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TO TRADE OR NOT TO TRADE: ANALYSIS OF NCLAT's ORDER IN *UNION OF INDIA v. VIJAYKUMAR V. IYER*

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ABSTRACT

In Union of India v. Vijaykumar V Iyer, the National Company Law Appellate Tribunal held the 'spectrum licenses', which are key assets of the company being resolved as a going concern, cannot be transferred through insolvency proceedings under IBC without payment of dues in relation to these licences. The Appellate Tribunal also ruled that these dues cannot be 'white-washed' under IBC in accordance with the resolution plan.

The position taken by the Appellate Tribunal deviates from established jurisprudence on treatment of operational creditor dues. The authors, in this article, capture the far-reaching implications of this ruling and suggest a way forward with the help of insights from other jurisdictions and the UNCITRAL Legislative Guide on Insolvency Law.

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I. Introduction

In ***Union of India v. Vijaykumar V. Iyer***,[1] in dealing with the question of, *inter alia*, transfer of the spectrum assets licensed to Aircel Limited, Dishnet Wireless Limited and Aircel Cellular Limited ("**Aircel Entities**"), pursuant to the Corporate Insolvency Resolution Process ("**CIRP**"), the National Company Law Appellate tribunal ("**NCLAT**") has held that (i) spectrum licenses cannot be transferred through insolvency proceedings under the Insolvency and Bankruptcy Code, 2016 ("**IBC**") without payment of overdue amounts, and (ii) outstanding dues payable in relation to the spectrum licences cannot be wiped off under IBC in accordance with the resolution plan.

Previously, these questions have been partially considered by the Hon'ble Supreme Court in ***Union of India v. Association of Unified Telecom Service Providers of India***[2] (read with subsequent modification dated September 25, 2020) ("**SC Order**") in the context of calculation of Adjusted Gross Revenue ("**AGR**") dues payable by telecom services providers, however, the Supreme Court directed these matters to be considered by NCLAT first.

In this case note we analyse the implications of the order of NCLAT in *Union of India v. Vijaykumar V. Iyer*.

II. Background

The Aircel Entities filed petitions for initiation of CIRP under section 10 of IBC, which were admitted in March 2018. The resolution plans submitted by UV Asset Reconstruction Company Limited (**UVARC**) ("**UVARC Plans**") for the Aircel Entities were approved by the Committee of Creditors ("**COC**").

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[1] Union of India v. Vijaykumar V. Iyer, 2020 SCC Online NCLAT 679.

[2] Union of India v. Association of Unified Telecom Service Providers of India, 2020 SCC Online SC 1247.

The National Company Law Tribunal ("**NCLT**") in its order dated June 9, 2020 ("**NCLT Order**"), approved the UVARC Plans, with certain modifications, while noting that the "*monitoring committee of the Aircel Entities shall take permission of the Department of Telecommunications ("**DOT**") with respect to the spectrum transactions and AL fibre and business transactions*". The DOT appealed before the NCLAT.

III. SPECTRUM CANNOT BE TRANSFERRED UNDER IBC PLANS?

Several insolvency resolutions in recent years have involved the transfer of licenses issued by Government authorities. Most notably the resolutions of both *Essar Steel Limited*[3] and *Bhushan Steel Limited*[4] involved the transfer of mining rights granted through letters of intent. The transfer of these rights, issued by the Government of Orissa was challenged in the High Court of the Orissa[5]. The Orissa HC rejected arguments suggesting that the mining licenses granted to these entities ought to be cancelled on grounds of 'insolvency' and subsequent resolution and takeover of these entities under the scheme of IBC.[6]

3 Standard Chartered Bank & Anr. v. Essar Steel India Limited, 2017 SCC Online NCLT 10751.
4 Central Bureau of Investigation v. Bhushan Power and Steel Limited, 2021 SCC Online Del 4085.
5 Chitta Ranjan Sahu v. Government of Odisha &Ors., [2018] WP (Civ) No. 9247 of 2018.
6 Relevant observations of the Orissa High Court have been extracted as follows:

"'*What is significant is that the major premise on which the Petitioner filed the present petition viz., that 'three companies, to whom the LOIs were issued were declared insolvent' is contrary to the factual position. The initiation of the process under the IBC is not to be equated with insolvency…. The IBC process involves appointing a resolution professional and it is only if the CIPR is unsuccessful that the question whether the entity should be declared insolvent arises…*'

"'The altered reality makes the very basis of filing of the present petition non-existent. Each of the three entities, i.e. Opposite Party Nos. 5, 6 and 7 are back to functioning as fully solvent companies with all the creditors dues being satisfied. The apprehension, therefore, that their alleged bankruptcy rendered them ineligible and incapable of operating the mining lease, if granted in their favour, is not factually or legally tenable.

Post the conclusion of this case, the Ministry of Mines has also notified, inter-alia, the Minerals (Other than Atomic and Hydro Carbons Energy Mineral) Concession (Amendment) Rules, 2021, enabling transfer of letter(s) of intent (for grant of mining lease or licence) consequent to conclusion of insolvency, liquidation, or bankruptcy proceedings, subject to compliance with specified conditions. As such, the transfer of mining license(s) is permitted pursuant to implementation of IBC resolution plan, subject to conditions specified.

Conversely, in ***Union of India v. Vijaykumar V. Iyer,*** the NCLAT relied on the provisions of the Guidelines for Trading of Access Spectrum by Access Service Providers issued on October 12, 2015, by the Department of Telecommunications ("**Spectrum Guidelines**"), to rule that "t*he Spectrum Trading Guidelines cannot be substituted under the CIRP and the dues of the Licensor, which are required to be cleared by the Seller prior to concluding any agreement for spectrum trading in terms of Guideline 11, cannot be subjected to clearance by way of a provision in a Resolution Plan, more so, when the Seller is in breach under contract viz. the Licence Agreement".*

The NCLAT has held that even in the cases of resolution of a licensor under IBC, spectrum assets cannot be transferred to the new bidder without payment of overdue amounts and observed that "*while a licence can be transferred as an intangible asset of the Licensee/Corporate Debtor under Insolvency Proceedings in ordinary*

Mr. Sankaranarayanan, however, submitted that the question that still arises is whether the past illegalities should be 'condoned'? ***The Court is unable to accept the submission for the simple reason that each of the three entities have met all the eligibility conditions. Initiation of any proceeding against them under the IBC was not specified as a condition of ineligibility. The three entities fully met the requirement of 'net worth', which is a well understood expression in the world of finance. Merely because an entity might have unpaid loans owing to financial institutions would not mean that it has lost its 'net worth'. In fact the very process of initiating the CIPR under the IBC is to see how a company, which otherwise has a high net worth, can be restored to its full operational potential through restructuring, notwithstanding that it might have defaulted on the loans borrowed from financial institutions****.*

The Petitioner appears to have been under a misconception that merely because a proceeding under the IBC was initiated against three entities around the time when they were issued with LOI, that by itself rendered them ineligible for issuance of the LOI."

circumstances, however as the trading is subjected to clearance of dues by Seller or Buyer, as the case may be, in terms of Guidelines 10 and 11 of the Guidelines for Access Spectrum Trading for Access Service Providers[7]*, the Transferor/Seller or Transferee/Buyer being in default, would not qualify for transfer of licence under the insolvency proceedings."*

IV. UNDERSTANDING THE IMPLICATION OF THE NCLAT ORDER

Despite the contentions of DOT against the classification of spectrum dues as operational debt, the NCLAT categorically held that "*the dues payable to the Government would fall within the ambit of 'Operational Dues' thereby clothing the Central Government / Licensor with the status of an 'Operational Creditor'*", while in the same breath ruling that such dues cannot be wiped off under a resolution plan submitted in the CIRP, if such resolution plan requires the license asset to be traded.

There is substantial jurisprudence on the past dues and claims being extinguished upon approval of the resolution plan under IBC. This order of NCLAT deviates from this by requiring past license dues to be paid, if such resolution plan requires the license asset to be traded.

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[7] Relevant guidelines are extracted as follows:

"10) Both the licensees shall also give an undertaking that they are in compliance with all the terms and conditions of the guidelines for spectrum trading and the license conditions and will agree that in the event, it is established at any state in future that either of the licensee was not in conformance with the terms and conditions of the guidelines for spectrum trading or/and of the license at the time of giving intimation for trading of right to use the spectrum, the Government will have the right to take appropriate action which inter-alia may include annulment of trading arrangement.

11) The seller shall clear all its dues prior to concluding any agreement for spectrum trading. Thereafter, any dues recoverable up to the effective date of trade shall be the liability of the buyer. The Government shall, at its discretion, be entitled to recover the amount, if any, found recoverable subsequent to the effective date of trade, which was not known to the parties at the time of the effective date of trade, for the buyer or seller, jointly or severally. The demands, if any, relating to licenses of seller, stayed by the Court of Law, shall be subject to outcome of decision of such litigation.

Given the nature of the business of the Aircel Entities, a resolution plan proposed by a prospective resolution applicant for insolvency resolution of the Aircel Entities as a going concern will require the license asset to be traded. In ***Vijaykumar Iyer v Union of India,***[8]the NCLT directed DOT to not cancel the spectrum licences, acknowledging that presence of spectrum license is crucial for the debtors.[9]

The question now arises - whether by holding the satisfaction of the terms of the Spectrum Guidelines as a prerequisite for the transferability of spectrum license under a resolution plan, has the NCLAT order ignored the express provisions of IBC and existing jurisprudence on IBC?

The IBC is lucid regarding its overriding effect. Further, Section 31(1) of the IBC makes the resolution plan binding on the corporate debtor and its employees, members, 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, such as authorities to whom statutory dues are owed,* guarantors and other stakeholders involved in the resolution plan.

The order of the NCLAT has set a dangerous precedent leaving the treatment of such governmental dues in a state of limbo.

V. DO SPECTRUM DUES FALL UNDER A SPECIAL CATEGORY OF CREDITOR DUES?

Notably, the ruling of the NCLAT may be seen to distinguish spectrum dues from all other operational creditor dues, especially cases whereby courts have held that creditors of the same class must be treated similarly. In ***Swiss Ribbons Pvt Ltd. v. Union of India***, the Supreme Court imposed a condition

[8] Vijaykumar Iyer v. Union of India, MA-337/2018 in C.P. (IB)-298/(MB)/2018.
[9] The NCLT in its order stated "*without license, since no other valuable asset is available to the Company, no Resolution Applicant may show any interest in the business of this Debtor Company for its revival*".

that for a resolution plan to be approved there must be fair and equitable treatment of operational creditors. Additionally, the Supreme Court declared in ***CIT v. Monnet Ispat and Energy Ltd***. that government creditors such as the Income Tax authorities are prohibited from initiating separate recovery actions and must settle their claims through the IBC.

Arguably, this ruling also sets a precedent for contractual restrictions against transfer of assets, subject to the payment of existing dues trumping well established provisions under the IBC. This could result in arbitrary treatment of such creditors and creation of a new sub-class of operational creditors, whose claims would be fully satisfied above all others.

VI. SPECIAL CATEGORIES OF CREDITOR DUES IN FOREIGN JURISDICTIONS

A. United Kingdom (UK)

Since 2003, the HM Revenue & Customs (the UK's tax authority) has been an unsecured creditor in respect of all tax dues owed to it, unless it has separately taken security. However, the UK's Finance Act, 2020 as well as subsequent regulations reverted the position such that certain tax dues owed to the HMRC were given a preferential status under all insolvency proceedings commencing on or after December 1, 2020. This means that any dues owed to HMRC for such taxes are to be ranked in priority to debts owed to both the floating charge holders and the unsecured creditors.

B. United States (US)

Similarly, the US also has provisions in its Bankruptcy Code for priority unsecured claims. Like the UK, all types of claims which fall within this category are demarcated in chapter 11 of the US's Bankruptcy Code[10] Similar to the UK, the US also requires an amendment to its federal bankruptcy law to add additional categories of priority claims.

In both the UK and the US, the law can be differentiated from the order of NCLAT in ***Union of India v. Vijaykumar V. Iyer***, as, in both the countries the exceptions are created by way of legislation which expressly provided that such dues would rank in priority. Conversely, the order of NCLAT in *Union of India v. Vijaykumar V. Iyer* relied on the interpretation of a provision of the Spectrum Guidelines which predated the IBC. This contradicts section 238 of the IBC which states that the IBC shall have an over-riding effect over anything inconsistent therewith contained in any other law, unless expressly provided.

C. United Nations Commission on International Trade Law (UNCITRAL)

One of the nine key objectives of the UNCITRAL Legislative Guide on Insolvency Law ("**UNCITRAL Guide**") is the recognition of existing creditor rights and establishment of clear rules for ranking of priority claims. The UNCITRAL Guide, acknowledges that priority of claims are based on social and even political, considerations. Its suggested in the UNCITRAL Guide that the priorities of existing and post-insolvency commencement creditor claims be clearly provisioned for in the insolvency law or rules made thereunder and, more importantly, these priorities are consistently applied.

Such provisioning will aid in developing lender confidence in the insolvency regime as it makes the insolvency process more transparent and predictable in term of its impact on creditors, enabling them to assess more accurately the risks associated with lending and adopt appropriate measures to mitigate it.[11]

The NCLAT order in ***Union of India v. Vijaykumar V. Iyer*** contradicts this recommendation in the UNCITRAL Guide as the priority of the spectrum dues

[10] US Bankruptcy Code, 11 U.S.C. § 507(a).
[11] Legislative Guide on Insolvency Law (United Nations), 2005.

over the other unsecured operational creditors was not clearly stated or referred to in the IBC prior to this judgement. Further, to the contrary, Section 238 of the IBC states that the IBC shall have an over-riding effect over anything inconsistent therewith in any other law, unless expressly provided. Such a priority of spectrum dues was not clearly provided.

VII. CONCLUSION: CONSEQUENCES AND NEXT STEPS

The NCLAT Order has been appealed before the Supreme Court and is *sub-judice*. Upholding this jurisprudence may have an adverse impact on the insolvency cases of other telecom services providers, and indeed any business dealing with sovereign assets and licenses.

In order to clarify the primacy of IBC over existing laws further, the legislature may consider amending the spectrum guidelines to provide for transfer of spectrum licences under IBC, subject to appropriate conditions or may create a special priority for such government dues as is the case in the UK and the US. In order to ensure eligibility requirements of the transferee, the DOT may stipulate conditions that may be fulfilled by the successful bidder for it to be considered as a valid licensor.

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Siddharth Srivastava, Personal Insolvency Regime: The Legal Landscape and Developments, 10 (1) SCHOLASTICUS 10 (2023).

PERSONAL INSOLVENCY REGIME: THE LEGAL LANDSCAPE AND DEVELOPMENTS

Siddharth Srivastava⊥

ABSTRACT

A recent Supreme Court ruling has again brought forth the issue of selective enforcement of provisions pertaining to personal guarantors under Part III of the Insolvency and Bankruptcy Code, 2016. This selective enforcement has raised many important concerns ranging from the extent of delegation of power allowed under Section 1(3) of the Code to creation of distinctions between an individual and a personal guarantor. Part III of the Code deals with the insolvency resolution and bankruptcy for individuals and partnership firms, and inter alia provides two mechanisms for insolvency resolution Fresh Start Process and Personal Insolvency Process. While provisions pertaining Personal Insolvency Process have been made effective, the same is not the case with the Fresh Start Process.

This delay on behalf of the legislature in enforcing the entirety of Part III deters opportunities where insolvency of corporate entities could be avoided through acts of their promoters who stood as personal guarantors for the debts availed by such corporate entities. This paper aims to provide a holistic understanding of the two insolvency resolution processes under Part III of the code, highlight their nuances and analyse the consequences of the deferral in the enforcement of provisions relating to individual grantors to a corporate debtor.

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I. INTRODUCTION

The insolvency resolution and bankruptcy process for individuals and partnership firms is enacted under Part III of the Insolvency and Bankruptcy Code, 2016 ["**IBC**"][1].Pursuant to a notification issued by the Ministry of Corporate Affairs on 15th November 2019[2] ["**Notification**"] effective from 1st December 2019, certain provisions[3]of Part III of the IBC with respect to only personal guarantors were enforced. Personal guarantor[4] means an individual who is the surety in a contract of guarantee to a corporate debtor[5].

The Notification was challenged before the Hon'ble Supreme Court of India ["**Hon'ble Court**"] in the matter of ***Lalit Kumar Jain v. Union of India &Ors.***[6] The petitioners had furnished personal guarantees to banks and financial institutions against the loan availed by companies in which the petitioners were promoters, directors. The main contention of the petitioners was that the Notification enforced provisions of Part III only with respect to personal guarantors and such selected enforcement leading to a creation of a subcategory of individuals i.e. personal guarantors was an exercise of excessive delegation and therefore *ultra vires* of Section 1(3) of the IBC. In terms of

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[1] Insolvency and Bankruptcy Code, Part III, No. 21, Acts of Parliament, 2016 (India).
For personal guarantors, Insolvency and Bankruptcy (Application to Adjudicating Authority for Insolvency Resolution Process for Personal Guarantors to Corporate Debtors) Rules 2019 (Rules) is also applicable.

[2] Ministry of Corporate Affairs Notification No. S.O. 4126 (E), (Issued on Nov. 15, 2019).

[3]*"following provisions of the said Code only in so far as they relate to personal guarantors to corporate debtors, shall come into force:(1) clause (e) of section 2;(2) section 78 (except with regard to fresh start process) and section 79;(3) sections 94 to 187 [both inclusive];(4) clause (g) to clause (i) of sub-section (2) of section 239;(5) clause (m) to clause (zc) of sub-section (2) of section 239;(6) clause (zn) to clause (zs) of sub-section (2) of section 240; and(7) section 249."*

[4] *Supra* note 1, at §5(22).

[5] As per Section 3 (8) of IBC, *""corporate debtor" means a corporate person who owes a debt to any person"*. As per Rule 3(1)(e), *""guarantor" means a debtor who is a personal guarantor to a corporate debtor and in respect of whom guarantee has been invoked by the creditor and remains unpaid in full or part"*.

[6] Lalit Kumar Jain v. Union of India, Transferred Case (Civil) No. 245/2020..

Section 1(3) of the IBC, "*It* [IBC] *shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint: Provided that different dates may be appointed for different provisions of this Code*". The petitioners contented that Section 1(3) of the IBC gave power to appoint different dates for enforceability of different parts of the IBC, however, this power did not extend to limit the applicability to criteria of persons or to create distinction between an individual and a personal guarantor *(to a corporate debtor)*. The Hon'ble Court held that, *"the impugned notification is not an instance of legislative exercise, or amounting to impermissible and selective application of provisions of the Code. There is no compulsion in the Code that it should, at the same time, be made applicable to all individuals, (including personal guarantors) or not at all. There is sufficient indication in the Code- by Section 2(e), Section 5(22), Section 60 and Section 179 indicating that personal guarantors, though forming part of the larger grouping of individuals, were to be, in view of their intrinsic connection with corporate debtors, dealt with differently, through the same adjudicatory process and by the same forum (though not insolvency provisions) as such corporate debtors".*

In view of this, till date, only the insolvency resolution and bankruptcy of personal guarantors within the ambit of Part III of the IBC may be invoked.

II. INITIATION OF PERSONAL INSOLVENCY UNDER THE CODE

Part III of the IBC provides two mechanisms for insolvency resolution, namely the fresh start process provided in Chapter II of Part III (***Fresh Start Process***) and the insolvency resolution process provided in Chapter III of Part III (***Personal Insolvency Process***). While the Fresh Start Process is yet to come into force (*as opposed to Personal Insolvency Process*), however the threshold for invoking both the Personal Insolvency Process and Fresh Start Process is a minimum value of default of INR 1,000.

One of the most often debated issue is the ability to initiate Personal Insolvency Process against the personal guarantor even if corporate insolvency resolution process has not been initiated against the corporate debtor. This issue has been dealt with in the matters of ***State Bank of India v. Mahendra Kumar Jajodia***, Personal Guarantor to Corporate Debtor[7] wherein it was held that an application filed under Section 95 (1) of the IBC for initiation of Personal Insolvency Process is maintainable before the National Company Law Tribunal ["**NCLT**"] even if there is no corporate insolvency resolution process or liquidation process pending against the corporate debtor to which the personal guarantor has given guarantee. The National Company Law Appellate Tribunal ["**NCLAT**"] held that, "*The Sub-Section 2 of Section 60 requires that where a CIRP or Liquidation Process of the Corporate Debtor is pending before 'a' National Company Law Tribunal the application relating to CIRP of the Corporate Guarantor or Personal Guarantor as the case may be of such Corporate Debtor shall be filed before 'such' National Company Law Tribunal. The purpose and object of the sub-section 2 of Section 60 of the Code is that when proceedings are pending in 'a' National Company Law Tribunal, any proceeding against Corporate Guarantor should also be filed before 'such' National Company Law Tribunal. The idea is that both proceedings be entertained by one and the same NCLT. The sub-section 2 of Section 60 does not in any way prohibit filing of proceedings under Section 95 of the Code even if no proceeding are pending before NCLT*." The Hon'ble Supreme Court[8] has upheld the order of the NCLAT in the said matter.

[7] Mr. C. Vijayakumar Vs. M/s. Sahaj Bharti Travels &Anr.,Company Appeal (AT) Insolvency No. 60 of 2022.
[8] Mahendra Kumar Jajodia etc. Vs. State Bank of India,Civil Appeal No(s). 1871-1872/2022.

III. PERSONAL INSOLVENCY PROCESS AND FRESH START PROCESS

The difference between Personal Insolvency Process and Fresh Start Process lies in the nature of debt[9] for which the said processes may be initiated. In case of Personal Insolvency Process the minimum value of default will be calculated to be exclusive of liability to pay fine imposed by a court or tribunal, liability to pay damages for negligence, nuisance or breach of a statutory, contractual or other legal obligation, liability to pay maintenance to any person under any law for the time being in force, liability in relation to a student loan, any other debt as may be prescribed (Excluded Debts).

In case of Fresh Start Process the minimum value of default will be the Qualifying Debt i.e. "a*mount due, which includes interest or any other sum due in respect of the amounts owed under any contract, by the debtor for a liquidated sum either immediately or at certain future time and does not include (a) an excluded debt; (b) a debt to the extent it is secured; and (c) any debt which has been incurred three months prior to the date of the application for fresh start process".*

The Fresh Start Process can only be initiated by debtors. The Fresh Start Process excludes secured debts. In case of Personal Insolvency Process the claims from creditors are invited and there is a repayment plan however, the same is not done in case of Fresh Start Process wherein an order discharging the Qualifying Debt is passed.

A. Personal Insolvency Process

Personal Insolvency Process may be initiated by the debtor or a creditor. In terms of Section 94(1) of the IBC, an application for initiating the Personal

[9] *Supra* note 1, at §3(12).
Defined as *"non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be"*

Insolvency Process may be filed by any debtor[10]either itself or through a resolution professional before the Debt Recovery Tribunal *(in case of personal guarantors before the National Company Law Tribunal)*[11]unless the debtor is an undischarged, bankrupt or is undergoing Fresh Start Process, Personal Insolvency Process, bankruptcy process ,or an application for Personal Insolvency Process has been admitted during the 12 months preceding the date of submission of the said application.

In terms of Section 95(1) of the IBC, an application for initiating the Personal Insolvency Process may be filed by creditors individually or jointly with other creditors or through a resolution professional before the Debt Recovery Tribunal.[12] Prior to filing the application, a demand notice[13] has to be issued to the debtor. The application should include information and documents reflecting the debt owed by the debtor on the date of filing of the application along with evidence and failure by the debtor to pay debt within fourteen days of service of the demand notice. A copy of the application is required to be furnished to the debtor.

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[10] In case the debtor is a partner of the firm then the said application is required to be filed by at least majority of the partners of the firm.

[11] Under Part III of the IBC, Adjudication Authority means Debt Recovery Tribunal and under Part II of the IBC, Adjudication Authority means NCLT. In terms of Section 60 (1) (Part II of the IBC), "*The Adjudicating Authority, in relation to insolvency resolution and liquidation for corporate persons including corporate debtors and personal guarantors thereof shall be the National Company Law Tribunal having territorial jurisdiction over the place where the registered office of a corporate person is located*." In view of this for personal guarantors the Adjudicating Authority refers to NCLT, and Personal Insolvency Process against personal guarantors may be initiated before the NCLT in terms of Rule 3 (1)(a)(i) of the Rules. The Debt Recovery Tribunal and NCLT collectively referred as Adjudicating Authority in this article.

[12] In relation to a partnership debt the creditors may initiate the Personal Insolvency Process against one or more partners or the firm. In case an application is filed against a partner in the firm and subsequently an application is filed against another partner of the same firm then the application may be presented or transferred before the Adjudicating Authority before which the first application was filed. Further, the Adjudicating Authority may pass directions for consolidation of the proceedings under the applications.

[13] The Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, Form III, No. 828(E), Gazette of India, Extra.

On the date of filing of the application (by either the debtor or the creditor), an interim moratorium[14] is imposed to all debts of the debtor till the date of order of admission of the application. By virtue of the interim moratorium, all pending legal actions and proceeding in respect of any debt of the debtor are deemed to have been stayed and creditors of the debtor are prohibited from initiating any legal action or proceeding in respect of any debt of the debtor.

In case the application (by either the debtor or the creditor) is filed through the resolution professional, then within 7 days of the date of the filing of the application the Adjudicating Authority is required to direct the Insolvency and Bankruptcy Board of India ["**IBBI**"] to confirm within 7 days that there are no disciplinary proceedings pending against the resolution professional and confirm the appointment or reject the appointment of the resolution professional and nominate another resolution professional. In case the application is filed either by the debtor or the creditor itself then within 7 days of the date of the filing of the application, the Adjudicating Authority is required to direct the IBBI to nominate a resolution professional within 10 days of receiving such a direction. In both cases of nomination, the Adjudicating Authority pursuant to an order appoints the resolution professional.

In case the debtor or the creditor are of the opinion that the resolution professional is required to be replaced then an application to this effect may be filed before the Adjudicating Authority. Within 7 days of receipt of the application for replacement of the resolution professional, the Adjudicating Authority is required to make a reference to the IBBI. Within 10 days of receipt of such reference the IBBI is required to recommend the name of a resolution professional to the Adjudicating Authority against whom no disciplinary proceedings are pending. Subsequently the Adjudicating Authority passes an

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[14] In case of filing of application against a firm, the interim moratorium will be applicable against all partners of the firm as on the date of the application.

order appointing the new resolution professional. Such an order may include directions to the initial resolution professional to share information and co-operate with the new resolution professional.

The resolution professional is required to submit a report recommending for approval or rejection of the application recording the reasons for the same to the Adjudicating Authority within 10 days of his appointment, after examining the application to satisfy that requirements in terms for Section 94 or Section 95 are complied with. The resolution professional in the report may also recommend fresh start process. For examining the application, the resolution professional may seek additional information or explanation from any person including the creditor or the debtor who may provide such information. The person from whom such information or explanation is requisitioned is required to provide the information or explanation within 7 days of receipt for the requisition.

Thereafter the Adjudicating Authority, within 14 days of submission the report, vide an order admits or rejects the application. In the admission order the Adjudicating Authority may give directions for conducting negotiations between the debtor and the creditors for arriving at a repayment plan if prayer to such an effect is made by the resolution professional.

A full moratorium is imposed immediately upon admission of the application for insolvency. Pursuant to the moratorium[15], all pending legal actions, proceedings in respect of any debt are deemed to have been stayed, the creditors are prohibited from initiating any legal action or legal proceeding in respect of any debt and the debtor is prohibited from transferring, alienating, encumbering or disposing its assets, legal rights or beneficial interest.

[15] In case of a firm, the moratorium will be imposed against all the partners of the firm.

To set the Personal Insolvency Process in motion the Adjudicating Authority issues a public notice in at least one English and one vernacular newspaper prevalent in the state where the debtor resides as well as on the website of the Adjudicating Authority, within 7 days of the admission order to invite claims from creditors for a window of 21 days. The notice includes details of admission order, particulars of the resolution professional, last date of submission of claim, bench of the Adjudicating Authority. The claims are submitted by the creditor with the resolution professional via electronic mode or dispatched via courier or speed post or registered letter.

Based on the information so provided in the application and claims submitted the resolution professional prepares a list of creditors within 30 days of the publication of notice.

For the purpose of restructuring of debt or affairs, the debtor prepares a repayment plan in consultation with the resolution professional. The repayment plan may authorise or require the resolution professional to carry on the debtor's business on its behalf or name, realise the assets, administer or dispose of the funds of the debtor. The repayment plan includes the reasons for preparation of the repayment plan and grounds for the creditors to agree on the repayment plan, provision for paying the fee of the resolution professional.

The repayment plan along with a report on the repayment plan prepared by the resolution professional is filed before the Adjudicating Authority within 21 days from the last date of submission of claims. The report includes the compliance with the provisions of the law, reasonable prospect of approval and implementation, necessity of summoning a meeting of the creditors to consider the repayment plan if required. If the resolution professional is of the view that meeting of creditors is not required, then reasons for the same need tobe specified. The meeting if required, keeping in consideration the convenience of the creditors, has to be held after 14 days and before 28 days from the date of submission of the report. The notice of the meeting is issued at least 14 days before the meeting. Notice of the meeting along with address of the Adjudicating Authority, copy of the repayment plan, statement of affairs, report, proxy voting forms is provided to the creditors.

The prime reason for the meeting of the creditors is to approve, modify or reject the repayment plan. Creditors may vote on the repayment plan as per the assigned voting share unless the creditor is not included in the list of creditors or is an associate[16] of the debtor. The creditors are barred from voting in respect of a debt for an unliquidated amount. The meeting may be adjourned for a maximum of 7 days at a time.

The secured creditors participating and voting in relation to the repayment plan may forfeit its right to enforce the security during the period of repayment plan[17] in terms of their payment plan. The secured creditor not forfeiting its security right has to submit an affidavit to the resolution professional at the meeting of the creditors stating the estimated value of the unsecured part of the debt and that the right to vote exercised by the secured creditor is only in respect to the unsecured part of the debt and. Upon submission of the affidavit, the secured and unsecured parts of the debt are treated as separate debts.

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[16] *Supra* note 1, at §79(2).
Defined in the IBC as "(a) a person who belongs to the immediate family of the debtor; (b) a person who is a relative of the debtor or a relative of the spouse of the debtor; (c) a person who is in partnership with the debtor; (d) a person who is a spouse or a relative of any person with whom the debtor is in partnership; (e) a person who is employer of the debtor or employee of the debtor; (f) a person who is a trustee of a trust in which the beneficiaries of the trust include a debtor, or the terms of the trust confer a power on the trustee which may be exercised for the benefit of the debtor; and (g) a company, where the debtor or the debtor along with his associates, own more than fifty per cent. of the share capital of the company or control the appointment of the board of directors of the company. Explanation. - For the purposes of this sub-section, "relative", with reference to any person, means anyone who is related to another, if(i) they are members of a Hindu Undivided Family; (ii) one person is related to the other in such manner as may be prescribed"

[17] Period of repayment plan commences from the date of order of the Adjudicating Authority on the repayment plan till the issuance of notice by the resolution professional that the repayment plan has been implemented or when the resolution professional submits a report to the Adjudicating Authority that the repayment plan has come to an end prematurely.

Concurrence of the secured creditor is required be obtained if the secured creditor does not participate in the voting on repayment plan, but provision of the repayment plan affects its right to enforce security.

The repayment plan or a modification to it is approved by a majority of more than three fourth in value of the creditors either present in person or by proxy, voting on the repayment plan in the meeting of the creditors.

The resolution professional prepares a report of the meeting of the creditors on the repayment plan. The report provides if the repayment plan was approved or rejected and the list of modifications, the proposed resolutions and the decision on the resolutions, list of creditors present or represented at the meeting and the corresponding votes and any other necessary information. The copy of the report is furnished to the debtor, creditors and the Adjudicating Authority. On the basis of the report of the meeting of the creditors or the report on the repayment plan (if meeting of creditors was not summoned) submitted by the resolution professional, the Adjudicating Authority approves or rejects the repayment plan by passing an order. The order may include directions for implementing the repayment plan. If the Adjudicating Authority is of the view that the repayment plan requires modifications then it may issue directions for re-convening the meeting of the creditors for reconsidering the repayment plan. The repayment plan approved by the Adjudicating Authority takes effect as if it was proposed by the debtor in the meeting and the approved repayment plan is binding on the creditors mentioned in the repayment plan and the debtor. Upon rejection of the repayment plan by the Adjudicating Authority, the debtor and the creditor may file an application for bankruptcy.

Upon completion of the repayment plan, within 14 days[18] the resolution professional sends a notice stating that the repayment plan has been fully

[18] Resolution Professional may prayer before the Adjudicating Authority to extend the timeline beyond 14 days, subject to the cap of 7 days.

implemented along a copy of a report summarizing receipts and payments made and extent of the implementation of the repayment plan vis-à-vis the repayment plan approved in the meeting of the creditors to persons bound by the repayment plan.

If the repayment plan has not been fully implemented in respect of persons bound by it within the prescribed timelines under the repayment plan, then the repayment plan is deemed to have come to an end prematurely. In this case the resolution professional submits a report to the Adjudicating Authority stating the receipts and payment made reasons for premature end, details of creditors whose claims have not been satisfied. Thereafter the Adjudicating Authority passes an order observing that the repayment plan has not been completely implemented. The debtor or creditor whose claims have not been fully satisfied under the repayment plan may apply for bankruptcy order.

In term of the repayment plan, the resolution professional may apply to the Adjudicating Authority for a discharge order in relation to the debts specified in the repayment plan. The repayment plan may have provisions for early discharge or discharge upon competition of the repayment plan.

In terms of information available in the public domain it is noted that certain provisions of the Part III have been challenged before the Hon'ble Supreme Court in the matter between ***Gurmeet Sodhi v. Union of India &Ors***.[19] The contention is that the Personal Insolvency Process under Part III of the IBC takes away the right of the personal guarantors to be heard before filing of Personal Insolvency Process by the creditors or appointment of a resolution professional, thus violating the fundamental right to natural justice. In terms of order dated 29 April 2022 the Hon'ble Court has restrained the personal

[19] Gurmeet Sodhi vs. Union of India &Ors, W.P.(C) No. 307/2022.

guarantor from transferring, alienating, encumbering or disposing of his assets, legal rights, beneficial interest. Further, the resolution professional has been directed to not proceed with filing of the report *(recommending for approval or rejection of the Personal Insolvency Process application).* It may be noted that this direction to the resolution professional may encourage personal guarantors to file similar petition or use this order for delaying the Personal Insolvency Process qua them.

B. Fresh Start Process

A debtor may either personally or through a resolution professional file an application before the Adjudicating Authority if it is unable to pay its Qualifying Debt, subject to the gross annual income of the debtor not exceeding INR 60,000, the aggregate value of the assets of the debtor not exceeding INR 35,000, debtor not being an undischarged bankrupt, not owning a dwelling unit, there being no subsisting Fresh Start Process, Personal Insolvency Process or bankruptcy process and no Fresh Start Process having been made in the preceding 12 months of the application for Fresh Start Process. The application is filed along with an affidavit stating the list of debts, interest payable, name of creditors, list of securities, financial information of the debt and immediate family for up to 2 years prior, personal details, grounds for filing the application, details of legal proceedings known to the debtor to have commenced against the debtor and confirmation that no Fresh Start Process has been made in the preceding 12 months. Upon filing of the application for Fresh Start Process, interim moratorium is imposed till the date of admission or rejection of the application, which is akin to the interim moratorium for Personal Insolvency Process. Thereafter the process of appointment/confirmation/replacement of the resolution professional is akin as Personal Insolvency Process.

The resolution professional examines the application within 10 days of appointment and submits a report to the Adjudicating Authority accepting or rejecting the application with reasons. This report includes opinion of the resolution professional regarding amounts which are Qualifying Debt and liabilities eligible for discharge. The resolution professional shall opine for accepting the application if the resolution professional can presume that the debtor is unable to pay debts if the information provided in the application suggests the same and there is no ground to believe otherwise, there has been no change in financial circumstances since the filing of the application. The resolution professional shall opine for rejecting the application if the conditions for filing the application provided in Section 80 of the IBC are not satisfied or the debt does not fall within the definition of Qualifying Debtor if the debtor has deliberately made false representation or omission in the application or documents or information submitted. The resolution professional for preparing the report may call for information or explanation as in case of Personal Insolvency Process. The Adjudicating Authority thereafter within 14 days of submission of the report passes an order for accepting or rejecting the application. The admission order mentions the amount accepted as Qualifying Debt and other amounts eligible for discharge for the purpose of Fresh Start Process.

From the date of the admission order, moratorium is imposed till 180 days unless the order admitting the application is revoked. By virtue of the moratorium, all pending legal actions, proceedings in respect of any debt are deemed to have been stayed, the creditors are prohibited from initiating any legal action or legal proceeding in respect of any debt save and except the objections filed by the creditor under Section 86 of the IBC. During the moratorium, the debtor is prohibited from acting as a director of any company or taking part either directly or indirectly in the promotion formation or management of a company, disposing of or alienating assets and travelling outside India except with the permission of the Adjudicating Authority. Further the debtor is required to disclose to its business partners regarding the ongoing Fresh Start Process, to parties to financial or commercial transactions to be entered into, disclose the name under which the debtor enters into business transactions if it is different from the name mentioned in the application admitted.

In terms of Section 86 of the IBC, the creditors may file an application for objection to the resolution professional pursuant to the order of admission for reasons of inclusion of a debt as Qualifying Debt or incorrectness of the details of the Qualifying Debt specified in the order with 10 days of the order. Thereafter the resolution professional accepts or rejects the objections and also examines any other relevant matter prior to making a final list of Qualifying Debt for the purpose of discharging. Subsequent to the examination, the resolution professional may prepare an amended list of qualifying debt for the purpose of discharging, file application before the Adjudicating Authority for directions under Section 90 of the IBC or take any other steps. The debtor or the creditor may challenge the action of the resolution professional before the Adjudicating Authority for reasons if the opportunity to make representations was not given, the resolution professional colluded with other party for arriving at the decision or the resolution professional has not complied with the requirements of Section 86 of the IBC.

The resolution professional may file an application before the Adjudicating Authority seeking revocation of its order for admission of Fresh Start Process in case of change in financial circumstances of the debtor which makes the debtor ineligible for Fresh Start Process, non-compliance restrictions imposed during moratorium or if the debtor has acted in a mala fide manner and has willingly failed to comply with Chapter II (Fresh Start Process) of the IBC. The Adjudicating Authority shall pass an order admitting or rejecting the application within 14 days of receipt of the application.

Prior to at least 7 days before the moratorium ceasing, the resolution professional submits the final list of Qualifying Debt to the Adjudicating Authority. Thereafter the Adjudicating Authority passes a discharge order for discharging the debtor from the Qualifying Debt. The Adjudicating Authority may also discharge the debtor from penalties in respect of the Qualifying Debt, interest including penal interest, any other sums owed under any contract in respect of the Qualifying Debt for the period from the date of the application till the date of the discharge order.

IV. CONCLUSION

A perusal of the recent judicial[20] and business trends shows that enforcement of part III of the IBC to the limited extent of personal guarantors of corporate debtors has been successful in acting as a deterrent in cases where insolvency of corporate entities could be avoided through acts of their promoters who generally stood as personal guarantors for the debts availed by such corporate entities. This experiment ought to encourage the legislature to proceed with enforcement of Part III of IBC for individuals and firms as a whole. As the Code continues to mature in its more than 6 years of existence and enforcement of Part-III in its entirety would in all likelihood strengthen the

[20] The Quarterly Newsletter of the Insolvency and Bankruptcy Board of India, January-March 2022, Vol.22.
In terms of the Quarterly Newsletter of the IBBI for January - March 2022, 926 applications have been filed as on 31 March 2022 out of which 82 applications are filed by the debtors and 844 applications by the creditors.

insolvency and restructuring framework by adding to it the resolution of debts of individual and firms.

SCHOLASTICUS

Swarnendu Chatterjee & Priyanshi Sarin, *Interplay of Law of Limitation vis-à-vis Insolvency and Bankruptcy Code, 2016,* 10 (1) SCHOLASTICUS 27 (2023).

INTERPLAY OF LAW OF LIMITATION VIS-À-VIS INSOLVENCY AND BANKRUPTCY CODE, 2016 – A CRITICAL ANALYSIS

Swarnendu Chatterjee,[⊥] *& Priyanshi Sarin*[ø]

ABSTRACT

It has been pointed out that the Law of Limitation are not only meant to destroy the rights of the parties but are meant to look to the parties who do not resort to the tactics but in general to seek remedy. This article analyses the impact of the 2018 Amendment to the Insolvency and Bankruptcy Code 2016 (hereinafter referred to as "Code"), which has brought the entire process of Corporate Insolvency Resolution Process (hereinafter referred to as "CIRP") under the garb of limitation Act. In the article, authors have traced the evolution of the jurisprudence of Section 238A of the Insolvency and Bankruptcy Code,2016 in light of the precedents given by the Hon'ble Supreme Court. The article also delves into the applicability of COVID-19 relaxations upon the filing of claims to a resolution professional/liquidator. Lastly, the authors argue the persistence of a legal vacuum, when it comes to discerning the power to condone delay with the resolution professional and therein urge statutory clarification and/or, necessary amendments to the Code by the Parliament, which shall be in furtherance to the scope and object of the Code, which mandates time-bound process/ completion of the CIRP/liquidation.

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I. INTRODUCTION

The law of limitation stems from the need of providing certainty and promoting diligence to ensure that a petitioner sleeping on his legal rights shall not be given the benefit of the right to sue.[1] In this article, the authors discuss the extent of applicability of the Limitation Act, 1963,[2] to the Insolvency and Bankruptcy Code ("the Code") upon initiation of the Corporate Insolvency Resolution Process ("**CIRP")** which is triggered upon admission of applications/petitions filed under Section 7,[3] Section 9 or Section 10 of the Code. The authors further intend to decipher the legislative intent behind the 2018 Amendment,[4] which inserted Section 238A in the Code and therein removed the air of subjectivity stirred after the judgment of the Hon'ble Supreme Court in ***Neelkanth Township and Construction Pvt. Ltd. v. Urban Infrastructure Trustees Ltd***.[5] wherein the Hon'ble Supreme Court was pleased to dismiss an appeal filed against the order of Hon'ble National Company Law Appellate Tribunal ("**NCLAT**") however, refrained from answering the question on applicability of the law of limitation vis-à-vis the Code. This article further seeks to analyze the interpretations according to the varied factual matrix and therein amalgamates precedents to demonstrate the jurisprudence developed by the Hon'ble Supreme Court about adopting a liberal interpretation based on the phrase "*as far as may be*" mentioned in Section 238A of the Code. In light of the pandemic, limitation laws gained widespread traction and therein a suo-moto cognizance by the Supreme Court had issued an order granting extension. In **Part I** of the article, authors have traced the evolution of the jurisprudence of Section 238A in light of the ratio decidendi given by the Hon'ble Supreme Court**.** In **Part II** of the article, the authors

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[1] Law Commission of India (Eighty-Ninth Report) on the Limitation Act, 1963.
[2] The Limitation Act, No. 36 Acts of Parliament, 1963 (India).
[3] Insolvency and Bankruptcy Code, 2016, § 7, No. 31, Acts of Parliament, 2016 (India).
[4] The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018.
[5] Neelkanth Township and Construction Pvt. Ltd. v. Urban Infrastructure Trustees Ltd., (CIVIL APPEAL NO. 10711 OF 2017- Order dated 23.08.2017).

inspect the powers of the resolution professional to condone the delay in filing the resolution plans. Lastly, **Part III** seeks to provide a persuasive recommendation for initiating effective amendments to the Code that may turn out to be the carving tool for a modern jurisprudence which shall ensure that the Code promotes completion of liquidation in a time-bound manner.

II. EVOLUTION OF THE JURISPRUDENCE

In the landmark Judgment of ***B.K. Educational Services Private Limited v. Parag Gupta and Associates*** the Hon'ble Supreme Court interpreted the Report of the Insolvency Law Committee of March 2018and deduced [6], that applicability of Section 238A is "*retrospective in nature*" and because Sections 7 and 9 of the Code would be applicable in such applications therein it shall be read conjointly with Article 137 of the Limitation Act (residuary provision). Thus, the "*right to sue*" against default of payment shall automatically lapse if three years have passed since the occurrence of default. However, relief can be sought by resorting to filing an application for condonation of delay. Herein, it is imperative to mention the relevant excerpt of the report of the Insolvency Law Committee[7], which was relied upon by the Hon'ble Supreme Court in BK Educational Services, to cull out the realintention behind the introduction of Section 238A. In the report, it was unanimously decided by the Committee members that the intent of the Code could not have been to give a new lease of life to debts that are time-barred. While discussing the application of the Limitation Act, the Court deliberated upon various NCLT and NCLAT judgments to conclude that non-applicability of the Limitation Act might lead

[6] B.K. Educational Services Private Limited v. Parag Gupta and Associates, AIR 2018 SC 5601.
[7] Insolvency Law Committee Report, March 2018, https://ibbi.gov.in/ILRReport2603_03042018.pdf.

to re-opening the right of financial and operational creditors holding time-barred debts under the Limitation Act to file for CIRP, as a result, it would trigger a default on debt above INR one lakh. Though the Code is not a debt recovery law, the trigger being 'default in payment of debt' renders the exclusion of the law of limitation counter-intuitive. Second, it re-opens the right of claimants (pursuant to the issuance of public notice) to file time-barred claims with the IRP/RP, which may potentially be a part of the resolution plan. Understanding that the intent of the statute was not to reopen the gates of opportunity for the creditors who failed to exercise remedy under the existing framework within the given limitation period, it was considered appropriate to insert a specific section applying the Limitation Act to the Code. The relevant entry under the Limitation Act may be on a case to case basis.[8] Further, in ***Sesh Nath Singh and Ors. v. Baidyabati Sheoraphuli Co-operative Bank Ltd. and Ors.*** [9]**, the Hon'ble Supreme Court** held that Section 14 of the Limitation Act applies to the Code by a liberal interpretation, that seeks to harmonize the object and the subject matter of the legislation, and the said discretion is exercisable in interpreting the term "*as far as may be*" stipulated under Section 238A. Therein, it was noted that the application in the Hon'ble NCLT filed by the financial creditor was well within the three-year limitation if the period from the date of institution of the Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 ("**SARFAESI Act**") until the date of filing of the application under Section 7 of the Code was excluded. The aforesaid finding was based on the reasoning that proceedings under the SARFAESI Act are deemed to be "*civil proceedings*". The Court also averred that the laws of limitation shall apply to the IBC only to the extent they are not patently inconsistent with the latter's provisions. With reference to the applicability of Section 18 of the Limitation Act, the Hon'ble

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[8] *Id.*
[9] Sesh Nath Singh and Ors. v. Baidyabati Sheoraphuli Co-operative Bank Ltd. and Ors., Civil Appeal No. 9198 of 2019.

Supreme Court in ***Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. and Ors*,**[10] observed that applicability of the Limitation Act to the Code has to be determined by ascertaining facts surrounding the case since it is a **mixed question of law and fact** and thus, owing to lack of sufficient evidence exemplifying adequate acknowledgement it was noted that Section 18 was not applicable. Though this judgment was decided based upon its peculiar facts and circumstances, various conflicting decisions came up later on. While some of them reiterated the ruling in *Babulal* and followed the same,[11] there were others that distinguished it on the basis of facts and reinstated the applicability of Section 18 to the IBC.[12]

In the case of ***Laxmi Pat Surana v. Union Bank of India and Ors.***[13] Hon'ble Supreme Court, while stating the decision in *Babulal* was rather fact-specific and hence did not rule out the possibility of application of Section 18 to the Code, categorically held that Section 18 of the Limitation Act would be attracted against the corporate guarantor in a situation wherein acknowledgement of debt has been issued solely by the principal borrower based on the principle of co-extensive liability.[14] Further, in a recent decision of ***Asset Reconstruction Company (India) Limited v. Bishal Jaiswal and Ors.*,**[15] what amounts to acknowledgement was clarified by the Hon'ble Supreme Court wherein it was held that *"Entry made in the books of accounts, including the balance sheet amounts to an acknowledgement of liability within the meaning of Section 18 of the Limitation Act, 1963*". Therefore, acknowledgement of debt for any creditor in the audited balance

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10 Babulal Vardharji Gurjar v. Veer Gurjar Aluminium Industries Pvt. Ltd. and Ors, AIR 2020 SC 4668.
11 Jagdish Prasad Sarada v. Allahabad Bank Company, (AT) (Insolvency) No. 183 of 2020
12 Yogesh Kumar Jashwantlal Thakkar v. Indian Overseas Bank Company, Appeal (AT) (Insolvency) No. 236 of 2020.
13 Laxmi Pat Surana v. Union Bank of India and Ors., Civil Appeal No. 2734 of 2020.
14 Indian Contract Act, 1872, § 128.
15 Asset Reconstruction Company (India) Limited v. Bishal Jaiswal and Ors.,2021 SCC OnLine SC 321.

sheet of the debtor company shall result in continuity of the default and shall also result in a continuation of the limitation period. This judgment cleared the air and settled the law surrounding the application of the Limitation Act to the proceedings of IBC.

In ***Rajendra Narottamdas Sheth and Ors. v. Chandra Prakash Jain and Ors.***,[16]it was held that the Adjudicating Authority i.e. NCLT/NCLAT is under an obligation to assess the application of Section 7in respect of the Limitation Act. The argument of not raising a plea seeking applicability of Section 18 would not be permissible.[17]

It is imperative to note that "conduct of the plaintiff" is of prime importance while determining the contention of an application being barred by limitation. For instance, in the case of ***Unitek Power Solutions India Ltd. V. JM Financial Asset Reconstruction Company Ltd.***,[18] the Kerala High Court rightly refrained from interfering with the NCLAT order permitting initiation of CIRP since the petitioner on an earlier occasion had admitted liability without raising the defense of limitation before NCLT.

Further, the Hon'ble Supreme Court in ***V. Nagarajan v. SKS Ispat and Power Ltd. and Ors***.[19] has conclusively held that the Code has an overriding effect over the Limitation Act and the date of filing an appeal before Hon'ble NCLAT, from the order of Hon'ble NCLT starts from the date of pronouncement of the order and not from the date of supply of certified copy.

Given the aforesaid precedents, the authors are of the view that harmonious construction of Section 238A of the Code has established the following:

a) That reviving time-barred debts is not the intention behind the Code.

[16] Rajendra Narottamdas Sheth and Ors. v. Chandra Prakash Jain and Ors., Civil Appeal No. 4222 of 2020.
[17] Noharlal Verma v. District Cooperative Central Bank Limited, Jagdalpur, AIR 2009 SC 664.
[18] Unitek Power Solutions India Ltd. v. JM Financial Asset Reconstruction Company Ltd., OP(C) No. 268 of 2019.
[19] V. Nagarajan v. SKS Ispat and Power Ltd. and Ors., Civil Appeal No. 3327 of 2020.

b) That by virtue of ***B.K. Educational Services Private Limited v. Parag Gupta and Associates.***,[20] application of Section 7 under the Code is to be governed as per Article 137 of the Limitation Act and therein have to be filed within three years of default.

c) Acknowledgement of debts by the corporate debtor/principal borrower would result in computation of fresh limitation period.

d) Delay in the filing of applications may be condoned if the pleadings are meritorious and satisfy the Hon'ble Court of a bona fine intention.

III. TIMELINES UNDER THE CODE VIS-À-VIS RESOLUTION PLANS

The Hon'ble Supreme Court of India, in ***Ghanashyam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited and Ors***.[21]has propounded that "*Resolution plan once duly approved by the Adjudicating Authority, the claims as provided in the resolution plan would stand frozen and will be binding on the Corporate Debtor and its employees, members, creditors".* Thus, non-filing of claims within the issued time limit shall adversely impact the stakeholders involved in a CIRP.

In the case of ***Kalpraj Dharamshi and Ors. v. Kotak Investment Advisors Ltd. and Ors***.[22], Kalpraj (Appellants) had submitted a resolution plan post expiry of the time limit which was accepted by the Resolution Professional. Therein, Kotak Investment Advisors Ltd. (KIAL) filed objections against the said approval in the NCLT which were rejected; however, NCLAT had allowed

[20] *Supra* note 6.
[21] Ghanashyam Mishra and Sons Private Limited v. Edelweiss Asset Reconstruction Company Limited and Ors., Writ Petition (Civil) No. 1177 of 2020 and Civil Appeal Nos. 1550-1553 of 2021 (Arising out of Special Leave Petition Nos. 7147-7150 of 2020).
[22] Kalpraj Dharamshi and Ors. v. Kotak Investment Advisors Ltd. and Ors., 2943-2944, 3138-3139, 2949-2950 of 2020 and Civil Appeal Nos. 847-848/2021 (D. No. 24125 of 2020).

the appeal of KIAL. In appeal, the Hon'ble Supreme Court held that the time utilized in the filing of the Writ Petition in the High Court against the judgment of Hon'ble NCLT shall be excluded from the purview while determining the period of limitation under Section 14 of the Limitation Act.

The substantial question of law which was dealt with by the Hon'ble Supreme Court also pertains to the jurisdiction of Hon'ble NCLAT in interfering with the decision of the Committee of Creditors regarding approval of a resolution plan. Section 30(2) of the Code empowers the resolution professional to examine the resolution plan and as per clause (e), he shall ensure that the plan does not contravene any provisions of law for the time being in force. It is pertinent to exhibit the views of the Bankruptcy Law Reforms Committee ("**BLRC**") exhibited in their report of 2015[23]in reference to the powers of the resolution professional:

No constraints have been implemented on the proposals that the resolution professional can present to the CoC. The solution must explicitly state that any interim financing and costs associated with the insolvency resolution process must be paid in priority before any other payments. Further, the plan must explicitly include payment to all creditors who are not members of the creditors' committee within a reasonable period of time after the solution is implemented. Finally, the plan should be in accordance with the existing laws that govern the entity's actions. The CoC will retain the authority to decide on a final solution through majority votes in the negotiation. The condition to receive a majority vote is more than or equal to 75 per cent of the creditors' committee by weight of the total financial liabilities.

A. Obtaining the resolution to insolvency in the IRP

[23] The report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design (2015) available at https://ibbi.gov.in/BLRCReportVol1_04112015.pdf.

In the beginning, the Committee deliberated on who should serve on the CoC, given the CoC's ultimate authority to keep the entity operating or liquidate it. Typically, operational creditors are unable to make decisions regarding the entity's insolvency and are unwilling to take the risk of deferring payments in exchange for better future prospects for the entity. The Committee reasoned that members of the CoC must be creditors capable of assessing viability and willing to negotiate terms of existing liabilities. Typically, operational creditors are unable to make decisions regarding the entity's insolvency and are unwilling to take the risk of deferring payments in exchange for better future prospects for the entity. The Committee concluded that, in order to ensure a swift and efficient process, the Code will require that the CoC be limited to financial creditors.

The committee believes that the overall market should be allowed to propose solutions for maintaining the entity as a going concern. Because the manner and nature of possible solutions are contextual and dependent on the time and environment in which insolvency becomes visible, they are expected to evolve over time and with market development. The Code will be receptive to all possible solutions for sustaining the entity without prejudice, as long as they adhere to the remainder of the IRP's constraints. As a result, the Code will make no provision for how to resolve insolvency. There will be no restriction in the Code on the types of changes that can be made to the entity's business model, financial model, or both, to keep the entity a going concern. The Code will make no reference to the entity being revived, the debt being restructured, or the entity being liquidated. This decision will be made after the CoC deliberates on the market solutions proposed.

The analysis of the said report uncovers the intention of the Committee to ensure free decision-making by the resolution professional in presenting the resolution plan to the Committee of Creditors as long as the three requirements have been fulfilled. The aforesaid recommendation of the BLRC was upheld by the Hon'ble Supreme Court as a norm in a catena of judgments, namely, (i) ***Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta,***[24] (ii) ***K. Sashidhar v. Indian Overseas Bank and Ors***.,[25] (iii) ***Maharashtra Seamless Limited v. Padmanabhan Venkatesh and Ors.***[26]and (iv) ***ArcelorMittal India Private Limited v. Satish Kumar Gupta and Ors***.[27]

The authors agree to the view taken in the aforesaid judgments and additionally, it is important to mention that the Resolution Professional or the CoC should be entrusted with ensuring adherence to strict timelines, as prescribed under the Code.[28]

In ***Swiss Ribbons Pvt. Ltd. and Ors. v. Union of India (UOI) and Ors***.[29], the Hon'ble Supreme Court, has emphasized that the intention of this Code is aimed at the revival of the corporate debtor and therefore strict adherence to the timelines shall ensure maximization of the value of assets. The authors argue that a faster process would offer twin benefits to the CoC and the Corporate debtor, namely: (i) Ensuring greater monetary value, for instance, a going concern would be able to set off more claims than a company left with minimal/diluted assets. (ii) Creditors would be able to satisfy their claims faster and in a better manner.

IV. ACCEPTANCE OF CLAIMS VIS-A-VIS COVID -19 (PANDEMIC)

Whether the Resolution Professional / Liquidator appointed under the Code enjoy the power to condone any kind of delay under the Code? Effect of the

[24] Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta, (2020) 8 SCC 531.
[25] K. Sashidhar v. Indian Overseas Bank and Ors., AIR 2019 SC 1329.
[26] Maharashtra Seamless Limited v. Padmanabhan Venkatesh and Ors., AIR 2020 SC 3779.
[27] ArcelorMittal India Private Limited v. Satish Kumar Gupta and Ors., AIR 2018 SC 5646.
[28] Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta, (2020) 8 SCC 531.
[29] Swiss Ribbons Pvt. Ltd. and Ors. v. Union of India (UOI) and Ors., AIR 2019 SC 739.

Order of the Hon'ble Supreme Court in *In re Cognizance For Extension of Limitation.*[30]

It is necessary to point out that none of the provisions or judgments or committee reports have dealt with or, are rather silent as to the power of the Resolution Professional to condone the delay. The situation becomes peculiar owing to the judgment by the Supreme Court which has extended the time limit for filing of applications, suits and other proceedings. An order issued by the Supreme Court in *Cognizance For Extension of Limitation,*[31] by which the limitation period was extended with effect from 15.03.2020 keeping in view the onset of the COVID-19 pandemic.

In the above segment of the article, the grey area as to lack of clarification concerning the power to condone delay with the Resolution Professional has been highlighted. Therein, the moot question that the authors would also like to emphasize is that; whether the time period for filing of claims before the resolution professional has also been extended owing to this pandemic (Covid-19)?

In the case of ***GPR Power Solutions (P) Ltd. v. Supriyo Chaudhuri,***[32] the appellant was unable to file his claim with the Resolution Professional within the stipulated time period owing to the nation-wide lockdown. Upon rejection of the said claim, an application was filed for condonation of delay under Section 60(5) of the IBC which was dismissed and subsequently the appeal filed under Section 61 was also dismissed by NCLAT. **Therein, reference was made to the suo-moto cognizance undertaken by the Court which**

[30] Cognizance For Extension of Limitation: In Re, (2021) 5 SCC 452.
[31] *Id.*
[32] GPR Power Solutions (P) Ltd. v. Supriyo Chaudhuri, CIVIL APPEAL NO. 6553 OF 2021.

juxtaposed limitation law with the pandemic and thus it was concluded that

"In computing the limitation for any application, the period from 22.03.2020 till 14.3.2021 is to be excluded. All litigants whose limitation expired after 22.03.2020 would be entitled to an extension of limitation till the 90th day from 15.03.2021." The Hon'ble Supreme Court was pleased to set aside the orders of Hon'ble NCLT and NCLAT and allowed the appeal of M/s GPR Power Solutions (P) Limited, thus, implying an affirmative answer to the question raised regarding the applicability of the order of extension of limitation owing to Covid-19 (pandemic).

V. CONCLUSION

In the era of promoting ease of doing business, dynamism is a core feature that needs to be focused on while evolving the Code to cope with the volatile post-pandemic environment. The Courts have expressed at least three differing reasons supporting the existence of statutes of limitation, which are: (1) the long-dormant claims have more of cruelty than justice in them (2) that a claimant should be penalized, who might have lost the evidence to disprove a stale claim, and (3) that persons with good causes of actions should pursue them with reasonable diligence and not sit on the fence waiting to get into the arena.[33]

The authors are of the view that the object of the Code; i.e. to maximize the value of assets can only be fructified when strict adherence to the timelines prescribed under the Code is followed, unless and until there are pressing circumstances, like a pandemic where the State has to encounter a natural disaster. The aforesaid view of the authors is pursuant to interpretation of "laws relating to limitation" in Halsbury Laws of England, which states the following;

[33] *Id* at 36.

"*object of the law of limitation is to prevent disturbance or deprivation of what may have been acquired in equity and justice by long enjoyment or what may have been lost by a party's own inaction, negligence, or laches*".[34] The aforesaid view stands affirmed by the Hon'ble Supreme Court in the case of ***Rajender Singh and Ors. v. Santa Singh and Ors.***[35]

The authors are of the view that Sec. 238A of the Code which mandates applicability of Article 137 of Limitation Act, 1963, is a step forward in promoting the object of the Code and as mentioned above, helps in separating the wheat from the chaff. However, this provision of Sec. 238A of the Code is only made applicable to filing applications as financial creditors and operational creditors, however, the object of the Code shall get more fructified, if the Code is suitably amended to empower the Resolution Professional as an administrative officer, or, the liquidator to reject the claims which are beyond the three-year time period, as otherwise also, the claimants would be powerless to move the Court/Tribunals to claim such amount. Such an exercise, in the opinion of the authors, shall result in a reduction of appeals/applications before the Hon'ble NCLT and shall, in the opinion of the authors, in the interest of the object of the Code.

[34] 24 HALSBURY'S LAWS OF ENGLAND 181, para 330.
[35] Rajender Singh and Ors. v. Santa Singh and Ors, (1973) 2 SCC 705.

SCHOLASTICUS

Priyadarshini Rao, *Valuing IPO Valuation*, 10 (1) SCHOLASTICUS 40 (2023).

VALUING IPO VALUATION

Priyadarshini Rao.[⊥]

ABSTRACT

*Over the last two years, initial public offerings ("**IPOs**") have proved to be a popular way to raise funds for the new age technology companies ("**NATCs**"), while simultaneously giving its existing shareholders an exit opportunity. As a result, the securities market regulator, the Securities and Exchange Board of India ("**SEBI**"), is paying closer scrutiny to IPO valuation, implementing various policy changes.This paper explores the increasing regulatory involvement of SEBI in IPO valuation and the possible implications. As is the process, SEBI has released consultation papers inviting public comments on this subject matter. Furthermore, the paper also discusses the challenges in sharing such additional information in a public offer, compared to private placements to seasoned private equity firms. Whereas the future of the IPO valuation of NATCs is uncertain, theoutcome ofthe latest SEBI consultation paper might provide a ray of hope to the stakeholders from a governance perspective. Since the jurisprudence of IPO valuation is continuously evolving, a deeper understanding of advanced markets and foreign jurisdictions becomes pertinent to remedy the problem of IPO valuation in the era of unicorns.*

Readers' Note: This article takes into account regulatory updates issued till March 31, 2022.

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I. INTRODUCTION

The Indian equity capital markets space witnessed close to 70 initial public offerings ("**IPOs**") in the year 2021.[1] These include some of the largest public offers made in the Indian regulated market, including the companies behind widely recognized brands such as PaytM, Zomato,Nykaa, KFC, Policy Bazaar, Fortune, MedPlus, and many more. A large number of these companies are 'new age technology companies("**NATCs**"), with rather interesting and unique business models. While these NATCs (many with a 'unicorn' status) had rather glamourous IPO openings, several of these are facing market-based valuation correction after listing. This has naturally caught the attention of the Indian securities market regulator, the Securities and Exchange Board of India ("**SEBI**") leading to much discussion and debate on the IPO valuation process, especially in relation to NATCs.

As a quick background, companies that list their securities on the Indian stock exchanges have the option to follow either a (i) "fixed price process", where the issuer company ("**Issuer**") determines the IPO allotment price without formal feedback from potential investors on the valuation through their bids; or (ii) "book building process", where the Issuer determines a price range and formally obtains feedback from potential investors in their bids to determine the exact price per security offered in its IPO ("**IPO Security**").

Typically, Issuers in India follow the "book building process"[2] in accordance with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, as amended ("**ICDR Regulations**"), for their IPO pricing. This process

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[1] SECURITIES AND EXCHANGE BOARD OF INDIA, https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=3&ssid=15&smid=12 (last visited Apr. 9,2022).

[2] Issue of Capital and Disclosure Requirements (ICDR) Regulations, 2018, Schedule XIII).

starts before the Issuer makes its first formal filing with SEBI in relation to its IPO (the draft red herring prospectus, or the "**DRHP**"), when determining the estimated issue size for the IPO. At this stage, the Issuer has in mind an expected valuation, which is made based on several factors, such as its financial performance and corresponding projections, several operational parameters, estimated cashflows, price per earnings ratio, and periodic growth rates. Prior to the launch of the IPO, the Issuer (along with the SEBI registered merchant bankers engaged by the Issuer for its IPO) narrows the range of the expected valuation and releases a price band to the potential investors, inviting bids at various price points within the price band. Based on the bids received from the potential investors,the Issuer, in consultation with the merchant bankers, determines the final IPO issue price.

II. INCREASED REGULATORY INVOLVEMENT IN IPO VALUATION AND PRICING

SEBI has considered several policy changes last year, including updates to the "book building process" for the determination of the IPO price band. With an aim to make IPO price discovery more transparent, the Primary Market Advisory Committee recommended a minimum range for the price band, such that the cap price is not less than 105% of the floor price.[3] While the ICDR Regulations previously accounted for a maximum range of 20%[4], this new proposal was brought in light of the narrow price bands of Re.1, Rs. 2, and Rs.3 on a large number of transactions. The regulator saw this as an attempt to camouflage a fixed price issue as a book-built issue to circumvent the regulatory requirements and stated that it raised concerns on fair and transparent price determination in a book-built IPO. With this spirit, SEBI released a

[3] SEBI Press Release no. 38/2021 dated December 28, 2021.
[4] *Id*. at Reg 29(2).

consultation paper[5] inviting comments from the public and relevant stakeholders. Based on comments received, SEBI in its board meeting dated December 28, 2021, approved the amendment to insert a minimum range for IPO price bands, and the amendment was notified in the official gazette on January 14, 2022.[6] While this amendment applies to all kinds of Issuers, and not just to NATCs, it signals SEBI's increased attention to IPO pricing practices followed in India.

Subsequently, as a result of the unexpected market correction of the valuation of several listed NATCs last year, SEBI also heightened scrutiny on the disclosures classified as 'basis for issue price' that include standard parameters considered in IPO valuation. For instance, companies behind the brands PayTM and CarTrade that listed below their IPO issue price, and the entity behind Policy Bazaar currently trading much below its IPO issue price. In this regard, SEBI released another consultation paper[7] seeking comments on this matter. This consultation paper has raised several questions for consideration regarding the content of the disclosures on the 'basis for issue price'.

Historically, the ICDR Regulations have prescribed disclosure of critical accounting ratios, i.e., earnings per share, price to earnings, return on net worth, and net asset value, along with a comparison of such ratios with comparable industry peers of the Issuer.[8]Though these factors may be relevant for profitable companies, for NATCs these parameters for 'basis for issue price' seemed to fall short and not provide a comprehensive picture. Keeping in mind

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[5] Securities and Exchange Board of India, consultation paper on "*Review of Price Band and Book Building Framework for public issues*" (Issued October 4, 2021).

[6] Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022, No. 24 of 2022, §30 (Jan. 14, 2022).

[7] Securities and Exchange Board of India, Consultation paper on "*Disclosures for 'Basis of Issue Price' section in offer document under SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018*" (Issued February 18, 2022.).

[8] ICDR REGULATIONS, *supra* note 2, at Schedule VI, para 9(K).

these valuation challenges, NATCs do rely on other financial and operational parameters, called 'key performance indicators ("**KPIs**") to give potential investors an idea of the prospective growth opportunities for the company. KPIs are not specific to NATCs, and vary from industry to industry, and include quantifiable factors such as store count, footfalls, website visits, inventory size, and sales growth. Other traditional companies also use KPIs to supplement their marketing, however, these KPI disclosures have a more significant bearing on NATCs. Keeping this in mind, the first substantive question for consideration in this consultation paper is whether KPIs should be included as a part of the disclosures on the 'basis of issue price'.

Incidental to this is the question of how does one identify the KPIs to be included in the 'basis of issue price'? Unlike the financial ratios mentioned above, these cannot be standardised across the industry and the initial identification of the KPIs that are disclosed under 'basis of issue price' will have to be made by the Issuer. In the consultation paper, SEBI has proposed that Issuers must disclose all the material KPIs shared with their earlier investors in the three years preceding their IPO, with an explanation of how these KPIs affect the 'basis of issue price'. However, non-material KPIs shared with the investors are also required to be disclosed, with an explanation of how they are not relevant. SEBI has also included other procedural aspects linked to these disclosures, including the lookback period for comparison, peer comparisons, and certifications to verify the disclosures.

In addition to KPIs, SEBI has also considered disclosure of secondary sales and acquisitions (other than gifts) of the securities proposed to be listed ("**IPO Securities**") in the eighteen months preceding the filing of the DRHP if they account for 5% or more of the then outstanding share capital of the Issuer. The current disclosure requirements under the ICDR Regulations require disclosures on the average cost of acquisition of IPO Securities by the promoters or any shareholder selling their shares in the IPO ("**Selling**

Shareholders").[9] Further, the ICDR Regulations also require disclosure of the weighted average cost of acquisition of IPO Securities in the year preceding the DRHP/offer document filing by the promoters and Selling Shareholders.[10] Over the last few months, we have also seen DRHPs filed by Issuers with additional disclosures on the price at which IPO Securities were acquired by Selling Shareholders in the last three years providing more disclosures on the cost of acquisitions through the secondary sale. The proposal in the consultation paper is another attempt to encourage transparent disclosures to help potential IPO investors understand the valuation and pricing of the IPO Securities and determine the fairness of the IPO valuation. If approved the new disclosures will include, among other things, the weighted average cost of acquisition of IPO Securities through (i) primary issuances; and (ii) secondary sales, each over the last eighteen months, along with a comparison against the IPO floor price and IPO cap price and explanations on the differences.

III. CONCLUSION

To be able to appreciate the impact of these changes, specifically under the second consultation paper, it is very important to understand how they may affect NATCs. NATCs are typically known to have aggressive growth strategies, with a focus on inorganic growth through strategic acquisitions and investments instead of more traditional capital expenditure. As a result, these companies tend to have a low or negative net worth and are likely to report losses in their accounts. The idea of having loss-making companies access the public market is not new, and we have had loss-making brick and mortar companies make public offers in the past. However, the valuation of such

[9] *Id.* at Schedule VI, Schedule VI, para 4(M).
[10] ICDR REGULATIONS, *supra* note 2, at Schedule VI, para. 4(M).

companies has not been as challenging as for NATCs with the existing set of disclosures under 'basis for issue price' because of the greater relevance of KPIs over the traditional financial ratios for NATCs.

We should soon expect to see the outcome of the SEBI consultation paper dated February 18, 2022. It will be interesting to see the amendments that finally get incorporated. Details of acquisition costs are more objective in disclosure, however, identification of material KPIs may pose some challenges. Pre-IPO investments in NATCs typically involve engagement with private equity firms with a deeper understanding of the sectors and a higher risk appetite. These firms look are long-term projections in loss-making NATCs. IPOs however also involve retail investors and high net worth non institutional investors who may not have the same perspective as private equity firms. Additional details may overload such investors with information they cannot comprehensively process and potentially affect IPO participation. We can only look to more advanced markets, such as the United States, to borrow from their tried and tested models and hope they can over time be adapted to the needs of the Indian market.

SCHOLASTICUS

Ankit Srivastava, Kaustubh Tiwari & Aditya Tripathi, *A study on Fintech and Competition Law Concerns*, 10 (1) SCHOLASTICUS 47 (2023).

A STUDY ON FINTECH AND COMPETITION LAW CONCERNS

Ankit Srivastava,⊥Kaustubh Tiwari,ø Aditya Tripathi⊤

ABSTRACT

Due to technological advancement, banking is run on a click and after global economic recession of 2008, there emerged Cryptocurrency and Fintech regime. Fintech is not only limited as a medium for exchange of money but also extend to investment advisory, crypto currency and insurance aggregators.

The authors in this article have discussed various sectors that are undergoing transformational changes through Fintech and also the changes that are taking place in those sectors. The authorse discussed about the various giants like Apple, Facebook, Alibaba acquiring notable market share in these Fin-Tech based platforms and the the problem it created by hampering the competitive spirit of the market. With this article, the authors have put forth the lacuna in the laws, particularly Indian Competition Act when compared with the development of digital sector. The archaic law is unable to do justice and solve the modern problems and thus requires certain modifications. The authors also went on to discuss the various issues that are pertinent in the Fintech era under an oligopolistic structure.

The article concluded with certain suggestions and recommendations to make Fintech more efficient by introduction of strong and robust legal framework so that neither competition nor innovation is hampered by taking a leaf out of various countries method of dealing with the same issue.

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I. INTRODUCTION

"Men quarrel over three main reasons- Competition, Distrust and Glory"

- *Thomas Hobbes*[1]

In all possibility, the people of the city of Summer, an ancient civilization that was founded in Mesopotamia around the year 3000 B.C, could not have imagined that their idea to use money as an instrument to facilitate exchange would come to form the most indispensable cog in the economic wheel of nations ever- after. Equally, neither would Bob Kahn and Vint Cerf (founders of the internet) have imagined that their invention when applied to the Summerian idea could indelibly change the world forever.

With its pervasive reach and overarching presence today, the internet has transgressed every periphery of modern life and society. Technological advancement has made it possible to run the world on a click and certainly, banking remains no exception to it. Moreover, banks have been responsible for most innovations in the financial industry like the introduction of credit card in 1950s and ATMs in 1970s. However, despite such technological advancement in the banking sector, it failed to overcome the public scepticism since the economic crisis of 2008 that caused rippling effects around the world by driving in a global economic recession. This phenomenon inevitably laid a solid foundation for the Crypto-currencies and FinTech regime. Especially, in the case of FinTech, smartphones coupled with the internet and e-banking services became the clincher.

Simply put, eyeing a comprehensive overhaul in the aftermath of the 2008 economic meltdown, technological innovations successfully ventured to simplify the banking system by helping business groups with innovative ideas by developing platforms that would no longer depend on the outmoded

[1] 3 RAYMOND WACKS, UNDERSTANDING JURISPRUDENCE: AN INTRODUCTION TO LEGAL THEORY 18 (Oxford University Press 2012).

banking systems and simultaneously, aid in the formation of an effective business outreach that ultimately resulted as FinTech. Though, the term FinTech lacks any particular definition but has been loosely termed as the use of technology in finance.[2]

In an attempt to escape difficulty, for the purpose of this article, FinTech is defined as the innovative use of technology to help people use financial services of the bank even if they are not a user of the banking services per se and these financial services are incorporated with different services which diverge from payments, credit reporting, lending, and factoring. One of the major achievements of FinTech technologies has been that it has bridged the gap between quick money transfer in real time and user-friendly interface coupled with discount offers. This created an appreciable impact on the customers as now the travails of going to a bank and then transferring the money which took time could be replaced with just a click or touch. Further, the impediment of regulations that were required by banks to oblige in the movement of money could now be circumvented through the medium of FinTech.

II. APPROACHES AND DEVELOPMENTS OVER THE YEARS

The FinTech landscape has diversified over the years. Whereas, earlier FinTech platforms were only a medium for exchange of money, now, they have metamorphosised themselves into a variety of day-to-day services catering to essential need such as investment advisory, cryptocurrency, and insurance aggregators. They now also includes technology-based businesses such as

[2] William Magnuson, *Regulating Fintech*, Vol.71(4) VANDERBILT LAW REVIEW 1167 (2018).

Amazon has started to use Amazon pay services which provide lucrative and big discounts.[3]

According to a report by the World economic Forum, Fin-tech enterprises have disrupted businesses of the existing financial institutions and would continue to do so in the future.[4]

The sectors that are undergoing a transformational change through FinTech revolution are:

i. *Payments:* As discussed since the demonetisation the discourse on the payment system has changed considerably. Seeing no easy payment techniques at that moment the customer had to shift to these platforms, because of which were earlier struggling for a way ahead, in times of demonetisation were seeing high traffic which made their servers to crash at times. Fin-tech has huge potential in this sector also since the decrease in the internet data charges people have shifted considerably on these services. Companies such as Paytm, Mobikwik, PayU and PayPal have taken considerable advantage of these changes. This shows that in the emerging landscape Fin-tech could be a giant which was hidden behind the bushes for too long.[5]The Fin-tech service providers through their Payment banking licenses have collaborated mobile services with banking services which further has been linked with a unique identity the "Unified Payment Interface ("**UPI**")"[6] which was

[3] KPMG, Fintech in India - A global growth story 53 (KPMG & NASSCOM 100 2016), available at: https://assets.kpmg/content/dam/kpmg/pdf/2016/06/FinTech-new.pdf.

[4] WORLD ECONOMIC FORUM, BEYOND FINTECH: A PRAGMATIC ASSESSMENT OF DISRUPTIVE POTENTIAL IN FINANCIAL SERVICES (World Economic Forum & Deloitte 2017), available at: https://www.weforum.org/reports/beyond-fintech-a-pragmatic-assessment-of-disruptive-potential-in-financial-services

[5] Payment banks can only perform a limited set of functions. They can't advance loan or issue a credit card but carry out most banking functions.

[6] UPI was developed by National Payments Corporation of India (NPCI). UPI helps users to send or receive money through an UPI Id which is a unique personal Id generated by the system for transfer of online money. This eliminates the exchange of information such as account numbers etc.

launched in 2016 for increasing mobile banking. This system has made transfers through mobiles way easier and way safer.

ii. *Funding, Lending and Investment*: During pandemic, we saw that a lot of charities and individual came ahead to help families which were suffering from financial crunch by asking for funds. These funds were mostly collected through the mode of online transactions which come under the purview of Fin-tech. RBI also issued a master circular[7] for the peer-to-peer lending platforms which bring together the lenders and the borrower for the exchange of money. This has helped a lot of businesses that run on the online channel with international funding.

iii. *Insurance and advisory services*: Earlier insurance could only be done by going in person to different companies which could take a lot of time because of the due- diligence involved. Since the coming of Fin-tech insurance can be bought online and this has reduced the hefty task of going to the agents as the smartphones have themselves become the agents.

iv. *Trade finance and cryptocurrency*: The recent development of cryptocurrency and blockchain have made a multifarious appeal in the market. We see all the newer applications which run on blockchain and also all the apps working in stock trading and stock market investing are a product of FinTech. Not only this all the digital currencies which float in the market run on the Fintech platform. We now on see all the market-related information can be gathered on the mobile and hence fin-tech in this sector has seen an exponential growth.

[7] The Reserve Bank of India, Master Direction – Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017, RBI/DNBR/2017-18/57 (Updated as on Oct. 05, 2021), available at: https://www.rbi.org.in/scripts/notificationuser.aspx?id=11137.

III. FINTECH &COMPETITION IN CONTEXTUAL AND COMPARATIVE FRAMEWORK

With a significant thrust visible towards the FinTech- based platforms, market giants like Facebook, Amazon, WhatsApp, Apple, etc. have climbed the bandwagon of this revolution by entering the business and taking over the new start-ups in this sector. Therefore, the entry of the FinTech regime in the competition fray became apparent as these tech giants acquired notable market share. More specifically, companies like Apple, Facebook, Amazon, and Alibaba which hold majority of the market space have sort of crafted obstacles for the new players to enter the market, axiomatically reflecting to the prevailing problem in securing robust competition in the market.

Take for instance, the recent complaint filed against Google Pay.[8] It was alleged in the complaint that Google has been involved in abusing its dominant position in the market through its control over the Playstore as it has created such an ecosystem which has helped Google Pay, earlier known as Tez, to outgrow its competitors. It was a one of its kind allegations for the Competition Commission of India (hereinafter as "**CCI**") as never, since its inception, came across such a scenario where a play-store, which is a virtual platform to download applications for phone, was allegedly construed as a market in terms of the Competition Act, and Google the developer of the platform was being alleged to misuse and abuse its market power. The CCI, therefore, ordered investigation in this matter, the reports of which are still awaited.

The developments in the digital sector have been a huge problem for the laws regulating the competition framework.[9]In the present framework, the Indian Competition Act (hereinafter as "**the Act**") revolves particularly around the

[8] XYZ v. Alphabet Inc., 2020 SCC OnLine CCI 41.
[9] ARIEL EZRACHI & MAURICE STUCKE, VIRTUAL COMPETITION: THE PROMISE AND PERILS OF THE ALGORITHM-DRIVEN ECONOMY (Harvard University Press 2016).

markets which are more related to selling of goods and services that can be accounted for. On the other hand, where the Act takes into account the digital or technological driven market-base, it can be found to be missing essential ingredients on multiple fronts that renders its implementation ineffective.[10] For example, to account for any investigation of a merger, there is a certain pre-requisite threshold. In today's era where the companies are being opened in one's own laptop, this has become a huge problem as even though they might not meet the required threshold, it is still possible that they could furnish data which would account for a more lot in this sector.[11] This has already been witnessed in the classic case of Facebook/WhatsApp Inc. merger,[12] where the CCI was legally handicapped to take cognisance of the matter as the threshold limits couldn't be reached.

In United States, where the competition law is majorly governed by the Sherman Act, FinTech is defined in a report presented by the US Department of Treasury as "financial technology".[13] The impact of FinTech on American competition market can be assessed as it led to newly established Financial Services, Fintech, and Banking Sector under the US Department of Justice (hereinafter as "**DOJ**") to specifically look into anti-trust measures employed by

[10] Akash Krishnan and V.K. Unni, *Competition regulation in two-sided markets: The Indian jurisprudence, National Conference on Economics of Competition Law*, COMPETITION COMMISSION OF INDIA (2019), availableat:https://www.cci.gov.in/sites/default/files/page_document/Papers-presented-in-2019-Conference.pdf.
[11] Inge Graef, *Market Definition and Market Power in Data: The Case of Online Platforms*, Vol. 38(4) WORLD COMPETITION: LAW AND ECONOMICS REVIEW, pp. 473–506 (2015).
[12] Case No. Comp/M7217, decision dated 3.10.2014 by European Union.
[13] U.S. Department of The Treasury, Executive Order 13772 on Core Principles for Regulating the United States Financial System, *A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation* (2018), available at:https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation.pdf.

FinTech companies.[14]Recently, in 2020 the DOJ pursued a lawsuit against Visa's acquisition of Plaid alleging that such acquisition would strangulate the potential competitive threat to Visa and will tend to provide a springboard for Visa's monopoly in the area of online debt market. Resultantly, such merger was prevented and competition sustained. This was not a new event or happenstance. Similarly, in 1998 as well, the DOJ filed a lawsuit against Visa and MasterCard for violating the Sherman Act by contractually compelling banks to exclude the issuance of cards on the American Express or Novus card networks.[15]While ruling that the exclusionary practice devised by Visa and MasterCard as anti- competitive, the court further stated that such activities have an adverse effect on consumer welfare and competition.[16]

Even after almost two decades, since the decision handed down in United States v. Visa,[17] the market presence of the major entities involved in the particular field has remained more or less same and stable. Over the years, the number of non-prepaid debit card transactions in the United States has grown proportionally faster than the number of credit card transactions.[18] Estimations show that non- prepaid transactions have increased 9 times with transaction value amounting to 72.7 billion between 2000-2018.[19] With the ever expanding dominion of the FinTech regime, and seeing the turn- around in the Plaid matter, one thing crops up abundantly clear and indicates the growing concern of the DOJ in order to secure robust competition in the market because new

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[14] Michael Murray, *The Muscular Role for Antitrust in Fintech, Financial Markets, and Banking: The Antitrust Division's Decision to Lean In*., U.S. Dep't of Justice, ,(2020), available at: https://www.justice.gov/opa/speech/file/1327491/download.

[15] United States v. Visa, 163 F. Supp. 2d at 333.

[16] *Id* at 341-343.

[17] United States, *supra* note 16.

[18] Dr. Ling LingAng & Dr. Will Taylor, *Fintech Developments and Antitrust Considerations in Payments*, vol. 35(2) Antitrust Magazine, 71 (American Bar Association) (2021), available at: https://www.nera.com/content/dam/nera/publications/2021/2021%20%20Fintech%20Developments%20and%20Antitrust%20Considerations%20in%20Payments.pdf.

[19] United States, *supra* note 15.

entrant to the market with innovations tend to tilt the balance of dominance in the market through killer acquisitions.

In 2018, reports have shown that 51% of the adult population of the European Union (hereinafter as "**EU**") avail the facility of online banking.[20] This data reflects the nearly doubling of the population from the previous decade indulged in online banking activity.[21] This shift in the utilisation of banking facilities significantly testifies to the impactful role played by the FinTech firms over the years by side-lining the conventional and traditional banking system. This phenomenon has led all the incumbent banking entities to embark on a digital transformational process creating a FinTech ecosystem and opening gates for innovations. Therefore, by calculation, the market size of FinTech in EU market in 2016 stands at 2.2 billion Euros.[22] However, the fundamental competition issue that the EU is facing is the threshold value to attract competition law plus the identification of relevant markets as the FinTech firms are engaged in multiple activities like banking, payments, personal finance, capital markets, etc.[23]The FinTech in some jurisdictions today have acquired the tag of a multi-headed hydra, whose operation in multifarious domain with a concentrated market nature has enabled it, in some cases, to defy the legislative mandate and threshold of competition laws and carry on with nefarious motives intended to hurt consumer welfare and foist monopoly in the market.

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20 Douglas Donahue & Jonathan Ching, *European Parliament Considers Competition Challenges In Fintech Sector*, LINKLATERS, available at:https://www.linklaters.com/en-us/insights/blogs/fintechlinks/2018/august/european-parliament-considers-competition-challenges-in-fintech-sector.
21 *Id.*
22 *Id.*
23 Alberto Fraile Carmona et. al., *Competition issues in the Area of Financial technology (FinTech),* Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament (2018), available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2018/619027/IPOL_STU(2018)619027_EN.pdf.

The desiderata for the FinTech era have been a sound internet infrastructure.[24] This maybe the reason why FinTech in India only gained acceptance and prominence post the internet revolution propelled by the telecom giant Jio just before demonetisation and subsequently, the same proved to be the ultimate catalyst for FinTech revolution in India. FinTech in the Indian context was a concept people weren't inclined to but after demonetisation which was implemented in 2016 to curb black money, saw an exponential surge in transferring the money digitally. Applications such as Paytm, Pay Pal, Phone pay, BHIM among others got a robust customer base and hence increased the traffic as well as competition law issues. Even though the Indian banking sector is one of its kind wherein RBI has been mandated to make laws regarding each aspect but still the structure has seen constraints when it comes to Fin-Tech.[25] It has become haywire for the system to consider to catch up with modern technology. As the nature of these transactions usher in a new concept for all the established regimes to follow, and the laws in this regard are changing in a critical way including the situations which arise on a day-to-day basis. Competition authorities around the world have recognised Fin-tech as a market disruptor who has enough potential to disrupt the banking and financial sector market.[26]

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[24] Adrain Johnson &VivekBelgavi, *Fintech Trends Report*, StartupBootcampFintech& PWC (2017), available at: https://www.pwc.in/assets/pdfs/publications/2017/fintech-india-report-2017.pdf.

[25] The Reserve Bank of India, *Report of the working group on Fintech and Digital Banking* (Issued on November 23, 2017), available at: https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/WGFR68AA1890D7334D8F8F72CC2399A27F4A.PDF.

[26] Erik Feyen et. al., *Fintech and the Digital Transformation of financial services: implications for market structure and public policy,* BIS Papers No. 117, Monetary and Economic Department, Bank for International Settlement (2021), available at https://www.bis.org/publ/bppdf/bispap117.pdf.

IV. COMPETITION ISSUES IN THE FINTECH FRAMEWORK

Ever since the concept of FinTech has found manifestation, it has generated great traction and has ensconced itself as a futuristic technology owing to the time-saving and less cumbersome process that it offers.[27] Apart from such generic benefits garnered through technological advancement proclaimed donning the rose-tinted glasses of innovation, the substratum of such claims when examined on the anvil of sustaining competition in the market becomes highly problematic in a given set of few dominant players. Following are issues that have set a strong foothold in the FinTech era under an oligopolistic market structure:-

(i) *Entry Barrier*: The fundamental identifier of a market that is oligopolistic in nature is the small number of players with a significant proportion of market share. Google Pay, Amazon Pay, Apple Pay are multi-national tech-companies with humongous market share and technological edge in the field of FinTech. With their operations in IT they have a considerable loyal customer base that has been acquired through lucrative deals, discounts, and accumulation of data.[28] Data is the key, distinct advantageous factor for the thriving of these tech companies.[29] Tech Giants are like few players in a market that is oligopolistic in nature with deep pockets including the willingness to suffer initial losses in order to establish, and cement themselves as major market powers in an excessively profitable market, being legally oblivious to the obligation of market regulation of traditional banking system that are driven by the 21st

[27] *Id.*

[28] Abir Roy, *Competition Law in Digital World: Understanding the Frontiers*, SUNDAY GUARDIAN, Jul. 30, 2020, available at: https://www.sundayguardianlive.com/legally-speaking/competition-law-digital-world-understanding-frontiers.

[29] *Id.*

century oil i.e. data, for sure, tend to, and most probably have, in certain instance created entry barrier for new entities to enter the Fintech fray.[30]Their involvement in different diverse businesses from production, supply, distribution of goods and service to production of films (as visible in the case of Amazon, where it has subsequently entered production of materials departing from the acquired status of product aggregator and delivery platform) have elevated their market prominence as the customer finds it comfortable to be a part of single, hassle- less ecosystem.[31] This for many new entrants who only focus on FinTech market seems to act as a hurdle and unsurmountable endeavour.

(ii) *Defining Relevant Market*: Identifying the relevant market for the FinTech firms has been a major challenge for competition regulators across jurisdictions. As discussed above in the Google Pay case,[32] Facebook/WhatsApp merger[33] and the Visa case[34] the primary difficulty for regulators lies in determining what constitutes relevant market in the age of platform-based tech companies who are involved in diverse operations. Whether Google Playstore can be termed as relevant marketplace or does violation of a certain set threshold would cater to the legal objective of anti-competitive law is an issue of immense concern and investigation. There is a legal shortcoming and lacuna with respect to such cause. Similarly, in the

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[30] Charles Arthur, *Tech Giants May Be Huge, But Nothing Matches Big Data,* THE GUARDIAN, Aug. 23, 2013, available at: https://www.theguardian.com/technology/2013/aug/23/tech-giants-data?view=mobile.

[31] *The world's most valuable resource is no longer oil, but data*, THE ECONOMIST, May 6, 2017, available at:https://www.economist.com/leaders/2017/05/06/the-worlds-most-valuable-resource-is-no-longer-oil-but-data.

[32] William Magnuson, *supra* note 3.

[33] Inge Graef*, supra* note 11.

[34] United States, *supra* note 15.

Visa case,[35] while determining the controversy of relevant card market, the court propounded that the issue relates to the Chicken-and-Egg problem of the competition law regime in which, it observed that it is sometimes difficult to identify and differentiate what causes what.[36] Further, the legal chasm in the EU jurisdiction prevails on the ground of identifying relevant market as the traditional means to do so have become outmoded in the face of technological advancements.[37] Another problem that plagues the EU competition structure is the issue of network effects in which when a product's value to one consumer increases with consumption/ participation by other different sets of consumers and can result in a "winner takes all" outcome.[38] In effect, this means increased barriers to entry and insulation of successful participants in the market from competition, especially in highly concentrated markets such as FinTech.[39]

Coming to the Indian laws, the modus operandi on which the Act functions is whether or not an act or agreement has caused or is likely to cause an appreciable adverse effect on the market in India. The Act defines relevant market u/s 2 I as the market which may be determined by the CCI with reference to the relevant product market or the relevant geographic market or with reference to both the markets.[40]Therefore, the Act empowers the CCI to determine the relevant market which has been contradictory and ambiguous in nature. This in effect means that the determination of what constitutes a

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[35] United States, *supra* note 15.
[36] Bernard Caillaud & Bruno Jullien, *Chicken & Egg: Competition among Intermediation Service Providers*, vol. 34(2) THE RAND JOURNAL OF ECONOMICS., pp. 309-328 (2003).
[37] Douglas Donahue & Jonathan Ching, *supra* note 20.
[38] *Id.*
[39] *Id.*
[40] The Competition Act, 2002, § 2 (r), (s), (t), No. 12, Acts of Parliament, 2003 (India).

relevant market(s) will depend on the decisions rendered by Tribunals and the Supreme Court of India. Nonetheless, at the initial stage of the investigation the CCI seem to have a contradictory approach. The CCI with respect to determining FinTech's relevant market that will aid in construing dominant position and abuse of it, happens to be contradictory.[41] In the WhatsApp Pay case,[42] the CCI observed that the relevant market to be "*the market for the over-the-top messaging services for smartphones in India*" and *prima facie* found that WhatsApp is dominant in the said market. Further, it held that UPI is a separate relevant product market in India. Astonishingly, when the matter related to the abuse of dominance allegedly to have been done by Google in the "*market for supply of licensable operating system (OS) for smartphones*" in order to influence the "*market for apps facilitating payments through UPI*", the CCI taking a contradictory position held that due to the "must-have" nature of some of Google's products in the smartphone ecosystem such as Google Search, Google Chrome etc., there appears to be an unequal relationship between Google and smartphone manufacturers.[43] Such contradictory and subjective stance of the CCI in issues of vital importance that will lay foundation of the emerging field of FinTech certainly aid in the creation of confusion and cacophony. Using these kind of loopholes, dominant players seem to exploit the market, abuse their position and kill competitive threats. Therefore, the competitive regulators across jurisdictions are grappling with the proliferating FinTech firms and making efforts to harmonies their understanding and the relevant laws to catch up with ever changing dynamics of the world. Further, the CCI is looking into the allegation against Google for the Mobile Application Distribution Agreement (hereinafter as "**MADA**") which creates an unnecessary obligation

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41 Geeta Gouri, *Convergence of competition policy, competition law and public interest in India*, RUSSIAN JOURNAL OF ECONOMICS, vol. 6(3), pp. 277-293 (2020).

42 Harshita Chawla v. WhatsAppInc., 2020 SCC OnLine CCI 32.

43 Aniket Ghosh, *India: Antirust Regulation in the UPI Payments Sector*, KLUWER COMPETITION LAW BLOGS (Jul. 7, 2021), available at: India: Antirust Regulation in the UPI Payments Sector - Kluwer Competition Law Blog.

on mobile manufacturer to have pre-installed Google features like the search engine and play store.[44]

If we examine and put CCI in juxtaposition with its foreign counterparts in the USA and EU regarding MADA, it is found that DOJ observed, consistent with it's previous approach, in an identical case against Google, that "*consumers typically do not change their mobile device's default search functions, making securing pre-set default status for search access points important for effective distribution of general search engines*".[45]In a similar case, EU held that specific condition in the MADA to be abusive of dominant position and anti-competitive practices as it enables a significant and impactful status-quo bias for users.[46] One thing that is painfully clear from the approach adopted in the aforementioned two jurisdiction (US and EU) is the clarity of threshold constituting relevant market, however, the same does not apply to CCI as it acts on ambiguity that eventually leads to uncertainty in implementation.

(iii) *Algorithms and Collusion*: Access to data is in another territory of contestation when it comes to competition in the market. Data gives a technological upper hand to the entity in possession of it as it can manoeuvre its action to beat the prevalent competition in the market by harmonising and using the data from the consumer in a way that may with the passage of time lead to creation of a monopoly as other small or nascent players would find it onerous to compete in a cut-throat competition. This situation will not only be

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44 Umar Javed v. Google LLC, 2019 SCC OnLine CCI 42.

45 United States v. Google LLC, No. 1:20-cv-3010 (D.D.C. 20.10 2020) (Compl.), Federal District Court for the District of Columbia, available at: https://www.justice.gov/atr/case-document/file/1329131/download.)

46 CASE AT.40099 (Google Android), "Commission Decision of 18.7.2018 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union (the Treaty) and Article 54 of the EEA Agreement", (pages 169-193), available at https://ec.europa.eu/competition/antitrust/cases/dec_docs/40099/40099_9993_3.pdf.

detrimental to competition in the market but is bound to have an adverse on consumer welfare and interest. Further, computer algorithms themselves may also result in anti-competitive practices. They may do so in a way that promotes express and tacit collusion because they can learn by themselves and conclude that the best way to maximise profits is to develop collusive practices.[47]Algorithm-based collusion is antithetical to the principles of competition as level playing field is disrupted for it enables the segregation of different users and raises the risk of exclusion of users and price discrimination.[48]

In the Indian context, algorithm-based anti-competitive activity, can understood with reference two case- ***Samir Agarwal v. ANI Technologies Ltd***.[49] and ***Airline Cartel*** case. In *Samir Agarwal* case, the CCI held that the Ola and Uber cab aggregators have formed a hub-and-spoke cartel through algorithms and, inter alia, holding that the use of such algorithm does not amount to collusion because any agreement of price coordination among drivers is truant. Further, on deciding the appeal challenging the order of the CCI, the NCLAT unequivocally held that the case of abuse of dominance will not pass muster as in the taxi/cab market no player is in a dominant position.

In the *Airline Cartel* case,[50]it was alleged that the domestic airlines in India have formed a cartel and on investigation made by the DG the role and use of algorithms prominently appeared. However, despite the finds of the DG, CCI opined that the personnel working in the revenue management team of each airline determined the algorithm and the final ticket price and the involvement

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47 A. Fraile Carmona & A. Gonzalez Lombardo, *Competition Issues In The Area Of Financial Technology*, Directorate General for Internal Policies, pp.14 (2018) available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2018/619027/IPOL_STU(2018)619027_EN.pdf.
48 *Id.*
49 Samir Agrawal v. ANI Technologies Pvt. Ltd., CII Case No. 37 of 2018.
50 In Re: Alleged Cartelization in the Airlines Industry, CII Suo Motu Case No. 03 of 2015.

of the software was limited only to the extent of aiding the revenue management team to arrive at a price for optimal revenue.[51] Though, the CCI can use S. 3(3) to prevent collusion but its approach has remained highly unsatisfactory. The proposed recent amendment to the Act that widens the definition of cartel may be an effective tool to deal with such algorithmic collusions.

In the US anti-trust jurisdiction, the famous ***Topkins*** case[52] is relevant in order to understand the nature of algorithms in constituting competitive concerns. In this case, the defendant being registered with Amazon marketplace for sales of certain products controlled the supply and coordinated price through an algorithm that was in clear contravention to S.1 of the Sherman Act.

Now, coming to the FinTech market, it is possible that big tech companies can coordinate algorithms to form cartel and establish control over market. We have already seen how Google has abused its dominant position in the search engine market in EU to help online shopping platforms. Therefore, it not a distant and far-fetched presumption that through technology and their extended customer bases tech giants could monopolise the interface with customers by controlling loan origination and the distribution business.[53] Moreover, they can employ their existing data of consumer habits and conduct to influence them through the means of algorithms. In the initial stage, tech giants can prove to enhance robust competition in the market but this

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51 Digvijay R. Singh, *Algorithmic Collusion: Can the Competition Act Protect against Self-Learning Algorithms?,* INDIA CORP LAW BLOG (Jan 2022), available at: https://indiacorplaw.in/2022/01/algorithmic-collusion-can-the-competition-act-protect-against-self-learning-algorithms.html.

52 United States of America v. David Topkins, 15 cr-00201-WHO.

53 Xavier Vives, *Digital Disruption in Banking and Its Impact on Competition*, pp. 23 (OECD 2020) available at: https://www.oecd.org/daf/competition/digital-disruption-in-financial-markets.htm.

phenomenon could be reversed in the long run if they continue to dominate consumer interface.[54]

(iv) *Risk to Banking*: Since its inception, the FinTech regime has introduced a slew of innovation in the financial sector and riding on the crest of innovation they have been able to encroach the space of traditional businesses of banks. Notably, the FinTechs have exerted pressure on the incumbent banks with their focus on customers-oriented approach side-lining the products-oriented approach of the banks. When we venture to see the FinTech platforms from the lenses of tech giants (as discussed above) and their engagement with the collection of data coupled with the enormous customer base and easy access to capital, it is patently visible that they can compete with the incumbent banking system head-to-head.[55] This is not a proposition in vacuum but a living testimonial example coming from the UK and China.

The Chinese tech giant, Alibaba's FinTech- arm Ant Financial, dealing in financial services like payments, wealth management, lending, insurance, and credit scoring has come to dominate the banking space in China by managing wealth that is equivalent to the total wealth managed by the top four traditional Chinese lenders.[56] Evidence from the UK point out that P2P FinTech lending till 2017 has been 8.4 billon in euros.[57]These staggering facts when looked from the lenses of the Bank for International Settlements (hereinafter referred to as "**BIS**") are worrisome. It is noted by the BIS that in the absence of any internationally agreed financial regulatory standards or policies in the context of

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[54] *Id.*
[55] Miguel de la Mano and Jorge Padilla , *Big Tech Banking*, vol. 14(4), JOURNAL OF COMPETITION LAW & ECONOMICS pp. 499 (2018) available at https://s1.aebanca.es/wp-content/uploads/2018/12/de-la-mano-padilla-2018-big-tech-banking-15.0.pdf.
[56] Report by Financial Stability Board, *FinTech and market structure in financial services: Market developments and potential financial stability implications*, pp.24 (2019) available at :https://www.fsb.org/wp-content/uploads/P140219.pdf.
[57] *Id.*

FinTech, credit lending with subsequent disparity in national regulation can raise threat to the concept of competition in the event when the FinTech lending- regime chooses to go cross borders.[58] Indeed, an alarming concern. With such high stakes on the nascent and largely unregulated regime of FinTech there are also chances that on a rainy day it may cripple the global economy thrusting the burden of a new economic meltdown.

Further, with data superiority, tech giant operated FinTechs, can enter into platform envelopment, meaning that, "entry by one platform provider into another's market by bundling its own platform's functionality with that of the target's so as to leverage shared user relationships and common components."[59] Take for instance, a person searching on Google to buy a product like a laptop or mobile phone can, simultaneously, also opt to avail the financial services offered by Google which is only possible through multi-layered platform envelopment which the traditional banking system by no stretch of imagination can compete with. This trait of tech giants in the market signals towards the anti- competitive activity of monopolisation as they may be able to exclude other platforms as well as intermediaries operating one-sided businesses.[60] Interestingly, the practice of enveloping happens to be circumstantial in nature. It may be proved or disproved depending on the material circumstance in consideration. Therefore, proving monopoly by enveloping is difficult at the very threshold. A presumption cannot be put on envelopment as it tends to drive out incompetent competitors and benefit the consumer.[61] Its anti-competitive effects are only visible when the entity engaged in it concentrates

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[58] Basel Committee on Banking Supervision, *Implications of FinTech developments for banks and bank supervisors*, (2018), available at : https://www.bis.org/bcbs/publ/d415.pdf.
[59] Thomas Eisenman & Geoffrey Parker, *Platform Envelopment*, vol. 32(12), STRATEGIC MANAGEMENT JOURNAL, pp. 1270-1285 (2011).
[60] Xavier Vives, *supra* note 53.
[61] *Id*.

on a single platform.[62] Therefore, the competition in the area of banking, which initially seemed to provide a thriving competition, may with the passage of time and accumulation of market power by tech giant through their respective FinTech arms, represents an existential threat to competition in the respective market and aid in the establishment of monopoly and pose serious risk to the existing framework of financial stability in a country and globally.

V. CONCLUSION

Fintech today has become a two- edged knife. Its success or failure depends on the effective usage of it. Even though it has replaced and has come to resolve the issues pervading the traditional banking system, at the same time, it is positioned in a way that is detrimental to competition in the market as it hampered efficiency and adversely affects the consumer welfare by creating a market of its own. Initially, it did counter the existing concentrated market of bank and financial institutions by its innovative idea of making it accessible on a mobile phone, but clearly over the years because of lack of definitive legislation controls and regulations, it has grown to dominate the particular field and manufacture a concentrated market of its own, replacing the traditional one.

FinTech and Crypto- currencies are undoubtedly the future of modern economies. However, the threat over this future looms large as its market has become concentrated in the hands of a few, dominant players that may prove to be ominous for further innovation. To create a check on this proposition, a strong and well-thought legal framework needs to be brought to existence so that neither competition nor innovation is affected. Some of the suggestive measures can be formation of an advisory council which would look into the matters relating to the recent developments, nations such as Hong Kong which

[62] Jay Pil Choi, *Tying in Two-Sided Markets with Multi-Homing*, vol. 58(3), JOURNAL OF INDUSTRIAL ECONOMICS, pp. 607-626 (2011).

have established Securities and Futures Commission which helps in suggestive regulatory framework for the sector,[63] Australian Securities and investments Commission has established a Digital Finance Advisory Committee which would look into the matters pertaining to this sector and would elaborate on the problems thus arising.[64] Other suggestive measure could be ministry setting up a monitor body which would look into the day to day transaction happening for example Singapore has already formed a institute which is being runned in collaboration of Monetary Authority of Singapore ("**MAS**"), National Research Foundation ("**NAS**") and the National University of Singapore[65]which is trying to come up with a mechanism to help regulation of such transaction and the last and most relevant would be the passing of the amendment act of 2020[66] which inclusion of "Data" under the definition of price[67] which would increase the purview of the authority so that it could take cognisance in such matters.

We have witnessed on occasion how certain big players are using their market power, both in the relevant and different markets, to stifle the growth of new players who pose a threat to their existing dominance. We have also witnessed how algorithm-based dominance is forming a vital component in the success of many players and disrupting the level playing field. We have also witnessed the

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63 Fintech Advisory Group, Securities and Futures Commission, available at https://www.sfc.hk/web/EN/sfc-fintech-contact-point/fintech-advisory-committee/ (Last updated on 22 Nov 2021.

64 Digital Financial Advisory Panel,ASIC - Australian Securities and Investments Commission. (Oct 2017), available at:. https://asic.gov.au/for-business/innovation-hub/asic-and-fintech/digital-finance-advisory-panel/.

65 Sai Fan PEI, *Singapore approach to develop and regulate FinTech*, HANDBOOK OF BLOCKCHAIN, DIGITAL FINANCE, AND INCLUSION: CRYPTOCURRENCY, FINTECH, INSURTECH, AND REGULATION(2018) available at https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=6910&context=lkcsb_research.

66 Competition Amendment Bill, 2020.

67 The Competition Act, 2002,§ 2 (o), No. 12, Acts of Parliament, 2003 (India).

worry of competition regulators across various jurisdictions to catch-up with the fast-moving and ever-changing Fintech regime, however, their hands tied to archaic laws proves to be a major impediment in the effective implementation of the same. Therefore, all these issues warrant a need to be addressed by a comprehensive legal framework to fill the lacuna and shortcomings of the present structure of competition law to regulate the Fintech regime in India and elsewhere.

SCHOLASTICUS

Prarthana Balasubramanian, *Surge In Initial Public Offerings ("IPO"): Smooth Sailing or A Forthcoming Sink?*, 10 (1) SCHOLASTICUS 69 (2023).

SURGE IN INITIAL PUBLIC OFFERINGS ("IPO"): SMOOTH SAILING OR A FORTHCOMING SINK?

Prarthana Balasubramanian[⊥]

ABSTRACT

*The onset of a Bubonic-plague-like pandemic made mankind risk averse and uncertain about their future. Daily lifestyle and methods of doing business changed drastically. The falling economic growth worldwide, including in India, was a clear reflection of these changes. But the booming recovery of the Indian financial markets after experiencing historical falls was completely against the doomsday scenario presented by this pandemic. As we plunge into the second and third wave of the pandemic, the Indian IPO market is writing history, by recording high magnitude of successful IPOs. This IPO boom presents a magical paradox which begs some logical explanation. This paper attempts to analyse economic and legal reasons behind this IPO boom, by considering recent changes. The principal changes in economic behaviour, induced by the pandemic, and recent legal amendments present a prudential picture for the future of financial markets and upcoming IPOs. However, comparisons against similar stock market booms from the past, in America, present clear warnings of this rise being a bubble waiting to burst. Hence, the stories of successful IPOs like Zomato and Paytm must be considered, with a pinch of salt, by their successors. However, the time is ripe for Securities and Exchange Board of India (**"SEBI"**) as the protector of all stakeholders in the market to balance the concerns of all parties to maintain this buoyancy. A conservative approach by SEBI is urged to prevent a harsh fall in the future.*

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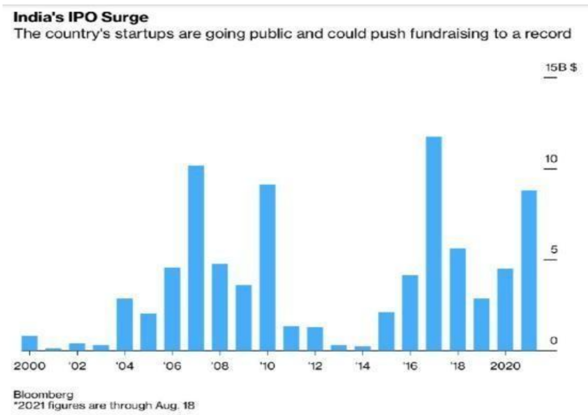
I. INTRODUCTION TO THE RISING WAVES

"The concept of loss aversion is certainly the most significant contribution of psychology to behavioural economics."

-Daniel Kahneman, "Thinking, Fast and Slow", Penguin Books (2011)

Loss aversion is the idea that when humans evaluate outcomes, the losses loom larger than gains. COVID-19 has made mankind risk averse, especially about their health, thereby drastically changing daily lifestyles for many and resulting in falling economic growth worldwide. According to World Bank, India's Gross Domestic Product (**"GDP"**) contracted to 7.3% in 2020-21. The fall of economic growth and the sheer loss of life due to the pandemic should make people risk averse.[1] The historical fall of the financial markets in March 2020 was in tune with this risk aversion. However, the subsequent growth of the financial markets, while the nation suffered through a complete lockdown, may come as a surprise for many. By the end of 2020, the Nifty 50 Index had gained close to 80% from its 52-week low on March 23, 2020.[2]



[1] Ben Carlson, *Economic Side Effects from the Pandemic*, A WEALTH OF COMMON SENSE (Oct. 19, 2021), https://awealthofcommonsense.com/2021/10/economic-side-effects-from-the-pandemic/

[2] Hormoz Fatakia, *How India IPOs fared in 2020,* BLOOMBERG QUINT (Dec. 15, 2020), https://www.bloombergquint.com/ipos/how-indian-ipos-fared-in-2020.

Table I [3]

Increase in IPOs is a factor which has both, given a hand in the redemption of the market and gained from their steady rise. The number of companies getting publicly listed has seen a steady rise during the lockdown and is set to hit a record in 2021. The first half of the year has seen companies raising approximately Rs. 46,000 crores from the financial markets, which is more than the amounts raised through IPOs in each of 2018, 2019 and 2020.[4] Fundraising through IPOs hit a record of Rs. 67,1547 crores in 2017 and the projections of 2021 are set break this record, as is evident from the projections given in Table I. The rise of financial markets in juxtaposition to the falling economic growth in India begs for an explanation about the reasons behind this oxymoronic relationship.[5]Whether the theories related to financial markets like market sentimentality are the only explanation or do policy changes introduced by regulatory authorities have any role to play in the driving this surge in number of IPOs?

This paper shall begin by analysing a few economic reasons, including high liquidity, rise in number of retail investors and the rub-off effect of markets, influencing the increase in IPOs. After elaborating upon these reasons, the paper shall explain the legal reasons supporting this surge which include amendments made in 2020 to the Companies Act, 2013. These amendments can, in some ways, be termed as the *causus belli* of the surge in IPOs. Further,

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[3] Bloomberg, *Graph – India's IPO Surge*, COLOMBO GAZZETTE, https://colombogazette.com/2021/08/31/cses-new-tech-savvy-investors-will-be-the-future-of-startups/graph-indias-ipo-surge/.

[4] Manojit Saha, *Why 2021 could be the best year for IPOs,* DECCAN HERALD (Jul. 24, 2021),https://www.deccanherald.com/opinion/why-2021-could-be-the-best-year-for-ipos-1012312.html.

[5] Fredrik Langlet and Fredrik Lilliehöök, *The Impact of Macroeconomic Variables on IPO Volume in Europe*, KTH ROYAL INSTITUTE OF TECHNOLOGY SCHOOL OF INDUSTRIAL ENGINEERING AND MANAGEMENT (2017), https://www.diva-portal.org/smash/get/diva2:1193663/FULLTEXT01.pdf

the paper shall expand on the amendments introduced in the SEBI Regulations in the year 2021 which can be termed as an influence of successful IPOs on the regulatory authority, resulting in easier procedures for conducting IPOs in the future. After establishing a promising picture for the Indian IPO market, the paper shall give a word of caution against this surge by giving reasons for an impending IPO doom. Lastly, the paper shall end by proposing some regulatory changes to ensure buoyancy in the IPO market, even during the impending downfall of the surge in IPOs.

II. VARIOUS REASONS EXPLAINING THE MAGICAL PARADOX

A. Using Common Sense

Before entering the legal jargon of company law to explain the magical paradox of increase in IPOs and contracting economic growth of the country, it is necessary to apply common sense to analyse possible economic reasons including high liquidity, rise in number of retail investors and a rub-off effect.

Firstly, there has been a sudden increase of liquidity in the market resulting in a lot of cash-in-hand for the common man. Both the Federal Bank in the United States[6] and the Reserve Bank of India[7] (**"RBI"**) have reduced the interest rates catering to the slack demand of credit. The interest available on Fixed Deposits is also low, thereby preventing people from locking money in their bank

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[6] Kuntala Sarkar, *US Is Ready For Tapering, But Not Interest Rate Hike: Fed's Jerome Powell, Wall Street Indexes Went Down*, GOOD RETURNS (Oct. 23, 2021), https://www.goodreturns.in/news/us-is-ready-for-tapering-but-not-interest-rate-hike-fed-s-jerome-powell-wall-street-indexes-went-1227889.html ; Alexandria White, *Fed rate cut lowers interest rates to near zero—but how much are you really saving on yourcredit card debt?*, CNBC (Oct. 11, 2021), https://www.cnbc.com/select/impact-of-fed-rate-cut-amid-coronavirus-concerns/; James Chen, Low Interest Rate Environment, Investopedia (Oct. 21, 2021), https://www.investopedia.com/terms/l/low-interest-rate-environment.asp

[7] George Mathew and Sunny Verma, *Explained: Why the RBI has left interest rates unchanged,* INDIAN EXPRESS (Aug. 10, 2020),https://indianexpress.com/article/explained/reserve-bank-of-india-interest-rates-unchanged-shaktikanta-das-indian-economy-6543140/

accounts. Thus, RBI's expansionary monetary policy[8] has led to the accumulation of public savings. Further, the interest rates are bound to be low until there is a clear sight of a steady economic recovery. Policies of Central Banks across the world are driven by the goal of increasing cash-in-hand for people to ensure economic recovery.[9]This increase in global liquidity has increase participation of Indian retail investors in the stock market.[10] Further, the election-induced volatility of the US stock markets had a positive in the Indian markets.[11] Thus, with a lot of cash-in-hand and limited areas to invest, the base of retail investors willing to subscribe to IPOs has expanded, which is self-evident from the following graphs:

[8] Maurico Kugler and Shakti Sinha, *The Impact of COVID-19 and the policy response in India,* BROOKINGS (Jul. 13, 2020), https://www.brookings.edu/blog/future-development/2020/07/13/the-impact-of-covid-19-and-the-policy-response-in-india/; Tamal Bandyopadhyay, *Lending, spending ... and bending,* BUSINESS STANDARD (May 24, 2020), https://www.business-standard.com/article/opinion/lending-spending-and-bending-120052400922_1.html; Ankur Bhardwaj, *Covid-19 and Policy: How Nations Responded to the Challenge,* CENTRE FOR ECONOMIC & DATA ANALYSIS, ASHOKA UNIVERSITY (Aug. 27, 2021),https://ceda.ashoka.edu.in/covid-19-and-policy-how-nations-responded-to-the-challenge/.

[9] Victoria Mayer and Jack Caporal, *The Shifting Roles of Monetary and Fiscal Policy in Light of Covid-19,* CENTER FOR STRATEGIC & INTERNATIONAL STUDIES (Feb. 23, 2021), https://csis-website-prod.s3.amazonaws.com/s3fs-public/publication/210223_Meyer_Monetary_Fiscal.pdf?lPd.UOY.lxNalGcHcCG4A7irYwWBONFr.

[10] Mint, *Why more and more individual investors in India are investing in stock market*, MINT (Jun. 22, 2021), https://www.livemint.com/market/stock-market-news/why-more-and-more-individual-investors-in-india-are-investing-in-stock-market-11624337297582.html

[11] Manojit Sinha, *Why Indian stock markets have hit all-time high despite Covid, lockdown, record slowdown,* THE PRINT (Nov. 10, 2020), https://theprint.in/economy/why-indian-stock-markets-have-hit-all-time-high-despite-covid-lockdown-record-slowdown/540678/

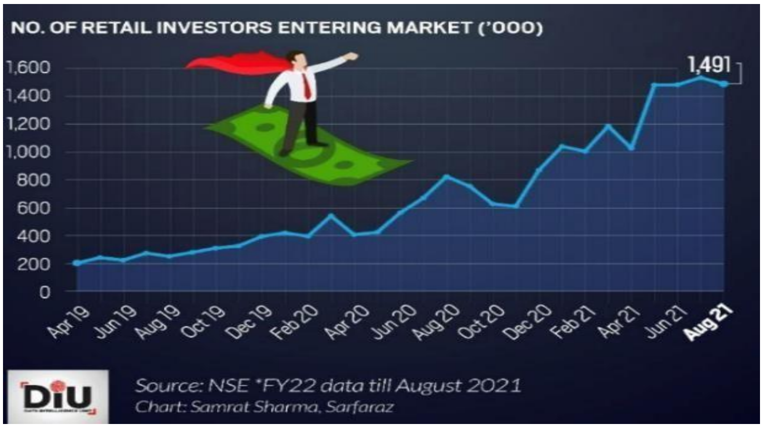

Table II[12]

Data on the number of retail investors entering the stock market shows a major increase in the number of retail investors between April 2019 and August 2021. The growth has been slow but steady, near the beginning of FY 2019, but has picked up especially after December 2020. Despite fluctuations, the overall trend has been of an increasing growth in the participation of retail investors.

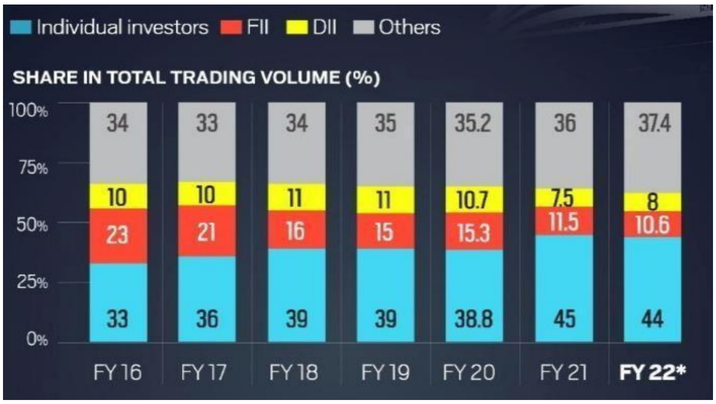

Table III [13]

FY 2020 saw a fall in the share of retail investors or individual investors, attributable to the uncertainty created by pandemic, which broke the trend of a

[12] Samrat Sharma, *Aided by tech, small-town India pours into stocks in new order*, BUSINESS TODAY (Sep. 27, 2021), https://www.businesstoday.in/markets/top-story/story/aided-by-tech-small-town-india-pours-into-stocks-in-new-order-307795-2021-09-27
[13] *Id.*

steady increase in this share. But FY 2021 witnessed an unprecedented jump from 38.8% to 45% i.e. rise of 6.2%. The maximum amount of increase from one financial year to another has been of 3 percentage points till 2018.

Secondly, this expansion of the base of retail investors is fuelled by a decline in personal expenditures of the common man, like travelling, entertainment, apparels. India has seen a rise of the internet ecosystem. It has become oneof the largest internet markets with almost 800 million internet users and about a half a billion smartphone users as of Financial Year (**"FY"**) 2021. Mobile data usage in India has seen an increase of 20 times over the past five years, which has been spurred by a sharp fall in costs of mobile data in India. Over the past year, there has been a faster shift to online, amid Covid-19 containment measures and a widespread shift towards staying-at-home.[14]This has further impacted the preferred modes of investments for Indians like real estate[15] and gold.[16]An increase in accumulated cash-in-hand in consonance with these restricted modes of investment has increased people's reliance on investment mechanisms available online. Mobile applications like Binomo have aided people in online investments. The upcoming IPOs filed by Fintech companies such as PayTM, Pine Labs is also an indication of the increasing reliance on tech-based mechanisms of investments as many of these applications allow

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[14] Goldman Sachs, *Indian Equities: Digital Transformation as Private Goes Public,* Global Strategy Paper No. 48, Portfolio Strategy Research(Sept. 19, 2021).

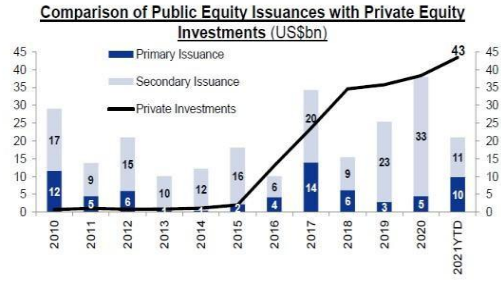
[15] Manu Kaushik, *Indians prefer to invest in real estate over gold, fixed deposits or stocks, finds survey*, ECONOMIC TIMES NOW (Jun. 17, 2020), https://www.timesnownews.com/business-economy/real-estate/article/indians-prefer-to-invest-in-real-estate-over-gold-fixed-deposits-or-stocks-finds-survey/607907

[16] Sunil Fernandes, *How Gold Prices In India Have Moved In The Last 10-years?*, GOOD RETURNS (Jun. 8, 2021), https://www.goodreturns.in/personal-finance/investment/how-gold-prices-in-india-have-moved-in-the-last-10-years-1211566.html?story=1

Exhibit 1: Fund raising in India via private equity deals has risen in recent years...

Source: Venture Intelligence, Goldman Sachs Global Investment Research

Exhibit 2: ... and has exceeded public market issuance



Source: Venture Intelligence, Bloomberg, Goldman Sachs Global Investment Research

Table IV [17]

trading.[18]Financial innovations, like the Application Programming Interface (**"API"**) software India Stack, have reduced the cost of setting up operations, acquiring customers and increased digital transactions and payments in India.[19]Consequently, this high liquidity and increase in retail investor base is directed towards the IPO markets through the influx of privately funded unicorns in the public markets, providing a secured high-returns investment opportunity.[20]

Thirdly, the rebound of the secondary market, after hitting a record time low in 2020 has had a rub-off effect on the primary market. Many companies conducted successful IPOs during the period of 2020 and 2021 which has incentivized other companies to file their IPOs in the coming months. The steady recovery of the Indian financial markets, since March 2020, has made India as an attractive recipient of Foreign Portfolio Investments (**"FPIs"**). Private Equity(**"PE"**)investments have risen in recent years and have exceeded public market issuances as depicted by Table IV above. This is coupled with a

[17] *Id.*
[18]*Supra* 4.
[19]*Supra* 14.
[20] *Id.*

steady increase of PE exits via public markets, thereby creating a safe environment for IPOs.[21] This flow of capital in the financial markets or secondary markets has influenced the primary markets.[22]

The increase in the capacity of retail investors coupled with the surge in IPOs has increased the market capitalization in recent years. BSE Sensex has increased by 1.8 times in early/mid 2021 as compared to its value the previous year.[23] More capital is simply getting invested in the financial markets through the public issuances of various companies. The increase in market capitalization is further influencing future IPOs.

Thus, a significant expansion in the size of Indian markets can be expected, with an estimated US$400 Bn of market capitalization to be added from new IPOs over the next 2-3 years. A major part of this capital is raised by India's digital ecosystem which has received a huge push due to the pandemic and is an indication of India becoming a mature tech eco-system.[24] Envisaging this rise in Indian equity, the next section shall explain the regulatory changes promoting the surge of IPOs.

B. Improving Ease of Doing Business – Changes in Corporate Law

The Companies Act, 2013 (**"the Act"**) defined "listed company" as a company having any of its securities listed in the stock exchange.[25]However, the Companies (Amendment) Act, 2020 (**"the Amendment"**) read with the Companies (Specification of definitions details) Second Amendment Rules, 2021 has empowered the SEBI to specify certain companies to be exempted

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[21] *Id.*
[22]*Supra* 18.
[23] MINT, *Why more and more individual investors in India are investing in stock market*, Mint (Jun. 22, 2021), https://www.livemint.com/market/stock-market-news/why-more-and-more-individual-investors-in-india-are-investing-in-stock-market-11624337297582.html
[24]*Supra* 14.
[25] Companies Act, § 2(52), (2013).

from being considered as listed companies despite having securities other than equity shares listed in the stock exchange.[26]

The Amendment has allowed public companies to get directly listed in foreign stock exchanges by inserting sub-section (3) under Section 23 of the Act. It has empowered the Central Government to exempt companies from complying with the requirements mentioned under Chapter III i.e. Prospectus and Allotment of Securities, and Chapter IV i.e. Share Capital and Debentures when they are getting listed on foreign exchanges.[27] This has enabled companies like Freshworks to file an IPO in the United States, thereby improving India's global image as an emerging economy and supporting future prospects of global IPOs by Indian companies.

Further, the Amendment has reduced the penalisation for non-compliance, by restricting it to only monetary fines in most cases and removing the provisions for imprisonment under the Act.[28]A few instances of this trend, relating to IPOs specifically can be seen where the Amendment has changed Section 26 of the Act which related to "Matters to be states in the Prospectus" by removing the terms of imprisonment for every person linked with the issue of prospectus, thereby restricting it to the imposition of monetary sanctions for penalising the cases of non-disclosure or misstatement in the prospectus.[29]Similarly, the Amendment has removed the term of imprisonment in case of non-compliance with the provisions Section 40 of the Act with respect to the "Securities to be dealt with in Stock Exchanges". The same trend can be observed in the changes introduced by the Amendment to the provisions under Chapter IV relating to "Share Capital and Debenture".[30]

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[26] Companies (Amendment) Act, §2(2020); Companies (Specification of definitions details) Second Amendment Rules (2021).
[27] Companies (Amendment) Act, §5, (2020).
[28] Companies (Amendment) Act, §§3,4 (2020).
[29] Companies Act, § 26 (2013); Companies (Amendment) Act, § 6 (2020).
[30] Companies Act, § 43-72 (2013); Companies (Amendment) Act, §§8-15 (2020).

Pursuant to the Amendment and seeing the positive trend of IPOs, SEBI has relaxed various norms related to listing requirements, thereby making listing of start-ups easier. These include reduction in pre-issue lock-in period from two to one year, allowing discretionary allotment to eligible investors, et cetera.[31] Recently, SEBI notified changes to existing Regulations in August 2021 to support the surge of IPOs in India.[32]This was based on a SEBI Consultation Paper on Review of the regulatory framework of promoter group and group companies as per SEBI(Issue of Capital and Disclosure Requirements) Regulations, 2018 (**"ICDR Regulations"**).[33] Under Regulation 16 of ICDR Regulations the minimum promoter's contribution was locked in for a period of three years which has now been reduced to Eighteen months under certain conditions. The lock-in for promoter holdings in the access of minimum promoters' contribution has been reduced to six months from the previous one year. Under Regulation 17 of ICDR Regulations, the lock-in period for the entire pre-issue capital held by non-promoters is now six months from the previous one year. In fact, despite having a lock-in of three years, promoters had already begun to retain their holdings an increased time as they only invested after an excruciating due diligence of the growth projections of a company. These changes were driven by the shift in the objectives behind listing as historically, companies raised public capital for greenfield projects, thereby creating the need of ensuring that promoters had a continuous 'skin in the game'. The lock-in requirement for promoters ensured that the company would perform well as an obligation to its promoters. Today, companies often

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31 *Supra* 14.

32 PR No. 24, SEBI Board Meeting Resolution (Aug. 6, 2021), Available at https://www.sebi.gov.in/media/press-releases/aug-2021/sebi-board-meeting_51707.html.

33 No. SEBI/LAD-NRO/GN/2018/31, SEBI (Issue of Capital and Disclosure Requirements) Regulations, (Sep 11, 2018) Available at https://www.sebi.gov.in/legal/regulations/sep-2018/securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-regulations-2018-_40328.html.

receive funds through FPIs or PE investments in the pre-IPO stage, thereby guaranteeing their growth when they undergo public issuance.[34] The pre-IPO funding provides two advantages. Firstly, it prevents amateur companies from undergoing IPOs to raise capital. Secondly, they ensure that the faith reposed by the retail investors in the management of the company is not ill-founded, while subscribing to these IPOs.

Additionally, SEBI has reduced the disclosure requirements at the time of IPO. After the changes introduced, only the names and registered office address of all group companies needs to be disclosed in the Offer Document. A reduction in disclosure requirements is a welcome step, especially when countries like United States are seeing a rise in the concept of Special Purpose Acquisition Companies (**“SPACS”**) for the purpose of providing a short cut for private businesses to go public with reduced expenses in terms of registrations, disclosures and processes, by getting acquired by a SPACS which is an entity set up for the sole purpose of raising public money for a buyout.[35]The attempt made by SEBI at streamlining the disclosures in an IPO is a welcome initiative and possible alternative to the prospect of a ‘desi-SPACS’.

Lastly, SEBI has agreed to an in-principal shift from the concept of ‘promoters’ to the concept of ‘person in control’. This is due to the changing nature of ownership among listed entities which give rise to the possibility where people exercise an influence, in the management of the listed entity, which is disproportionate to their economic interest. In fact, several promoter-less

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[34] Consultation Paper on “Review of the regulatory framework of promoter, promoter group and group companies as per Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018, Securities and Exchange Board of India, available at https://www.sebi.gov.in/sebi_data/attachdocs/may-2021/1620799119170.pdf.

[35] See more about SPACS at Ashwin Mohan, *The SPACS Craze: What’s the Big Deal Anyway*, MONEY CONTROL (Feb. 17 2021, 5:40 PM), https://www.moneycontrol.com/news/business/the-spac-craze-whats-the-big-deal-anyway-6534571.html; John Coates, *Statement by Acting Director Coates on SPACS, IPOs and Liability Risks under the Securities Laws*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (Apr. 9, 2021).https://corpgov.law.harvard.edu/2021/04/09/statement-by-acting-director-coates-on-spacs-ipos-and-liability-risk-under-the-securities-laws/

companies like LNT, HDFC are seen raising capital in the stock market. This may imbalance the liability placed on various stakeholders. It also misleads the retail investors who invest in these entities under indirect influence of the promoters. Further, shareholders have shifted their focus on better corporate governance, instead of investing solely based on list of promoters. SEBI is urging towards the elimination of 'promoters' to increase the focus on corporate governance.[36]

This in principle shift to a promoter-less governance structure highlights a shift in the allocation of risk liability in the various principal-agent relationships of corporate law.[37] Diversification within the class of principal investors has increased the role of managing agents as the face of corporate entitles. While maintaining the management as the face of the entity, the risk allocation remains focussed on principal investors. This is achieved by a change in composition of the management itself, undertaken by principal investors like PEs who often take the right of appointing independent directors as a pre-condition to making an investment. Such reorganisation of the management of entities has supported the steps towards reduction of ex-post and ex-ante compliances and disclosures. An increase in investor knowledge and their direct control over managerial positions has done away with the purpose of large compliances.

[36] *Id* at 34; Explained, *SEBI wants to Eliminate 'Promoters': Changing Corporate Ownership Terminology,* FINANCIAL EXPRESS (May 14, 2021 3:45 PM) available at https://www.financialexpress.com/market/sebi-wants-to-eliminate-promoters-proposes-changing-corporate-ownership-terminology-explained/2251285/.

[37] John Armour, Henry Hansmann & Reiner Kraakman, *Agency Problems, Legal Strategies and Enforcement,* Discussion Paper No. 644, The Harvard John M. Olin Discussion Paper Series (2009)http://www.law.harvard.edu/programs/olin_center/.

Thus, the Amendments to the Act partially supported the surge in IPOs which influenced the changes in SEBI ICDR Regulations. However, both changes are set to provide robust opportunities for the IPO market in the future.[38]

III. FLIPPING THE COIN – A WORD OF CAUTION

The story till now seems to portray that the Indian IPO market is thriving. Though it is hard to pinpoint the exact beginning of this surge, it is true that the economic reasons highlighted above laid its foundational stone. The journey was carried forward by the amendments in the Act and SEBI Regulations which have ensured buoyancy in the IPO market. Further, successful IPOs like PayTM, Zomato, Nykaa have kept the spirits of the IPOs players from drifting away and have provided encouragement to their future colleagues. However, it is necessary to return to the Magical Paradox of financial markets doing so well during the contracting Indian and global economic growth, spearheaded by the pandemic. In such a context, it becomes important to ascertain – is this financial activity sustainable, or is it reflecting the upward financial trajectory which in the past has been followed by a crash? Is this a bubble waiting to burst?

A. Similarities with the Past

Generally, the total volume of IPOs in an economy increases as the overall GDP also increases.[39] This also makes intuitive sense. As the overall real income of the economy increases, more companies can hope to raise capital by going public. But in India, the financial markets are thriving despite the overall

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[38] Raajan Joshi, *Investor Friendly: SEBI Reduces Post IPO Lock-in Period for Promoters to 18 Months,* NFA Post (Aug. 7, 2021)https://thenfapost.com/2021/08/07/investor-friendly-sebi-reduces-post-ipo-lock-in-period-for-promoters-to-18-months/; Reena Zacharia, *SEBI Halves Lock-in Period for Promoters in IPO to 18 Months,* Economic Times (Aug. 8, 2021 %:10 PM)https://economictimes.indiatimes.com/markets/ipos/fpos/sebi-nod-to-halve-lock-in-for-promoters-in-ipos/articleshow/85117372.cms.

[39] *Supra* 5.

economy having suffered a set-back because of the pandemic in the current and the previous years. Moreover, although Zomato has had a successful IPO, raising Rs 9,375 crore, it is a company which is yet to show positive yields on the capital raised in the IPO.[40] Though Zomato's successful IPO has created a rub-off effect on its tech neighbors to file an IPO, they seem to rely too much of the predicted projections of Zomato's IPO which are yet show real results.[41] A successful IPO does not imply that the capital raised using public money will necessarily lead to higher productivity, thereby causing the growth of the company and economy in general. The bullish trend of financial markets seems less conducive, considering that both the dotcom crash[42] and the 2008 global financial crisis were preceded by a similar surge in IPOs (over 100 IPOs in 2007)[43]. Researchers have concluded that stock market bubble in United States during the late 1990s was not related much to an increase in primary activity. Rather, it was a result of a rational investor's uncertainty about the future of U.S. economy. During that period, investors faced high uncertainty about the future of U.S. economy. This uncertainty had a large impact on stock markets, driving them to high volatility. However, the anticipated Third Industrial Revolution turned out to be unlikely and hence the bubble curst.[44]

B. Unruly Tides

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[40] Bismah Malik, *India having a unicorn flurry year, $20 billion raised so far in 2021*, BUSINESS TODAY (Oct. 2, 2021),https://www.businesstoday.in/entrepreneurship/news/story/india-having-a-unicorn-flurry-year-20-billion-raised-so-far-in-2021-308305-2021-10-02; Dion Global Solutions Limited, *Zomato Ltd.*, Money Control (2021),https://www.moneycontrol.com/financials/zomato/profit-lossVI/Z.

[41] *Id.*

[42] Joanna Ossinger, *The current IPO craze is starting to look a lot like 1999 tech bubble*, ECONOMIC TIMES (Dec. 11, 2020), https://economictimes.indiatimes.com/markets/ipos/fpos/the-current-ipo-craze-is-starting-to-look-a-lot-like-1999-tech-bubble/articleshow/79677512.cms

[43] *India's IPO boom and the road ahead,* KrAsiaIndia Digest Volume 65,KrAsia (Sep. 6, 2021),https://kr-asia.com/indias-ipo-boom-and-the-road-ahead-india-digest-volume-65.

[44] Wei Li and Hui Xue, *A Bayesian's Bubble,*64 The Journal of Finance 2665, 2695(2009).

There have also been apprehensions expressed about the retail participation turning into a herd mentality, causing this financial activity to be unsustainable.[45]The US financial markets, while undergoing a similar IPO boom, has shown signs of volatility. This volatile nature has been significant enough to prevent other companies from undergoing an IPOs.[46]As seen above, one of the ways adopted by SEBI to support the IPO boom has been to reduce the disclosure requirements during an IPO, which is possibly inspired by the concept of SPACS gaining popularity in US due to lesser compliances. Therefore, it makes sense for the Indian market to take a word of caution from the volatility observed in US markets.

In fact, a recent SBI report has cautioned about “…an issue of financial stability which has arisen recently as the stock market has boomed with real economy suffering”, while discussing the increase in market capitalization in Indian financial markets.[47]Thus, there are already exist clear signs of the growth in IPOs being unmatched by consequent developments in the primary economy.

C. A View at the Numbers from Recent IPOs

To support this conservative view of the IPOs boom, this paper shall analyze pre and post IPO performance of three recent public issues: Zomato, Paytm and Nykaa.

The pre-IPO performance for Zomato was weak. Its losses were mounting and revenue for FY21 had decreased by 23% due to fall in the food delivery business. Overall, the company was not profitable and had sustained losses consecutively in the previous fiscal years.[48]In the April-June quarter, while the

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[45] *Id* at 43.
[46] Echo Wang and Anirban Sen, *U.S. IPO boom braves market volatility*, REUTERS (Oct. 12, 2021), https://www.reuters.com/world/us/us-ipo-boom-braves-market-volatility-2021-10-11/.
[47] MINT, *Why more and more individual investors in India are investing in stock market*, MINT (Jun. 22, 2021), https://www.livemint.com/market/stock-market-news/why-more-and-more-individual-investors-in-india-are-investing-in-stock-market-11624337297582.html.
[48] Priyanka Choudhary, *Zomato IPO Financial Analysis,* TOPSHAREBROKERS.COM (Apr. 28, 2021), https://www.topsharebrokers.com/ipo-review/zomato-ipo-financial-analysis/95.

company was undergoing its issue, Zomato experienced net losses worth 168%.[49]Coupled with these bleak foundations, the issue was overpriced.[50]Consequently, Zomato's losses tripled in its first quarterly earnings post the issue and the company is yet to witness profits.[51]

Nykaa presents a comparatively positive picture for the IPO market. It was a profitable company before its issue. It made profits in three fiscal years before its IPO. Its issue was oversubscribed by 82 times.[52] However, the company saw a fall in net profits by 96% in the September quarter of 2021.[53]

Paytm was far from break-even point when it went ahead with its IPO. Its revenue in FY21 had fallen by 11%. It launched a public issue almost a decade after entering the industry and was bound to experience tough competition. Yet, it launched one of India's biggest IPOs which was only 1.89 times oversubscribed.[54] Since then, Paytm's share price has been falling and hitting

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[49] *Zomato's revenue grows to Rs 844 crore as losses widen 168% for April-June quarter,* THE ECONOMIC TIMES (Aug. 11, 2021), https://economictimes.indiatimes.com/tech/startups/zomatos-revenue-grows-to-rs-844-crore-as-losses-widen-168-for-april-june-quarter/articleshow/85215231.cms.

[50] Priyanka Choudhary, *Zomato IPO Financial Analysis,* TOP SHARE BROKERS.COM (Apr. 28, 2021), https://www.topsharebrokers.com/ipo-review/zomato-ipo-financial-analysis/95; Sandeep Soni, *Zomato's FY20 losses swell to Rs. 2,451 cr while revenue jumps 98% ahead of likely IPO in 2021,* Financial Express (Jan. 5, 2021), https://www.financialexpress.com/industry/sme/zomatos-fy20-losses-swell-330-while-revenue-jumps-84-ahead-of-likely-ipo-in-2021/2163889/.

[51] Manish Singh, *Zomato's losses widen in first quarterly earnings since IPO,* TECH CRUNCH (Aug. 10, 2021), https://techcrunch.com/2021/08/10/zomato-losses-widen-in-first-quarterly-earnings-since-ipo/.

[52] Ananya Bhattacharya, *Why Nykaa IPO did better than the Paytm IPO,* QUARTZ (Nov. 11, 2021), https://www.msn.com/en-us/money/other/why-the-nykaa-ipo-did-better-than-the-paytm-ipo/ar-AAQAHK3.

[53] Deepsekhar Choudhury, *After bumper listing, Nykaa reports 96% decline in Q2 net profit,* THE BUSINESS STANDARD (Nov. 15, 2021), https://www.business-standard.com/article/companies/nykaa-q2-results-net-profit-declines-by-96-after-bumper-listing-121111400916_1.html.

[54] Ananya Bhattacharya, *Why Nykaa IPO did better than the Paytm IPO,* QUARTZ (Nov. 11, 2021), https://www.msn.com/en-us/money/other/why-the-nykaa-ipo-did-better-than-the-paytm-ipo/ar-AAQAHK3.

record lows. The stock has been on a declining trend in the last 12 sessions with its price falling 26% in the process.[55]

Therefore, the so-called 'successful' IPOs of Zomato and Paytm should serve as a precedent for its successors to consider with a pinch of salt, especially since they were loss-making entities and filed an IPO without any legal promoters (in case of Zomato).

IV. THE WAY AHEAD FOR SUSTAINABLE GROWTH OF THE IPO MARKET

SEBI is supposed to be a protector of the most vulnerable participants in the financial markets. It can be said that retail investors can lose the most,if their investments go awry because this robust activity was based only on financial fiction, rather than being coupled with a proportional rise in productive activity. Though SEBI's recent reforms seem to make the process of filing an IPO easier, SEBI as an informed regulator needs to orient its policies towards sustainable growth of the IPO market and take a conservative stance in simplifying this process. This is because in addition to relaxations by SEBI on the existing disclosure-based regime, companies have also mastered the art of masking facts in complying with disclosures, thereby presenting a false prospective outlook on its future growth. While disclosing high valuations, the companies often hide the ways of getting these valuations. They mostly withhold the financial nature of risk factors associated with the public issue. Companies mostly make private placement of shares in the run-up to their

[55] Shubham Raj, *Paytm crashes to lifetime low of Rs 990; down 26% in last 12 session,* THE ECONOMIC TIMES (Jan. 19, 2022), https://economictimes.indiatimes.com/markets/stocks/news/paytm-share-crashes-to-lifetime-low-of-rs-990-down-26-in-last-12-sessions/articleshow/88991996.cms?from=mdr; Tanya Aneja, *From Nykaa to Paytm, here's how D-street debutants performed since listing,* BUSINESS TODAY (Dec. 21, 2021), https://www.businesstoday.in/markets/stocks/story/from-nykaa-to-paytm-heres-how-d-street-debutants-performed-since-listing-316357-2021-12-21.

IPOs, and this provides a steep jump to their valuation. However, they do not disclose the valuation received by their pre-IPO in their Red Herring Prospectus.[56]This calls for careful intervention by SEBI in balancing the interests of investors and firms. Though the IPO market has not yet reached the stage of a bubble which is about to burst, it seems to be moving in that direction. Thus, this is the appropriate time to take preventive measures. The pandemic has introduced us to lifestyles in every field and people are uncertain about the changes that might occur in ways of doing business, as we progress in different waves of this pandemic. As shown above in the case of the dotcom bubble in US, present uncertainties cause the general population to speculate positive stabilities in the future. Thus, necessitates timely intervention, by taking cues from past uncertainties. A possible solution for the Regulator is to push for governance-based legal strategies. They can channel distribution of power and payoffs within companies to reduce opportunism. One way of doing this is to accord decision rights to investors.[57] This is akin to something SEBI has in principle agreed to do, by encouraging strong corporate governance and shifting the focus away from promoters.[58] Further, appointment rights over top managers are already being enjoyed by Qualified Institutional Buyers like PEs. As these big investors have more skin-in-the-game through investing large amounts, they are bound to ensure efficient management of companies, to accrue higher future gains. This in turn reduces the risk associated with IPO subscriptions for companies supported by such investors. Thus, SEBI needs to support such investors.

[56] Sajeet Manghat, *What an IPO Prospectus Isn't Telling You Clearly,* BLOOMBERG (Nov. 09, 2021), https://www.bloombergquint.com/opinion/what-an-ipo-prospectus-isnt-telling-you-clearly.
[57] John Armour, Henry Hansmann & Reiner Kraakman, *Agency Problems, Legal Strategies and Enforcement,* Discussion Paper No. 644, The Harvard John M. Olin Discussion Paper Series (2009).
[58] *Id* at 34.

Though the rub-off effect might have led IPOs in the primary sector, they have not yet been successful and the rise in primary production activity corresponding to the capital raised is yet to be seen.[59] Further, financial stability of an economy cannot have direct correlations with the projections of big corporations. The stakes are even higher when other economies in the world are only in the process of recovery after the pandemic. Hence, without adequate balancing and intervention, we might be risking devastating consequences for making the most of a questionable, unusual, and counter-intuitive window for companies to go public.

[59] Sakshi Bajaj, *Retail Participation In Stock Markets Rising: SBI Report,* NDTV (Jun. 22, 2021), https://www.ndtv.com/business/retail-participation-in-stock-markets-rising-sbi-report-2469464.

SCHOLASTICUS

Siddharth Jain & Sridutt Mishra, *Protecting Minority Shareholders: Shareholder Litigation and the Need for Derivative Actions,* 10 (1) SCHOLASTICUS 89 (2023).

PROTECTING MINORITY SHAREHOLDERS: SHAREHOLDER LITIGATION AND THE NEED FOR DERIVATIVE ACTIONS

Siddharth Jain[⊥] *& Sridutt Mishra*[ø]

ABSTRACT

The article comments on the evolution of shareholder litigation to ensure good corporate governance and protect the rights of minority shareholders. The development of shareholder litigation by way of a direct class action is an American story and derivative actions find their roots in common law principles established nearly a century ago. Yet, the idea of shareholder litigation has not received adequate attention in India as it has in other jurisdictions. Though the enactment of the Companies Act, 2013 has marked a significant shift toward a stricter corporate governance framework, the Indian legislation still lacks imperative machinery to ensure the wellbeing of the company. By way of this article, the authors try to highlight the mechanism in the hands of the members for enforcement of the director's liability of running a company in its best interest. In fact, in accessing the ease of doing business index of a nation, the World Bank places reliance on a few key factors, one of which is the protection of minority shareholders. With India being a common law country and the United Kingdom having a high rank in the protection of minority shareholders indicator, the authors have analysed the provisions of derivative actions in the United Kingdom, to formulate their opinion. While comparing the provisions in the two nations, the authors suggest certain policy measures which can help improve the legislative recourse available to minority shareholders.

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I. INTRODUCTION

The COVID-19 pandemic has banished people from roads, forcing them to remain indoors to minimize viral transmission. Nevertheless, trade and commerce persist in operation. From the very inception of the pandemic in 2020, businesses switched to virtual set-ups and video conferencing applications were employed as new virtual platforms to replace physical meetings. Among others, one of the applications whose business mushroomed during the pandemic is Zoom. Unfortunately, Zoom's rapid ascent has also been accompanied by greater scrutiny, particularly about its end-user agreement and privacy practices.[1] As a result, it was pounded with a series of lawsuits.[2]

The most recent suit was a class action filed by one of its shareholders, Michael Drieu, based on the alleged loss of investment owing to the overstatement of Zoom's security measures which caused its share prices to tank.[3] Herein, the class included all persons similarly situated who 'purchased or otherwise acquired Zoom securities between April 18, 2019, to April 06, 2020'.[4]

With more stringent corporate governance measures and regulatory compliances in every jurisdiction, class action suits remain a strong instrument at the hands of the shareholders. Proper enforcement of commercial regulations and corporate laws is a huge incentive for businesses to establish their operations in a country. It is not only important from the perspective of a company, which seeks investment, but also from the point of view of the

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[1] E&T Editorial Staff, *Zoom slapped with class action lawsuit over Facebook data-sharing issues*, E&T ENGINEERING AND TECHNOLOGY (Apr. 1, 2020), https://eandt.theiet.org/content/articles/2020/04/zoom-slapped-with-class-action-lawsuit-over-facebook-data-sharing-issues/.

[2] Zack Whittaker, *Zoom sued by shareholder for 'overstating' security claims*, TECH CRUNCH (Apr. 8, 2020, 10:55 PM), 2020 https://techcrunch.com/2020/04/08/zoom-sued-shareholder-security/.

[3] Maria Ponnezhath, Shubham Kalia & Vinay Dwivedi, *Zoom sued for overstating, not disclosing privacy, security flaws*, REUTERS (Apr. 8, 2020, 2:20 PM), https://www.reuters.com/article/us-zoom-video-commn-privacy-lawsuit/zoom-sued-for-overstating-not-disclosing-privacy-security-flaws-idUSKBN21Q10V.

[4] *Id.*

investors. Most investors tend to invest in businesses where they not only believe that the returns will be attractive but also where there are sufficient protections in place.[5] Shareholder litigations are a powerful tool for corporate governance and thus, the protection of minority investors is one of the indicators in the World Bank's Doing Business Index.[6]

Before delving into the technicalities of shareholder litigations, it is essential to understand the origin and subsequent expansion of this principle. To that end, this article begins with a brief introduction of the roots of shareholder litigation, followed by a discussion of its evolution in India. In the third segment, the authors analyze the statutory derivative action regime in the United Kingdom (*hereinafter* "**UK**"). Lastly, the authors conclude with a few suggestive policy measures that can be acted upon.

II. EVOLUTION OF SHAREHOLDER LITIGATION

There are two different kinds of representative actions that can be initiated by shareholders: the *first*, a direct class action, where the shareholder class is affected, and a suit is brought on their behalf for damages and the *second*, a derivative action, which is also brought by some shareholders, but on behalf of the company.

The history of the modern era of direct class action suits is an American story. It harks back to the United States Supreme Court case of ***West v. Randall***,[7]

[5] Robert Daines & Charles Jones, *Mandatory Disclosure, Information Asymmetry and Liquidity: The Effect of the 1934 Act*, Jones, (2005) SSRN Electronic Journal, available at https://pdfs.semanticscholar.org/2f3c/39d52109b8e0d8a2189e967a60279ac55e0e.pdf?_ga=2.81187679.999296999.1592311379-1270096974.1592311379.

[6] The World Bank, *Protecting Minority Investors methodology*, DOING BUSINESS, https://www.doingbusiness.org/en/methodology/protecting-minority-investors.

[7] West v. Randall, 29 F. Cas. 46 (1820) (No. 17,424).

wherein Justice Joseph Story opined that "*It is a general rule in equity, that all persons materially interested ought to be made parties to the suit, however numerous they may be*". This was further concretized by the United States Federal Equity Rules in 1822, which operated till 1938.[8] With the wave of legislative revolution in the country, the above-mentioned provision was subsequently amended and re-presented as Rule 23 of the Federal Rules of Civil Procedure, 1938.[9] The provision provided for three types of class action suits based on the jural relationship involved: *first*, a 'true class' action suit which dealt with the joint or common rights of the class members;[10] *second*, a 'hybrid class' action suit which aggregated the members' several rights for reasons of equitable treatment;[11] *lastly*, a 'Spurious suit' which like a hybrid suit, joined individually-held rights but without any equitable connection.[12] Though the era saw an aggressive use of this provision, it was not without loopholes. The major dilemma that troubled the practitioners was whether the class action is a mere procedural device or is it a regulatory instrument.[13] Another concern with Rule 23 was that it disabled class members from opting out of the action, thereby binding them in the rigmaroles of litigation.

Its formalistic approach and judge-made amendments to this doctrine provoked the legislators to put the 1938 version on the advisory committee agenda.[14] The committee expressed its aversion to the above-mentioned classification as being instrumental in confused judicial inquiries.[15] Instead, they intended the new

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[8]United States Federal Equity Rules 1822, Rule 48.
[9]FED. R. CIV. P., 23 [*hereinafter*"**FED. CIV.**"].
[10]James Wm. Moore & Marcus Cohn, *Federal Class Actions-Jurisdiction and Effect of Judgment*, 32 ILL. L. REV. 309 (1938).
[11]DANIEL R. COQUILLETTE ET AL., MOORE'S FEDERAL PRACTICE (3d ed.) (2019).
[12]Pentland v. Dravo Corp., 4 F.R.D. 350 (W.D. Pa. 1945).
[13]James P. McDonald, *Milberg's monopoly: restoring honesty and competition to the plaintiffs' bar*, 58 DUKE L. J. (2008).
[14]RECORDS OF THE U.S. JUDICIAL CONFERENCE, *microformed on* CIS No. CI-4707-02 (Cong. Info. Serv.).
[15] Letter from Benjamin Kaplan to the Chairman and Members of the Advisory Committee on Civil Rules (Nov. 3, 1960), in RECORDS OF THE U.S. JUDICIAL CONFERENCE, microformed on CIS No. CI-6701-03 (Cong. Info. Serv.).

version to focus on adequate representation.[16] This legislative intent resonated with the judicial developments, leading to the formulation of the 1966 version of the class action rule. Apart from the aforementioned changes, the Rule also made provisions enabling members to opt-out from the class action.[17] The popularity of this doctrine in England and the USA had an instrumental role in its recognition in other countries as well. While most countries such as Australia,[18] Canada,[19] Germany,[20] and Italy[21] established this principle by the way of legislative enactment, few states like Argentina[22] ensured the same by the way of judicial decisions.

Contrary to the history of class action suits, the derivative suits have their origin in the common law development in the English courts.[23] Although the root for both the American as well as the English derivative action lies in common law, English common law restricted such actions to certain exceptional situations as decided in the landmark case of ***Foss v. Harbottle*** [*hereinafter* "**Foss Case**"].[24] It was available for those acts which involved nonratifiable conduct such as illegal and fraudulent action.[25] Further, it was allowed to only those

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16 Topic Ee: Tentative Proposal to Modify Provisions Governing Class Actions— Rule 23, at EE-2 (1962), in RECORDS OF THE U.S. JUDICIAL CONFERENCE, *microformed on* CIS No. CI-6309-44 (Cong. Info Serv.).

17 *History of Class Action Lawsuits,* LEVIN PAPANTONIO, https://www.levinlaw.com/history-class-actions.

18 Federal Court of Australia Act 1976, **No. 156, 1976** (Austl.).

19 Class Proceedings Act, S.O. 1992, c. 6 (Can.).

20 Gesetzüber Musterverfahren in kapitalmarktrechtlichen Streitigkeiten [Act on Model Case Proceedings in Disputes under Capital Markets Law], Oct. 19, 2012 (Ger.).

21 *Legislative Decree n. 206*, TEDIOLAI STUDIO LEGALE (Sept. 6, 2006), https://www.tedioli.com/Italian_class_action_text_english_version.pdf.

22 Francisco Verbic, *An Overview Of Class Actions In Argentina,* GLOBAL CLASS ACTION EXCHANGE (2017), http://globalclassactions.stanford.edu/sites/default/files/documents/ARGENTINA.pdf.

23 Hawes v. Oakland, 104 U.S. 450, 460 (1881) [*hereinafter* "**Hawes**"].

24 Foss v. Harbottle, 67 E.R. 189 (1843) [*hereinafter* "**Foss**"].

25 Brian R. Cheffins & Bernard S. Black, *Outside Director Liability Across Countries*, 84 Tex. L. Rev. 1404 (2006).

shareholders who owned enough shares to dictate the voting outcomes,[26] thereby practically extinguishing this remedy for the minority shareholders to protect themselves or disciple the management.[27] It was majorly this shortcoming that spurred the codification of the common law precedential principle of derivate action in the Companies Act of 2006 [*hereinafter* "**2006 Act**"].[28]

For the American jurisprudence, many of it on the derivative suits is derived from the English laws.[29] Currently, almost all states in America provide statutory recognition to the instrument of derivative action by way of the Model Business Corporation Act[30] which was drafted by the American Bar Association in 1950 and revised substantially in 1984.[31] However, several hurdles discourage shareholders from opting for this mechanism. *First,* the courts require that the plaintiff must be a shareholder at the time of the challenged transaction.[32] Thus, it ignores situations where a Plaintiff is a post-transaction shareholder but still suffers from the negative implications of the transaction at a subsequent period. *Second,* the plaintiff must adequately represent the interests of the corporation.[33] This is a subjective condition that grants huge discretion to the courts. *Third,* the plaintiff must hold specific stock of the company to initiate a suit. If not, the courts then require the plaintiff to post a bond to cover the defendant's reasonable expenses.[34] This poses a tremendous financial burden on the

[26] *Id.*
[27] Bernard S. Black, Brian R. Cheffins, Martin Gelter, Hwa-Jin Kim, Richard C. Nolan, Mathias Siems & Linia Prava, *Legal Liability of Directors and Company Officials Part 2: Court Procedures, Indemnification and Insurance, and Administrative and Criminal Liability (Report to the Russian Securities Agency)*, 2008 Colum. Bus. L. Rev. 26 (2008).
[28] Companies Act 2006, c. 46 (U.K.) [*hereinafter* "**2006 Act**"].
[29] Hawes, *supra* note 23.
[30] FED. CIV. *supra* note 9, at 23.1(a); MODEL BUS. CORP. ACT § 7.40(1) (2002) [*hereinafter* "**MBCA**"].
[31] John E. Mulder, Foreword to ABA-ALI MODEL BUS. CORP. ACT, at iii (1959).
[32] FED. CIV. *Supra* note 9, at 23.1(a); MBCA *supra* note 30,§ 7.41.
[33] FED. CIV. *Supra* note 9, at 23.1(a); MBCA *supra* note 30,§ 7.41.
[34] WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE, 2d § 1835 (2006).

plaintiff, given that it nevertheless has a little financial incentive as any monetary compensation recovered belongs to the corporation.[35]

III. SHAREHOLDER LITIGATION IN INDIA

In India, the establishment of a class action regime as a result of a few sour experiences. Previously, the role of the class action regime was fulfilled by either representative suits under Civil Procedure Code 1908 [*hereinafter* "**CPC**"]or Public interest Litigation. Such instruments were not well-defined with regard to class action and thus, devoid of the *sui generis* nature. In fact, such an unintended substitute could not help the victims of the infamous Bhopal Gas Tragedy[36] who were unable to initiate a proper class action suit due to lack of a proper procedure in place for collective actions, causing the government to undertake the claim on their behalf in the exercise of the doctrine of *parenspatriae*. This doctrine, literally meaning the 'Parent of the People', empowers the state to have a "third-party standing" and bring a lawsuit on behalf of any of its citizens when the concerned suit implicates the state's quasi-sovereign interests for its citizen's well-being.

Another instance was the vile case of 'Satyam Scandal'[37] wherein the founders of the firm, Satyam Computers Services Limited, fiddled with the accounting books to act in their favour. They intended to increase the revenue figures fictitiously, thereby causing a tremendous increase in profits. All these favourable figures attracted huge investors which further increased the share

35 STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS, § 1.2, 362-63 (2002).
36 Union Carbide Corporation v. Union of India, 1992 AIR 248.
37 Ashima Obhan and Vrinda Patodia, *Class Action Suits In India: Government Notifies Thresholds For Filing Class Action Suits*, MONDAQ (May 28, 2019), https://www.mondaq.com/india/class-actions/809134/class-action-suits-in-india-government-notifies-thresholds-for-filing-class-action-suits.

price. However, after a tragic series of events, one of the founders resigned from the position of Chairperson, and left a 5-page letter where he confessed a scandal of 7,000 crores. In this case, since all the shareholders of the defaulting firm were the aggrieved parties, ideally, a suit should have been brought by all of them, or by some of them on behalf of all. Yet, the shareholders were disabled from claiming damages due to the absence of class action provisions in the Companies Act, 1956. The shareholders in the United States, where the concept of securities class actions was developed, unlike in India were able to settle with a heavy sum of $125 million as damages.[38] Though the remedy of class action was inserted in the 2013 for the first time, there have been several other statutes that have proffered this remedy to the beneficiaries from way long back but restricted only to the scope of that particular statute. Such statutes that provide for collective actions are the CPC,[39] Industrial Disputes Act 1947,[40] the Competition Act 2002,[41] and the newly passed Consumer Protection Act, 2019[42]. A separate provision for a "securities class action" is also provided under section 37 of the 2013 Act. It is evident here that there exist certain overlapping remedies under the different acts. However, we shall confine our discussion to the 2013 Act.

It was majorly owing to this anomaly that the Parliament of India formulated the Companies Bill, 2009 which finally led to the introduction of the concept of class action in the Companies Act, 2013 [*hereinafter* "**2013 Act**"].[43] For the first time, under the provisions of the company law in India, the members were

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[38] Jonathan Stempel, *Satyam to pay 125 million to settle US suit over fraud,* REUTERS (Feb. 17, 2011), https://www.reuters.com/article/us-satyam-settlement/satyam-to-pay-125-million-settle-u-s-suit-over-fraud-idUSTRE71G0N420110217.

[39] CODE OF CIV. PROC., No. 5 of 1908, Order 1 Rule 8.

[40] Industrial Disputes Act, No. 14 of 1947, INDIA CODE (2019), § 2(k).

[41] Competition Act, No, 12 of 2003, INDIA CODE (2019), § 53N(1).

[42] Consumer Protection Act 2019, § 17.

[43] Companies Act, No. 18 of 2013, INDIA CODE (2019) §§ 241-245, https://indiacode.nic.in [*hereinafter* "**2013 Act**"].

given an option of monetary relief or damages in addition to an injunctive relief, as a class.[44]

Even though Indian laws provide for such recourse as a collective action, these provisions are rarely used, and collective action is not a very popular civil remedy in India. This is further substantiated by the fact that since the notification of class action and allied provisions in 2016,[45] there are only three reported cases regarding the same, all related to oppression and mismanagement. The first case was related to the siphoning of assets by the director without a proper board resolution and was decided by the National Company Law Tribunal [*hereinafter* "**NCLT**"], Mumbai.[46] The second was an appeal to the National Company Law Appellate Tribunal [*hereinafter* "**NCLAT**"] related to the omissions made by statutory auditors in collusion with the board of directors.[47] While in the first case, only an injunction was sought, the petitioners in the second prayed for exemplary costs from the statutory auditors. The third case was of Tata Sons Ltd. wherein, after the ousting of Cyrus Mistry from the company, the minority shareholders of the company filed for damages for the erosion of the share value. The entire episode was nothing short of a Bollywood flick where the actual events are still in a grey area. The claimed amount was a whopping INR 41 Crores by the minority shareholders, the leave for which was denied by the Bombay High Court.[48] However, the petition for oppression and mismanagement, filed in NCLT Mumbai by the Mistry family-backed investment firms which control the minority shares did not meet the same fate. The NCLAT allowed the

[44] *Id,* § 245 (1)(g).
[45] Ministry of Corporate Affairs Notification, 2016 Gazette of India, pt. II sec. 3 (2) (Jun. 1, 2016).
[46] R. Prasanth v. U.B.C. Engineers Private limited, (2018) 142 CLA 212 (NCLT).
[47] Shanta Prasad Chakravarty v. M/s. Bochapathar Tea Estate Private Limited, (2017) Company Appeal (AT) No. 297 of 2017.
[48] Pramod Premchand Shah and Ors. v. Ratan N. Tata and Ors*.,* (2018) (1) ALL MR 255.

petition[49]filed by Cyrus Mistry in his personal capacity and heard his plea along with his family backed investment firms.[50] After a long legal battle, the NCLAT decided that the removal of Cyrus Mistry from the board of directors was not valid and ordered to restore him as the executive chairman of Tata Sons.[51] However, the Supreme Court overturned the decision of NCLAT and held that, *inter alia,* neither the removal of a person from an executive position nor the affirmative voting rights prescribed in the Article of Association can be termed as oppression or mismanagement.[52]

With stronger corporate governance guidelines and the introduction of concepts such as independent directors, India is trying to move forward to a more investor/shareholder accountable corporate legal structure. However, shareholder activism is still seen with scepticism. This is because even in large public companies, the shareholding is still highly concentrated with individuals or institutions.[53]

Notably, this half-baked approach to class action is replete with shortcomings at multifarious levels. The major frailty which persists is about the numerical threshold. To file a class action suit for oppression and mismanagement, a minimum of 100 shareholders or those holding at least 10% of the share capital of the company is required.[54] This precisely was the problem in the Tata Case. The Mistry group held only 2.1% of the total share capital in Tata Sons, albeit

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[49] PTI, *NCLAT admits Mistry's petition against order upholding his removal,* CFO.COM FROM ECONOMIC TIMES(Aug. 29, 2018), https://cfo.economictimes.indiatimes.com/news/nclat-admits-mistrys-petition-against-order-upholding-his-removal/65592158.

[50] Cyrus Investments Private Limited and Anr. v. Tata Sons Limited and Ors., (2020) 154 CLA 47.

[51] *Id.*

[52] Cyril AmarchandMangaldas, *In review: M&A litigation claims by shareholders in India*, LEXOLOGY (Dec. 2, 2021), https://www.lexology.com/library/detail.aspx?g=954d6362-5967-437a-9200-85a2cf559cee.

[53] Rajesh Chakrabarti, *Corporate Governance in India – Evolution and Challenges*, unnumbered working paper no 2005-20; Available at: http://ssrn.com/abstract=649857 [*hereinafter* "**Corporate Governance**"].

[54] Companies Act, No. 18 of 2013, INDIA CODE (2019) § 244, https://indiacode.nic.in.

the shareholding being 18.37% in equity shares.[55] The legislature carved out an escape route by allowing the NCLT to waive off this requirement in cases of oppression and mismanagement,[56] however no such proviso exists for class actions in general.[57] However, to bring more clarity, the central government has recently amended the NCLT Rules regarding class action suits under Section 245. It has filled the gap concerning the percentage of the members or depositors required to file a class actions suit.[58] The threshold for class action earlier was the lesser of the two: 100 members/depositors or the percentage of members/depositors as may be prescribed. The prescribed percentage has been notified vide the amended rules as 5%.[59] It is quite peculiar that the other common law countries from which India borrowed the concept of class action do not have any such threshold.

While borrowing the concept of shareholder litigations from common law jurisdictions, the Indian legislature did not conceptually capture derivative actions. A direct suit can be brought under the 2013 Act. However, derivative suits are not codified under the 2013 Act and are filed under the CPC as representative suits. The only substantive law to file a derivative action in India is by reference to common law principles. The above discussed Foss Case has been relied upon by Indian courts to date.[60] Very few cases have been filed in

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[55] *Mistry Files Appeal in Supreme Court; Says His Family Deserved More Relief from NCLAT*, THE ECONOMIC TIMES(Feb. 17, 2020), https://economictimes.indiatimes.com/news/company/corporate-trends/mistry-files-appeal-in-supreme-court-says-his-family-deserved-more-relief-from-nclat/articleshow/74175711.cms?from=mdr.

[56] 2013 Act, *supra* note 39, § 244.

[57] 2013 Act, *supra* note 39, § 244

[58] Ministry of Corporate Affairs Notification, 2016 Gazette of India, pt. II sec. 3 (1) (May 8, 2019).

[59] *Id.*

[60] Nirad Amilal Mehta v. Genelec Limited and Ors. [2008] 146 CompCas 481 (Bom); Ahmed Abdulla Ahmed Al Ghurair and Ors. v. Star Health and Allied Insurance Company Limited and Ors., AIR 2019 SC 413.

India on the principle of a derivative action, and even fewer have been admitted. In ***Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd.***[61] the court determined that if the benefit of the alleged action is accrued incidentally to a director the claim ought to be rejected. Thus, the Indian courts have modified the principle laid down in the Foss case over time, and have consequentially narrowed the ambit of the same.

IV. DERIVATIVE ACTIONS IN THE UNITED KINGDOM

London is considered a business hub, owing to its great commercial atmosphere and corporate laws. Protection of minority investor index of UK is ranked at number 7 by the World Bank, due to its investor-friendly corporate laws.[62] India, being a common law country derives most of its jurisprudence from the UK. However, in India, the test laid down in Foss Case is still used to determine the legitimacy of a derivative action whereas, in the UK in the 2006 Act[63] introduced the concept of statutory derivative claims.

The members can approach the court in the case of negligence, default, breach of duty or breach of trust by a director of a company.[64] However, in this case, the claim should be sought on behalf of the company.[65] For a personal remedy, an unfair prejudice claim can be brought by the member. Here we can see the parallel between the provisions of oppression and mismanagement and class action in the Companies Act 2013.

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[61] Needle Industries (India) Ltd. v. Needle Industries Newey (India) Holding Ltd., AIR 1981 SC 1298.
[62] *Explore Economies: United Kingdom*, DOING BUSINESS, https://www.doingbusiness.org/en/data/exploreeconomies/united-kingdom.
[63] 2006 Act, *supra* note 28.
[64] 2006 Act, *supra* note 28, § 260(3)
[65] 2006 Act, *supra* note 28, § 260(2).

A claim by way of derivative action can be brought by the members of a company.[66] This extends to those members as well who became a shareholder after the alleged act or omission had occurred, unlike the provisions in the USA. Though the 2006 Act does not categorically restrict derivative actions to be brought about by majority shareholders, such an action would likely be dismissed. The England and Wales High Court opined that derivative suits brought by shareholders in control of the company shall succeed only in 'very exceptional' cases.[67] However, it is pertinent to note that the court itself did not describe what these 'very exceptional circumstances might be.

The procedure to bring such actions is a two-staged process. In the first stage, a *prima facie* case has to be established in front of the court, and only then the court shall provide permission to commence the action. In the second stage, the court examines the merits of the case by evaluating the factors set out in the 2006 Act.[68] Even though, there exists no numerical threshold to bring such action as, the question regarding the threshold to decide what a prima facie case is has often divided the courts. In 2009, the court in ***Iesini v. Westrip HoldingsLtd***.[69]determined this threshold as there is a *prima facie* case that the company has a good cause of action and that the cause of action arises out of a director's default or breach of duty. A year later, in ***Wishart v. Castlecroft Securities***,[70] a lower threshold was decided, and the court opined that the first stage is only a gateway through which each claim must pass. If the company has a cause of action, the claim should be allowed to proceed to the second stage.

In the second stage, the strength of the claim is evaluated by the court. The statute provides for situations, as to when a claim should be rejected by the

66 2006 Act, *supra* note 28, § 260.
67 Cinematic Finance Ltd. v. Ryder and Ors., [2010] EWHC 3387 (Ch).
68 2006 Act, *supra* note 28, § 263.
69 Iesini v. Westrip Holdings Ltd., [2010] BCC 420 [*hereinafter* "**Iesini**"].
70 Wishart v. Castlecroft Securities, [2009] CSIH 65.

court. When an action is ratified or authorized by the company, then a claim cannot be brought. However, not all claims are ratifiable; fraudulent acts and act ultra vires the Memorandum of Association cannot be ratified.[71] The court also has to check whether the member has brought the claim in good faith, and he must not have hidden intentions. A claim driven by personal interest is likely to be rejected.[72] However, there will always exist a collateral personal benefit for a member, as the foremost reason for bringing a derivative claim is to benefit the company.[73]

The court also decides whether under normal circumstances a director would pursue this claim. This would involve exercising rational business judgement, the likelihood of success and the costs and time involved.[74]

V. RECOMMENDATIONS AND CONCLUSION

In light of the above, it is evident that the development of shareholders litigations, which is one of the most important instruments for ensuring the protection of minority interests, is still at a nascent stage in India. Though the dire need for legislative changes has been occasionally manifested by way of failure of justice in corporate cases, the Indian legislature has been dragging its feet way behind the beat to enact legislative changes to that effect.

As pointed out above, derivative actions have not been codified under the 2013 Act and are still pursued under CPC. Under CPC, a representative suit is filed on behalf of people in a similar situation,[75] whereas derivative suits are brought on behalf of the company. Thus, on technical grounds, derivative suits should

[71] Burland v. Earle, [1902] AC 83.
[72] Barrett v. Duckett, [1995] 1 BCLC 243.
[73] Iesini, *supra* note 68.
[74] Franbar Holdings Ltd v. Patel and ors., [2008] EWHC 1534.
[75] *Supra* note 39.

not be under the ambit of CPC.[76] To tackle this paradox of legislative incongruency, the authors suggest a few policy changes that may help to straighten these out,

First, the authors recommend the inclusion of derivative suits within the ambit of 2013 Act. This would ensure that the tribunals which are equipped to deal with technical company law matters handle such petitions. Stemming from the essence of the 2006 Act, the derivative actions should be allowed to be brought by any number of minority shareholders. However, one important reason, why a numerical threshold should exist is the costs of litigation. The costs of pursuing a derivative claim are rarely paid by the plaintiff; it is borne by the corporation.[77] Where a shareholder has no monetary consequences to pursue a claim, frivolous or spurious suits are likely to arise. Therefore, if an act or omission requires legal action to be taken under the 2013 Act by the minority shareholder, the numerical threshold provides a way to ensure that it is not a frivolous suit.

Second, a member who became a shareholder after the alleged action or omission took place should be allowed to continue/proceed with the action. A provision should be made to include an application to be made to the NCLT to allow a member to pursue the claim, who originally was not a part of the litigation. The Indian judiciary is plagued with delays in pronouncing judgments.[78] A plaintiff shareholder might just run out of patience and exit the company before a judgment has been given. Furthermore, it may so happen that a shareholder might not continue to proceed with the claim with the same fervor as they had

76 Vikramaditya Khanna, and Umakant Varottil, *The Rarity of Derivative Actions in India: Reasons and Consequences* In: D. Puchniak, H. Baum and M. Chow, ed., *The Derivative Action in Asia: A Comparative and Functional Approach,*(2012) Sydney Law Review, Cambridge University Press.
77 MARGARET CHEW, MINORITY SHAREHOLDERS' RIGHTS AND REMEDIES (2nd ed. 2017).
78 Rajesh Chakrabarti, *Corporate Governance in India – Evolution and Challenges*, unnumbered working paper no 2005-20, http://ssrn.com/abstract=649857.

started and may simply refuse to continue with the filings. The 2006 Act allows for a member to continue the claim as a derivative claim if they satisfy the court that the claim has not been pursued diligently.[79] Therefore, this will ensure that a claim is pursued diligently till the judgement is handed down by the court.

Lastly, the two-step process of evaluation of claims in the UK should be carried forward to the 2013 Act. The first step concerns the establishment of the *prima facie* case and the second step, is the evaluation of the merits of the case. Though the threshold for a prima facie case faces several judicial interpretations in the UK, India can adopt a much more linear approach. There should be a two-prong test to determine a prima facie case: *first*, the numerical threshold and *second*, that the company has a cause of action. The numerical threshold should be reasonable considering the non-dispersed shareholding of companies in India.

It is the view of the authors that shareholder litigations shall become a more commonplace in the future, owing to the gradual change in shareholding patterns, making the control of the company more dispersed. The viability of derivative actions as an instrument of corporate governance can be gauged only after the unnecessary legislative restrictions are removed and the process is streamlined.

[79] 2006 Act, *supra* note 28, § 260(2).

SCHOLASTICUS

Pooja Dhamor & Vaishnavi Bansal, *Addressing the issues in functioning of the ARCs in resolution of Stressed Assets,* 10 (1) SCHOLASTICUS 105 (2023).

ADDRESSING THE ISSUES IN FUNCTIONING OF THE ARC IN RESOLUTION OF STRESSED ASSETS

Pooja Dhamor[⊥] *& Vaishnavi Bansal*[∅]

ABSTRACT

*ARCs are projected to play a vital role in the face of a major expansion of NPAs in the financial system. By eliminating persistently problematic stressed financial assets from originators' accounts, the ARC architecture allows them to focus on their main job of lending. Following the purchase of such financial assets, ARCs serve as the principal agent for recovery. The ARC framework is also intended to assist borrowers in reviving their enterprises, which safeguards the economy's viable and productive assets while also ensuring that banks/financial institutions ("**FIs**"), commonly referred to as "lenders," get a better return on their stressed assets.*

The article also deals with why the ARCs are not performing as well as expected, discussing the reasons behind its falling behind the IBC in terms of resolution statistics, and attempting to bring out the structural flaws which hinder its successful participation as resolution applicant under the IBC. It tries to bring out suggestions to encourage a greater success rate in resolution, hence helping the economy in rehabilitation and thriving (by avoiding liquidation).

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I. INTRODUCTION

Banking system is financial backbone of any country and the amount of Non-Performing Assets ("**NPAs**") in the economy is the indicator of the wellness or aliment of the economy. The Indian banking system has frequently been burdened with large levels of NPAs, hurting the profitability and, consecutively, the capital position of banks, especially Public Sector Banks ("**PSBs**"). The Financial Stability Report of July 2021 published by the Reserve Bank of India ("**RBI**") indicates that the Gross Non-Performing Asset ("**GNPA**") ratio of Scheduled Commercial Banks ("**SCBs**") may transition to 9.80% in the baseline scenario by March 2022 and may increase to 10.36% and 11.22% under the other stress scenarios.[1]

In this background, the Asset Reconstruction Companies ("**ARCs**") were introduced in India. The main goal was to tackle the problem of growing NPAs and reduce the load of already overburdened banks in the country. ARCs are registered under the RBI and regulated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 ("**SARFAESI Act, 2002**").[2] ARCs are defined as the companies which is formed for the purpose of carrying on the business of asset reconstruction, or securitisation, or both.[3] The principal business of ARCs is either asset reconstruction or securitisation or both. However, Section 10 extends the business of ARCs to acting as a recovery agent for banks or financial

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[1] *Financial Stability Report*, 23 RBI , (2021), https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/FSRJULY20210595CD3BEDFA466EBE9169BCE426E32C.PDF.

[2] Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002, § 2(1)(ba), No. 54, Acts of Parliament, 2002 (India) (hereinafter "**SARFAESI, 2002**").

[3] *Id.*

institutions, acting as managers, and receiver appointed by the courts or tribunals.[4]

Asset reconstruction and Securitisation

Section 2(1)(b) of the SARFAESI Act, 2002 defines "asset reconstruction," as acquisition of any financial assistance for the purpose of its realisation would amount to asset reconstruction.[5] While this definition is a little broad, what can be inferred from the same is that acquisition is the first step and realisation is the last step, and whatever happens in between is "reconstruction." Therefore, asset reconstruction can be said to be the process of realising an asset, by first acquiring that asset. Securitisation means acquisition of financial assets by an ARC from any originator.[6] The acquisition shall be by raising funds from qualified buyers by issue of Security Receipts ("**SR**") representing undivided interest in such financial assets or otherwise.

It is important here to note that previously, the law governing securitization and reconstruction talked about two types of companies, that is, firstly, securitisation companies and secondly, reconstruction companies, where both such companies were assumed to be carrying on the business of securitisation and reconstruction interchangeably.[7] However, the law, after the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, has subsumed the concept of twin companies into one, viz., ARCs.[8]

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[4] SARFAESI, 2002, *supra* note 2, §10.
[5] SARFAESI, 2002, *supra* note 2, §2(1)(b).
[6] SARFAESI, 2002, *supra* note 2, §2(1)(z).
[7] Vinod Kothari, Securitisation, Asset Reconstruction and Enforcement of Security Interests, Chap. 9 (Law and Practices of Asset Reconstruction in India) (6th ed.).
[8] Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016, No. 44, Acts of Parliament, 2016 (India).

II. STRUCTURE OF AN ARC

Contemporarily, the ARCs operate on a multitude of structures accompanied by banks, promoters, investors and funding houses. The following are a few kinds of ARC structures prevalent in the industry:

A. Conventional Structure

In conventional structures the ARCs aggregate and buys the distressed asset from banks at combination of cash and SRs and ARCs resolve the asset in time period of 5 to 8 years. However, this structure doesn't have much success rate in terms of dues recovery. Additionally, the change of RBI provisioning norms over the time has made the conventional model less attractive.

B. Portfolio Structure

Under portfolio structure, funded by distressed funds work with banks. ARCs aggregate the asset and pay in cash to lenders while also undertaking resolution of the asset. The contradiction is this case is that ARCs should have consolidated the majority of debt from multiple lenders for being successful. Multiple large distressed funds have been entering India with the intention of using ARCs for this purpose.[9]

C. ARCs working in conjunction with the existing promoters

In such systems, ARCs fund the promoters' One Time Settlement ("**OTS**") by purchasing the loan from the banks. In this instance, banks typically utilise the Swiss-challenge approach for fair price discovery. The OTS is funded by ARCs who secure funding from funds/investors. The promoters are usually the ones who give OTS to pay off the loan. In addition, ARCs here work with existing promoters to restructure the debt with them. Promoters refinance the loan after

[9] Vishal Agarwal & Rajesh Agarwal et al., *Asset Reconstruction Companies (ARCs): Tax and regulatory framework*, THE DBRIEFS M&A TAX SERIES, (2019), https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/in-tax-asset-reconstruction-companies-tax-regulatory-framework-noexp.pdf.

a specific period of time to allow ARCs to exit. This is a good structure to use when banks don't want to deal with existing promoters due to restrictions imposed by Section 29A of the IBC.

D. Arbitrage Approach

Under arbitrage approach, the resolution plan is visible but there is uncertainty as to the timing of the resolution and the banks need to undertake resolution on priority. In this instance, the ARCs present a settlement proposal and take possession of the assets until the resolution. Following that, the ARCs resolve the asset and deliver it to the investor.

E. Pre-pack NCLT

Before being admitted to NCLT, ARCs negotiate with possible investors/lenders to either buy out the loans or come up with a new resolution strategy. The important point to note here is that the resolution plan is negotiated between banks and investors before to admission to the NCLT. ARCs have two alternatives in this structure: they can buy the loan and take the company to NCLT, or they can participate as resolution applicants with the investors backing the ARCs.

F. Complex Structures

This structure is mostly used when the borrower has multiple assets and resolution is through a piece-meal sale of assets. IBC does allow selling of assets in piece-meal basis. ARCs participate as a resolution applicant and devise a resolution plan based on investor requirements. Submits a resolution plan to the NCLT based on the asset's evaluation. Once the resolution plan has been approved by the NCLT, the assets are sold to investors depending on asset category.

III. EXISTING LEGAL FRAMEWORK GOVERNING ARC IN INDIA

As mentioned earlier, SARFAESI is the governing framework for ARCs. ARCs can acquire financial assets from banks and financial institutions ("**FIs**") as specified in Section 5(1) of the Act.[10] Another benefit of being categorized as a FI under the Act is that it receives enforcement rights over secured financial assets under Section 13, in addition to the ability to sell financial assets to ARCs.[11]

A. Who can obtain SRs

Only qualified purchasers ("**QBs**") are entitled to obtain SRs issued by ARCs under Section 7 of the Act.[12] A financial institution, insurance company, bank, state financial corporation, state industrial development corporation, ARC, or any asset management company investing on behalf of a mutual fund or a SEBI registered foreign institutional investor, any category of non-institutional investors as defined by RBI, or any other body corporate as defined by SEBI are all considered QBs under Section 2(1)(u) of the Act.[13]

B. Guidelines Applicable on Sponsors

According to Section 2(1)(zh) of the Act, a Sponsor is someone who owns at least 10% of an ARC's paid-up equity capital.[14] RBI has the authority under Section 3(3)(f) of the Act to prescribe appropriate and proper criteria for ARC Sponsors.[15] As a result, the RBI Master Direction of October 25, 2018 lays out the criteria for determining a sponsor's fit and suitable status, as well as a structure for monitoring that status.[16]

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[10] SARFAESI, 2002, *supra* note 2, §5(1).
[11] SARFAESI, 2002, *supra* note 2, §13.
[12] SARFAESI, 2002, *supra* note 2, §7.
[13] SARFAESI, 2002, *supra* note 2, §2(1)(u).
[14] SARFAESI, 2002, *supra* note 2, §2(1)(zh).
[15] SARFAESI, 2002, *supra* note 2, §3(3)(f).
[16] RBI Master Direction - Fit and Proper Criteria for Sponsors - Asset Reconstruction Companies (Reserve Bank) Directions, 2018(Oct. 25, 2018), https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11402.

This activity includes, among other things, a review of sources and the stability of funding. These standards are designed to guarantee that the integrity, reputation, track record, and compliance with applicable laws and regulations of the sponsor, management, and executives match regulatory expectations.

C. Involvement of the Indian Trust Act, 1882 on the governance of ARCs

The Indian Trust Act, 1882 governs the creation of trusts by ARCs for the purpose of securitization. According to Section 7(2A) of the SARFAESI Act, such trusts must be managed by ARCs, who must hold assets in trust for the benefit of the QBs.[17] According to ARC regulations, ARCs must invest and hold at least 15% of each class's SRs until all of the SRs issued by them under each scheme have been redeemed.[18] The fact that ARCs have a stake in the game helps to connect the interests of QBs (beneficiaries) and ARCs (trustee). As part of the consideration for transferring assets to the trust, selling lenders may also purchase SRs.

D. Guidelines on Restructuring Measures

As previously stated, Section 9(2) of the Act authorizes the RBI to regulate and issue guidelines on measures for asset reconstruction procedures.[19] As a result, RBI has given thorough recommendations in this regard. The following is a quick rundown of these guidelines:

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[17] SARFAESI, 2002, *supra* note 2, §7(2A).

[18] RBI Master Circular - Asset Reconstruction Companies, RBI/2021-22/154 DOR.SIG.FIN.REC 84/26.03.001/2021-22, **Para 7.2 (Feb. 10,** 2022**),** https://www.rbi.org.in/scripts/FS_Notification.aspx?Id=12225&fn=14&Mode=0, (hereinafter "**RBI Master Circular**") inserted vide Circular No.DNBS(PD) CC.No.41/SCRC/26.03.001/2014-15 (Aug. 05, 2014), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9154&Mode=0.

[19] SARFAESI, 2002, *supra* note 2, §9(2).

E. Taking over the management of the borrower's business[20]

An ARC Trust can take over or bring a change in the management of a borrower's business in line with Section 15 of the SARFAESI Act and Board-approved policy. Such a takeover is allowed on the grounds of wilful default, inept management, or management working against creditors' interests.

Such a takeover is allowed only if:

(a) the amount owed to the ARC trust is at least 25% of the total assets possessed by the borrower; or

(b) if the borrower is financed by more than one secured creditor (including ARC)

- the secured creditors possess at least 60% of the outstanding SRs; and
- there is mutual understanding between these secured creditors with respect to the decision of such takeover, takeover of borrower's management is allowed.

1) *Enforcement of Security Interest*[21]

Only if the sale is done through a public auction may the ARC buy the secured assets, either for its own use or for resale, in conformity with the terms of Section 13 of the Act.

2) *Conversion of Debt into Equity in a Borrower Firm*[22]

The ARC/shareholding trust's in the post-converted equity of the company under reconstruction should not exceed 26 percent or the sectoral FDI maximum. The 26% limit can be increased if the ARC fits specific criteria.

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[20] RBI Master Circular, inserted vide Circular No.DNBS/PD (SC/RC) No.17/26.03.001/2009-10, Para 6.B.1 (April 21, 2010), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=5616&Mode=0.

[21] RBI Master Circular, *supra* note 18, Para 6.B.4.

[22] RBI Master Circular, *supra* note 18, Para 6.B.6.

Further, Board-approved policy is also an important consideration in this regard.

3) *Rescheduling and settlement of debts payable*

This shall be in consonance with the policy developed/made by the Board of Directors.

4) *Leasing out/selling the business of the borrower*

No guidelines in this respect have been issued by the RBI to date. Further, as per the notification titled DNBS (PD) CC. No. 15 / SCRC / 26.03.001/ 2009-2010 issued by the RBI on July 1, 2009, no Securitisation Company or Reconstruction Company shall sell/lease out the business of the borrower in the absence of any guidelines in this regard by the RBI.[23]

F. Important regulations relating to functioning of ARCs

It is mandatory for an ARC to have a minimum Net Owned Fund ("NOF") of Rs.100 crore on an ongoing basis. While it not permitted to acquire financial assets on a bilateral basis from sponsor banks/ FIs or an entity in the Group; ARCs are permitted to partake in public auctions for financial asset acquisition. Furthermore, a minimum of 15% of SRs are required to be invested in each class, under each scheme. It is mandatory that the assets be realized within 5 years; which limit may be extended up to 3 more years with the approval of their Board.

The asset classification to be recorded in the ARCs' books includes four categories: (i) standard; (ii) sub-standard; (iii) doubtful; and (iv) loss assets.

[23] RBI Notification DNBS (PD) CC. No. 15 / SCRC / 26.03.001/ 2009-2010 updating The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003, (July 01, 2009) https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=5080#GN1.

i. Standard: During the planning period of 6 months.
ii. Sub-standard Asset: for a period not exceeding twelve months from the date it was classified as NPA. The provisioning requirement for the same is 10% of the outstanding value.
iii. Doubtful Asset: if the asset remains a sub-standard asset for a period exceeding 12 months. The provisioning requirements for the same include 100% provision to the extent the asset is not covered by the estimated realizable value of security as well as % of the remaining outstanding value.
iv. Loss Asset: if the asset is non-performing for a period exceeding 36 months; the financial asset including SRs is not realized within the total time frame specified. Pursuant to the provisioning requirements, the entire asset shall be written off. Additionally, if the asset is retained in the books, 100% provisioning for the same shall be provided for.

G. Other Applicable Guidelines on ARCs

When acquiring financial assets, ARCs must realize the assets within the maximum allowed time frame of eight years from the date of purchase.[24] Section 9(1) of the Act specifies asset reconstruction measures that ARCs can apply.[25] Section 2(1)(b) of the Act defines 'Asset Reconstruction' as the acquisition by an ARC of any bank or financial institution's right or interest in any financial assistance for the purpose of realizing such financial assistance.[26]

The Act authorizes the RBI to establish asset reconstruction recommendations under Section 9(2), and Section 9(3) makes it mandatory for ARCs to adopt these actions in compliance with RBI instructions.[27] There is a wide gamut of

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24 RBI Master Circular - Asset Reconstruction Companies, RBI/2021-22/154DOR.SIG.FIN.REC 84/26.03.001/2021-22, Para 6.A.2(d) (Feb. 10, 2022),https://www.rbi.org.in/scripts/FS_Notification.aspx?Id=12225&fn=14&Mode=0.
25 SARFAESI, 2002, *supra* note 2, §9(1).
26 SARFAESI, 2002, *supra* note 2, §2(1)(b).
27 SARFAESI, 2002, *supra* note 2, §9(2), §9(3).

items on the list of important guidelines issued by RBI regarding the working of the ARCs. As suggested in the Report, is important to consolidate all the applicable guidelines in one Master Directions and update it timely.[28] Following the advice of this Report, RBI consolidated all present instructions and guidelines on the governance of ARCs in a master circular in February 2022.[29]

ARCs are allowed to use their finances to restructure acquired assets only for the purpose of paying down their debts. Under certain situations, trusts may use a portion of cash obtained through a scheme from QBs to restructure assets acquired through related schemes.[30] One of the restrictions is that the cash used for reconstruction should not exceed 25% of the total funds received under the plan.[31]

The efforts of ARCs to resolve assets result in the redemption of SRs. ARCs, on the other hand, claim the management fee for managing the assets, as well as any expenditures and incentives, if any, from the individual trusts.

The SRs provided to the QBs are redeemed via residual recovery. The residual recovery over the purchase cost, referred to as 'upside revenue,' is allocated among the QBs and ARCs according to the terms of the agreement.[32]

The NAV of the SRs is used to calculate the management charge for ARCs.[33] The NAV, in turn, is determined by the credit rating provided by a SEBI-

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[28] RBI Report, Para C.7.

[29] RBI Master Circular - Asset Reconstruction Companies, RBI/2021-22/154 DOR.SIG.FIN.REC 84/26.03.001/2021-22, (Feb 10. 2022), https://www.rbi.org.in/scripts/FS_Notification.aspx?Id=12225&fn=14&Mode=0.

[30] RBI Master Circular, inserted vide Circular No.DNBS (PD) CC.No.37/SCRC/26.03.001/2013-14, Para 7(3) (Mar. 19, 2014), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=8776&Mode=0.

[31] RBI Master Circular, inserted vide Circular No.DNBS (PD) CC.No.37/SCRC/26.03.001/2013-14, Para 7.3(ii) (Mar. 19, 2014), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=8776&Mode=0.

[32] RBI Report, Para C.11.

registered credit rating agency (CRA).[34] ARCs are required to get their first rating within six months following asset purchase.[35] After that, a CRA evaluates the rating every six months. The rating is given on a 'recovery rating scale,' which has a range of likely recovery expressed in percentage terms linked with it.[36] The face value of outstanding SRs is multiplied by the lower end of the range to arrive at NAV. The management fee will be recognized on an accrual basis and will be reversed if it is not realized within 180 days or if the NAV falls below 50% of face value during that time.

The explanation for the rating should be provided to ARCs on a regular basis, according to current ARC criteria. SRs owned by the ARC that have not been redeemed within the maximum allowed duration of 8 years must be classified as loss assets, according to prudent accounting standards. In the event that assets are not realized within the required timeframe, QBs owning SRs worth at least 75% of the entire amount of SRs issued under a scheme are entitled to summon a meeting of all QBs and approve a resolution binding on the ARC under Section 7(3) of the Act.[37]

IV. REVIEW OF THE PROBLEMS FACED BY ARC

A. Issue in Resolution of stressed assets under IBC, 2016

Section 9(1) of the Act specifies the asset reconstruction procedures that ARCs may use in accordance with RBI recommendations.[38] According to data, nearly 80% of the sector's recovery has so far been achieved through the use of

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33 Guidance Notes for Asset Reconstruction Companies, RBI Master Circular, Para 2(vi) https://rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=12225#FT22.
34 *Id.*, at Para 2(vi)(a).
35 *Id.*
36 *Id.*
37 SARFAESI, 2002, *supra* note 2, §7(3).
38 SARFAESI, 2002, *supra* note 2, §9(1).

rebuilding procedures that do not always result in economic rebirth.[39] Changes in the management of the borrower's firm or the conversion of the borrower's debt into equity have rarely been utilized by ARCs as means for reconstruction.[40] Only 19.9% of the recoveries made by ARCs involved rescheduling debt payments.[41] This pattern has remained continuous throughout the sector's history.

1. *Deviation from the pattern – Moving towards IBC*

This pattern has remained continuous throughout the sector's history. The adoption of IBC as a resolution mechanism when it became accessible is the lone deviation from the pattern. IBC, 2016 gives ARCs the authority to apply IBC rather than the Act. IBC is increasingly being used to settle assets purchased after FY14. However, because ARCs' involvement in IBC may be forced, with main lenders taking the initiative, ARCs' usage of IBC may not be indicative of a preference for IBC.

2. *Validity of ARCs as Resolution Applicants*

While ARCs are allowed to use the IBC to resolve their financial assets as secured creditors, they are not allowed to use the IBC to act as Resolution Applicants due to the current regulatory and legal framework. This is because ARCs' legal and regulatory systems are aimed around recovering debt from borrowers rather than resolving insolvency. Simultaneously, the Act provides ARCs with insolvency resolution mechanisms like management change/takeover, debt-to-equity conversion, etc. While ARCs, on the other hand, have not been using these tools in general.

3. *RBI Review Committee's Report on ARCs vis-à-vis IBC*

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[39] RBI Report, Para D.2.1.
[40] RBI Report, Chart D6.
[41] *Supra* Note 53.

ARCs are envisioned as a key vehicle for resolving stressed assets, therefore, the legislation should allow them to do so using the IBC framework as well. Allowing ARCs to apply for resolutions as Resolution Applicants can help with this. IBC's expertise in resolving borrower insolvency will aid ARCs in collecting more debt. The ARC, on the other hand, should keep its assets modest in order to prevent conflicts of interest when deciding between assets bought through trusts managed by them and assets purchased directly on their balance sheet. As a result, the RBI Review Committee proposes that ARCs be allowed to engage in Resolution Applicants solely as SR trustees or through their sponsored AIFs as Resolution Applicants.

The RBI Review Committee proposes a middle ground. While ARCs are permitted to establish AIFs to facilitate asset recovery and participate in bankruptcy resolution under the IBC, the Act requires that they continue to focus on financial asset reconstruction. As a result, ARCs should be subject to a PBR. The AUM gained through AIF and IBC should never exceed the AUM gained through SR issuance when calculating PBR via ARCs.[42]

4. *Case Study: Aircel Limited, Dishnet Wireless Limited & Aircel Cellular Limited*

The RBI has rejected the UVARCL resolution proposal for Aircel Limited ('Aircel'). The NCLT has given its approval to the scheme in an order dated June 9, 2020.[43]

Section 30(4) of the Code,[44] read with Regulation 37(1)(l) of the (Insolvency Resolution Process for Corporate Persons) Regulations, 2016,[45] requires the

[42] RBI Report, Para D.2.11.
[43] In the matter of Aircel Limited, Dishnet Wireless Limited & Aircel Cellular Limited IA No. 1864-MBII-2019 in CP (IB) No.298-MB.II-2018, IA No. 1863-MB.II-2019 in CP (IB) No.302-MB.II-2018 & IA No. 1865-MB.II-2019 in CP (IB) No.300-MB.II-2018, https://ibbi.gov.in//uploads/order/39083848a5dd943a4e2cbdc570ee80f4.pdf (hereinafter "**Aircel Dishnet Case**").
[44] Insolvency and Bankruptcy Code of India, 2016, §30(4), No. 31, Acts of Parliament, 2016 (India).
[45] IBBI Insolvency Resolution Process for Corporate Persons Regulations, 2016, Reg. 37(1)(1).

resolution applicant to get essential permissions from relevant authorities as needed by law at the time.

The NCLT noted in approving UVARC's resolution plan that the RBI's regulatory permission is necessary because an asset reconstruction business is acquiring Aircel shares. As a result, before implementing a resolution plan, ARCs must get RBI permission under the SARFAESI Act of 2002.[46]

Whereas the Association of ARCs in India has requested clarity on the RBI's decision,[47] it has been claimed that the regulator made the decision because the resolution plan violates ARC rules and the SARFAESI Act, 2002.[48]

It is believed to be in violation of the RBI notice titled 'Conversion of debt into equity- Review' issued on November 23, 2017 ("**2017 Notification**").[49] This is a review of January 23, 2014 ("**2014 Notification**") notification on 'Conversion of debt into shares, consent level of security enforcement activities, and authority to purchase debt from other SC/RCs'.[50] The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 are referenced in these notices.

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46 *Supra* note 43, Aircel Dishnet Case at p. 48.

47 Ishita Guha Shayan Ghosh, ARCs seek clarity on why RBI nixed Aircel sale plan, LIVEMINT (June 8, 2022, 7:14 pm), https://www.livemint.com/companies/news/arcs-seek-clarity-on-why-rbi-nixed-aircel-sale-plan-11598460424587.html.

48 RBI rejects resolution plan to sell Aircel's assets to UVARC: Report, MONEY CONTROL (August 2020), https://www.moneycontrol.com/news/business/rbi-rejects-resolution-plan-to-sell-aircels-assets-to-uvarc-report-5758021.html.

49 RBI Notification RBI/2017-18/101 DNBR.PD(ARC)CC. No.04/26.03.001/2017-18, (Nov. 23, 2017), https://pdicai.org/docs/Notification-No.-RBI-2017-18-101_2411201711105434.PDF.

50 RBI Notification RBI/2013-2014/460 DNBS (PD) CC. No. 35/SCRC/26.03.001/2013-2014 on Conversion of debt into shares, consent level of security enforcement actions and permission to acquire debt from other SC/RCs, (Jan. 23, 2014), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=8707&Mode=0.

According to the 2014 Notification, securitization or reconstruction businesses are permitted to acquire up to 26 percent of the post-converted equity of the company under reconstruction (in case of debt conversion to equity).

The 2017 Notification allows for a 26 percent exemption provided the following requirements are met:

- On a continuous basis, the ARC must meet the NOF requirement of 100 crore.
- Independent directors make up at least half of the ARC's Board of Directors;
- The ARC's Board of Directors must approve its debt-to-equity conversion policy, and it may delegate authority to a Committee comprised of a majority of independent directors to make decisions on debt-to-equity conversion proposals;
- The equity shares purchased under the programme will be evaluated and marked to market on a regular basis. At least once a month, valuations must be performed.

In the situation at hand, UVARC will receive a 76 percent stake in Aircel Limited in the first five years after the resolution plan is approved.[51] As a result, the RBI rejected the resolution plan for exceeding the 26% threshold and (presumably) failing to meet the exemption criteria.

The subject of whether or not ARCs can be resolution applicants has been raised. As multiple ARCs are participating in various CIRPs, the legal position must be addressed as quickly as practicable since many ARCs have placed offers for various entities under resolution.

[51]*Supra* note 47.

There is currently no indication that the RBI has issued any explanation for its decision. However, the Economic Times reported on August 31, 2020, that the government may propose revisions to the SARFAESI Act, 2002, allowing ARCs to compete as resolution applicants for bankrupt enterprises.[52]

V. REPORT OF THE COMMITTEE TO REVIEW THE WORKING OF ASSET RECONSTRUCTION COMPANIES, 2021

The RBI Review Committee has suggested a plethora of changes in the framework of asset reconstruction companies. A few of them are discussed in the following section:

A. Changes recommended in the SARFAESI Act

1. *Creating Guidelines on the Sale and Lease of borrower's business.*

The RBI is considering providing guidelines on the sale and lease of borrowers' enterprises by ARCs without taking over management as required under Section 9(1)(b).

2. *Expansion of ambit of Section 5 of SARFAESI Act.*

The goal of Section 5 of the SARFAESI is to allow ARCs to purchase 'financial assets' from regulated institutions designated by the RBI - AIFs, foreign portfolio investors, AMCs making investments on behalf of mutual funds, NBFCs (including HFCs), regardless of asset size, and retail investors – allowing them to aggregate debt of a borrower.

[52]Devina Sengupta, RBI may propose tweaks to SARFAESI Act to bridge regulation gap with IBCs for ARCs, ECONOMIC TIMES (June 8, 2022, 7:24 pm), https://economictimes.indiatimes.com/markets/stocks/news/rbi-may-propose-tweaks-to-sarfaesi-act-to-bridge-regulation-gap-with-ibcs-for-arcs/articleshow/77858087.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

3. *Modification in the definition of secured creditors.*

By changing the definition of "secured creditor," ARCs will be granted enforcement rights under Section 13 of the SARFAESI Act, even if assignors do not.

4. *Modification in Charge Provisions.*

The Indian government is considering a method for automatic charge transfer without the borrower's approval when assets are sold to an ARC. This would demand modifications to the Companies Act, 2013 regulations governing the registration/modification of a charge by a borrower.

B. Changes reflecting confluence with the RBI's Master Directions on Transfer of Loan Exposures

The Report recommends that in the event of a default of INR 100 crore or more, lenders' resolution plans must consider selling or auctioning NPAs to ARCs as one of the possibilities.

Additionally, allowing the selling of fraudulent accounts if proper controls and accountability are in place.

Furthermore, the Secondary Loan Market Association will supply lenders with a detailed checklist of information to submit to ARCs for due diligence and transaction appraisal at the pre-deal stage, with the data room open for 30 days. In any event, any debt transfer via a public auction, such as a Swiss challenge, as specified in the Master Directions, requires this.

Another suggestion was regarding a high level committee. It stated that a high-level committee with the authority to wipe off the loan will make the final decision on the reserve price. Further nitty-gritty regarding the high-level committee has not been ironed out yet and will need further contemplation.

C. Measures for acquisition and asset reconstruction

The first and the most talked-about recommendation is for to allow ARCs to apply for resolution under the IBC either through their SR trust or through an AIF they sponsor.

Furthermore, while asset resolution under the IBC framework is not one of the allowed procedures under SARFAESI, a two-year suspension of proceedings against the borrower is suggested upon acquisition of 66 percent of debt by an ARC, together with payment deferment of government dues. This will give ARCs and borrowers alike much-needed time to devise a revival plan, and the ARC will avoid being subjected to a flurry of court processes during the resolution process, which might hinder the revival process.

Thirdly, in order to guarantee that ARCs are backed by financially robust sponsors, the minimum net value was suggested to be enhanced from INR 100 crore to INR 200 crore.

Additionally, Report recommends that SEBI should extend to ARCs the exemption from the open offer that is now granted to banks and public financial institutions for pledge invocations.

D. Governance of ARCs

The RBI Review Report suggested that in the case that an ARC supports an AIF, half of its board members must be independent directors. Secondly, it suggested that for submitting periodic filings with several authorities like the RBI, MCA, RoC, NeSL, CERSAI, and others, a common data staging platform should be used. This prevents data duplication, data consistency, and information symmetry, which were all envisioned in the 2016 SARFAESI amendments.

E. Analysis and Suggestions

The Committee's proposals are a positive start in strengthening and streamlining India's ARC framework. If approved by the government and regulatory/statutory agencies, these ideas will help to improve the ARCs' position as a vital tool for addressing the NPA problem.

When one considers the recommendations, as well as the rationale and objectives (which include expanding the breadth of their capital base, asset pool, debt resolution routes, and so on), it becomes evident that, in addition to streamlining the framework by incorporating elements of clarity, openness, consistency, and governance, the goal is to guarantee that the ARCs are well equipped to operate in a commercially effective manner in order to fulfil their debt resolution/revival goals.

Strengthening the ARC ecosystem would also provide the IBC ecosystem a much-needed respite, since the IBC has become the preeminent mechanism for stress resolution, resulting in a large backlog of cases and straining institutional capacity.

The authors, based on their analysis, suggests a few more recommendations which could be taken into consideration for further strengthening of ARC framework in India.

F. Establishing a Secondary Market for Resolution of distressed assets.

The Indian distressed asset market now has about US$ 150 billion in potential.[53] However, due to illiquidity in the Indian distressed assets market, investment is still behind. The progress under the IBC has also been uneven, mainly due to a lack of pricing transparency and a slew of expensive litigation that has plagued the process.

[53] Radhika Merwin, Covid impacts sale of distressed assets, BUSINESS LINE (June 8, 2022, 7:26 pm) www.thehindubusinessline.com/news/national/covid-impacts-sale-of-distressed-assets/article32801525.ece.

Therefore, there is a need to offer a liquidity to this market. One way to offer this liquidity is by establishing a secondary market and devising appropriate price discovery mechanisms. ARCs with the vast resources they have can work extremely well on price discovery, if supported with state infrastructure. By laying down the foundations of a promising distressed asset market for the global investors, and strengthening its banking system in the process, a lucrative and efficient way of asset resolution can be opened.

G. Need to address the issues not yet covered in the RBI Review Committee Report

While the Report makes several important recommendations, it fails to address issues such as the sale of ARCs (which is currently covered by an RBI circular), clarity on the requirement for meeting net worth criteria at the time of incorporation, and the ability to buy equity in companies other than its borrowers, to name a few.[54] There is a need to address these issues in order to *firstly*, ensure more clarity in the framework and *secondly*, to ensure the robustness of the market.

VI. CONCLUSION

After a thorough analysis on the research questions, it can be concluded that despite ARCs being an important tool in addressal of the looming issue of NPA and the associated crisis in India, the functioning of ARCs has been dissatisfactory and inadequate. The problems faced by ARCs range from using limited measures for asset reconstruction, issues in business models,

[54] Dhananjay Kumar, Abhishek Mukherjee & Misha Patel, Overhaul of the ARC Framework – Need of the Hour, INDIA CORPORATE LAW, A CYRIL AMARCHAND MANGALDAS BLOG (June 8, 2022, 7:27 pm) https://corporate.cyrilamarchandblogs.com/2021/11/overhaul-of-the-arc-framework-need-of-the-hour/.

transparency and governance issues, etc. These issues are indicative of problems in the regulatory and legal landscape governing ARCs.

In the light of advent of IBC, 2016, its intersection with ARCs has become increasingly relevant. The IBC 2016 was a watershed moment in India's asset resolution infrastructure development. In recent years, the percentage of assets recovered by IBC has increased, whereas the percentage of assets recovered through ARCs has decreased. ARCs, on the other hand, account for around 30% of overall assets recovered through different channels and remain a supplementary asset resolution tool even in the post-IBC environment.

While ARCs are permitted to resolve their financial assets through the IBC process as secured creditors, they are not permitted to act as Resolution Applicants under the IBC due to the present regulatory and legal framework. This has led to blocking of a few resolution plan (Aircel bid by UVARCL) in recent past.

Owing to this sub-optimal performance and increased problems arising out of inadequate regulatory and legal landscape governing ARCs a review Committee was set up by the RBI to detect the challenges in the current ARC framework and offer solutions for the same. The RBI Review Committee has suggested a plethora of changes in the framework of ARCs. This includes the changes suggested in the SARFAESI Act, changes reflecting confluence with the RBI's Master Directions on Transfer of Loan Exposures, suggestions on measures for acquisition and asset reconstruction (including a middle way on allowing ARCs as resolution applicants), as well as suggestions on further improving governance of ARCs.

While the Report includes several important recommendations which are equal parts feasible and effective, it does not address issues such as the sale between ARCs (which is currently covered by an RBI circular), clarity on the requirement for meeting net worth criteria at the time of incorporation, and the ability to purchase equity in companies other than its borrowers, to name a few.

Apart from these recommendations by the RBI Review Committee Report, based on her study, the author makes a few further ideas that should be considered for further enhancing the ARC framework in India. These include establishing a secondary market for resolution of distressed assets such that the illiquidity in this arena is addressed. This will allow India to bank on the untapped opportunity of global investment in the secondary market for resolution of distressed assets. Secondly, the issues left undiscussed by the RBI Review Committee Report shall also be discussed and resolved for strengthening the ARC framework in India.