Newsletter

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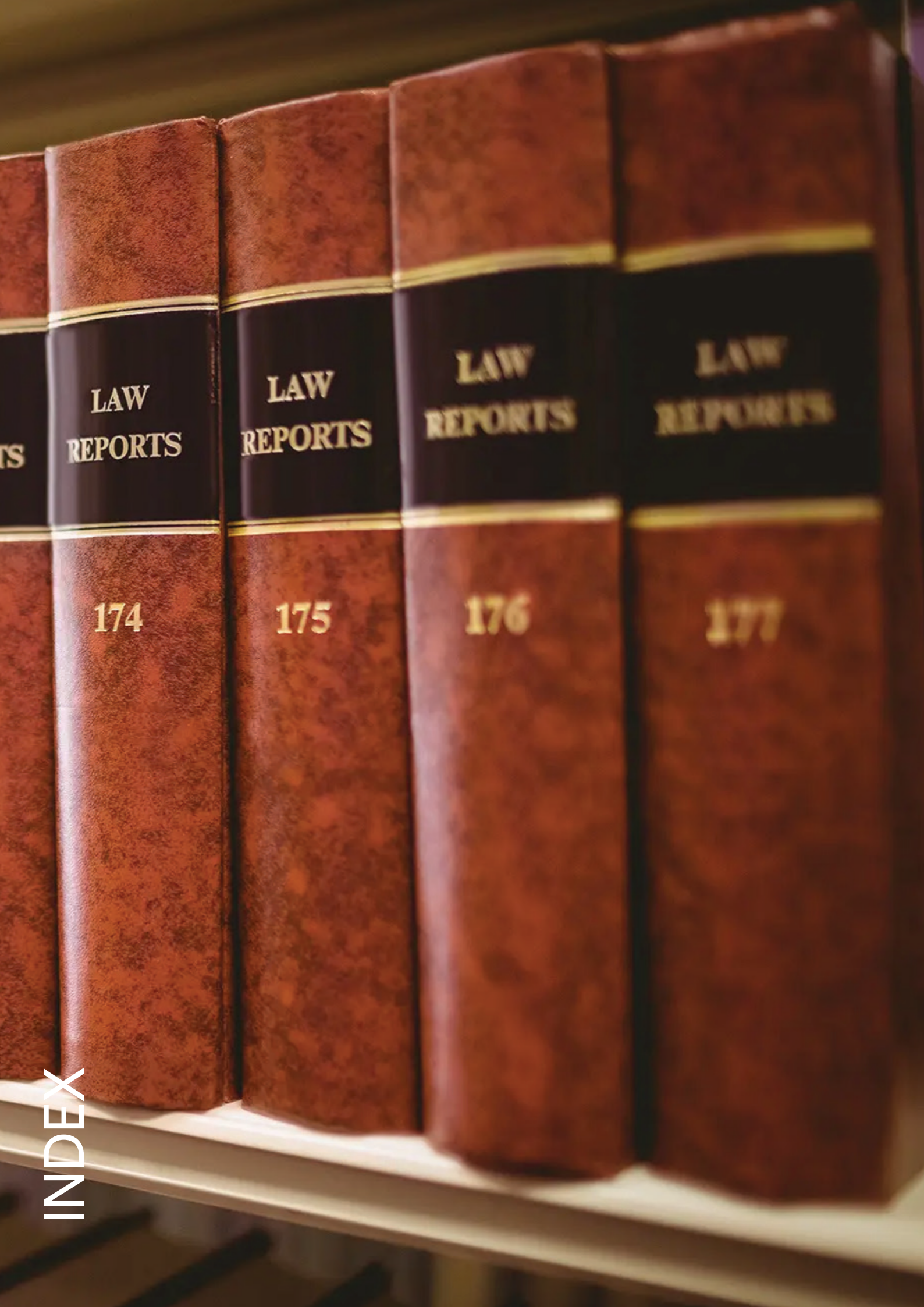
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Editor's note

Dear Readers,

I am pleased to share with you the 10th edition of the SNG & Partners' Newsletter for the month of May, 2023.

It is noteworthy that the Hon'ble Supreme Court of India has held that Unstamped Arbitration Agreements are invalid in law. Further, in another landmark judgement, the Supreme Court has held that arbitration proceedings are not possible in the absence of arbitration clause in the principal agreement. While dealing with the matters under the IBC, the Supreme Court has held that the waterfall mechanism is distinct in the IBC and Companies Act as the objective of both Acts is different. The RBI circulars on KYC and LIBOR transition are important.

I hope you will find this edition useful and informative.

Best wishes,

Rajesh Narain Gupta

Managing Partner,
SNG & Partners

A. ARBITRATION

1. SC rules: Unstamped Arbitration Agreements are invalid in law

The Supreme Court explained that an arbitration agreement within a contract exigible for Stamp Duty could not be enforced if it is inadequately stamped or signed. The decision was upheld by a 3:2 ratio, with Justice Bose and Justice Ravikumar agreeing with Justice Joseph. They concluded that an instrument subject to stamp duty, including an arbitration clause, but not stamped cannot be considered a legally enforceable contract under Section 2(h) of the Contract Act and is not enforceable under Section 2(g) of the Contract Act. However, Justice Rastogi and Justice Roy opined that the arbitration agreement could still be enforced, even if the substantive instrument lacked stamp duty or had insufficient stamping, as the deficiency could be rectified.

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2. SC Expounds: No Arbitration is possible when Dispute Arises from a Non-Arbitrable Agreement

The Supreme Court declared that arbitration proceedings were not feasible if no arbitration clause was present in agreements other than the principal agreement. The Court upheld that the primary agreement and the other agreements had no conjunction; therefore, the arbitration clause could not apply to the other agreements.

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3. SC Upholds: Primacy of Pre-Amendment Law in Cases of Notice invoking Arbitration before Enforcement of Amendment Act, 2015

The Supreme Court in a bench comprising Hon'ble Mr. Justice M.R. Shah and Hon'ble Mr. Justice C.T. Ravikumar upheld the judgment of the Telangana High Court stating that in situations where the notice seeking arbitration was served prior to the promulgation of the Amendment Act, 2015, and the plea for the appointment of an arbitrator was filed after it had come into effect, the legal system prevailing before the amendment shall be in force. Hence, the Arbitration & Conciliation Act, 1996 shall govern the matter.

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4. Gujarat High Court Expounds: An Arbitration Clause in a Partnership Deed is rendered invalid after the Firm is dissolved

Hon'ble Justice Biren Vaishnav of the Gujarat High Court has held that the arbitration clause in a partnership deed cannot be used to refer disputes between partners to arbitration once the partnership has been dissolved.

The case pertained to an arbitration clause that allowed disputes related to the "dealing of the firm" to be referred to arbitration.

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5. Bombay High Court rules: Invalid Board Resolution a curable procedural error, and can't result in the termination of Arbitration Proceedings

The Bombay High Court ruled that a defect in the board resolution authorizing a person to initiate arbitration is curable and only a procedural irregularity.

Therefore, such a defect cannot result in the rejection of claims or termination of arbitral proceedings, according to the court. Justices K.R. Shriram and Rajesh S. Patil held that the requirement of a board resolution authorizing a person to take legal action on behalf of a company is procedural and defects in it cannot defeat the substantive rights of a party.

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B. INSOLVENCY AND BANKRUPTCY CODE (IBC)

1. SC rules: Waterfall mechanism distinct in IBC and Companies Act as the objective of both Acts is different

The Supreme Court expounded that the Legislature made a conscious decision to exclude the sums such as provident fund, pension fund and gratuity fund out of workmen dues and to put workmen dues for 24 months preceding the liquidation date at an equal pedestal with the dues owed to the secured creditor. This decision cannot be claimed to be unconstitutional.

It was categorically held that the workman and the secured creditor can be kept at an equal footing only when the secured creditor has relinquished its security and the same is the part of the sage of the liquidation pool.

The broader goal of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as "IBC") is to explore whether the Corporate Debtor can be revived or not and if not, then economic assets have to be maximized and hence, the waterfall mechanism should be seen in light of this. Conflicting interests must be balanced when economics are involved.

Lastly, the Bench highlighted the difference between the waterfall mechanism given in the Companies Act, 2013 and the IBC stating that the waterfall mechanism is based on a structured mathematical formula and therefore, the hierarchy is created in terms of payment of debts. Striking off any one thing would disbalance the entire structure and disrupt the working as the interest of all the stakeholders would get affected. Further, the waterfall mechanism as envisaged under the IBC is way more beneficial than the one in the Companies Act, 2013.

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2. NCLAT, Delhi expounds: Date of default not same for borrower and guarantor

The NCLAT, Principal Bench Delhi noted that as per Article 137 of the Limitation Act, 1963, the period begins when the right to apply accrues. In the present case, the Corporate Guarantor is the Corporate Debtor and therefore, what needs to be seen was when was the default committed by the Corporate Guarantor.

The Bench ruled that as per the Insolvency and Bankruptcy Code, 2016 (as "IBC"), both Corporate Guarantor and the Principal Borrower become liable to pay when the default is committed. The default even though committed by the

Principal Borrower, would become due against both Principal Borrower and the Corporate Guarantor.

Further, the loan agreement with the Principal Borrower and the Bank as well as the Deed of Guarantee between the Bank and the guarantor are different transactions and therefore, the liability of the Guarantor would be extracted from the Deed of Guarantee.

In the present case, as per the Deed of Guarantee, the Guarantor would become liable on default committed by the Principal Borrower but for initiation of an action, a demand must be made. Therefore, the date of default for the Principal Borrower and Guarantor could not be taken as the same.

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3. IBBI, India invites comments on the Regulations notified under the IBC, 2016

The Insolvency and Bankruptcy Board of India ("IBBI") has invited comments from the public on the Regulations notified under the Insolvency and Bankruptcy Code, 2016 ("IBC").

Noting that public consultation enables collective choice and therefore, plays an important role in the evolution of the regulatory framework, the IBBI has invited public comments, including the comments from the stakeholders on the regulations already notified under the IBC, till date.

The comments received from 4th May 2023 till 31st December 2023 will be processed together and accordingly, necessary modifications will be carried out.

The process for the same shall be as follows:

a. Visit IBBI's website.
b. Go to the Public Comments section.
c. Select the stakeholder category and then select the regulation on which you want to provide a comment.

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4. SC Clarifies: Only Competent Authority can Declare Ineligibility of Resolution Applicant under Section 164 ②(b) of the Companies Act, 2013

The Supreme Court confirmed that the ineligibility of a resolution applicant under Section 164②(b) of the Companies Act, 2013 cannot be presumed unless the competent authority declares the disqualification. The Court held that such an interpretation is necessary to ensure that the Insolvency and Bankruptcy Code, 2016 ("IBC"), is not misused by promoters or directors of companies who may be disqualified under the Companies Act but seek to participate in the insolvency resolution process.

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5. SC Explicates: NCLT's Obligation to Admit Application under Section 7 of the IBC in case of default

The Supreme Court elucidated that once the National Company Law Tribunal ("NCLT") was satisfied with the occurrence of a default, it was devoid of any discretion to refuse admission of the application under Section 7 of the Insolvency and Bankruptcy Code, 2016 ("IBC").

The Apex Court noted that even the non-payment of a fraction of the debt that had matured and necessitated settlement would unequivocally amount to default on the part of the corporate debtor.

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C. RESERVE BANK OF INDIA (RBI)

1. Amendment to the Master Direction on KYC- Instructions on Wire Transfer

The RBI has issued a circular to amend the Master Direction ("MD") on KYC in order to bring it in consonance with the relevant FATF recommendation. Further, the definitions of relevant terms used in the amended Wire Transfer will be added to Section 2 of the MD on KYC. The amended provisions shall come into force with immediate effect

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2. LIBOR Transition

Vide this notification, RBI has drawn attention to of banks/ financial institutions ("FIs") to the Reserve Bank advisory on "Roadmap for LIBOR Transition" dated July 08, 2021 wherein banks/FIs were recommended to -

a. To cease and encourage their customers to cease, entering into a new financial contract that refers London Interbank Offered Rate ("LIBOR") as a benchmark and instead use widely accepted Alternate Reference Rates ("ARR") as soon as possible and mandatorily by December 31st, 2021

b. To incorporate robust fallback clauses in all financial contracts that refer to LIBOR.

Further, Banks and Financial Institutions are requested to ensure that no new transaction is undertaken by them or their customers using the US$ LIBOR or the MIFOR.

After June 30, 2023, the publication of the remaining five US$ LIBOR settings will cease permanently. The MIFOR, a domestic interest rate benchmark reliant on US$ LIBOR, will also cease to be published by Financial Benchmarks India Pvt. Ltd. ("FBIL") after June 30, 2023.

Banks/FIs are expected to have developed the systems and processes to manage the complete transition away from LIBOR from July 1, 2023.

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3. Master Circular- Basel III Capital Regulations

A master circular has been issued to consolidate all the prudential guidelines and framework on Basel III Capital adequacy issued to the banks till date.

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D. SECURITIES EXCHANGE BOARD OF INDIA (SEBI)

1. Master Circular for Custodians

SEBI has issued multiple circulars and guidelines for Custodians. To make it easier for the stakeholders to access, a master circular has been issued to consolidate all the circulars issued till date.

In addition to the Master Circular, the Custodians shall independently comply with other requirements as specified by SEBI for market intermediaries such as the Levy of Goods and Services Tax on the fees payable to SEBI.

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2. Introduction of Legal Entity Identifier ("LEI") for issuers who have listed and/or propose to list non-convertible securities, securitized debt instruments and security receipts

LEI is a unique global identifier for legal entities participating in financial transactions. It is a 20-character code to identify legally distinct entities that engage in financial transactions. Presently, it is mandated by RBI, that non-individual borrowers having aggregate exposure of more than Rs. 25 crores, to obtain the LEI code.

It has been specified that issuers having outstanding listed non-convertible securities as, of 31st August 2023 shall obtain LEI code on or before 1st September 2023. The issuers having listed securitized debt instruments and security receipts shall report the LEI code to the depositories on or before 1 September 2023.

LEI code can be obtained from any of the Local Operating Units accredited by the Global Legal Entity Identifier Foundation.

The circular will come into force with immediate effect.

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3. Registration with the FINNET 2.0 System of the Financial Intelligence Unit of India ("FIU-India")

On 19 April 2023, the FIU-India issued a letter specifying guidelines including red flag indicators for detecting suspicious transactions by the Debenture Trustees under Rule 7③ of the Prevention of Money Laundering (Maintenance of Records) Rules, 2005.

It has been informed by FIU-India that:

a. All reporting entities qualifying as Debenture Trustees are required to re-register in FINNET 2.0 system/module.

b. Those who haven't registered yet with FIU-India shall register in FINNET 2.0 system/module.

All the SEBI registered Debenture Trustees are advised to re-register/register in FINNET 2.0 system/module.

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4. Direct Market Access ("DMA") to SEBI registered Foreign Portfolio Investors ("FPIs") for participating in Exchange Traded Commodity Derivatives ("ETCDs")

FPIs were allowed to participate in ETCDs vide circular dated 29 September 2022 to promote institutional participation. Thereafter, vide other circulars, the framework for the DMA facility for institutional investors was laid down.

DMA facilitates the clients of the broker to directly access the exchange trading to place/execute orders without the intervention of the broker. It has now been decided to allow stock exchanges to extend DMA Facility to FPIs for participation in ETCDs subject to certain conditions:

a. Stock exchanges shall comply with SEBI circulars dated 20th February 2009 and 12th August 2012.

The circular shall come into effect immediately.

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5. Investment in units of Mutual Funds in the name of the minor through the guardian

Vide Circular dated 24 December 2019, SEBI prescribed a uniform process for Asset Management Companies, in respect of investments made in the name of a minor through a guardian. Based on certain recommendations, it has been decided:

a. Para 1(a) of the above-mentioned circular shall be:

"Payment for investment by any mode shall be accepted from the bank account of the minor, parent or the legal guardian of the minor or from a joint account of the minor with the parent or legal guardian. For existing folios, the AMCs shall insist upon a change of pay-out Bank mandate before the redemption is processed."

b. All redemption proceeds shall be credited only to the verified bank account of the minor.

Necessary changes are to be facilitated in the mutual fund transactions w.e.f. June 15, 2023.

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6. Revision in the computation of the Core Settlement Guarantee Fund in the Commodity Derivatives Segment

Vide circular dated August 27, 2014, SEBI prescribed norms related to Core Settlement Guarantee Fund. Further, vide another circular a minimum amount of Rs. 10 crores for Minimum Required Corpus ("MRC") were mandated for stock exchanges having Commodity Derivatives Segment.

Recent representation has been received from Clearing Corporations to the target corpus level and the methodology for computation of the Core Settlement Guarantee Fund be revised and reviewed.

It has therefore been decided that the Clearing Corporations in Commodity Derivatives Segment may align their Core Settlement Guarantee Fund in terms of circulars dated August 27th, 2014 AND July 11th, 2018 and excess contribution may be returned to the contributing stakeholders on a pro-rata basis.

The circular will come into effect from June 01, 2023.

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7. Model Tripartite Agreement between the Issuer Company, Existing Share Transfer Agent and New Share Transfer Agent as per Regulation 7④ of SEBI (LODR) Regulation, 2015

As per Regulation 9A (I)(b) of SEBI (Registrar to an Issue and Share Transfer Agent) Regulations, 1993 and Regulation 7④ of SEBI [Listing

Obligation and Disclosure Requirements ("LODR")] Regulation, 2015, a model tripartite agreement has been prepared.

The RTAs and companies are advised to publish the format on their respective websites and comply with the conditions.

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8. Comprehensive Guidelines for Investor Protection Fund and Investor Services Fund at Stock Exchanges and Depositories

SEBI has decided to modify the existing guidelines for Investor Protection Fund ("IPF") and Investor Services Fund ("ISF"). The comprehensive guidelines for IPF and ISF are:

A. Investor Protection Fund

i. Constitution and Management of IPF

All stock exchanges and depositories shall establish IPF which will be administered through separate trusts. There shall be 5 trustees.

ii. Contribution to IPF (Stock exchange)

Several contributions have been specified that shall be made by the stock exchange to the IPF such as 1% listing fees received on a quarterly basis, several penalties collected, charges collected from members of the exchange etc.

iii. Contribution to IPF (Depository)

Several contributions have been specified that shall be made by the Depository to the IPF such as 5% of the profit every year, fines and penalties, interest, or income out of investments etc.

iv. Review of IPF corpus

A half-yearly review should be conducted to ascertain the adequacy of the IPF corpus.

v. Manner of inviting claims from investors

A notice must be published by the stock exchanges inviting legitimate claims against the defaulter within a specified period.

In addition to this, eligibility and threshold of claims have been specified and the procedure for disbursement of claims has been explained.

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