financial Services Centres Authority (IFSCA).

To provide flexibility to the Resident entities, it has now been decided to permit resident entities to hedge their exposures to price risk of gold using OTC derivatives in the IFSC in addition to the derivatives on the exchanges in the IFSC, subject to the stipulations set out in the Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022.

The instructions will be applicable with immediate effect.

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11. CIMS Project Implementation - Submission of Statutory Returns (Form A, Form VIII and Form IX) on CIMS Portal

After the launch of Reserve Bank's next generation data warehouse, viz., the Centralised Information Management System (CIMS), it has been decided to shift the submission of Form A, Form VIII and Form IX Returns from the XBRL Portal to the CIMS Portal.

Banks shall, accordingly, submit the fortnightly Form A Return from the Reporting Friday June 14, 2024, monthly Form VIII Return from May 2024 and the annual Form IX Return from December 31, 2024 respectively on the CIMS Portal only.

Banks shall continue to submit Form A & Form VIII both on XBRL as well as CIMS portals concurrently till the date/ month indicated.

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E. SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

1. Standardization of the Private Placement Memorandum (PPM) Audit Report

In order to have uniform compliance standards and for ease of compliance reporting, standard reporting format for PPM Audit Report applicable to various categories of AIF has been prepared in consultation with pilot Standard Setting Forum for AIFs (SFA).

The PPM audit reports shall be submitted to SEBI by AIFs online on the SEBI Intermediary Portal (SI Portal) as per the format provided.

The reporting requirement shall be applicable for PPM audit reports to be filed for the Financial Year ending March 31, 2024 onwards.

To keep pace with the fast-changing landscape of AIF industry and for policy and supervision purposes, the aforesaid reporting format shall be reviewed periodically by pilot SFA in consultation with SEBI. In case of any revisions in the reporting format, revised format shall be made available on websites of the Associations which are part of SFA.

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2. Cross Margin benefits for offsetting positions having different expiry dates

In consultation with stock exchanges, Clearing Corporations and Risk Management Review Committee of SEBI, it has been decided to extend the cross margin benefit on offsetting positions having different expiry dates subject to the following:

a. A spread margin of 40% would be levied in case of offsetting positions in correlated indices having different expiry dates. Spread margin of 30% would continue to get levied in case of same expiry date (i.e. existing requirement).
b. A spread margin of 35% would be levied in case of offsetting positions in index and its constituents having expiry date different from index. While the expiry date of index futures can be different from that of its constituents, the expiry date of futures contracts of all constituents should be same in order to obtain the aforesaid cross margin benefit. Further, spread margin of 25% would continue to get levied in case of same expiry date of index and constituents (i.e. existing requirement).

c. The aforesaid spread margin benefit would be revoked at the beginning of the expiry day of the position which expires first (i.e. first of the expiring indices or constituents) in case the expiry dates of both legs of the position are different.

d. Exchanges/Clearing Corporations to put in place suitable monitoring mechanism to keep track of cross margin activities of participants.

e. All other requirements pertaining to cross margin remain unchanged and applicable.

The circular would be effective three months from its date of issuance.

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3. Ease of Doing Business: Text on Contract Note with respect to Fit and Proper status of shareholders

Various representations were received from the market participants to relax the requirement provided under the Chapter 6 at Para 2.4.2.2.2 of the Master Circular (Stock Exchanges and Clearing Corporations) dated October 16, 2023, of publishing the text pertaining to 'fit and proper' on the contract note in terms of Regulation 19 and 20 of the SEBI (Securities Contract (Regulation) (Stock Exchanges and Clearing Corporation) Regulations, 2018 (i.e. SCR (SECC) Regulations, 2018).

As part of taking steps towards ease of doing business, the requirement to publishing the text of Regulation 19 of the SCR (SECC) Regulations, 2018 on the contract notes is no longer required and Clause 2.4.2.2.2 under Chapter 6 of the Master Circular (Stock Exchanges and Clearing Corporations) dated October 16, 2023, stands amended as under:

"In the post listing scenario, in lieu of text only a reference of the applicable regulation with regard to fit and proper (by mentioning the URL/weblink of Regulation 19 and 20 of the SCR (SECC) Regulations, 2018) shall be made part of the contract note."

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4. Flexibility to Alternative Investment Funds (AIFs) and their investors to deal with unliquidated investments of their schemes

SEBI has notified the Securities and Exchange Board of India (Alternative Investment Funds)(Second Amendment) Regulations2024 ("AIF Regulations Amendment").

a. Regulation 2(1)(ia) of AIF Regulations

> "dissolution period" means the period following the expiry of the liquidation period of the scheme for the purpose of liquidating the unliquidated investments of the scheme of the Alternative Investment Fund.

b. Regulation 29(9) of AIF Regulations

> "Notwithstanding anything contained in sub-regulation (7), during liquidation period of a scheme, an Alternative Investment Fund may distribute investments of a scheme which are not sold due to lack of liquidity, in-specie to the investors or enter into the dissolution period, after obtaining approval of at least seventy five percent of the investors by value of their investment in the scheme of the Alternative Investment Fund, in the manner and subject to conditions specified by the Board from time to time.
>
> Provided that in the absence of consent of unit holders for exercising the options under sub-regulation (9) during liquidation period, such investments of the scheme of the Alternative Investment Fund shall be dealt with in the manner as may be specified by the Board from time to time."

In consideration of the above, the following conditions have been specified:

a. Before seeking the requisite investor consent, the AIF/ manager shall arrange bid for a minimum of 25% of the value of its unliquidated investments.
b. The AIF / manager shall disclose the proposed tenure of the Dissolution Period and An indicative range of bid value, along with the valuation of the unliquidated investments carried out by two independent valuers to investors prior to seeking their consent.
c. Prior to expiry of the Liquidation Period, the AIF/ manager shall intimate SEBI about obtaining the investor consent and the investors' decision to enter into Dissolution Period
d. If the AIF / manager successfully arranges bid for a minimum of 25% of the value of unliquidated

investments of the scheme, the dissenting investors of the scheme shall be offered an option to fully exit the scheme out of the25% bid arranged by the AIF.

e. If the AIF / manager fails to arrange bid for a minimum of 25% of the value of unliquidated investments of the scheme, the AIF can still opt for Dissolution Period, provided that it obtains consent of at least 75% of the investors by value of their investment in the scheme of the AIF.

f. The performance of the manager during the Dissolution Period shall be captured separately and reported to Performance Benchmarking Agencies, distinct from the performance of the scheme before entering into Dissolution Period.

g. The manager of the AIF shall not charge management fee during the Dissolution Period.

Regulation 29A(8)of AIF Regulations:

"No Alternative Investment Fund shall launch any new liquidation scheme under this regulation after the notification of the Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2024:

Provided that any liquidation scheme launched by an Alternative Investment Fund prior to the notification of the Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2024 shall continue to be governed by regulation 29A and the other provisions of these regulations till such schemes are wound up."

In consideration of this, the following has been specified:

Any Liquidation Scheme launched by an AIF prior to April 25, 2024(i.e. the date of notification of AIF Regulations Amendment) shall continue to be governed by SEBI Circular dated June 21 2023 on 'Modalities for launching Liquidation Scheme and for distributing the investments of AIFs in-specie', till such schemes are wound up.

The circular will come into effect immediately.

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5. Framework for Category I and II Alternative Investment Funds (AIFs) to create encumbrance on their holding of equity of investee companies

Category I and Category II AIFs may create encumbrance on equity of investee company, which is in the business of development, operation or management of projects in any of the infrastructure sub-sectors listed in the Harmonised Master List of Infrastructure issued by the Central Government, only for the purpose of borrowing by such investee company and subject to such conditions as may be specified by the Board from time to time.

In consideration of the above, the following conditions have been specified:

a. Existing schemes of Category I or Category II AIFs who have not on-boarded any investors prior to April 25, 2024, may create encumbrance on equity of investee company for the purpose of borrowing of the said investee company as specified in para 2 above, subject to explicit disclosure with respect to creation of such encumbrance in this regard and disclosure of associated risks in their Private Placement Memorandums(PPMs).

b. Any encumbrances already created by a scheme of Category I or Category II AIF prior to April 25, 2024,on the securities of investee company for the purpose of borrowing of such investee company, may continue if such encumbrances were created after making an explicit disclosure in the PPM of the scheme.

c. Category I or Category II AIFs shall ensure that the borrowings made by the investee company against the equity investments encumbered by the AIFs are utilised only for the purpose of development, operation or management of investee company as stated in para 2 above, and not utilised otherwise including to invest in another company. The aforesaid limitation on usage of borrowing shall be included as one of the terms of the investment agreement entered between the AIF and the investee company.

d. The duration of encumbrance created on the equity investments shall not be greater than the residual tenure of the scheme of the Category I or Category II AIFs.

e. Any Category I or Category II AIF with more than 50% foreign investment or with foreign sponsor/ manager or with persons other than resident Indian citizens as external members in its investment committee which is set up to approve its decisions, shall ensure compliance

with para 7.11.2 of RBI Master Direction dated January 04, 2018on 'Foreign Investments in India', as thought he AIF isa person resident outside India.

f. Schemes of Category I or Category II AIFs shall not create encumbrance on their investments in foreign investee companies.

The circular shall come into effect immediately.

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6. Relaxation in requirement of intimation of changes in the terms of Private Placement Memorandum of Alternative Investment Funds through Merchant Banker

Based on review received from the Market Participants, it has been decided that the changes in the terms of PPM may not be required to be submitted through a merchant banker and may be filed directly with SEBI.

Large Value Fund for Accredited Investors (LVFs) shall be exempted from the requirement of intimating any changes in the terms of PPM through a merchant banker. LVFs may directly file any changes in the terms of PPM with SEBI, along with a duly signed and stamped undertaking by CEO of the Manager of the AIF (or person holding equivalent role or position depending on the legal structure of Manager)and Compliance Officer of Manager of the AIF. The format has been provided in Annexure B.

The provisions will come into effect immediately.

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7. Ease of doing business- Fund manager for Mutual fund schemes investing in commodities and overseas securities

A working group was constituted to review the present regulatory framework under SEBI (Mutual Funds) Regulation, 1996 and recommend measures to promote ease of doing business for mutual funds.

Based on the recommendations received from the Working group, the following has been decided:

a. In partial modification to the Clause 3.3.11 of the Master Circular for Mutual Funds dated May 19, 2023, it has been decided as under:

"For commodity based funds such as Gold ETFs, Silver ETFs and other funds participating in commodities market, appointment of a dedicated fund manager shall

be optional. However, the person appointed as fund manager of such funds should have adequate expertise and experience to manage investments in commodities market. The Board of the Asset Management Companies (AMCs) shall be responsible for ensuring compliance and reporting regarding the same to trustees, on a periodic basis."

b. in partial modification to the Clause 12.19.3.1 of the Master Circular for Mutual Funds dated May 19, 2023, it has been decided as under:

"Appointment of a dedicated fund manager for making the above overseas investments stipulated under paragraph 12.19.2.1 to 12.19.2.9 shall be optional. However, the person appointed as fund manager of such funds should have adequate expertise and experience to manage investments in overseas securities. The Board of the AMCs shall be responsible for ensuring compliance and reporting regarding the same to trustees, on a periodic basis."

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8. Nomination for Mutual Fund unitholders – exemption for jointly held folios

Earlier the requirement for nomination/opting out of nomination for all the existing individual unit holder(s) holding Mutual Fund units was either solely or jointly, by June 30, 2024, failing which the folios shall be frozen for debits.

To simplify, ease and reduce cost of compliance, a working group was constituted to review the present regulatory framework of Mutual Funds and recommend measures to promote the ease of doing business. Based on the recommendations of the Working Group, it has been decided that requirement of nomination specified underclause17.16 of the Master Circular for Mutual Funds shall be optional for jointly held Mutual Fund folios.

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F. DECIPHERING THE DISTINCTION: ANALYZING SUPREME COURT'S RULING ON FINANCIAL DEBT VS. OPERATIONAL DEBT UNDER THE INSOLVENCY AND BANKRUPTCY CODE, 2016

Introduction

The Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "**the Code**") categorizes debt into two main classifications: operational debt and financial debt. 'Operational debt' pertains to claims arising from transactions associated with the operational activities of an entity, typically involving the provision of goods or services. On the other hand, 'financial debt' encompasses contractual obligations primarily centered around financial matters, such as loans or debt securities. The primary distinction between these two in the insolvency process lies in the nature of their claims. The object of the Code is to strike a balance between the two for an efficient corporate insolvency resolution process. However, drawing a line of difference has led to certain moot questions, some of which have been answered by the Hon'ble Supreme Court in a recent case of ***Global Credit Capital Limited & Anr. v. Sach Marketing Pvt. Ltd. & Anr***[1] which provides valuable insights into the intricate comprehension of debt classification under the Code.

Background: Swiss Ribbons' Case

The Hon'ble Supreme Court, in 2019, in the case of ***Swiss Ribbons Ltd. v. Union of India***[2] addressed the challenges to the differentiation between financial and operational creditors under the Code. The Court clarified that a financial debt involves borrowing money against the consideration for the time value of money, while operational debt pertains to claims relating to the provision of goods or services, including employment, or dues payable under any law to the government or local authority.

The court, in the above case observed that *"A perusal of the definition of 'financial creditor'' and 'financial debt' makes it clear that a financial debt is a debt together with interest, if any, which is disbursed against the consideration for time value of money. It may further be money that is borrowed or raised in any of the manners prescribed in Section 5(8) or otherwise, as Section 5(8) is an inclusive definition. On the other hand, an 'operational debt' would include a claim in respect of the provision of goods or services, including employment, or a debt in respect of payment of dues arising under any law and payable to the Government or any local authority"* and, *"financial creditors generally lend finance on a term loan or for working capital that enables the corporate debtor to either set up and/or operate its business. On the other hand, contracts with operational creditors are relatable to supply of goods and services in the operation of business. Financial contracts generally involve large sums of money. By way of*

1 2024 INSC 340

2 (2019) 4 SCC 17

contrast, operational contracts have dues whose quantum is generally less." [3]

The above case reinforced the fundamental principles and objectives of the Code, aiming to protect and prioritize the welfare of the economy, creditors, and corporate debtors in diverse scenarios through a meticulously structured approach.

The Case: Global Credit Capital Limited & Anr. v. Sach Marketing Private Limited & Anr.

Introduction

The Hon'ble Supreme Court recently dealt with the question that, when does debt become financial debt and/ or operational debt under the Code, and also laid down the criteria of demarcation for the same, by upholding the decision of the National Company Law Appellate Tribunal (NCLAT) with respect to Sach Marketing Private Limited (First Respondent) being a financial creditor.

Brief Facts

In the present case, Oriental Bank of Commerce had initiated insolvency proceedings against M/s. Mount Shivalik Industries Limited (Corporate Debtor) under Section 7 of the Code. The National Company Law Tribunal (NCLT) admitted the application under Section 7 of the Code and consequently, a moratorium under Section 14 of the Code was imposed by the NCLT with respect to the Corporate Debtor.

The issue in the appeal pertains to execution of the following two agreements/ letters executed between the Corporate Debtor and First Respondent in the year 2014 and 2015 respectively.

- By the letter dated April 01, 2014, the Corporate Debtor appointed the First Respondent as a 'sales promoter' to promote beer manufactured by the Corporate Debtor at Ranchi, (Jharkhand) for a period of 12 (twelve) months. The First Respondent was entitled to receive INR 4,000 per month for the said promotion. One of the conditions incorporated in the said letter/ agreement was that, the First Respondent would deposit a minimum security of INR 53,15,000/- with the Corporate Debtor, which will carry interest @ 21% per annum. The letter further stated the Corporate Debtor will pay the interest on INR 7,85,850/- @ 21% per annum.
- The terms of the second letter dated April 01, 2015 were identical with the first letter except that the Corporate Debtor was to pay interest on INR 32,85,850/- @21% per annum.

During the insolvency proceedings against the Corporate Debtor, the First Respondent had initially filed its claim as an 'operational creditor'. However, the said claim was later withdrawn and re- filed as a 'financial creditor' under Section 60 (5) of the Code, seeking direction for admission of its claim as a financial creditor. The NCLT rejected

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the application/ claim made by the First Respondent. During the pendency of the said application before the NCLT, the Committee of Creditors approved the resolution plan submitted by M/s. Kals Distilleries Pvt. Ltd and later applied to the NCLT to accept the resolution plan based on the approval.

Aggrieved by the aforesaid order of NCLT, the First Respondent preferred an appeal in the NCLAT. NCLAT held that, the First Respondent was a financial creditor and not an operational creditor under the Code, which came to be challenged before the Hon'ble Supreme Court of India.

Arguments

The appellants, argued that the security deposit shouldn't be categorized as a financial debt under the Code, since, the First Respondent was engaged to provide services rather than extend any financial assistance and hence would fall under the definition of an operational debt according to Section 5 (21) of the Code. The First Respondent contended that upon an analysis of the true effect of the transactions comprised of in the letters executed between the Corporate Debtor and First Respondent, it reveals that the transactions satisfied the three criteria of disbursal, time value of money and commercial effect of borrowing and hence constituted a financial debt.

Findings of the Court

The Hon'ble Supreme Court concluded that, in the case of a contract of service, there must be the correlation between the services agreed and the claim for a debt to qualify as an operational debt. It stated that in the light of the agreements executed between the parties, only claim under the agreements which had any connection with the services rendered by the First Respondent were the claim relating to INR 4000 per month and no such co relation was found to exist between the services of the 'sales promoter' and the security deposit.

The Hon'ble Court further examined the definition of financial debt under Section 5 (8) of the Code and held that there was no doubt in the debt being inclusive of interest @21% per annum and construed the security deposit to mean a debt that represented consideration for time value of money due to the interest associated with it.

The Hon'ble Supreme Court stated that in cases where a debtor owes a debt to another party under a written agreement for services rendered, the nature of the transaction must be examined beyond the written document. It held that on determination of the nature of transaction in the agreement, it was evident that apart from the sum of INR 4000, there was no commission payable to the First Respondent for rendering its services as a 'sales promoter'. Further, there was no clause for the forfeiture of the security deposit and the Corporate Debtor was liable to refund the same with an interest @ 21% per annum. The security deposit had no co-relation with any other clause of the agreements and this claim of security deposit cannot be said to be concerning

the provision of services and hence could not be qualified as an operational debt.

Further, the claim of security deposit was qualified as a financial debt under clause (f) of Section 5(8) of the Code owing to the following set of reasons:

- The provision made for interest payment on deposit represented consideration for the time value of money;
- The Corporate Debtor had provided for amounts of interests on the security deposit as 'long term loans and advances' in its books; and
- The financial statement of the Corporate Debtor for the financial year 2016-17 showed the amounts paid by the First Respondent as "other long-term liabilities".

Conclusion

In conclusion, it can be aptly stated that for a debt to meet the criteria of being a financial debt under Section 5 (8) of the Code, there must be an existence of debt along with interest. Conversely, a debt qualifies as an operational debt only if the claim associated with the debt has a tangible link or relevance to the 'service' aspect of the transaction. Determining the true essence of the transaction as evidenced in the documentation or the agreement is essential in discerning whether it constitutes a financial debt or an operational debt.

Therefore, straightjacketed understandings of the agreements should not be the sole means of ascertaining the nature of the debts, rather, it should be accompanied with analysis of the real nature of the transactions and the terms associated with the obligations to decipher co-relations and commercial effect of such undertakings.

This case involved an important discussion on sub-clause (f) of Section 5(8) of the Code which covers all those transactions, having commercial effect of borrowing, beyond those as specified in other sub-clauses of the relevant section. Additionally, the payment of interest cannot be the sole criterion of determining financial debts. The cases covered by categories (a) to (i) of sub-section (8) of the Code must satisfy the existence of debt along with interest laid down by the earlier part of section 5(8) of the Code. The present Supreme Court ruling has substantially contributed to the jurisprudential clarity while segregating operational and financial debts.

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