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MESSAGE

I am extremely proud to announce inaugural edition of the NLIU Journal of Business Laws to the legal and corporate community. The NLIU Journal of Business Laws aims to serve as a forum for promoting discourse on contemporary and pressing legal and commercial concerns at both the national and international level. Through its first Volume, this student helmed publication operating under the aegis of Centre for Business and Commercial Laws (CBCL) has sought to cultivate a style of scholarship that explores both the theoretical and the practical concerns of the legal world. To ensure this, it has consistently employed stringent evaluation techniques with emphasis on contemporaneity, critical thinking, originality and lucidity of prose.

This Volume revolves around various themes related to Business Laws, wherein authors have delved into topics such as whether inclusion of women in the boardroom is a reality or a mirage, aspects of good forum shopping in relation to cross border insolvency, enforceability of non-compete clauses in employment contracts, hostile takeover and related defense mechanisms discussing further L&T-Mindtree saga, innovation being treated as a yardstick in merger control analysis, non-performing assets and the challenges so forth for the Indian banking industry, proper court rule and powers with tribunals to grant interim relief under The Arbitration Act,1996.

I extend my congratulations to Prof. (Dr.) V. Vijayakumar and Prof. (Dr.) Ghayur Alam for a successful publication and commend the student members of CBCL for their work and dedication. May the Editorial Committee maintain the same vigour in the coming years and may the students, academicians, lawyers and judges and all other readers find this publication stimulating and beneficial.

(Ravi Shankar Jha)

MESSAGE FROM THE PATRON

At the outset I would like to appreciate the joint efforts taken by the faculty and students of NLIU, Bhopal, in bringing out this first volume of NLIU Journal of Business Laws. Along with the exponential increase in the trade and business in India, there has been an equally important increase in the statutes, amendments, rules, regulations, notifications and the like that directly or indirectly impact trade and business. Along with these, the judicial decisions and decisions by appropriate Tribunal in India have created a huge legal regime that needs to be constantly reviewed, updated and revised. The publication of this Journal of Business Laws is a small, yet meaningful academic contribution for the legal fraternity in India and abroad.

The Journal is peer-reviewed and has experts in diverse fields on the Board of Advisors and Reviewers who would contribute to the status and contents of this journal. The journal is expected to bring the latest information to the students, researchers and the teachers alike in India. To make this journal accessible, every initiative would be taken to see its presence in all the libraries of National Law Universities and other leading institutions imparting legal education in India. This in turn is expected to prompt scholars to join hands and contribute well-articulated research articles for publication in the later publications of this journal.

As the maiden effort comes to fruition, one can see a wide range of articles included in this volume. From the inclusion of women in the Boardroom to employment contract, hostile takeovers, merger control, cross-border insolvency, proper court rule under the

Arbitration Act, tribunals, non-performing assets and concurrent delay have been critically analyzed and presented by distinguished researchers. I would like to thank them for their contribution to this maiden publication and request them to contribute to this very significant area of trade and business. In the forthcoming publications, I wish that the journal would also feature two or three book reviews to make it a complete Journal of Business Laws.

For any educational institution to prosper and enhance its public perception, the students' activities play a major role. With this publication of NLIU Journal of Business Laws by the students, they have certainly contributed immensely to the public perception of NLIU among the legal fraternity. I would also like to express my sincere appreciation to the students behind this publication along with the faculty advisor, Prof. (Dr.) Ghayur Alam. I am confident that this journal would earn the status and recognition from among the legal fraternity and continue to prosper in the years to come.

PROF. (DR.) V. VIJAYAKUMAR
VICE CHANCELLOR
NATIONAL LAW INSTITUTE UNIVERSITY, BHOPAL, INDIA

MESSAGE FROM THE EDITOR-IN-CHIEF

It is a matter of great satisfaction that we have been successful in our endeavor of launching the Inaugural Issue of the NLIU Journal of Business Laws. The Centre for Business and Commercial (CBCL) has been established with the objective of generating cutting-edge quality research in the area of business laws. This Journal is a means to realize the desired objective.

The main focus of the legal research till 1980s was on public law and the focus on private law was relatively limited. The fundamental changes brought about by politics, economics and technology in the 1990s ushered in disruptive changes in the nature and functions State and law. The State besides being a Police State and Welfare State also acquired the characteristics of Regulatory and Managerial State. This change, inter alia, necessitated the unprecedented changes in law and legal structure. One of the visible changes was creation of regulatory authorities. The other fundamental shift was from strict division of public law and private law to the convergence thereof. Emergence of the big corporations increasingly altered the models of governance from the root. Given these fundamental changes, the reverse happened in the area of legal research and the focus shifted from public law to public-private law. Business and corporate laws including intellectual property rights, cyber law, technology law, public private partnership, competition law, alternative dispute resolution amongst others acquired the centre stage in legal research.

We, at NLIU have been offering courses and doing research on various dimensions of business laws but were not able to bring out a publication. Thanks to the students of NLIU who took the initiative of starting NLIU Journal of Business Laws. Publication of this Inaugural Issue got unduly delayed. The main reason has been the completion of ISSN formalities. Spread of COVID - 19 Pandemic and extended lockdown added to the delay. But it also gave us an opportunity to revise the articles. We are grateful to the students who took pains in getting the formalities of ISSN completed. Mr. Shounak, Mr. Mudit, Mr. Suyash and Mr. Ishaan were at the forefront and deserve our special thanks. My students will forgive me whose names I have missed out. All of them, CBCL Team of 2019-20 and CBCL Team of 2020-21 have been working tirelessly to make this Journal a reality. After all, like any other work, it is a team work and the whole credit for making this Journal a reality goes to the team. Dear Students, Thank you so much.

The articles in this Issue encompass a range of contemporary topics from gender equality in the corporate sector to trends in hostile takeovers and the newly established insolvency regime in India.

The article '*The Insolvency and Bankruptcy Code, 2016 Interpreted-Constructed by the Supreme Court*' seeks to analyze judgments of the Supreme Court of India interpreting-constructing the Insolvency and Bankruptcy Code, 2016. An attempt has been made to find out whether the Court has been merely interpreting the text of the Code or it has also been constructing the meaning of the ambiguous and vague provisions of the Code. Topic is of significance primarily for three related reasons. First, in less than four years of its life the Code has been amended several times - perhaps no other Act has been amended so many times in four years. Second, in such a short time, the Supreme Court of India decided around two hundred cases. Third, holding of some of the decisions of the Supreme Court has been quickly incorporated in the Code by way of amendment. Rarely, the Parliament amends the statute because of the court decision. The legislative and judicial trends show that ease of doing business may be effectively facilitated by coordination between the legislature and executive.

In '*National Guidelines for Responsible Business Conduct and their Importance in remodeling Business Responsibility and Accountability*', Mr Bhumesh Verma, Anoushka Ishwar and Sana Sarosh, examine the reasons behind the introduction of the guidelines for responsible business conduct and analyze its contribution to the current business responsibility and accountability scenario in India. The article analyzes and categorizes each of the principles set forth in the guidelines to quantify its impact on the pre-existing domestic legal framework. It also describes the current and possible impact of the guidelines on the current domestic corporate governance norms as well as India's international obligations concerning the same.

In '*Inclusion of Women in the Boardroom – a Reality or a Mirage?*', Annapurna Sinharay has examined the gender bias that plagues boardrooms across the country. Explaining the relevant provisions of the Companies Act, 2013 relating to the mandatory appointment of at least one woman in the board of directors of certain classes of companies, the author argues that while this move was welcomed by the companies, but is nothing more than a formality. The article advocates the appointment of women as independent directors who can play an active part in the decision-making process of companies.

In '*Defining Contours of Enforceability in Non-Compete Clauses in Employment Contracts*', Purbasha Panda and Shambhavi Srivastava have dealt with emerging issues of non-compete clauses in employment contracts and their enforceability in India. The article discusses the limitations imposed by Section 27 of the Indian Contract Act, 1872 and traces the development of Indian jurisprudence on the subject. In particular, it highlights the grey areas concerning the novel garden leave clauses in employment contracts.

In '*Hostile Takeovers and Defence Mechanisms*', Abhinav Srivastava has examined the various defences that are available to companies victimized by hostile takeovers and their efficacy of preventing such takeovers. The article lays down the commercial practice regarding takeover defences, which are generally employed in foreign jurisdictions and discusses their viability in the Indian context.

In '*Innovation as a Yardstick in Merger Control Analysis: A Study of Agrochemical, Telecommunication and Pharmaceutical Sectors*', Manal Shah and Husna Fayaz have analyzed innovation as a criterion in merger control mechanisms and their incorporation in the laws of the European Union, India and the United States. Further, the article examines case studies to understand the importance of innovation in merger control mechanisms in agricultural, telecommunication and pharmaceutical sectors.

In '*Good Forum Shopping in Cross Border Insolvency: Hampered by Three Month-Look-Back-Period and Gibbs Principle*', Nitesh Jindal and Shiphali Patel have illustrated how debtors and creditors may jointly agree to forum shop to find a jurisdiction that will benefit both parties. It examines whether the three-month-look-back-period included in the draft on cross-border insolvency will negatively impact good forum shopping. Furthermore, it analyses the Gibbs principle and its relevance in the contemporary world, especially in Indian Courts.

In '*The Hot "Seat" Conflict in Indian Domestic Arbitration-Exploring the "Proper Court*" Rule Under S. 2(1)(e) of the Arbitration and Conciliation Act, 1996', Anubhav Khamroi seeks to elucidate the need for certainty and predictability in decision making process of courts. The article highlights possible errors and oversights that might have been made in important judgments in the context of the provisions of the Act and the authority of the BALCO judgment. The article concludes with clarifying the current legal position by using hypothetical scenarios.

In '*Teeth to the Tribunal-Is the Controversy Settled?*', Rajvansh Singh and Atif Ahmed have focused on the debate surrounding tribunals ordering interim relief, by examining the development of relevant provisions under the Arbitration Act, 1940, and the Arbitration and Conciliation Act, 1996. It also elucidates the usage of the term "inefficacious" in the context of tribunal-ordered interim relief by studying the concept of "inefficacious orders" in established jurisdictions around the world.

In '*Non Performing Assets and the Indian Banking Industry, Addressing Challenges to NPA Realization'*, Yash Mittal aims at analyzing the root causes of the NPA issue. It also looks into the challenges that arise in the recovery process. It further goes on to analyze whether new instruments applied to curb this issue are effective and suggests how good corporate governance practices can help ease this problem. The article also highlights the instruments that are already in place to ease the burden in such matters.

In '*Concurrent Delay - A Legal Pandemonium'*, Aakash Laad and Srishti Gupta have analyzed the problem: why concurrent delay in construction contracts has become a legal conundrum and how jurisdictions across the globe have dealt with it. They argue that there is a need to view this problem from a non-conventional approach, as the view from a conventional approach indicates that the problem is a non-issue.

Now it is time to express our gratitude and thanks to our mentors. First of all, we are grateful and thankful to Hon'ble Acting Chief Justice Mr Ravi Shankar Jha, Madhya Pradesh High Court – Patron-in-Chief of this Journal, for his constant encouragement and guidance. We are thankful to our Vice-Chancellor and the Patron, Prof. (Dr.) V. Vijayakumar for his guidance and encouragement. Without his support publication of this Journal would not have been possible. We thank the members of the Board of Advisors for their time and commitment to this Journal. We thank all the contributors to the Issue whose dedication and hard work has made this Issue a possibility.

The members of the Peer Review Board and the student body of the Centre for Business and Commercial Laws (CBCL) deserve a special thanks for successfully accomplishing the job of screening and evaluating the manuscripts submitted to the Journal.

Comments and criticism, without fear or favor, are necessary for meaningful discourse. Meaningful discourse is necessary to produce ideas of social relevance. Hence, we invite comments and criticism on the articles published in this Journal. Kindly feel free to make suggestions and comments for improving the quality of this Journal. We will be publishing the comments and criticism in the next Issue of this Journal.

PROF. (DR.) GHAYUR ALAM
EDITOR-IN-CHIEF
PROFESSOR IN BUSINESS AND IP LAWS
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THE INSOLVENCY AND BANKRUPTCY CODE, 2016 INTERPRETED-CONSTRUCTED BY THE SUPREME COURT OF INDIA

Ghayur Alam[1], Abhinav Pradhan[2] and Sayed Aqa Raza[3]

ABSTRACT

This article seeks to analyze judgments of the Supreme Court of India interpreting-constructing the Insolvency and Bankruptcy Code, 2016. The Insolvency and Bankruptcy Code, 2016 several amendments have been introduced to the Code so far and the law declared by the Supreme Court of India has been swiftly incorporated in the Code by the Parliament. The objective of this article is two-fold: (i) to find out whether the Supreme Court has merely interpreted the text of the Code or it has also constructed the ambiguous and vague provisions of the Code and (ii) to cull out the principles of law from the decisions of the Supreme Court.

This article has been divided into three parts. Part I identify the holdings of the Court which have been incorporated in the

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Authors acknowledge the contribution of Mr. Amit Pratap Singh, Assistant Professor, National Law Institute University, Bhopal for providing a list of Supreme Court judgments.

Insolvency and Bankruptcy Code, 2016 through amendments. Part II analyses the judgments in thirteen broad categories. Part III concludes.

Keywords: Insolvency and Bankruptcy Code, Corporate Insolvency Resolution Process, Resolution Plan, Committee of Creditors, Resolution Professional, Financial Creditors, Corporate Debtor, Liquidation, Non-performing Assets, Winding up.

INTRODUCTION

This article seeks to analyze judgments of the Supreme Court of India ("the Court") interpreting-constructing[4] the Insolvency and Bankruptcy Code, 2016[5] ("the Code"). An attempt has been made to find out whether the Court has been merely interpreting the text of the Code or it has also constructed the meaning of the ambiguous and vague provisions of the Code. Objective of the article is to cull out the principles of law from the decisions of the Court.[6] This study is significant primarily for three related reasons. First, in less than four years of its life the Code has been amended

[4] *See* Lawrence B. Solum, *The Interpretation-Construction Distinction*, 27 CONSTITUTIONAL COMMENTARY 95-118 (2010).
[5] Insolvency and Bankruptcy Code, 2016.
[6] Judgments of the Supreme Court have been taken from <www.judis.nic.in>; names of the Judges constituting the Bench and date of judgment are given in the footnotes so that if required the judgment may be retrieved. Further the name of the Judge who delivered the judgment of the Court is highlighted in bold in the footnotes. Para number and page number are references to para number and page number of the judgment available at <www.judis.nic.in>.

for several[7] times - perhaps no other Act has been amended so many times in such a short span of time. Second, in less than nine months of the Code, the Court delivered first judgment on the Code and in less than four years the Court has delivered around two hundred judgments. Third, the Parliament of India has amended the Code incorporating holdings of judgments of the Court - a rare phenomenon in India and that too happening very quickly.

For the sake of convenience, this article has been divided into three parts. Part I begins by identifying the holdings of the Court which have been incorporated in the Code through amendments. To cull out the principles of law from the judgments, Part II analyses the judgments to find out whether the Court has merely interpreted the text of the Code or it has also constructed the meaning of the ambiguous and vague provisions of the Code. Judgements are broadly divided into thirteen categories, namely: Section 29 of the Code; initiation of corporate insolvency resolution process; Code and Resolution Professional/ Resolution Plan; Code and Financial Creditors; Code and expenses incurred by the resolution plan; Code and National Company Law (Appellate) Tribunal; Trade Union as an Operational Creditor under the Code; Code and the Reserve

[7] The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, Act of Parliament No. 7; The Insolvency and Bankruptcy Code (Amendment) Act, 2017, Act of Parliament No. 8; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018, Act of Parliament No. 8; The Insolvency and Bankruptcy Code (Second Amendment) Act, 2018, Act of Parliament No. 26; The Insolvency and Bankruptcy Code (Amendment) Act, 2019, Act of Parliament No. 26; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019, Act of Parliament No. 16 ; The Insolvency and Bankruptcy Code (Amendment) Act, 2020, Act of Parliament No. 1; The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, Act of Parliament No. 9.

Bank of India; Code and the auction of assets; Code and arbitration proceedings; Code and winding-up petitions; application of the Limitation Act, 1963[8]; and, Code and application of other laws. It is noted that wherever a judgment involves more than one issue, the same has been analyzed under more than one category. Part III concludes.

I. HOLDINGS OF THE SUPREME COURT AND AMENDMENTS TO THE CODE

Law declared by the Supreme Court has been quickly incorporated in the Code by the Parliament by way of amendment in a timely manner.[9] Holdings of the Court which have been incorporated by amendments to the Code are as under:

In *Surendra Trading Company v. Juggilal Kamlapat Jute Mills Company Limited*,[10] the question was whether adherence to the time of seven days prescribed by proviso to sub-section (5) of Section 9 of the Code to remove defects in the application is mandatory or

[8] Indian Limitation Act, 1963.

[9] In this regard, the Finance Minister, Government of India while discussing the Statutory Resolution Disapproving the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2019 and the Insolvency and Bankruptcy Code (Amendment) Bill, 2020 on March 12, 2020 asserted that the amendments are coming consciously due to two reasons: firstly, the Government tries to carry out the verdicts of the Supreme Court in the letter and spirit and secondly, the Government is responding to the requirements of the people outside the industry, leaders, MSMEs, inclusive and their needs. <http://164.100.47.7/newdebate/251/12032020/Fullday.pdf> accessed June 06, 2020.

[10] A. K. Sikri and Ashok Bhushan, *JJ.* 19-09-2017.

directory.[11] The National Company Law Appellate Tribunal ("NCLAT") had declared the said proviso as mandatory. The Court reversing the judgment of NCLAT, in part, declared the said proviso as directory[12] and reasoned that the logic of judgments cited by NCLAT, as to the period within which adjudicating authority has to pass the order is only directory and not mandatory in nature, would apply while interpreting proviso to sub-section (5) of Section 7, Section 9 or sub-section (4) of Section 10 as well[13] for applicant does not gain anything by not removing the objections inasmuch as till the objections are removed, such an application would not be entertained.[14] The Court interpreted-constructed the provisions of Code. To avoid delays in admission of applications, in sub-section (4) of Section 7 of the Code a proviso was inserted through the Insolvency and Bankruptcy Code (Amendment) Act, 2019. By virtue of this proviso, the Adjudicatory Authority shall record the reasons in writing, where an application for admission is not disposed of within the stipulated time.[15]

In *Arcelormittal India Private Limited v. Satish Kumar Gupta*,[16] the question was whether resolution applicants were eligible to submit

[11] *Ibid*, ¶7 at 7.
[12] *Ibid.*, ¶24 at 28-29.
[13] *Ibid.*, ¶23 at 28.
[14] *Ibid.*
[15] The following proviso was inserted in sub-section (4) of Section 7 of the Bankruptcy and Insolvency Code, 2016 by the Insolvency and Bankruptcy Code (Amendment) Act, 2019:

> Provided that if the Adjudicating Authority has not ascertained the existence of default and passed an order under sub-section (5) within such time, it shall record its reasons in writing for the same.

[16] Rohinton Fali Nariman and Indu Malhotra, *JJ.* 04-10-2018.

resolution plans after the insertion of Section 29A in the Code. The Court answered the question in negative and held that both sets of resolution plans that were submitted to the Resolution Professional even on April 02, 2018, are hit by Section 29A(c) and since the proviso to Section 29A(c) will not apply as the Corporate Debtors related to ArcelorMittal India Private Limited and Numetal have not paid off their respective non-performing asset ("NPAs"), hence, both resolution applicants were held to be ineligible under Section 29A(c).[17] A request was made before the Court on behalf of the Committee of Creditors ("CoCs"), to give one more opportunity to the parties to pay off their corporate debtors' respective debts in accordance with Section 29A as the best resolution plan can then be selected by the requisite majority of the CoCs so that all dues could be cleared as soon as possible. Invoking Article 142 of the Constitution of India ("the Constitution") as the law on Section 29A has been laid down for the first time by this judgment, the Court gave one more opportunity to both resolution applicants to pay off NPAs of their related corporate debtors within a period of two weeks from the date of receiving the copy of judgment in accordance with the proviso to Section 29A(c).[18] The Court further observed that if such payments are made within the aforesaid period, both resolution applicants can resubmit their resolution plans to the CoCs within a period of eight weeks from the date of the judgment to accept by the requisite majority, the best amongst the plans submitted, including the resolution plan submitted by Vedanta. The Court made it clear that in the event that no plan is

[17] *Ibid.*,¶113 at 153.
[18] *Ibid.* at 153-154.

found worthy of acceptance by the requisite majority of the CoCs, the corporate debtor, *i.e.* Essar Steel India Limited, shall go into liquidation.[19] The Court interpreted-constructed the Code, and observed that many corporate insolvency resolution processes were not completed within the stipulated time provided under Section 12.[20] To overcome this issue, of Section 12 (3), provisos were inserted by the Insolvency and Bankruptcy Code (Amendment) Act, 2019 requiring that the corporate insolvency resolution processes shall mandatorily be completed within three hundred thirty days.[21]

In *Swiss Ribbons Pvt. Ltd. v. Union of India*,[22] the question was whether Sections 29A(j), 12A[23] and 53[24] of the Code is constitutionally valid or not. It was argued that the members of the National Company

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[19] *Ibid.*, ¶113 at 153-154.

[20] *Ibid.*, ¶54 and 113 at 81-82 and 153-154.

[21] The following provisos were inserted in sub-section (3) of Section 12 of the Bankruptcy and Insolvency Code, 2016 by the Insolvency and Bankruptcy Code (Amendment) Act, 2019:

> Provided further that the corporate insolvency resolution process shall mandatorily be completed within a period of three hundred and thirty days from the insolvency commencement date, including any extension of the period of corporate insolvency resolution process granted under this section and the time taken in legal proceedings in relation to such resolution process of the corporate debtor:
>
> Provided also that where the insolvency resolution process of a corporate debtor is pending and has not been completed within the period referred to in the second proviso, such resolution process shall be completed within a period of ninety days from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019.

[22] Rohinton Fali Nariman and Navin Sinha, *JJ*. 25-01-2019.

[23] *Ibid.*, ¶53 at 101-102.

[24] *Ibid.*, ¶84 at 147-148.

Law Tribunal ("the NCLT") and certain members of the NCLAT, apart from the President, have been appointed contrary to the decisions of the Court. The Court upholding the constitutional validity of these provisions[25] observed that the rights of operational creditors are fairly incorporated under the Code. The Court interpreted-constructed the provisions of the Code and also directed the Union of India to set up Circuit Benches of the NCLAT within a period of 6 months from the date of the judgment[26] and referring to decision of Constitution Bench of the Court, eight years ago from the date of this judgment, in *Union of India v. R. Gandhi, President, Madras Bar Association,*[27] directed the Union of India to follow, the judgment both in letter and spirit.[28] To ensure fair and equitable distribution to operational creditors, Clause (b) of sub-section (2) of Section 30 of the Code was amended by the Insolvency and Bankruptcy Code (Amendment) Act, 2019.[29]

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[25] *Ibid.*

[26] *Ibid*., ¶16 at 43.

[27] (2010) 11 SCC 1, ¶120(xii).

[28] *Swiss Ribbons* (n 19) para 19 at 45.

[29] The following provisions were substituted in Clause (b) of sub-section (2) of Section 30 of the Insolvency and Bankruptcy Code, 2016 by the Insolvency and Bankruptcy Code (Amendment) Act, 2019:

Section 30. Submission of resolution plan—

(2) The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan –

(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than-

(i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under section 53; or

In *Pioneer Urban Land and Infrastructure Limited v. Union of India*,[30] the question was whether the amendments to the Code introduced through the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018 *(*the Amendment Act of 2018) are constitutionally valid or not. The Court upholding the constitutional validity of Explanation to Section 5(8)(f), Section 21(6A)(b) and Section 25A[31] declared that allottees/home buyers were included in Section 5(8)(f) with effect from the inception of the Code and any one of the allottees has the power to invoke the resolution

(ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of section 53,

whichever is higher, and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of section 53 in the event of a liquidation of the corporate debtor.

Explanation 1. — For removal of doubts, it is hereby clarified that a distribution in accordance with the provisions of this clause shall be fair and equitable to such creditors.

Explanation 2. — For the purpose of this clause, it is hereby declared that on and from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019, the provisions of this clause shall also apply to the corporate insolvency resolution process of a corporate debtor-

(i) where a resolution plan has not been approved or rejected by the Adjudicating Authority;

(ii) where an appeal has been preferred under section 61 or section 62 or such an appeal is not time barred under any provision of law for the time being in force; or

(iii) where a legal proceeding has been initiated in any court against the decision of the Adjudicating Authority in respect of a resolution plan.

30 Rohinton Fali Nariman, Sanjiv Khanna and Surya Kant, *JJ*. 09-08-2019.

31 *Ibid*., ¶86 at 183-184.

process.[32] Explanation added to Section 5(8)(f) of the Code by the Amendment Act of 2018 does not in fact enlarge the scope of the original Section as home buyers/allottees would be subsumed within Section 5(8)(f) as it originally stood[33] as the same is merely clarificatory in nature.[34] The Court concluded that the Amendment Act of 2018 does not violate Articles 14, 19(1)(g) read with Article 19(6) or 300A of the Constitution.[35] The Real Estate (Regulation and Development) Act, 2016[36] ("the RERA") is to be read harmoniously with the Code, as amended by the Amendment Act of 2018. It is only in the event of conflict that the Code will prevail over the RERA. Remedies that are given to allottees of flats/apartments are therefore concurrent remedies, such allottees of flats/apartments being in a position to avail of remedies under the Consumer Protection Act, 1986,[37] RERA as well under the Code.[38] Section 5(8)(f) as it originally appeared in the Code being a residuary provision, always subsumed within it allottees of flats/apartments. The explanation together with the deeming fiction added by the Amendment Act is only clarificatory of this position in law.[39] The Court interpreted-constructed the provisions of the Code. Holding of this judgment was incorporated through the Insolvency and Bankruptcy Code (Amendment) Act, 2019; and in sub-section (1) of Section 7 of the Code provisos were inserted, by

[32] *Ibid.*
[33] *Ibid.*, ¶85 at 183.
[34] *Supra* note 28 at 183.
[35] ¶86(i) at 184.
[36] Act 16 of 2016.
[37] Act 68 of 1986.
[38] *Pioneer Urban Land* (n 27) ¶86(ii) at 184.
[39] *Ibid.*, ¶86(iii) at 184.

virtue of which one hundred of creditors in the same class or not less than ten per cent of the total number of such creditor in the same class were made entitled to act as financial creditors.[40]

Two things become very clear from the above analysis. One, in all the judgments the Court not only interpreted the provisions of the Code but also constructed them wherever there was any gap, ambiguity or vagueness. Two, the Parliament was quick to incorporate the holdings of the judgments into the Code. The following Part seeks to analyze the judgments to cull out the principles of law declared by the Court.

II. PRINCIPLES OF INSOLVENCY AND BANKRUPTCY LAW DECLARED BY THE SUPREME COURT

This Part seeks to analyze the judgments to cull out the principles of insolvency and bankruptcy law declared by the Court. We begin by providing a quantitative analysis of judgments and then will move on the qualitative analysis thereof.

In a period of around four years, from the date of coming into effect of the Code to May 2020, the Court has delivered one

[40] The following provisos were inserted in sub-section (1) of Section 7 of the Code by the Insolvency and Bankruptcy Code (Amendment) Act, 2019:

> . . .
> Provided further that for financial creditors who are allottees under a real estate project, an application for initiating corporate insolvency resolution process against the corporate debtor shall be filed jointly by not less than one hundred of such allottees under the same real estate project or not less than ten per cent. of the total number of such allottees under the same real estate project, whichever is less:

hundred and ninety-five judgments and orders in matters relating to the Code. Out of the total one-hundred and ninety-five judgments nineteen judgments were delivered in the year 2017, seventy-four judgments in the year 2018, ninety judgments in the year 2019, and twelve judgments in the year 2020. Out of which one-hundred and eighty-two judgments were delivered by the Division Bench and thirteen judgments were delivered by the Full Bench. So far, no Constitution Bench has been constituted in any matter. First judgment was *Bank of New York Mellon London Branch v. Zenith Infotech Limited*[41] and the latest case one is *In Re: Cognizance for Extension of Limitation*.[42] It is noteworthy that no dissenting opinion has been given in any judgement. Maximum number of judgments were authored by Rohinton Fali Nariman, *J*. Following seeks to provide a qualitative analysis of judgments under thirteen categories.

A. SECTION 29 OF THE CODE

In *Swiss Ribbons Pvt. Ltd. v. Union of India*,[43] it was argued that that the members of the NCLT and certain members of the NCLAT apart from the President have been appointed contrary to the earlier decisions of the Court. The question was whether Section 29A(j) and Section 53 of the Code are constitutionally valid or not. Constitutional validity of Section 29A(j) read with the definition of "related party" was challenged on the ground that the mere fact that somebody happens to be a relative of an ineligible person cannot be good enough to oust such person from becoming a resolution

[41] Ranjan Gogoi and Abhay Manohar Sapre, *JJ*. 21-02-2017.
[42] S. A. Bobde, *C.J.I.*, Deepak Gupta and Hrishikesh Roy, *JJ*. 06-05-2020.
[43] *Supra* note 19.

applicant, if he is otherwise qualified. The Court held that the category of 'connected person' is not indeterminate and observed as under:

[P]ersons who act jointly or in concert with others are connected with the business activity of the resolution applicant. Similarly, all the categories of persons mentioned in Section 5(24A) show that such persons must be "connected" with the resolution applicant within the meaning of Section 29A(j). This being the case, the said categories of persons who are collectively mentioned under the caption "relative" obviously need to have a connection with the business activity of the resolution applicant. In the absence of showing that such person is "connected" with the business of the activity of the resolution applicant, such person cannot possibly be disqualified under Section 29A(j). All the categories in Section 29A(j) deal with persons, natural as well as artificial, who are connected with the business activity of the resolution applicant. The expression "related party", therefore, and "relative" contained in the definition Sections must be read *noscitur a sociis* with the categories of persons mentioned in Explanation I, and so read, would include only persons who are connected with the business activity of the resolution applicant.[44]

The Court rejected the contention that expression "connected person" in Explanation I, clause (ii) to Section 29A(j) cannot possibly refer to a person who may be in management or control of the business of the corporate debtor in future and observed as under:

[44] ***Ibid.***, ¶75 at 138-139.

This would be arbitrary as the explanation would then apply to an indeterminate person. This contention also needs to be repelled as Explanation I seeks to make it clear that if a person is otherwise covered as a "connected person", this provision would also cover a person who is in management or control of the business of the corporate debtor during the implementation of a resolution plan. Therefore, any such person is not indeterminate at all, but is a person who is in the saddle of the business of the corporate debtor either at an anterior point of time or even during implementation of the resolution plan. This disposes of all the contentions raising questions as to the constitutional validity of Section 29A(j).[45]

As to the retrospective application of Section 29A, the Court observed as under:

It is settled law that a statute is not retrospective merely because it affects existing rights; nor is it retrospective merely because a part of the requisites for its action is drawn from a time antecedent to its passing.[46]

. . . .

[I]t is clear that no vested right is taken away by application of Section 29A[47]. . . a resolution applicant who applies under Section 29A(c) has no vested right to apply for being considered as a resolution applicant.[48]

45 *Ibid.*, ¶76 at 139-140.
46 *Ibid.*, ¶64 at 119.
47 *Ibid.*, ¶65 at 120.
48 *Ibid.* 121.

As to the nature of Section 29A(c) that it treats unequals as equals, the Court held as under:

[V]arious clauses of Section 29A would show that a person need not be a criminal in order to be kept out of the resolution process. For example, under Section 29A(a), it is clear that a person may be an undischarged insolvent for no fault of his. Equally, under Section 29A(e), a person may be disqualified to act as a director under the Companies Act, 2013,[49] say, where he has not furnished the necessary financial statements on time.[50]

As to the period in Section 29(c) relating to NPAs, the Court observed as under:

What is important to bear in mind is also the fact that, prior to this one-year-three-month period, banks and financial institutions do not declare the accounts of corporate debtors to be NPAs. As a matter of practice, they first try and resolve disputes with the corporate debtor, after which, the corporate debtor's account is declared NPA. As a matter of legislative policy therefore, quite apart from malfeasance, if a person is unable to repay a loan taken, in whole or in part, within this period of one year and three months (which, in any case, is after an earlier period where the corporate debtor and its financial creditors sit together to resolve defaults that continue), it is stated to be ineligible to become a resolution applicant. The reason is not far to see. A person who cannot service a debt for the aforesaid period is obviously a person who is ailing

[49] *See* Section 164(2)(a) of the Companies Act, 2013.
[50] *Swiss Ribbons* (n 19) ¶67 at 122.

itself. The saying of Jesus comes to mind *"if the blind lead the blind, both shall fall into the ditch"*. The legislative policy, therefore, is that a person who is unable to service its own debt beyond the grace period referred to above, is unfit to be eligible to become a resolution applicant. This policy cannot be found fault with. Neither can the period of one year be found fault with, as this is a policy matter decided by the Reserve Bank of India and which emerges from its Master Circular, as during this period, an NPA is classified as a substandard asset. The ineligibility attaches only after this one-year period is over as the NPA now gets classified as a doubtful asset.[51]

As to the exemption of micro, small, and medium enterprises from Section 29A, the Court observed as under:

[T]he rationale for excluding such industries from the eligibility criteria laid down in Section 29A(c) and 29A(h) is because *qua* such industries, other resolution applicants may not be forthcoming, which then will inevitably lead not to resolution, but to liquidation.[52]

It can thus be seen that when the Code has worked hardship to a class of enterprises, the Committee constituted by the Government, in overseeing the working of the Code, has been alive to such problems, and the Government in turn has followed the recommendations of the Committee in enacting Section 240A. This is an important instance of how the executive continues to monitor the application of the Code, and exempts a class of enterprises from

[51] *Ibid.*, ¶71 at 128-29. *See generally,* ¶70-72 at 124-130.
[52] *Ibid.*, ¶80 at 142.

the application of some of its provisions in deserving cases. This and other amendments that are repeatedly being made to the Code, and to subordinate legislation made thereunder, based upon Committee Reports which are looking into the working of the Code, would also show that the legislature is alive to serious anomalies that arise in the working of the Code and steps in to rectify them.[53]

The Petitioner argued that in the event of liquidation, operational creditors will never get anything as they rank below all other creditors, including other unsecured creditors who happen to be financial creditors. On this ground, it was further argued that Section 53 and in particular Section 53(1)(f) is discriminatory and arbitrary and thus, violates Article 14 of the Constitution. The Court upheld the constitutional validity of Section 53 and observed that there is an *intelligible differentia* for differentiating between secured financial debts and unsecured operational debts. The Court elaborated the rationale as under:

It will be seen that the reason for differentiating between financial debts, which are secured, and operational debts, which are unsecured, is in the relative importance of the two types of debts when it comes to the object sought to be achieved by the Insolvency Code. We have already seen that repayment of financial debts infuses capital into the economy inasmuch as banks and financial institutions are able, with the money that has been paid back, to further lend such money to other entrepreneurs for their businesses. This rationale creates an intelligible differentia between

[53] *Ibid.*, ¶81 at 144.

financial debts and operational debts, which are unsecured, which is directly related to the object sought to be achieved by the Code. In any case, workmen's dues, which are also unsecured debts, have traditionally been placed above most other debts. Thus, it can be seen that unsecured debts are of various kinds, and so long as there is some legitimate interest sought to be protected, having relation to the object sought to be achieved by the statute in question, Article 14 does not get infracted. For these reasons, the challenge to Section 53 must also fail.[54]

In this case, the Court interpreted-constructed the Code and upheld the constitutional validity of Section 29A(j) and Section 53 of the Code.[55] Further, the Court held that an applicant under Section 29A(c) has no vested right to apply for being considered as a resolution applicant and directed the Union of India (Respondent) to set up Circuit Benches of the NCLAT within a period of six months from the date of the judgment.[56]

In *Chitra Sharma v. Union of India,*[57] the home buyers invested in residential projects proposed by Jaypee Infratech Limited ("JIL") and Jayprakash Associates Limited ("JAL"). IDBI Bank Limited sought the initiation of a Corporate Insolvency Resolution Process ("CIRP") against JIL. Resolution plan submitted by JAL was rejected and the Court held that they shall not be eligible to participate in the CIRP by virtue of Section 29A. The question was

[54] *Ibid.*, ¶84 at 147-148.
[55] *Ibid.*
[56] *See,* n 19, ¶16 at 43.
[57] Deepak Misra, A. M. Khanwilkar and Dr. D. Y. Chandrachud, *JJ.* 08-08-2018.

whether the Reserve Bank of India ("the RBI") may be allowed to direct banks to initiate CIRP against JAL. The Court observed as under:

Parliament has introduced Section 29A into the Code with a specific purpose. The provisions of Section 29A are intended to ensure that among others, persons responsible for insolvency of the corporate debtor do not participate in the resolution process. . . Parliament was evidently concerned over the fact that persons whose misconduct has contributed to defaults on the part of bidder companies misuse the absence of a bar on their participation in the resolution process to gain an entry. Parliament was of the view that to allow such persons to participate in the resolution process would undermine the salutary object and purpose of the Act. It was in this background that Section 29A has now specified a list of persons who are not eligible to be resolution applicants.[58]

Section 29A has been enacted in the larger public interest and to facilitate effective corporate governance. Parliament rectified a loophole in the Act which allowed a back-door entry to erstwhile managements in the CIRP. Section 30 of the Code, as amended, also clarifies that a resolution plan of a person who is ineligible under Section 29A will not be considered by the CoCs.[59]

The bar under Section 29A would preclude JAL/JIL from being allowed to participate in the resolution process. Moreover, the facts which have been drawn to the attention of the Court leave no

[58] *Ibid.*, ¶31 at 29-30.
[59] *Ibid.*, ¶32 at 31.

manner of doubt that JAL/JIL lack the financial capacity and resources to complete the unfinished projects. To allow them to participate in the process of resolution will render the provisions of the Act nugatory. This cannot be permitted by the Court.[60]

The apprehension of the home-buyers in regard to their financial incapacity is borne out by RBI, as a responsible institution has urged before the Court. The Code has been enacted in the form of a comprehensive bankruptcy law and with a specific legislative intent. With the amendment brought about by the Ordinance promulgated in June 2018, the interests of the home buyers have been sought to be safeguarded. Accordingly, we accede to the request made on behalf of the RBI to allow it to follow the recommendations of the Internal Advisory Committee to initiate a CIRP against JAL under the Code.[61]

. . . .

RBI is allowed, in terms of its application to this Court to direct the banks to initiate corporate insolvency resolution proceedings against JAL under the IBC.[62]

In this case, the Court interpreted the provisions of the Code and allowed RBI to initiate CIRP against JAL under the Code. The Court also observed that Section 29A has been enacted in the larger public interest and to facilitate effective corporate governance and reiterated that Section 30, as amended, clarifies that a resolution

[60] *Ibid.*, ¶35 at 35.
[61] *Ibid.*, ¶41 at 44.
[62] *Ibid.*, ¶42(v) at 45.

plan of a person who is ineligible under Section 29A will not be considered by the CoCs. Further, exercising the power under Article 142 of the Constitution, the Court directed that the initial period of 180 days for the conclusion of the CIRP in respect of JIL shall commence from the date of judgment. If it becomes necessary to apply for a further extension of 90 days, the Court permitted the NCLT to pass appropriate orders in accordance with the provisions of the Code.[63] The question whether the home buyers are secured creditors or not was left open[64] by the Court.

In *Arcelormittal India Private Limited v. Satish Kumar Gupta*,[65] the financial creditors filed a petition under the Code for financial debts owed to them by the corporate debtor Essar Steel India Limited. NCLT passed an order under Section 7 of the Code at the behest of financial creditors. Respondent was appointed as Interim Resolution Professional. Question before the Court was whether resolution applicants were eligible to submit resolution plans after the insertion of Section 29A into the Code. The Court observed as under:

Under sub-clause (2) of clause (q), a deeming fiction is enacted, by which a presumption is raised in the categories mentioned, that a person falling within one category is deemed to be acting in concert with another person mentioned in the same category, unless the contrary is established. The corporate veil is not merely torn but is left in tatters by sub-clauses (i) to (iv) of Regulation 2(1) (q)(2). What is also important to note is that "immediate relatives" are also

[63] *Ibid.*, ¶42(i) at 44-45.
[64] *Ibid.*, ¶40 at 41.
[65] *Supra* note 13.

covered by sub-clause (v) – *i.e.,* father and son, brothers, etc. Also, of importance is the definition of "associate" in the explanation to Regulation 2(1)(q)(2), which subsumes not merely immediate relatives but other forms in which a person can be associated with another - which includes the form of trust, partnership firm and HUF. What is of great importance is that wherever persons act jointly or in concert with the "person" who submits a resolution plan, all such persons are covered by Section 29A. It is interesting to note that the report of the Insolvency Law Committee of March, 2018, wanted to curtail the wide definition of persons acting jointly or in concert.[66]

. . . .

[T]he opening words of Section 29A furnish a clue as to the time at which sub-clause (c) is to operate. The opening words of Section 29A state: *"a person shall not be eligible to submit a resolution plan…"*. It is clear therefore that the stage of ineligibility attaches when the resolution plan is submitted by a resolution applicant.[67]

. . . .

[T]he expression "control", in Section 29A(c), denotes only positive control, which means that the mere power to block special resolutions of a company cannot amount to control. "Control" here, as contrasted with "management", means *de facto* control of

[66] *Ibid.*, ¶39 at 86.
[67] *Ibid.*, ¶43 at 73.

actual management or policy decisions that can be or are in fact taken.[68]

. . . .

Section 29A(c) speaks of a corporate debtor *"under the management or control of such person"*. The expression "under" would seem to suggest positive or proactive control, as opposed to mere negative or reactive control. This becomes even clearer when sub-clause (g) of Section 29A is read, wherein the expression used is "in the management or control of a corporate debtor". Under sub-clause (g), only a person who is in proactive or positive control of a corporate debtor can take the proactive decisions mentioned in sub-clause (g), such as, entering into preferential, undervalued, extortionate credit, or fraudulent transactions. It is thus clear that in the expression "management or control", the two words take colour from each other, in which case the principle of *noscitur a sociis* must also be held to apply. Thus viewed, what is referred to in sub-clauses (c) and (g) is de jure or *de facto* proactive or positive control, and not mere negative control which may flow from an expansive reading of the definition of the word "control" contained in Section 2(27) of the Companies Act, 2013, which is inclusive and not exhaustive in nature.[69]

. . . .

The interpretation of Section 29A(c) now becomes clear. Any person who wishes to submit a resolution plan, if he or it does so

[68] *Ibid.*, ¶48 at 76.
[69] *Ibid.*, ¶50 at 78-79.

acting jointly, or in concert with other persons, which person or other persons happen to either manage or control or be promoters of a corporate debtor, who is classified as a non-performing asset and whose debts have not been paid off for a period of at least one year before commencement of the CIRP, becomes ineligible to submit a resolution plan. This provision therefore ensures that if a person wishes to submit a resolution plan, and if such person or any person acting jointly or any person in concert with such person, happens to either manage, control, or be promoter of a corporate debtor declared as a non-performing asset one year before the CIRP begins, is ineligible to submit a resolution plan. The first proviso to sub-clause (c) makes it clear that the ineligibility can only be removed if the person submitting a resolution plan makes payment of all overdue amounts with interest thereon and charges relating to the non-performing asset in question before submission of a resolution plan. The position in law is thus clear. Any person who wishes to submit a resolution plan acting jointly or in concert with other persons, any of whom may either manage, control or be a promoter of a corporate debtor classified as a non-performing asset in the period . . . must first pay off the debt of the said corporate debtor classified as a non-performing asset in order to become eligible under Section 29A(c).[70]

. . . .

Since Section 29A(c) is a see-through provision, great care must be taken to ensure that persons who are in charge of the corporate debtor for whom such resolution plan is made, do not come back in

[70] *Ibid.*, ¶54 at 81-82.

some other form to regain control of the company without first paying off its debts. The Code has bifurcated such persons into two groups, as a perusal of sub-clauses (c) and (g) of Section 29A shows. If a person has been a promoter, or in the management, or control, of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place, and in respect of which an order has been made by the Adjudicating Authority under the Code, such person is ineligible to present a resolution plan under Section 29A(g). This ineligibility cannot be cured by paying off the debts of the corporate debtor. Therefore, it is only such persons who do not fall foul of sub-clause (g), who are eligible to submit resolution plans under sub-clause (c) of Section 29A, if they happen to be persons who were in the erstwhile management or control of the corporate debtor.[71]

. . . .

In the light of this object, Section 29A(i) will have to be read as a disability which corresponds to Section 29A(f) in view of the antecedent conduct on the part of the person applying as a resolution applicant in a jurisdiction outside India.[72]

. . . .

[I]t is clear that both sets of resolution plans that were submitted to the Resolution Professional, even on April 02, 2018, are hit by Section 29A(c), and since the proviso to Section 29A(c) will not

[71] *Ibid.*, ¶56 at 84-85.
[72] *Ibid.*, ¶102 at 142.

apply as the corporate debtors related to AMIPL and Numetal have not paid off their respective NPAs.[73]

In this case, the Court interpreted-constructed the provisions of the Code and declared the law of eligibility of resolution applicants under Section 29A(c) and held that the proviso to Section 29A(c) will not apply as the corporate debtors who have not paid off their respective NPAs.

B. INITIATION OF CORPORATE INSOLVENCY RESOLUTION PROCESS

In *Reliance Communications Limited v. State Bank of India*,[74] operational creditor company raised invoices from time to time in consideration of services provided to Appellant and on receiving no payment filed applications under Section 9 of the Code. Before NCLAT Appellant submitted that the matter had been agreed to be settled between the operational creditor and the Appellant. After Appellant failed to pay the agreed amount, a contempt petition was moved by the operational creditor. The question was whether failure of Appellant to pay agreed amount in pursuance to the Orders of NCLAT and Supreme Court amounts to the contempt of the Court. The Court answered the question in affirmative and observed that the contempt of the Court needs to be purged by payment of the agreed total sum with interest by the Appellant.[75] The Court interpreting the provisions of the Code ordered that in default of such payment, the Chairmen who has given undertakings to this

[73] *Ibid.*, ¶113 at 153.
[74] Rohinton Fali Nariman and Vineet Saran, *JJ.* 20-02-2019.
[75] *Ibid.*, ¶24 at 40.

Court will suffer three months imprisonment. In addition to the sum being paid, a fine amounting to INR 1 crore for each Company must also be paid to the Registry of this Court within four weeks from the date of the judgment which will be paid over to the Supreme Court Legal Services Committee. In default of payment of such fine, the Chairmen of these Companies will suffer one-month imprisonment.

In *Duncans Industries Ltd. v. A. J. Agrochem*,[76] Appellant was a corporate debtor company which owns tea gardens, but the Central Government in exercise of its power under Section 16E of the Tea Act, 1953 ("the Tea Act")[77] has taken over the control of certain tea gardens of Appellant. Respondent was an operational creditor of the Appellant and to recover the due payment, Respondent initiated the proceedings against the Appellant before NCLT under Section 9 of the Code. Appellant argued that once the management of tea unit has been taken over by the Central Government, then the proceedings for winding up or appointment of receiver cannot be initiated without the consent of the Central Government. The question was whether the Respondent's application under Section 9 of the Code would be maintainable even without the consent of the Central Government in terms of Section 16G of the Tea Act. The Court answered the question in affirmative and observed as under:

On a fair reading of Section 16G of the Tea Act. . .that Section 16G of the Tea Act shall be applicable only in a case where the actual management of a tea undertaking or tea unit owned by a company

[76] Arun Mishra, M. R. Shah and B. R. Gavai, *JJ.* 04-10-2019.
[77] The Tea Act, 1953.

has been taken over by any person or body of persons authorised by the Central Government under the Tea Act. Therefore, taking over the actual management and control by the Central Government or by any person or body of persons authorised by the Central Government is *sine qua non* before Section 16G of the Tea Act is made applicable. Therefore, in the facts and circumstances of the case, Section 16G(1)(c) shall not be applicable at all, as the appellant-corporate debtor is continued to be in management and control of the tea units/gardens.[78]

. . . .

Section 16G(1)(c) refers to the proceeding for winding up of such company or for the appointment of receiver in respect thereof. Therefore, as such, the proceedings under Section 9 of the Code shall not be limited and/or restricted to winding up and/or appointment of receiver only. The winding up/liquidation of the company shall be the last resort and only on an eventuality when the corporate insolvency resolution process fails. . . [T]he primary focus of the legislation while enacting the Code is to ensure revival and continuation of the corporate debtor by protecting the corporate debtor from its own management and from a corporate debt by liquidation and such CIRP is to be completed in a time bound manner. Therefore, the entire "CIRP" as such cannot be equated with "winding up proceedings". Therefore, considering Section 238 of the Code, which is a subsequent Act to the Tea Act, 1953, shall be applicable and the provisions of the Code shall have an overriding effect over the Tea Act, 1953 and that no prior

[78] *Duncans Industries* (n 73) ¶7.1 at 17-18.

consent of the Central Government before initiation of the proceedings under Section 7 or Section 9 of the Code would be required and even without such consent of the Central Government, the insolvency proceedings under Section 7 or Section 9 of the Code initiated by the operational creditor shall be maintainable.[79]

In this case, the Court interpreted the provisions of the Code and held that the entire CIRP as such cannot be equated with winding up proceedings and the provisions of the Code shall have overriding effect over the Tea Act, 1953. The Court further ordered that the Order passed by the NCLAT holding that insolvency petition under Section 9 initiated by the respondent- operation creditor shall be maintainable.[80]

In *Maharashtra Seamless Limited v. Padmanabhan Venkatesh,*[81] Appellant was successful Resolution Applicant in a CIRP and the Respondent was the promoter of the corporate debtor. The NCLT, Hyderabad Bench approved the resolution plan submitted by Appellant in an application filed by the Resolution Professional. On appeal NCLAT reassessed the resolution plan approved by the CoCs. The question was whether the NCLAT could reassess the approved resolution plan even if the same otherwise complies with the requirement of Section 31. The Court answered the question in negative and observed as under:

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[79] *Ibid.*, ¶7.4 at 24-25.
[80] *Ibid.*, ¶8 at 25.
[81] Rohinton Fali Nariman, Aniruddha Bose and V. Ramasubramanian, *JJ.* 22-01-2020.

[T]he object behind prescribing such valuation process is to assist the CoCs to take decision on a resolution plan properly. Once a resolution plan is approved by the CoCs, the statutory mandate on the Adjudicating Authority under Section 31(1) of the Code is to ascertain that a resolution plan meets the requirement of sub-sections (2) and (4) of Section 30 thereof.[82]

. . . .

The Appellate Authority has proceeded on equitable perception rather than commercial wisdom. On the face of it, release of assets at a value 20% below its liquidation value arrived at by the valuers seems inequitable. Here, we feel the Court ought to cede ground to the commercial wisdom of the creditors rather than assess the resolution plan on the basis of quantitative analysis. Such is the scheme of the Code. Section 31(1) lays down in clear terms that for final approval of a resolution plan, the Adjudicating Authority has to be satisfied that the requirement of sub-section (2) of Section 30 has been complied with. The proviso to Section 31(1) stipulates the other point on which an Adjudicating Authority has to be satisfied. That factor is that the resolution plan has provisions for its implementation. The scope of interference by the Adjudicating Authority is limited judicial review . . .[83]

The Court in this case, interpreted the Code and held that once a resolution plan is approved by the CoCs, statutory mandate on the Adjudicating Authority under Section 31(1) is to ascertain that a

[82] *Ibid.*, ¶27 at 34.
[83] *Ibid.*, ¶28 at 35.

resolution plan meets the requirement of sub-sections (2) and (4) of Section 30. Accordingly, the Court set aside the order of the NCLAT and affirmed the Order of the NCLT and directed the Resolution Professional to take physical possession of the assets of the corporate debtor and hand it over to the Maharashtra Seamless Limited.

In *Embassy Property Developments Pvt. Ltd. v. State of Karnataka,*[84] on the application of Appellant, NCLT ordered commencement of CIRP. At that time, the corporate debtor held a mining lease granted by Respondent. IRP filed a Writ Petition in the High Court of Karnataka seeking a declaration that mining lease should be deemed to be valid till the extended period in terms of the Mines and Minerals (Development and Regulation) Act, 1957.[85] During the pendency of the Writ Petition, Respondent rejected the proposal for deemed extension. Application filed by Resolution Professional for setting aside the order of the Respondent was allowed by NCLT. Division Bench of High Court of Karnataka stayed the order of NCLT. The first question before the Court was whether the High Court ought to interfere under Article 226/227 of the Constitution with the Order passed by NCLT in a proceeding under the Code, ignoring the availability of a statutory remedy of appeal to NCLAT and if so, under what circumstances. The Court answered the question in affirmative and observed as under:

[84] Rohinton Fali Nariman, Aniruddha Bose and V. Ramasubramanian, *JJ.* 03-12-2019.
[85] Act 67 of 1957.

NCLT did not have jurisdiction to entertain an application against the Government of Karnataka for a direction to execute Supplemental Lease Deeds for the extension of the mining lease. Since NCLT chose to exercise a jurisdiction not vested in it in law, the High Court of Karnataka was justified in entertaining the writ petition, on the basis that NCLT was *coram non judice*.[86]

The second question before the Court was whether NCLT/NCLAT is competent to enquire into allegations of fraud in the matter of the very initiation of corporate insolvency proceeding. The Court answered the question as under:

Even fraudulent tradings carried on by the corporate debtor during the insolvency resolution, can be inquired into by the Adjudicating Authority under Section 66. Section 69 makes an officer of the corporate debtor and the corporate debtor liable for punishment, for carrying on transactions with a view to defraud creditors. Therefore, NCLT is vested with the power to inquire into (i) fraudulent initiation of proceedings as well as (ii) fraudulent transactions. It is significant to note that Section 65(1) deals with a situation where corporate insolvency resolution proceeding is initiated fraudulently *"for any purpose other than for the resolution of insolvency or liquidation"*.[87]

. . . .

[I]t is clear that NCLT has jurisdiction to enquire into allegations of fraud. As a corollary, NCLAT will also have jurisdiction. Hence,

[86] *Embassy Property Developments* (n 81) para 45 at 49.
[87] *Ibid.*, ¶50 at 53-54.

fraudulent initiation of corporate insolvency resolution cannot be a ground to bypass the alternative remedy of appeal provided in Section 61.[88]

In this case the Court interpreted the provisions of the Code and held that fraudulent initiation of CIRP cannot be a ground to bypass the alternative remedy of appeal provided in Section 61.[89] The Court further observed that though NCLT and NCLAT would have jurisdiction to enquire into questions of fraud, they would not have jurisdiction to adjudicate upon disputes such as those arising under the Mines and Minerals (Development and Regulation) Act, 1957 and the rules issued thereunder, especially when the disputes revolve around decisions of statutory or quasi-judicial authorities, which can be corrected only by way of judicial review of administrative action. Hence, the High Court was justified in entertaining the writ petition.[90]

In *Surendra Trading Company v. Juggilal Kamlapat Jute Mills Company Limited,*[91] Respondent filed reference under Section 15(1) of the Sick Industrial Companies (Special Provisions) Act, 1985[92] ("the SICA") on becoming a sick company. Appellant (operational creditor) filed an application for initiation of CIRP. As to the nature of proviso to sub-section (5) of Section 9 the Court observed as under:

[88] *Ibid.*, ¶51 at 54.
[89] *Ibid.*, ¶51 at 54.
[90] *Ibid.*, ¶52 at 54-55.
[91] *Supra* note 7.
[92] Act 1 of 1986.

[T]he Applicant does not gain anything by not removing the objections inasmuch as till the objections are removed, such an application would not be entertained.[93]

. . . .

[P]rovision of removing the defects within seven days is directory and not mandatory in nature.[94]

. . . .

We are also conscious of the fact that sometimes applicants or their counsel may show laxity by not removing the objections within the time given and make take it for granted that they would be given unlimited time for such a purpose. There may also be cases where such applications are frivolous in nature which would be filed for some oblique motives and the applicants may want those applications to remain pending and, therefore, would not remove the defects. In order to take care of such cases, a balanced approach is needed. Thus, while interpreting the provisions to be directory in nature, at the same time, it can be laid down that if the objections are not removed within seven days, the applicant while refilling the application after removing the objections, file an application in writing showing sufficient case as to why the applicant could not remove the objections within seven days. When such an application comes up for admission/order before the adjudicating authority, it would be for the adjudicating authority to decide as to whether sufficient cause is shown in not removing the defects beyond the

[93] *Surendra Trading* (n 7) ¶23 at 28.
[94] *Ibid.*, ¶24 at 28-29.

period of seven days. Once the adjudicating authority is satisfied that such a case is shown, only then it would entertain the application on merits, otherwise it will have right to dismiss the application.[95]

In this case, the Court interpreted-constructed the Code and held that the period of removing of the defects within seven days is directory and not mandatory in nature.

In *Mobilox Innovations Private Limited v. Kirusa Software Private Limited,*[96] Respondent provided the requisite services to Appellant for conducting tele-voting for a program on entertainment channel and also raised monthly invoices. Payment was refused by Appellant alleging that Respondent had breached a non-disclosure agreement. Respondent filed an application before NCLT under Sections 8 and 9 stating that an operational debt was owed to Respondent. NCLT dismissed the aforesaid application. The question was whether NCLT can reject an application on the ground that there is no existence of a dispute under Section (8)(2)(a) of the Code. The Court answered the question in negative and observed as under:

[I]n the first Insolvency and Bankruptcy Bill, 2015 that was annexed to the Bankruptcy Law Reforms Committee Report, Section 5(4) defined "dispute" as meaning a "bona fide suit or arbitration proceedings…" In its present avatar, Section 5(6) excludes the expression "bona fide" which is of significance. Therefore, it is

[95] *Ibid.*, ¶25 at 29-30.
[96] Rohinton Fali Nariman and Sanjay Kishan Kaul, *JJ.* 21-09-2017.

difficult to import the expression "bona fide" into Section 8(2)(a) in order to judge whether a dispute exists or not.[97]

. . . .

It is clear, therefore, that once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility. It is clear that such notice must bring to the notice of the operational creditor the "existence" of a dispute or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties. Therefore, all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. It is important to separate the grain from the chaff and to reject a spurious defence which is mere bluster. . . So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application.[98]

. . . .

The confirmation from a financial institution that there is no payment of an unpaid operational debt by the corporate debtor is an important piece of information that needs to be placed before the adjudicating authority, under Section 9 of the Code, but given

[97] *Ibid.*, ¶35 at 77.
[98] *Ibid.*, ¶40 at 85-86.

the fact that the adjudicating authority has not dismissed the application on this ground and that the appellant has raised this ground only at the appellate stage, we are of the view that the application cannot be dismissed at the threshold for want of this certificate alone.[99]

. . . .

A dispute does truly exist in fact between the parties, which may or may not ultimately succeed, and the Appellate Tribunal was wholly incorrect in characterizing the defense as vague, got-up and motivated to evade liability.[100]

In this case, the Court interpreted the provisions of the Code and held that if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility then the complete application filed by the operational creditor must be rejected by the adjudicating authority under Section 9(5)(2)(d) of the Code.

In *Macquarie Bank Limited v. Shilpi Cable Technologies Ltd.,*[101] from a third-party Appellant purchased the original supplier's right, title and interest in a supply agreement. Appellant issued a demand notice under Section 8 of the Code to Respondent for the payment of the outstanding amount of the sale agreement. In reply, Respondent questioned the validity of the purchase agreement in favour of Appellant. NCLT held that for non-compliance of

[99] *Ibid.,* ¶41 at 86-87.
[100] *Ibid.,* ¶45 at 91.
[101] Rohinton Fali Nariman and Navin Sinha, *JJ.* 15-12-2017.

mandatory provision of Section 9(3)(c) of the Code, application of Respondent would have to be dismissed at the threshold. The first question before the Court was whether in relation to an operational debt the provision of Section 9(3)(c) is mandatory. The Court answered the question in negative and observed as under:

It is true that the expression "initiation" contained in the marginal note to Section 9 does indicate the drift of the provision, but from such drift, to build an argument that the expression "initiation" would lead to the conclusion that Section 9(3) contains mandatory conditions precedent before which the Code can be triggered is a long shot. Equally, the expression "shall" in Section 9(3) does not take us much further when it is clear that Section 9(3)(c) becomes impossible of compliance in cases like the present. It would amount to a situation wherein serious general inconvenience would be caused to innocent persons, such as the appellant, without very much furthering the object of the Act. . . and obviously, therefore, Section 9(3)(c) would have to be construed as being directory in nature.[102]

The second question was whether a demand notice of an unpaid operational debt can be issued by a lawyer on behalf of the operational creditor. The Court answered the question in affirmative and observed as under:

Section 8 of the Code speaks of an operational creditor delivering a demand notice. It is clear that had the legislature wished to restrict such demand notice being sent by the operational creditor himself,

102 *Ibid.*, ¶19 at 36-37.

the expression used would perhaps have been "issued" and not "delivered". Delivery, therefore, would postulate that such notice could be made by an authorized agent. In fact, in Forms 3 and 5 . . . it is clear that this is the understanding of the draftsman of the Adjudicatory Authority Rules, because the signature of the person "authorized to act" on behalf of the operational creditor must be appended to both the demand notice as well as the application under Section 9 of the Code. The position further becomes clear that both forms require such authorized agent to state his position with or in relation to the operational creditor. A position with the operational creditor would perhaps be a position in the company or firm of the operational creditor, but the expression "in relation to" is significant. . . It is clear, therefore, that both the expression "authorized to act" and "position in relation to the operational creditor" go to show that an authorized agent or a lawyer acting on behalf of his client is included within the aforesaid expression.[103]

. . . .

The *non-obstante clause* contained in Section 238 of the Code will not override the Advocates Act, 1961[104] as there is no inconsistency between Section 9, read with the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 and Forms, and the Advocates Act, 1961.[105]

. . .

[103] *Ibid.*, ¶33 at 58-60.
[104] Act 25 of 1961.
[105] *Macquarie Bank* (n 98) para 36 at 65.

Since there is no clear disharmony between the two Parliamentary statutes. . . which cannot be resolved by harmonious interpretation, it is clear that both statutes must be read together. Also, we must not forget that Section 30 of the Advocates Act, 1961 deals with the fundamental right under Article 19(1)(g) of the Constitution to practice one's profession. Therefore, a conjoint reading of Section 30 of the Advocates Act, 1961 and Sections 8 and 9 of the Code together with the Adjudicatory Authority Rules and Forms there under would yield the result that a notice sent on behalf of an operational creditor by a lawyer would be in order.[106]

The Court in this case interpreted the provisions of the Code and held that Section 9(3)(c) would have to be construed as being directory in nature. The Court also observed that the Advocates Act, 1961 and the Code must be read together and the notice sent on behalf of an operational creditor by a lawyer would be in order.

C. THE CODE AND RESOLUTION PROFESSIONAL/ RESOLUTION PLAN

In *Vijay Kumar Jain v. Standard Chartered Bank*,[107] Appellant was member of suspended Board of Directors of a corporate debtor company and was permitted to attend first meeting of CoCs but was denied to attend subsequent meetings. The question was whether resolution professional may be directed to provide all relevant documents including insolvency resolution plans in question to

[106] *Ibid.*, ¶36 at 69.
[107] Rohinton Fali Nariman and Navin Sinha, *JJ.* 31-01-2019.

Appellant. The Court answered the question in affirmative and observed as under:

[S]tatutory scheme. . .makes it clear that though the erstwhile Board of Directors are not members of the CoCs, yet, they have a right to participate in each and every meeting held by the CoCs, and also have a right to discuss along with members of the CoCs all resolution plans that are presented at such meetings under Section 25(2)(i). It cannot be gainsaid that operational creditors, who may participate in such meetings but have no right to vote, are vitally interested in such resolution plans, and must be furnished copies of such plans beforehand if they are to participate effectively in the meeting of the CoCs. This is for the reason that under Section 30(2)(b), repayment of their debts is an important part of the resolution plan *qua* them on which they must comment. So the first important thing to notice is that even though persons such as operational creditors have no right to vote but are only participants in meetings of the CoCs, yet, they would certainly have a right to be given a copy of the resolution plans before such meetings are held so that they may effectively comment on the same to safeguard their interest.[108]

. . . .

There is no doubt whatsoever that Notes on Clauses are an important aid to the construction of Sections of the Code as they show what the Drafting Committee had in mind when such provisions were drafted. However, a closer look at the Notes on

[108] *Ibid.*, ¶9 at 30-31.

Clause 24 makes it clear that the third sentence of the Notes on Clause 24 is itself problematic. First and foremost, it speaks of the resolution professional seeking information. The resolution professional does not seek information at a meeting of the CoCs, which is what Section 24 is all about. The resolution professional only seeks information from the erstwhile Board of Directors under Section 29 before preparing an information memorandum, which then includes the financial position of the corporate debtor and information relating to disputes by or against the corporate debtor etc. All this has nothing to do with Section 24 of the Code which deals with meetings of the CoCs. Secondly, the resolution professional does not prepare a resolution plan as is mentioned in the Notes on Clause 24; he only prepares an information memorandum which is to be given to the resolution applicants who then submit their resolution plans under Section 30 of the Code. The CoCs, in turn, gets information so that they can assess the financial position of the corporate debtor from various sources before they meet. It is, therefore, difficult to understand the Notes on Clause 24. Even assuming that the Notes on Clause 24 may be read as being a one-way street by which erstwhile members of the Board of Directors are only to provide information, we find that Section 31(1) of the Code would make it clear that such members of the erstwhile Board of Directors, who are often guarantors, are vitally interested in a resolution plan as such resolution plan then binds them. Such a plan may scale down the debt of the principal debtor, resulting in scaling down the debt of the guarantor as well, or it may not. The resolution plan may also scale down certain debts and not others, leaving guarantors of the latter kind of debts exposed for the entire amount of the debt. The Insolvency and

Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("the CIRP Regulations") also make it clear that these persons are vitally interested in resolution plans as they affect them. Thus, under Regulation 36 of the CIRP Regulations, the information memorandum that is given to each member of the CoCs and to any potential resolution applicant, will contain details of guarantees that have been given in relation to the debts of the corporate debtor.[109] Also, under Regulation 37(d) of the CIRP Regulations, a resolution plan may provide for satisfaction or modification of any security interest. Further, under Regulation 37(1)(f), a resolution plan may provide for reduction in the amount payable to the creditors, which again vitally impacts the rights of a guarantor. Last but not least, a resolution plan which has been approved or rejected by an order of the Adjudicating Authority, has to be sent to "participants" which would include members of the erstwhile Board of Directors – vide Regulation 39(5) of the CIRP Regulations. Obviously, such copy can only be sent to participants because they are vitally interested in the outcome of such resolution plan, and may, as persons aggrieved, file an appeal from the Adjudicating Authority's order to the Appellate Tribunal under Section 61 of the Code. Quite apart from this, Section 60(5)(c) is also very wide, and a member of the erstwhile Board of Directors also has an independent right to approach the Adjudicating Authority, which must then hear such person before it is satisfied that such resolution plan can pass muster under Section 31 of the Code.[110]

[109] *See* Regulation 36(2)(f) of the CIRP Regulations.
[110] *Vijay Kumar* (n 104) para 12 at 33-36.

. . . .

It is also important to note that every participant is entitled to a notice of every meeting of the CoCs. Such notice of meeting must contain an agenda of the meeting, together with the copies of all documents relevant for matters to be discussed and the issues to be voted upon at the meeting vide Regulation 21(3)(iii). Obviously, resolution plans are "matters to be discussed" at such meetings, and the erstwhile Board of Directors are "participants" who will discuss these issues. The expression "documents" is a wide expression which would certainly include resolution plans.[111]

. . . .

Under Regulation 24(2)(e), the resolution professional has to take a roll call of every participant attending through video conferencing or other audio and visual means, and must state for the record that such person has received the agenda and all relevant material for the meeting which would include the resolution plan to be discussed at such meeting. Regulation 35 makes it clear that the resolution professional shall provide fair value and liquidation value to every member of the committee only after receipt of resolution plans in accordance with the Code.[112] Also, under Regulation 38(1)(a), a resolution plan shall include a statement as to how it has dealt with the interest of all stakeholders, and under sub-clause 3(a), a resolution plan shall demonstrate that it addresses the cause of default. This Regulation also, therefore, recognizes the vital interest

[111] *Ibid.*, ¶13 at 36.
[112] *See* Regulation 35(2) of the CIRP Regulations.

of the erstwhile Board of Directors in a resolution plan together with the cause of default. It is here that the erstwhile directors can represent to the CoCs that the cause of default is not due to the erstwhile management, but due to other factors which may be beyond their control, which have led to non-payment of the debt. Therefore, a combined reading of the Code as well as the Regulations leads to the conclusion that members of the erstwhile Board of Directors, being vitally interested in resolution plans that may be discussed at meetings of the CoCs, must be given a copy of such plans as part of "documents" that have to be furnished along with the notice of such meetings.[113]

. . . .

So far as confidential information is concerned, it is clear that the resolution professional can take an undertaking from members of the erstwhile Board of Directors, as has been taken in the facts of the present case, to maintain confidentiality. The source of this power is Regulation 7(2)(h) of the CIRP Regulations, read with paragraph 21 of the First Schedule thereto. This can be in the form of a non-disclosure agreement in which the resolution professional can be indemnified in case information is not kept strictly confidential.[114]

As to the contention that a director *simpliciter* would have the right to get documents as against a director who is a financial creditor, the Court rejected the contention and observed as under:

[113] *Vijay Kumar* (n 104) ¶14 at 36-38.
[114] *Ibid.*, ¶15 at 38.

The proviso to Section 21(2) clarifies that a director who is also a financial creditor who is a related party of the corporate debtor shall not have any right of representation, participation, or voting in a meeting of the CoCs. Directors, *simplicitor*, are not the subject matter of the proviso to Section 21(2), but only directors who are related parties of the corporate debtor. It is only such persons who do not have any right of representation, participation, or voting in a meeting of the CoCs. Therefore, the contention . . . is not an argument that is based on the proviso to Section 21(2), correctly read, as it refers only to a financial creditor who is a related party of the corporate debtor.[115]

In this case, the Court interpreted the Code and held that Resolution Professional may be directed to provide all relevant documents including the insolvency resolution plans in question to Appellant and reiterated that every participant is entitled to a notice of every meeting of the CoCs.[116]

In *Rahul Jain v. Rave Scans Pvt. Ltd.,*[117] revised resolution plan submitted by Appellant was approved by NCLT. On appeal filed by Respondent on ground of discrimination between financial creditors, NCLAT modified the NCLT's final order. The question was whether resolution plan was discriminatory and violative of Section 30(2)(e) as similar treatment to the dissenting creditor was not provided. The Court answered the question in negative and observed as under:

[115] *Ibid.,* ¶16 at 39.
[116] *Ibid.,* ¶13 at 36.
[117] Arun Mishra and S. Ravindra Bhatt, *JJ.* 08-11-2019.

Section 30 lays out the duties of the resolution professional and the various steps that she or he has to take, as well as the considerations that are to weigh, in examining a resolution plan. The principle of fairness engrafted in the provision is that the plan should make a provision for repayment of debts of operational creditors having regard to the value, which shall not be less than what is prescribed by the Insolvency Board, repayable in the event of liquidation, spelt out in Section 53. Section 30(3) requires the resolution professional to present the resolution plan to the CoCs and Section 30(4) stipulates that approval shall be by a vote not less than 75% of the voting share of the financial creditors.[118]

. . . .

[I]t is noticeable that no doubt, Hero was provided with 32.34% of its admitted claim as it has dissented with the plan. On the other hand, Tata Capital Financial Services Ltd. was provided with 75.63% of its admitted claim; other financial creditors (Indian Overseas Bank, Bank of Baroda and Punjab National Bank) were provided with 45% of their admitted claims. Given that the resolution process began well before the amended regulation came into force and the resolution plan was prepared and approved before that event, the wide observations of the NCLAT, requiring the appellant to match the pay-out (offered to other financial creditors) to Hero, was not justified. The Court notices that the liquidation value of the corporate debtor ascertained at ₹ 36 crores. Against the said amount, the appellant offered ₹ 54 crores.

[118] *Ibid.*, ¶11 at 8-9.

In this case, the Court interpreted the text of the Code and held that the resolution plan was not discriminatory and violative of Section 30(2)(e) of the Code. The Court further held that the plan was approved and except objections of dissenting creditor plan has attained finality. The directions and order of the NCLAT was set aside and the order of NCLT was restored.[119]

D. THE CODE AND THE FINANCIAL CREDITORS

In *Pioneer Urban Land and Infrastructure Limited v. Union of India*,[120] Petitioner argued that the Amendment Act of 2018 through which allottees of real estate projects have been deemed to be "financial creditors" violates Article 14 of the Constitution. The question was whether Amendment Act of 2018 is constitutionally valid or not. The Court answered this question in affirmative and observed as under:

It can be seen that the Insolvency Law Committee found, as a matter of fact, that delay in completion of flats/apartments has become a common phenomenon, and that amounts raised from home buyers contributes significantly to the financing of the construction of such flats/apartments. This being the case, it was important, therefore, to clarify that home buyers are treated as financial creditors so that they can trigger the Code under Section 7 and have their rightful place on the CoCs when it comes to making important decisions as to the future of the building construction

[119] *Ibid.*, ¶13 at 10.
[120] *Supra* note 27.

company, which is the execution of the real estate project in which such home buyers are ultimately to be housed.[121]

. . . .

It is impossible to say that classifying real estate developers is not founded upon an *intelligible differentia* which distinguishes them from other operational creditors, nor is it possible to say that such classification is palpably arbitrary having no rational relation to the objects of the Code. . . [W]hat is unique to real estate developers *vis-à-vis* operational debts, is the fact that, in operational debts generally, when a person supplies goods and services, such person is the creditor and the person who has to pay for such goods and services is the debtor. In the case of real estate developers, the developer who is the supplier of the flat/apartment is the debtor inasmuch as the home buyer/allottee funds his own apartment by paying amounts in advance to the developer for construction of the building in which his apartment is to be found. Another vital difference between operational debts and allottees of real estate projects is that an operational creditor has no interest in or stake in the corporate debtor, unlike the case of an allottee of a real estate project, who is vitally concerned with the financial health of the corporate debtor, for otherwise, the real estate project may not be brought to fruition. Also, in such event, no compensation, nor refund together with interest, which is the other option, will be recoverable from the corporate debtor. One other important distinction is that in an operational debt, there is no consideration for the time value of money – the consideration of the debt is the

[121] *Ibid.*, ¶18 at 45.

goods or services that are either sold or availed of from the operational creditor. Payments made in advance for goods and services are not made to fund manufacture of such goods or provision of such services. Examples given of advance payments being made for turnkey projects and capital goods, where customisation and uniqueness of such goods are important by reason of which advance payments are made, are wholly inapposite as examples *vis-à-vis* advance payments made by allottees. In real estate projects, money is raised from the allottee, being raised against consideration for the time value of money. Even the total consideration agreed at a time when the flat/apartment is non-existent or incomplete, is significantly less than the price the buyer would have to pay for a ready/complete flat/apartment, and therefore, he gains the time value of money. Likewise, the developer who benefits from the amounts disbursed also gains from the time value of money. The fact that the allottee makes such payments in instalments which are co-terminus with phases of completion of the real estate project does not any the less make such payments as payments involving "exchange", *i.e.* advances paid only in order to obtain a flat/apartment. What is predominant, insofar as the real estate developer is concerned, is the fact that such instalment payments are used as a means of finance qua the real estate project. One other vital difference with operational debts is the fact that the documentary evidence for amounts being due and payable by the real estate developer is there in the form of the information provided by the real estate developer compulsorily under RERA. This information, like the information from information utilities under the Code, makes it easy for home buyers/allottees to approach the NCLT under Section 7 of the Code to trigger the

Code on the real estate developer's own information given on its webpage as to delay in construction, etc. It is these fundamental differences between the real estate developer and the supplier of goods and services that the legislature has focused upon and included real estate developers as financial debtors. This being the case, it is clear that there cannot be said to be any infraction of equal protection of the laws.[122]

. . . .

The object of dividing debts into two categories under the Code, namely, financial and operational debts, is broadly to sub-divide debts into those in which money is lent and those where debts are incurred on account of goods being sold or services being rendered. We have no doubt that real estate developers fall squarely within the object of the Code as originally enacted insofar as they are financial debtors and not operational debtors. . . So far as unequals being treated as equals is concerned, home buyers/allottees can be assimilated with other individual financial creditors like debenture holders and fixed deposit holders, who have advanced certain amounts to the corporate debtor. For example, fixed deposit holders, though financial creditors, would be like real estate allottees in that they are unsecured creditors. Financial contracts in the case of these individuals need not involve large sums of money. Debenture holders and fixed deposit holders, unlike real estate holders, are involved in seeing that they recover the amounts that are lent and are thus not directly involved or interested in assessing the viability of the corporate debtors. Though not having the

[122] *Ibid.*, ¶40 at 110.

expertise or information to be in a position to evaluate feasibility and viability of resolution plans, such individuals, by virtue of being financial creditors, have a right to be on the CoCs to safeguard their interest. Also, the question that is to be asked when a debenture holder or fixed deposit holder prefers a Section 7 application under the Code will be asked in the case of allottees of real estate developers – is a debt due in fact or in law? Thus, allottees, being individual financial creditors like debenture holders and fixed deposit holders and classified as such, show that they are within the larger class of financial creditors, there being no infraction of Article 14 on this score.[123]

. . . .

The Code is thus a beneficial legislation which can be triggered to put the corporate debtor back on its feet in the interest of unsecured creditors like allottees, who are vitally interested in the financial health of the corporate debtor, so that a replaced management may then carry out the real estate project as originally envisaged and deliver the flat/apartment as soon as possible and/or pay compensation in the event of late delivery, or non-delivery, or refund amounts advanced together with interest. . . [I]t cannot be said that a square peg has been forcibly fixed into a round hole so as to render Section 5(8)(f) manifestly arbitrary i.e. excessive, disproportionate or without adequate determining principle. For the same reason, it cannot be said that Article 19(1)(g) has been infracted and not saved by Article 19(6) as the Amendment Act is made in public interest, and it cannot be said to be an unreasonable

[123] *Ibid.*, ¶41 at 114-115.

restriction on the Petitioner's fundamental right under Article 19(1)(g). Also, there is no infraction of Article 300-A as no person is deprived of its property without authority of a constitutionally valid law.[124]

. . . .

[I]n point of fact, real estate allottees are really in the nature of financial creditors, and thus the UNCITRAL Legislative Guide has been followed, and not breached.[125]

. . . .

[A]ll the allottees of the project in question can either join together under the explanation to Section 7(1) of the Code, or file their own individual petitions after the Code gets triggered by a single allottee, stating that in addition to the construction of their flat/apartment, they are also entitled to compensation under RERA and/or under the general law, and would thus be persons who have a "claim", *i.e.*, a right to remedy for breach of contract which gives rise to a right to compensation, whether or not such right is reduced to judgment, and would therefore be persons to whom a liability or obligation in respect of a "claim" is due. Such persons would, therefore, have a voice in the CoCs as to future plans for completion of the project, and compensation for late delivery of the flat/apartment.[126]

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[124] *Ibid.*, ¶45 at 128-129.
[125] *Ibid.*, ¶46 at 130.
[126] *Ibid.*, ¶47 at 131-132.

As to the argument with reference to Regulation 9A of CIRP Regulations that home buyers would really fall within "other creditors" as a residuary class who would have to stand in line with their claims which would be made to resolution professional once the Code is triggered. The Court observed that we have already held that given the fact that home buyers/allottees give advances to the real estate developer and thereby finance the real estate project at hand are really financial creditors. Given this finding, this plea of the Petitioners must also be rejected. This challenge must also, therefore, fail.[127]As to the argument that placing allottees as financial creditors is directly contrary to the object of Code in maximizing the value of assets and putting corporate debtor back on its feet the Court observed as under:

[I]f a Section 7 application is admitted in favour of an allottee, and if the management of the corporate debtor is in fact a strong and stable one, nothing debars the same erstwhile management from offering a resolution plan, subject to Section 29A of the Code, which may well be accepted by the CoCs in which home buyers now have a voice. Equally, to assume that the moment the insolvency resolution process starts, corporate death must ensue is wholly incorrect. If the real estate project is otherwise viable, resolution plans from others may well be accepted and the best of these would then work in order to maximise the value of the assets of the corporate debtor.[128]

[127] *Ibid.*, ¶43 at 116-117.
[128] *Ibid.*, ¶48 at 132.

As to the challenge to Section 21(6A) and 25A of the Code, the Court observed as under:

Given the fact that allottees may not be a homogenous group, yet there are only two ways in which they can vote on the CoCs – either to approve or to disapprove of a proposed resolution plan. Sub-section (3A) of Section 25A goes a long way to ironing out any creases that may have been felt in the working of Section 25A in that the authorised representative now casts his vote on behalf of all financial creditors that he represents. If a decision taken by a vote of more than 50% of the voting share of the financial creditors that he represents is that a particular plan be either accepted or rejected, it is clear that the minority of those who vote, and all others, will now be bound by this decision. . . Thus, any challenge to the machinery provisions contained in Sections 21(6A) and 25A of the Code must be repelled.[129]

. . . .

[T]he Amendment Act has been held to be constitutionally valid, and considering that its language is clear and unambiguous, it is not possible to accede to the contentions of the Petitioners to read down the clear provisions of the Amendment Act in the manner suggested by them.[130]

As to the interpretation of Section 5(8)(f) of the Code, the Court observed as under:

[129] *Ibid.*, ¶144-145.
[130] *Ibid.*, ¶57 at 150.

[I]n order to be a "debt", there ought to be a liability or obligation in respect of a "claim" which is due from any person. "Claim" then means either a right to payment or a right to payment arising out of breach of contract, and this claim can be made whether or not such right to payment is reduced to judgment. Then comes "default", which in turn refers to non-payment of debt when whole or any part of the debt has become due and payable and is not paid by the corporate debtor. . . [A] debt is a liability or obligation in respect of a right to payment, even if it arises out of breach of contract, which is due from any person, notwithstanding that there is no adjudication of the said breach, followed by a judgment or decree or order. The expression "payment" is again an expression which is elastic enough to include "recompense", and includes repayment.[131]

. . . .

The definition of "financial debt" in Section 5(8) then goes on to state that a "debt" must be "disbursed" against the consideration for time value of money. . . The expression "disbursed" refers to money which has been paid against consideration for the "time value of money". In short, the "disbursal" must be money and must be against consideration for the "time value of money", meaning thereby, the fact that such money is now no longer with the lender, but is with the borrower, who then utilises the money. Thus far, it is clear that an allottee "disburses" money in the form of advance payments made towards construction of the real estate project.[132]

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[131] *Ibid.*, ¶60 at 152-153.
[132] *Ibid*, ¶61 at 153-154.

. . . .

And now to the precise language of Section 5(8)(f). First and foremost, the sub-clause does appear to be a residuary provision which is "catch all" in nature. This is clear from the words "any amount" and "any other transaction" which means that amounts that are "raised" under "transactions" not covered by any of the other clauses, would amount to a financial debt if they had the commercial effect of a borrowing.[133]

. . . .

Sub-clause (f) of Section 5(8) thus read would subsume within it amounts raised under transactions which are not necessarily loan transactions, so long as they have the commercial effect of a borrowing.[134]

. . . .

That this amendment is in fact clarificatory is also made clear by the Insolvency Committee Report, which expressly uses the word "clarify", indicating that the Insolvency Law Committee also thought that since there were differing judgments and doubts raised on whether home buyers would or would not be included within Section 5(8)(f), it was best to set these doubts at rest by explicitly stating that they would be so covered by adding an explanation to Section 5(8)(f). Incidentally, the Insolvency Law Committee itself had no doubt that given the 'financing' of the project by the

[133] *Ibid*, ¶65 at 158.
[134] *Ibid*, ¶66 at 159.

allottees, they would fall within Section 5(8)(f) of the Code as originally enacted.[135]

. . . .

[T]he deeming fiction that is used by the explanation is to put beyond doubt the fact that allottees are to be regarded as financial creditors within the enacting part contained in Section 5(8)(f) of the Code.[136]

. . . .

The explanation added to Section 5(8)(f) of the Code by the Amendment Act of 2018 does not in fact enlarge the scope of the original Section as home buyers/allottees would be subsumed within Section 5(8)(f) as it originally stood.[137]

. . . .

[A]llottees/home buyers were included in the main provision, *i.e.* Section 5(8)(f) with effect from the inception of the Code, the explanation being added in 2018 merely to clarify doubts that had arisen.[138]

In this case, the Court interpreted-constructed the provisions of the Code and concluded that the Amendment Act to the Code does not violate Articles 14, 19(1)(g) read with Article 19(6), or 300-A of the

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[135] *Ibid*, ¶69 at 162.
[136] *Ibid*, ¶84 at 182.
[137] *Ibid*, ¶85 at 183.
[138] *Ibid*, ¶86 at 183.

Constitution.[139] RERA is to be read harmoniously with the Code, as amended by the Amendment Act of 2018. It is only in the event of conflict that the Code will prevail over RERA. Remedies that are given to allottees of flats/apartments are therefore concurrent remedies, such allottees of flats/apartments being in a position to avail of remedies under the Consumer Protection Act, 1986, RERA as well as the triggering of the Code[140] and Section 5(8)(f) as it originally appeared in the Code being a residuary provision, always subsumed within it allottees of flats/apartments. The explanation together with the deeming fiction added by the Amendment Act of 2018 is only clarificatory of this position in law.[141]

In *Anuj Jain Interim Resolution Professional for Jaypee Infratech Limited v. Axis Bank Limited,*[142] lender-Banks of JAL claimed themselves as the financial creditor(s) of JIL. NCLT had rejected that claim but the NCLAT allowed the appeal. The question was whether Lender-Banks of JAL can be regarded as financial creditor(s) of JIL. Without going into details, the Court answered the question in negative and observed that the lender-Banks of JAL cannot be regarded as financial creditor(s) of JIL.[143] The Court, however, expressed to elaborate on this aspect in the final judgment.[144]

E. THE CODE AND EXPENSES INCURRED BY THE RESOLUTION PROCESS

[139] *Ibid*, ¶86(i) at 184.
[140] *Ibid*, ¶86(ii) at 184.
[141] *Ibid*, ¶86(iii) at 184.
[142] A. M. Khanwilkar and Dinesh Maheshwari, *JJ.* 10-12-2019.
[143] *Ibid*, p 4 of the order; paragraph number is not mentioned in the order.
[144] *See* generally, *Ibid*, pp 4-5 of the order.

In *S3 Electricals and Electronics Private Limited v. Brian Lau*,[145] question before the Court was who will bear expenses incurred by the Resolution Process. The Court observed that a bare reading of Regulation 33(3) of CIRP Regulations indicates that applicant is to bear expenses incurred by Resolution Process which shall then be reimbursed by the CoCs to the extent such expenses are ratified. When no CoCs was ever appointed as interim resolution process did not reach that stage. It is clear that the expenses fixed by the Adjudicating Authority will be borne by the creditor who moved the application.[146] The Court interpreted the text of Section 33(3).

F. THE CODE AND NATIONAL COMPANY LAW (APPELLATE) TRIBUNAL

In *Jaiprakash Associates Ltd. v. IDBI Bank Ltd.,*[147] Respondent filed an application under Section 7 after the appellant has become NPA. One of the home buyers' Association filed application before NCLT on September 17, 2018 seeking clarification as to the manner in which the voting percentage of the home buyers will be reckoned. In this regard an order was passed by the third Member of the NCLT on May 24, 2019. Respondent filed an application before NCLT for excluding the period of pendency of application for clarification regarding the manner of counting votes of concerned financial creditors from the period of 270 days of CIRP. On appeal, NCLAT granted relief to Respondent to exclude period from September 17, 2018 till June 04, 2019 for the purpose of

[145] Rohinton Fali Nariman and Surya Kant, *JJ.* 05-08-2019.
[146] *Ibid*, p 2 of the order; paragraph number is not mentioned in the order.
[147] A. M. Khanwilkar and Dinesh Maheshwari, *JJ.* 06-11-2019.

counting 270 days CIRP period. The question was whether NCLAT had power in law to exclude 90 days from the statutory period of the CIRP. The question remained unanswered[148] but the Court by exercising the power under Article 142 of the Constitution, issued directions[149] to all the concerned to reckon 90 days extended period from the date of the order[150] instead of the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019. The Court also expressed that these directions are issued in exceptional situation in the facts of the present case and shall not be treated as a precedent.[151]

In *Committee of Creditors of Essar Steel India Limited v. Satish Kumar Gupta*,[152] resolution applicant empowered CoCs to decide the manner in which financial package being offered would be distributed among secured financial creditors. On appeal, NCLAT restructured resolution plan approved by CoCs for financial creditors and operational creditors. The question was about the role of resolution applicants, resolution professionals and CoCs that are constituted under the Code and in particular whether the provisions of Sections 4, 6 and 30(2)(b) of the Insolvency and Bankruptcy Code (Amendment) Act, 2019 ("the Amending Act of 2019") are constitutionally valid. The Court upholding the constitutional validity of these provisions observed as under:

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[148] See, *Ibid*, ¶21(v) at 23-24.
[149] *Ibid*, ¶21 at 22-24.
[150] *Ibid*, ¶21(i) at 21.
[151] *Ibid* at 23.
[152] Rohinton Fali Nariman, Surya Kant and V. Ramasubramanian, *JJ.* 15-11-2019.

There is no doubt that the Amending Act of 2019 consists of several Sections which have been enacted/amended as difficulties have arisen in the working of the Code. While it is true that it may well be that the law laid down by the NCLAT in this very case forms the basis for some of these amendments, it cannot be said that the legislature has directly set aside the judgment of the NCLAT. Since an appeal against the judgment of the NCLAT lies to the Supreme Court, the legislature is well within its bounds to lay down laws of general application to all persons affected, bearing in mind what it considers to be a curing of a defective reading of the law by an Appellate Tribunal. There can be no doubt whatsoever that apart from the present case the amendments made by the Amending Act of 2019 apply down the board to all persons who are affected by its provisions. Also, it is settled law that bad faith, in the sense of improper motives, cannot be ascribed to a legislature making laws.[153]

. . . .

So far as Section 4 is concerned, it is clear that the original timelines in which a CIRP must be completed have now been extended to 330 days, which is 60 days more than 180 plus 90 days (which is equal to 270 days). But this 330-day period includes the time taken in legal proceedings in relation to such resolution process of the corporate debtor. . . the third proviso added to the Section also mandates that where the period of 330 days is over on the date of commencement of the Amending Act of 2019, a further grace period of 90 days from such date is given, within which such

[153] *Ibid*, ¶73 at 119-120.

process shall either be completed or the corporate debtor be sent into liquidation.[154]

. . . .

The *raison d'être* for Section 4 of the Amending Act of 2019 comes from the experience that has been plaguing the legislature ever since Sick Industrial Companies (Special Provisions) Act, 1985 was promulgated.[155]

. . . .

When it comes to the validity of the substitution of Section 30(2)(b) by Section 6 of the Amending Act of 2019, it is clear that the substituted Section 30(2)(b) gives operational creditors something more than was given earlier as it is the higher of the figures mentioned in sub-clauses (i) and (ii) of sub-clause (b) that is now to be paid as a minimum amount to operational creditors. The same goes for the latter part of sub-clause (b) which refers to dissentient financial creditors.[156]

. . . .

The challenge to sub-clause (b) of Section 6 of the Amending Act of 2019, again goes to the flexibility that the Code gives to the CoCs to approve or not to approve a resolution plan and which may take into account different classes of creditors as is mentioned in Section 53, and different priorities and values of security interests of a

[154] *Ibid*, ¶74 at 122-123.
[155] *Ibid*, ¶75 at 123.
[156] *Ibid*, ¶80 at 133-133.

secured creditor. This flexibility is referred to in the BLRC report, 2015 . . . Also, the discretion given to the CoCs by the word "may" again makes it clear that this is only a guideline which is set out by this sub-section which may be applied by the CoCs in arriving at a business decision as to acceptance or rejection of a resolution plan. For all these reasons, therefore, it is difficult to hold that any of these provisions is constitutionally infirm.[157]

In this case, the Court interpreted the text of the Code and declined accept that provisions of the Amending Act of 2019 were tailor-made to do away with the judgment of the NCLAT.

In *K. Sashidhardia v. Inn Overseas Bank*,[158] NCLAT rejected resolution plan on the ground that it has to garner support of not less than 75% of voting share of the financial creditors constituting the CoCs. The question was whether resolution plan which gets support of less than 75% of voting share of the financial creditors constituting the CoCs will be rejected and thereby warranted initiation of liquidation process of the concerned corporate debtor. The Court answered the question in affirmative and reiterated that the resolution plan of the concerned corporate debtors has not been approved by requisite percent of voting share of the financial creditors and in absence of any alternative resolution plan presented within the statutory period of two hundred seventy days, the inevitable sequel is to initiate liquidation process under Section 33 of the Code.[159] In this case, the Court interpreted the provisions of

[157] *Ibid*, ¶83 at 136.
[158] A. M. Khanwilkar and Ajay Rastogi, *JJ*. 05-02-2019.
[159] *Ibid*, ¶66 at 101.

the Code and held the resolution plan of corporate debtors has to be approved by requisite percent of voting share of the financial creditors.

In *State Bank of India v. Manibhadra Polycot*,[160] NCLAT in its impugned order has excluded a further twenty-one days from being counted as part of the two hundred seventy days period. The question was whether NCLAT has rightly excluded the said period. The Court answered the question in negative and observed as under:

[T]he first two sets of days, namely, 7 days and 11 days, cannot be excluded for the simple reason that they are not incurred in any litigation process. Even assuming that the last cluster, namely 3 days between August 08, 2018 and August 10, 2018 are to be excluded, and we add these days to May 01, 2019 when the litigation process has come to an end, we still reach May 04, 2019. The Resolution plan in question is submitted only on May 08, 2019, and is therefore clearly beyond the mandatory period laid down in the Code.[161]

In Lokhandwala Kataria Construction Private Limited v. Nisus Finance and Investment Managers LPP,[162] question was whether in view of Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 ("the IB Rules, 2016"), NCLAT could utilize the inherent power recognized by Rule 11 of the NCLAT Rules, 2016 to allow a compromise before it by the parties after admission of the matter. The Court reiterated the

[160] Rohinton Fali Nariman and Surya Kant, *JJ*. 09-08-2019.
[161] *Ibid*, ¶2 at 1-2.
[162] Rohinton Fali Nariman and Sanjay Kishan Kaul, *JJ*. 24-07-2017.

position of NCLAT that the inherent power could not be so utilized.[163] The Court invoking its power under Article 142 of the Constitution put a quietus to the matter.[164]

In Rojer Mathew v. South Indian Bank Limited,[165] question was restructuring of Tribunal System in the light of constitutional scheme as interpreted in decisions of the Supreme Court and the Expert Studies. The Court formulated following issues[166] for consideration for the appointment, norms and functioning of Debt Recovery Tribunals:

1. Creation of a regular cadres laying down eligibility for recruitment for Tribunals;

2. Setting up of an autonomous oversight body for recruitment and overseeing the performance and discipline of the members so recruited and other issues relating thereto;

3. Amending the scheme of direct appeals to this Court so that the orders of Tribunals are subject to jurisdiction of the High Courts;

4. Making Benches of Tribunals accessible to common man at convenient locations instead of having only one location at Delhi or elsewhere. In the alternative, conferring jurisdiction on existing courts as special Courts or Tribunals.

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[163] See, *Ibid*, ¶3 at 1.
[164] See, *Ibid*, ¶4 at 1-2.
[165] Adarsh Kumar Goel and Indu Malhotra, *JJ*. 07-05-2018.
[166] *Ibid*, ¶19 at 13; See also, ¶20 at 13.

The Court further observed that the above issues may require urgent setting up of a committee, preferably of three members, one of whom must be retired judge of Supreme Court who may be served in a Tribunal. Such Committee can have interaction with all stakeholders and suggest a mechanism consistent with the constitutional scheme as interpreted by this Court in several decisions referred to above and also in the light of recommendations of expert bodies. This exercise must be undertaken in a time bound manner.[167]

In *Jai Balaji Industries Limited v. State Bank of India*,[168] NCLAT set aside the order of NCLT and directed it to admit the application filed by Respondent under Section 7. The question was whether the Appellant's right to be heard has been violated in as much as Appellant has neither been served with notice of appeal before NCLAT nor been given a hearing before it. The Court answered the question in affirmative and observed:

Rule 48 of the NCLAT Rules clearly stipulates service of notice on the other side, pursuant to issuance of notice by the NCLAT in the appeal, regardless of supply of advance copy of appeal paper book prior to the issuance of notice by NCLAT.[169]

. . . .

Rule 52 of the NCLAT Rules categorically states that the judicial section of the registry of the NCLAT shall record, in the "Notes of

[167] *Ibid*, ¶20 at 13.
[168] N. V. Ramana and Mohan M. Shantanagoudar, *JJ.* 08-03-2019.
[169] *Ibid*, ¶8 at 5.

the Registry" column in the order sheet, the details regarding completion of service of notice on the Respondents.[170]

. . . .

[I]t is abundantly clear that no notice was served upon the appellant before the NCLAT as stipulated under the rules, and the right of the appellant to be heard, *audi alteram partem*, has been violated.[171]

In this case, the Court interpreted the provisions of the Code and remanded the matter back to the NCLAT for fresh consideration with a direction to dispose of the matter as expeditiously as possible after affording an opportunity of hearing to the parties.[172]

G. TRADE UNION AS AN OPERATIONAL CREDITOR UNDER THE CODE

In *JK Jute Mill Mazdoor Morcha v. Juggilal Kamlapat Jute Mills Company Ltd.*,[173] proceeding of closure of a jute mill was pending under the Sick Industrial Companies (Special Provisions) Act, 1985.[174] Appellant issued a demand notice on behalf of workers of a jute mill under Section 8 of the Code for outstanding dues of workers. The question was whether a trade union could be said to be an operational creditor for the purpose of the Code. The Court answered the question in affirmative and observed as under:

[170] *Ibid*, ¶9 at 5.
[171] *Ibid*, ¶11 at 6.
[172] *Ibid*, ¶12 at 6.
[173] Rohinton Fali Nariman and Vineet Saran, *JJ.* 30-04-2019.
[174] Sick Industrial Companies (Special Provisions) Act, 1985.

On a reading of the. . . statutory provisions,175 what becomes clear is that a trade union is certainly an entity established under a statute – namely, the Trade Unions Act, 1926,176 and would therefore fall within the definition of "person" under Sections 3(23) of the Code. This being so, it is clear that an "operational debt", meaning a claim in respect of employment, could certainly be made by a person duly authorised to make such claim on behalf of a workman. Rule 6, Form 5 of the IB Rules, 2016 also recognizes the fact that claims may be made not only in an individual capacity, but also conjointly. Further, a registered trade union recognized by Section 8 of the Trade Unions Act, 1926 makes it clear that it can sue and be sued as a body corporate under Section 13 of that Act. Equally, the general fund of the trade union, which inter alia is from collections from workmen who are its members, can certainly be spent on the conduct of disputes involving a member or members thereof or for the prosecution of a legal proceeding to which the trade union is a party, and which is undertaken for the purpose of protecting the

[175] JK Jute Mill, *Supra* Note 170. See generally, para 4 at 4-8. Referred provisions are: Section 5(20) of the Code (defines "operational creditor"); Section 5(21) of the Code (defines "operation debt"); Rule 6 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 [Application by operational creditor]; Form 5, to which Rule 6 refers, contains Part V, in which the note states: "Note: Where workmen/employees are operational creditors, the application may be made either in an individual capacity or in a joint capacity by one of them who is duly authorised for the purpose."; Section 3(23) of the Code (defines "person"); Section 2(h) of the Trade Unions Act, 1926 [Act 16 of 1926] (defines "trade union"); Section 2(g) of the Trade Unions Act, 1926 (defines "trade dispute"); Section 8 of the Trade Unions Act, 1926 (Registration); Section 13 of the Trade Unions Act, 1926 (Incorporation of registered Trade Unions); and Section 15 of the Trade Unions Act, 1926 (Objects on which general funds may be spent).

[176] The Trade Unions Act, 1926.

rights arising out of the relation of its members with their employer, which would include wages and other sums due from the employer to workmen.[177]

. . . .

[T]he NCLAT is not correct in stating that a trade union would not be an operational creditor as no services are rendered by the trade union to the corporate debtor. What is clear is that the trade union represents its members who are workers, to whom dues may be owed by the employer, which are certainly debts owed for services rendered by each individual workman, who are collectively represented by the trade union. Equally, to state that for each workman there will be a separate cause of action, a separate claim, and a separate date of default would ignore the fact that a joint petition could be filed under Rule 6 read with Form 5 of the IB Rules, 2016, with authority from several workmen to one of them to file such petition on behalf of all.[178]

In this case, the Court interpreted the provisions of the Code and held that trade union to be an operational creditor for the purpose of the Code.

H. THE CODE AND THE CIRCULAR OF RESERVE BANK OF INDIA

In *Dharani Sugars and Chemicals Ltd. v. Union of India*,[179] under an amended Circular of the RBI, a revised framework for resolution of

[177] JK Jute Mill, *Supra* note 170, para 6 at 8-9.
[178] *Ibid*, ¶11 at 14.
[179] Rohinton Fali Nariman and Vineet Saran, *JJ.* 02-04-2019.

stressed assets under Sections 35AA and 35AB of the Banking Regulation Act, 1949[180] ("the Banking Act") was introduced by which a lender whose stake is only one per cent can stall a resolution process *de hors* the Code. The question before the Court was whether the said Circular of the RBI was constitutionally valid or it was arbitrary and violative of Article 14 of the Constitution. The Court declared the impugned circular *ultra vires* of Section 35AA of the Banking Act and made the following observations:

A cursory reading of Section 35A makes it clear that there is nothing in the aforesaid provision which would indicate that the power of the RBI to give directions, when it comes to the Code, cannot be so given. The width of the language used in the provision which only uses general words such as 'public interest' and 'banking policy' etc. makes it clear that if otherwise available, we cannot interdict the use of Section 35A as a source of power for the impugned RBI circular on the ground that the Code could not be said to have been in the contemplation of Parliament in 1956, when Section 35A was enacted.[181]

. . . .

If a specific provision of the Banking Act makes it clear that the RBI has a specific power to direct banks to move under the Code against debtors in certain specified circumstances, it cannot be said that they would be acting outside the four corners of the statutes

[180] The Banking Regulation Act, 1949.
[181] Dharani Sugars, *Supra* note 176, para 24 at 52.

which govern them, namely, the Reserve Bank of India Act, 1934[182] and the Banking Act.[183]

. . . .

Section 35AA makes it clear that the Central Government may, by order, authorise the RBI to issue directions to any banking company or banking companies when it comes to initiating the insolvency resolution process under the provisions of the Code. The first thing to be noted is that without such authorisation, the RBI would have no such power. There are many sections in the Banking Act which enumerate the powers of the Central Government *vis-à-vis* the powers of the RBI. . . Section 36ACA(1). . . makes it clear that the RBI's satisfaction in superseding the board of directors of banking companies can only be exercised in consultation with the Central Government, and not otherwise. Similarly, under Sections 36AE and 36AF, the Central Government alone has the power to acquire undertakings of banking companies in certain cases, on receipt of a report from the RBI.[184]

. . .

[T]he Banking Act specifies that the Central Government is either to exercise powers along with the RBI or by itself. The role assigned, therefore, by Section 35AA, when it comes to initiating the insolvency resolution process under the Code, is thus,

[182] Act 2 of 1934.
[183] Dharani Sugars, *Supra* note 176, para 26 at 55.
[184] *Ibid*, ¶29 at 60-61.

important. Without authorisation of the Central Government, obviously, no such directions can be issued.[185]

. . . .

The corollary of this is that prior to the enactment of Section 35AA, it may have been possible to say that when it comes to the RBI issuing directions to a banking company to initiate insolvency resolution process under the Code, it could have issued such directions under Sections 21 and 35A. But after Section 35AA, it may do so only within the four corners of Section 35AA.[186]

. . . .

There is nothing to show that the provisions of Section 45L(3) have been satisfied in issuing the impugned circular. The impugned circular nowhere says that the RBI has had due regard to the conditions in which and the objects for which such institutions have been established, their statutory responsibilities, and the effect the business of such financial institutions is likely to have on trends in the money and capital markets. Further, it is clear that the impugned circular applies to banking and non-banking institutions alike, as banking and non-banking institutions are often in a joint lenders' forum which jointly lend sums of money to debtors. Such non-banking financial institutions are, therefore, inseparable from banking institutions insofar as the application of the impugned circular is concerned. It is very difficult to segregate the non-banking financial institutions from banks so as to make the circular

[185] *Ibid*, ¶29 at 64-65.
[186] *Ibid*, ¶30 at 64.

applicable to them even if it is *ultra vires* insofar as banks are concerned. . . [T]he impugned circular will have to be declared as *ultra vires* as a whole, and be declared to be of no effect in law. Consequently, all actions taken under the said circular, including actions by which the Code has been triggered must fall along with the said circular. As a result, all cases in which debtors have been proceeded against by financial creditors under Section 7 of the Code, only because of the operation of the impugned circular will be proceedings which, being faulted at the very inception, are declared to be *non-est*.[187]

In this case, the Court interpreted the provisions of the Code and held the Circular of the RBI *ultra vires* as a whole on the basis that the Circular applies to the banking and non-banking institutions alike and by virtue of Section 35AA, the insolvency resolution process can be initiated under the Code only with the authorization of the Central Government and no such directions can be issued by RBI in this regard without the authorization of the Central Government.

I. THE CODE AND THE AUCTION OF ASSETS

In *Anand Rao Korada v. Varsha Fabrics (P) Ltd.,*[188] to recover the payment of salaries and arrears of workmen, Odisha High Court directed the sale of assets of Respondent through public auction. The question was whether High Court was justified in passing orders for carrying out auction of assets of the corporate debtor

[187] *Ibid*, ¶45 at 83-84.
[188] Indu Malhotra and R. Subhash Reddy, *JJ.* 18-11-2019.

before NCLT. The Court answered the question in negative and observed as under:

In view of the provisions[189] of the Code, the High Court ought not to have proceeded with the auction of the property. . . once the proceedings under the Code had commenced, and an Order declaring moratorium was passed by the NCLT. The High Court passed the impugned Interim Orders dated August 14, 2019 and September 05, 2019 after the CIRP had commenced in this case. The moratorium having been declared by the NCLT on June 04, 2019, the High Court was not justified in passing the Orders dated August 14, 2019 and September 05, 2019 for carrying out auction of the assets of the. . . the Corporate Debtor before the NCLT. The subject matter of the auction proceedings before the High Court is a vast chunk of land admeasuring about 330 acres, including Railway lines and buildings. If the assets of the Respondent No. 4 (Hirakund Industrial Works Ltd.) – Company are alienated during the pendency of the proceedings under the Code, it will seriously jeopardise the interest of all the stakeholders. As a consequence, we set aside the impugned Interim Orders dated August 14, 2019 and September 05, 2019 passed by the Odisha High Court, as parallel proceedings with respect to the main issue cannot take place in the High Court. The sale or liquidation of the assts of Respondent No. 4 will now be governed by the provisions of the IBC.[190]

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[189] The Court referred to the Sections 12, 13, 14, 238, and 231 of the Code. See, *Ibid*, ¶6-8 at 7-10.

[190] Anand Rao, *Supra* note 185, ¶9 at 10-11.

. . . .

It is open for Respondent No. 13 (Hirakund Workers' Union) to file an application under Regulation 9 of the IB Regulations, 2016 for payment of arrears, salaries and other dues before the competent authority.[191]

In this case, the Court interpreted the provisions of the Code and held that the parallel proceedings with respect to the main issue cannot take place in the High Court. The Court further granted liberty to the parties to pursue whatever remedies are available in accordance with law.[192] Accordingly, the impugned Interim Orders passed by the High Court was set aside by the Court.

J. THE CODE AND ARBITRATION PROCEEDINGS

In *K. Kishan v. Vijay Nirman Company Pvt. Ltd.*,[193] Respondent entered into a sub-contract agreement with one Ksheerabad Constructions Private Limited ("KCPL"). During the course of the project, disputes arose between the parties and the same were referred to an Arbitral Tribunal. Arbitral Tribunal allowed one claim and rejected three claims of Respondent. KCPL challenged the award by filing a petition under Section 34 of the Arbitration and Conciliation Act, 1996[194] ("the Arbitration Act"). In the meantime, a petition was filed under Section 9 of the Code. The question was whether the Code can be invoked in respect of an operational debt

[191] *Ibid*, ¶10 at 11.
[192] *Ibid*, ¶11 at 13.
[193] Rohinton Fali Nariman and Indu Malhotra, *JJ*. 14-08-2018.
[194] Act 26 of 1996.

where an arbitral award has been passed against operational debtor which has not yet been finally adjudicated upon. The Court answered the question in negative and observed as under:

[O]perational creditors cannot use the Code either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures.[195]

. . . .

We repeat with emphasis that under our Code, insofar as an operational debt is concerned, all that has to be seen is whether the said debt can be said to be disputed, and we have no doubt in stating that the filing of a Section 34 petition against an Arbitral Award shows that a pre-existing dispute which culminates at the first stage of the proceedings in an Award, continues even after the Award, at least till the final adjudicatory process under Sections 34 and 37 has taken place.[196]

. . . .

Section 238 of the Code would apply in case there is an inconsistency between the Code and the Arbitration Act in the present case. We see no such inconsistency. On the contrary, the Award passed under the Arbitration Act together with the steps taken for its challenge would only make it clear that the operational debt, in the present case, happens to be a disputed one.[197]

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[195] *K. Kishan* (n 190) para 13 at 15-16.
[196] *Ibid*, ¶18 at 21.
[197] *Ibid*, ¶22 at 23.

In this case, the Court interpreted the provisions of the Code and held that operational creditors cannot use the Code either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures. The Court further observed that if there is any inconsistency between the two statutes, Section 238 of the Code would apply.

In *Alchemist Asset Reconstruction Company Ltd. v. Hotel Gaudavan Pvt. Ltd.*,[198] question before the Court was whether an arbitration proceeding may be started after imposition of moratorium under the Code. The Court answered the question in negative and observed as under:

The mandate of the new Insolvency Code is that the moment an insolvency petition is admitted, the moratorium that comes into effect under Section 14(1)(a) of the Code expressly interdicts institution or continuation of pending suits or proceedings against Corporate Debtors.[199]

In this case, the Court interpreted the provisions of the Code and held that the effect of Section 14(1)(a) of the Code is that the arbitration that has been instituted after the moratorium is *non est* in law.[200]

K. THE CODE AND WINDING-UP PETITIONS

[198] Rohinton Fali Nariman and Sanjay Kishan Kaul, *JJ*. 23-10-2017.
[199] *Ibid*, ¶5 at 2.
[200] *Ibid*, ¶6 at 2.

In *Swaraj Infrastructure Pvt. Ltd. v. Kotak Mahindra Bank Ltd.*,[201] Debts Recovery Tribunal ("the DRT"), Mumbai decided in favour of Respondent to recover debt owed by Appellant and other debtor companies. Respondent also issued statutory notices to companies under Sections 433 and 434 of the Companies Act, 1956.[202] The question was whether there is right of a secured creditor to file a winding up petition after obtaining a decree from DRT. The Court observed as under:

It is settled law that a winding up proceeding initiated under Section 433(e) and 434 of the Companies Act, 1956 is not a means of seeking to enforce payment of a debt.[203]

. . . .

[T]his Court has stated that a winding up petition is a form of equitable execution of a debt, but this is qualified by stating that a winding up order is not a normal alternative to the ordinary procedure for realization of debts due to a creditor. . . When it comes to a winding up proceeding under the Companies Act, 1956 since such a proceeding is not "for recovery of debts" due to banks, the bar contained in Section 18 read with Section 34 of the Recovery of Debts Due to Banks and Financial Institutions Act,

[201] Rohinton Fali Nariman and Navin Sinha, *JJ*. 29-01-2019.
[202] The Companies Act, 1956.
[203] Swaraj Infrastructure, *Supra* note 191, para 11 at 14.

1993[204] would not apply to winding up proceedings under the Companies Act, 1956.[205]

. . . .

Section 529(1)(c) of the Companies Act, 1956 specifically refers to the right of a secured creditor under the law of insolvency "with respect to the estates of persons adjudged insolvent". The express language of Section 529(1)(c) of the Companies Act, 1956 makes it clear that it is Section 47 of the Provincial Insolvency Act, 1920[206] alone that is attracted, and not Section 9(2), as was contended by learned counsel for the appellants before us. We may also add that reliance on Section 441(2) of the Companies Act, 1956 is misplaced for yet another reason. Section 441(2) has to be read with Section 441(1), and so read, makes it clear that it became necessary to enact sub-section (2), because a petition for voluntary winding up of a company presented before the Tribunal would be said to commence at an anterior point of time, namely, at the time of the passing of the resolution whereby the company resolves to voluntarily wind itself up. In contrast, therefore, Section 441(2) says "in any other case", i.e., in cases other than those falling under sub-section (1) of Section 441 of the Companies Act, 1956, the winding up of a company by the Tribunal shall be deemed to commence at the time of presentation of the petition for winding up. The context of the provision, therefore, makes it clear that it cannot be read so as to introduce Section 9(2) of the Provincial Insolvency Act, 1920 by the

[204] Recovery of Debts Due to Banks and Financial Institutions Act, 1993
[205] Swaraj Infrastructure, *Supra* note 198, para 13 at 15-16.
[206] Provincial Insolvency Act, 1920.

back door, as it were, when no such provision is contained in Section 439 of the Companies Act, 1956 itself.[207]

. . . .

We may only end by saying that cases like the present one have to be decided by balancing the interest of creditors to whom money is owing, with a debtor company which will now go in the red since a winding up petition is admitted against it.[208]

. . .

It is not open for persons like the appellant to resist a winding up petition which is otherwise maintainable without there being any *bona fide* defence to the same. We may also hasten to add that the respondent cannot be said to be blowing hot and cold in pursuing a remedy under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 and a winding up proceeding under the Companies Act, 1956 simultaneously.[209]

In this case, the Court interpreted the provisions of the Code and held that secured creditor has a right to file a winding up petition after obtaining a decree from DRT. The Court observed that such cases to be decided by balancing the interest of creditors to whom money is owing with a debtor company which will now go in the red since a winding up petition is admitted against it.[210]

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[207] Swaraj Infrastructure, *Supra* note 198, para 17 at 23-24.
[208] *Ibid*, ¶20 at 30.
[209] *Ibid*.
[210] *Ibid*.

L. THE CODE AND APPLICATION OF THE LIMITATION ACT, 1963

In *Sagar Sharma v. Phoenix Arc Ltd.,*[211] an application under Section 7 of the Code was made by the financial creditor stating that a default has been made. The question was whether the application under Section 7 was barred by limitation. The Court observed as under:

[F]or applications that will be filed under Section 7 of the Code, Article 137 of the Limitation Act, 1963 will apply. . . an application under Section 7 of the Code does not purport to be an application to enforce any mortgage liability.[212]

. . . .

Article 141 of the Constitution mandates that the judgments delivered by the Court are followed in letter and spirit. The date of coming into force of the Code does not and cannot form a trigger point of limitation for applications filed under the Code. Equally, since "applications" are petitions which are filed under the Code, it is Article 137 of the Limitation Act which will apply to such applications.[213]

In this case, Court interpreted the provisions of the Code and held that Article 137 of the Limitation Act, 1963 will apply on the applications filed under Section 7 of the Code.

[211] Rohinton Fali Nariman and V. Subramanian, *JJ*. 30-09-2019.
[212] *Ibid*, ¶2 at 1-2.
[213] *Ibid*, ¶3 at 2.

In *Jignesh Shah v. Union of India*,[214] a winding up petition filed by one IL&FS Financial Services Ltd. against La-Fin Financial Services Pvt. Ltd. was admitted by NCLT. NCLAT dismissed the appeal filed by the Appellant against the admission order of NCLT. NCALT reiterated the order of NCLT that the aforesaid transaction would fall within the meaning of "financial debt" under the Code and the bar of limitation would not be attracted as winding up petition was filed within three years of the date on which the Code came into force. The question was whether winding up petition is barred by lapse of time. The Court answered the question in affirmative and observed as under:

The trigger for limitation is the inability of a company to pay its debts. Undoubtedly, this trigger occurs when a default takes place, after which the debt remains outstanding and is not paid. It is this date alone that is relevant for the purpose of triggering limitation for the filing of a winding up petition. Though it is clear that a winding up proceeding is a proceeding *'in rem'* and not a recovery proceeding, the trigger of limitation, so far as the winding up petition is concerned, would be the date of default. . . Limitation attaches insofar as petitions filed under Section 433(e) are concerned at the stage that default occurs for, it is at this stage that the debt becomes payable.[215]

In this case, Court interpreted the provisions of the Code and held that winding-up petition was filed beyond the period of three-years

[214] Rohinton Fali Nariman, R. Subhash Reddy and Surya Kant, *JJ*. 25-08-2019.
[215] *Ibid*, ¶25 at 34.

mentioned in Article 137 of the Limitation Act, was time-barred, and cannot therefore be proceeded with any further.[216]

In *Gaurav Hargovindbhai Dave v. Asset Reconstruction Company (India) Ltd.,*[217] after exhausting the proceedings of DRT, Respondent filed application under Section 7. Applying Article 62 of the Limitation Act, 1963, NCLT admitted the application considering the claim was filed within limitation. NCLAT held that time of limitation would begin running for purposes of limitation only on and from the date on which the Code was brought into force. The question was whether the time of limitation of application under Section 7 would begin running for the purposes of limitation only on and from the date on which the Code was brought into force. The Court observed as under:

"[A]n application" which is filed under Section 7 would fall only within the residuary Article 137 of the Limitation Act.[218]

. . . .

It is not for us to interpret, commercially or otherwise, articles of the Limitation Act when it is clear that a particular article gets attracted. It is well settled that there is no equity about limitation - judgments have stated that often time periods provided by the Limitation Act can be arbitrary in nature.[219]

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[216] *Ibid*, ¶31 at 39.
[217] Rohinton Fali Nariman, R. Subhash Reddy and Surya Kant, *JJ*. 18-09-2019.
[218] *Ibid*, ¶6 at 3.
[219] *Ibid*, ¶7 at 4.

The Court in this case interpreted the provisions of the Code read with the Articles of the Limitation Act, 1963 and held that the time of limitation of application under Section 7 of the Code would begin running for the purposes of limitation only on and from the date on which the Code was brought into force.

In *Vashdeo R Bhojwani v. Abhyudaya Co-operative Bank Ltd.,*[220] a Recovery Certificate was issued by Respondent Bank against another Respondent. A petition of Respondent under Section 7 of the Code was admitted by NCLT on the ground that as the default continued, no period of limitation would attach. The question was whether the Recovery Certificate plainly shows that there is a default; and cause of action in the case was continuing and no limitation period would apply.[221] The Court answered the question in negative and observed that when the Recovery Certificate was issued, the Certificate injured effectively and completely the Appellant's rights as a result of which limitation would have begun ticking.[222]

M. THE CODE AND APPLICATION OF OTHER LAWS

In *Jaipur Metals & Electricals Employees Organisation v. Jaipur Metals & Electricals Ltd.,*[223] account of Respondent had become NPA and a reference was made to the Board for Industrial and Financial Reconstruction under the SICA.[224] In a writ petition filed by a

[220] Rohinton Fali Nariman and Surya Kant, *JJ.* 02-09-2019.
[221] *Ibid*, ¶2 at 2.
[222] *Ibid*, ¶4 at 3.
[223] Rohinton Fali Nariman and M. R. Shah, *JJ.* 12-12-2018.
[224] *Supra* note 89.

workers' union, Rajasthan High Court directed the Official Liquidator to be provisionally attached to the Court. In the meanwhile, the Respondent preferred an application under Section 7. The question was whether High Court can refuse to transfer winding-up proceedings pending before it to NCLT. The Court observed as under:

[U]nder Section 434 as substituted by the Eleventh Schedule to the Code *vide* notification dated November 15, 2016, all proceedings under the Companies Act, 2013[225] which relate to winding up of companies and which are pending immediately before such date as may be notified by the Central Government in this behalf shall stand transferred to the NCLT. The stage at which such proceedings are to be transferred to the NCLT is such as may be prescribed by the Central Government.[226]

. . . .

It is clear that the present case relates to Rule 5(2) of the Companies (Transfer of Pending Proceedings) Rules, 2016 alone. Despite the fact that Section 20 of the SIC Act speaks of a company being wound up under the Companies Act, 1956 under the just and equitable provision, which is Section 433(f) of the Companies Act, 1956, yet, since cases that fall under Section 20 of the SIC Act are dealt with separately under Rule 5(2), they cannot be treated as petitions that have been filed under Section 433(f) of the Companies Act, 1956, which are separately specified under Rule 6.

[225] Act 18 of 2013.
[226] Jaipur Metals, *Supra* note 220, para 12 at 16-17.

The High Court is therefore not correct in treating petitions that are pursuant to Section 20 of the SIC Act as being pursuant to Section 433(f) of the Companies Act, 1956 and applying Rule 6 of the 2016 Transfer Rules.[227]

. . . .

[B]y the amendment to Section 434(1)(c), with effect from August 17, 2018, where any party to a winding up proceeding pending before a Court immediately before this date may file an application for transfer of such proceedings, and the Court, at that stage, may, by order, transfer such proceedings to the NCLT. The proceedings so transferred would then be dealt with by the NCLT as an application for initiation of the CIRP under the Code. It is thus clear that under the scheme of Section 434 (as amended) and Rule 5 of the 2016 Transfer Rules, all proceedings under Section 20 of the SIC Act pending before the High Court are to continue as such until a party files an application before the High Court for transfer of such proceedings post August 17, 2018. Once this is done, the High Court must transfer such proceedings to the NCLT which will then deal with such proceedings as an application for initiation of the corporate insolvency resolution process under the Code.[228]

. . . .

[T]hat the NCLT was absolutely correct in applying Section 238 of the Code to an independent proceeding instituted by a secured financial creditor, namely, the Alchemist Asset Reconstruction

[227] *Ibid*, ¶14 at 18.
[228] *Ibid*, ¶15 at 19-20.

Company Ltd. This being the case, it is difficult to comprehend how the High Court could have held that the proceedings before the NCLT were without jurisdiction. On this score, therefore, the High Court judgment has to be set aside. The NCLT proceedings will now continue from the stage at which they have been left off. Obviously, the company petition pending before the High Court cannot be proceeded with further in view of Section 238 of the Code.[229]

In this case, Court interpreted the provisions of the Code and held that High Court cannot refuse to transfer the winding-up proceedings pending before it to NCLT. The Court also observed that NCLT was absolutely correct in applying Section 238 of the Code to an independent proceeding instituted by a secured financial creditor.

In *State Bank of India v. V. Ramakrishnan*,[230] Respondent was the guarantor in respect of credit facilities that had been availed from Appellant. Respondent did not pay its debts in time and the account of Respondent was classified as NPA. Consequently, Appellant issued a notice under Section 13(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002[231] demanding the outstanding amount. The question was whether Section 14 of the Code which provides for a moratorium for limited period mentioned in the Code, on admission of an insolvency petition would apply to a personal

[229] *Ibid*, ¶18 at 22.
[230] Rohinton Fali Nariman and Indu Malhotra, *JJ*. 14-08-2018.
[231] Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

guarantor of a corporate debtor. The Court answered in negative and observed as under:

Sections 96 and 101, when contrasted with Section 14, would show that Section 14 cannot possibly apply to a personal guarantor. When an application is filed under Part III, an interim-moratorium or a moratorium is applicable in respect of any debt due. First and foremost, this is a separate moratorium, applicable separately in the case of personal guarantors against whom insolvency resolution processes may be initiated under Part III. Secondly, the protection of the moratorium under these Sections is far greater than that of Section 14 in that pending legal proceedings in respect of the debt and not the debtor are stayed. The difference in language between Sections 14 and 101 is for a reason. Section 14 refers only to debts due by corporate debtors, who are limited liability companies, and it is clear that in the vast majority of cases, personal guarantees are given by Directors who are in management of the companies. The object of the Code is not to allow such guarantors to escape from an independent and coextensive liability to pay off the entire outstanding debt, which is why Section 14 is not applied to them. However, insofar as firms and individuals are concerned, guarantees are given in respect of individual debts by persons who have unlimited liability to pay them. And such guarantors may be complete strangers to the debtor – often it could be a personal friend. It is for this reason that the moratorium mentioned in Section 101 would cover such persons, as such moratorium is in relation to the debt and not the debtor.[232]

[232] State Bank of India, *Supra* note 227, para 23 at 24-25.

In this case, Court interpreted the provisions of the Code and held that Section 14 of the Code would apply to a personal guarantor of a corporate debtor on admission of an insolvency petition.

In *Pr. Commissioner of Income Tax v. Monnet Ispat and Energy Ltd.,*[233] question before the Court was whether the Code will override anything inconsistent contained in any other enactment, including the Income-Tax Act, 1961.[234] Court in this case interpreted the Code and held that by virtue of Section 238, it is obvious that the Code will override anything inconsistent contained in any other enactment, including the Income-Tax Act, 1961.[235]

In *Innoventive Industries Ltd. v. ICICI Bank,*[236] in terms of the restructuring plan, a master restructuring agreement was entered into between Appellant and consortium formed by the creditor banking entities, led by the Central Bank of India. Respondent made an application in which it was stated that Appellant being a defaulter within the meaning of the Code and accordingly the insolvency resolution process ought to be set in motion. In reply, Appellant claimed that there was no debt legally due inasmuch as under the Maharashtra Relief Undertakings (Special Provisions) Act, 1958[237] ("the Maharashtra Act") and all liabilities of the Appellant were temporarily suspended for a period of one year. The question was whether moratorium imposed under Section 4 of the

[233] Rohinton Fali Nariman and Indu Malhotra, *JJ.* 10-08-2018.
[234] Act 43 of 1961.
[235] *Pr. Commissioner* (n 230) p 2 of the order; paragraph number is not mentioned in the order.
[236] Rohinton Fali Nariman and Sanjay Kishan Kaul, *JJ.* 31-08-2017.
[237] Maharashtra Relief Undertakings (Special Provisions) Act, 1958.

Maharashtra Act would directly clash with the moratorium to be issued under Sections 13 and 14 of the Code. The Court observed as under:

[T]he moment initiation of the CIRP takes place, a moratorium is announced by the adjudicating authority vide Sections 13 and 14 of the Code, by which institution of suits and pending proceedings etc. cannot be proceeded with. This continues until the approval of a resolution plan under Section 31 of the said Code. In the interim, an interim resolution professional is appointed under Section 16 to manage the affairs of corporate debtors under Section 17.[238]

. . . .

It is clear that the later (Section 238 of the Code) *non-obstante* clause of the Parliamentary enactment will also prevail over the limited *non-obstante* clause contained in Section 4 of the Maharashtra Act. For these reasons, we are of the view that the Maharashtra Act cannot stand in the way of the CIRP under the Code.[239]

In this case, Court interpreted the provisions of the Code and held that the Maharashtra Act cannot stand in the way of CIRP under the Code and also reiterated that the Code is a Parliamentary law that is an exhaustive code on the subject matter of insolvency in relation to corporate entities.[240]

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[238] Innoventive Industries, *Supra* note 233, para 54. Page number is not mentioned in the judgment.
[239] *Ibid*, ¶55.
[240] *Ibid*, ¶53.

In *Bank of New York Mellon London Branch v. Zenith Infotech Limited,*[241] Respondent filed an application for Reference under Section 15 of the SICA[242] before the authorities of the Board for Industrial and Financial Reconstruction. Application was dismissed on the ground that Respondent was not an industrial company within the meaning of SICA. First question was whether dismissal of application for Reference by authorities was within the jurisdiction of the said authorities. Court affirmed the decision of Bombay High Court that refusal of Reference sought by Respondent by authorities of the Board was *non-est* in law. The Court observed as under:

When the Regulations framed under the statute vests in the Registrar or the Secretary of the Board the power to "scrutinize" an application prior to registration thereof and thereafter to register and place the same before the Bench, we do not see how such power of scrutiny can be understood to be vesting in any of the said authorities the power to adjudicate the question as to whether a company is an industrial company within the meaning of Section 3(e) read with 3(f) and 3(n) of the SIC Act.[243]

The second question was whether in view of the order of winding up passed by Company Court, and affirmed by the High Court, is there any further scope for registration of Reference sought for by Respondent under the provisions of the SICA if the order declining registration by the aforesaid authorities is to be understood to be

[241] Ranjan Gogoi and Abhay Manohar Sapre, *JJ*. 21-02-1017.
[242] Act 1 of 1986.
[243] Bank of New York, *Supra* note 197, para 17 at 25-26.

non-est was decided.[244] The Court concluded that this question becomes redundant in view of conclusion that reference sought by Respondent must be deemed to have been pending on the date of commencement of the Code particularly Section 252 thereof.[245] The Court interpreted the provisions of the Code and held that the reference must be pending before the Board on the relevant date attracting the provisions of Section 252 of the Code.[246] The Court further held that it would still be open to respondent to seek its remedies under the provisions of Section 252 of the Code read with what is laid down in Sections 13, 14, 20 and 25.[247]

III. CONCLUSION

Out of 195 total decisions of Supreme Court till May 2020, only thirty-seven judgments have declared or reiterated the principles of law. Remaining one hundred and fifty-eight decisions were short orders. Out of thirty-seven decisions, Court constructed-interpreted the provisions of the Code in four decisions;[248] interpreted the provisions of the Code in thirty-one decisions;[249] neither interpreted

[244] *Ibid*, ¶11 at 13-14.
[245] *Ibid*, ¶19 at 33-34.
[246] *Ibid*, ¶18 at 32.
[247] *Ibid*, ¶20 at 34.
[248] *See* Surendra Trading Company, *Supra* note 7, and *Supra* note 88; Arcelormittal India, *Supra* note 13 and *Supra* note 62; Swiss Ribbons *Supra* note 19 and *Supra* note 40; and Pioneer Urban *Supra* note 27 and *Supra* note 117.
[249] *See* Surendra Trading Company, *Supra* note 7, and *Supra* note 88; Arcelormittal India, *Supra* note 13 and 62; Swiss Ribbons, *Supra* note 19 and 40; Pioneer Urban, *Supra* note 27 and 117; Chitra Sharma, *Supra* note 54; Reliance Communications, *Supra* note 71; Duncans Industries, *Supra* note 73; Maharashtra Seamless, *Supra* note 78; Embassy Property Developments,

nor constructed in two orders[250] while leaving two questions unanswered.[251] On the basis of above analysis following principles of insolvency and bankruptcy law may be culled-out:

1. The period of removing of defects within seven days in proviso to sub-section (5) of Section 9 of the Code is directory and not mandatory in nature.[252]

2. The proviso to Section 29A(c) will not apply where corporate debtors have not paid-off their respective non-performing asset.[253]

3. The opening words of Section 29A furnish a clue as to the time at which sub-clause (c) is to operate.[254]

Supra note 81; Mobilox Innovations, *Supra* note 93; Macquarie Bank Limited, *Supra* note 98; Vijay Kumar, *Supra* note 104; Rahul Jain, *Supra* note 114; S3 Electricals, *Supra* note 142; Committee of Creditors of Essar Steel India Limited, *Supra* note 149; K. Sashidhardia, *Supra* note 155; State Bank of India, *Supra* note 157; Lokhandwala Kataria Construction, *Supra* note 159; Jai Balaji Industries Limited, *Supra* note 165; JK Jute Mill Mazdoor Morcha, *Supra* note 170; Dharani Sugars, *Supra* note 176; Anand Rao Korada, *Supra* note 185; K. Kishan, *Supra* note 190; Alchemist Asset Reconstruction Company, *Supra* note 195; Swaraj Infrastructure, *Supra* note 198; Sagar Sharma, *Supra* note 208; Jignesh Shah, *Supra* note 211; Gaurav Hargovindbhai, *Supra* note 214; Vashdeo R Bhojwani, *Supra* note 217; Jaipur Metals, *Supra* note 220; State Bank of India, *Supra* note 227; Pr. Commissioner of Income Tax, *Supra* note 230; Innoventive Industries, *Supra* note 233; and Bank of New York Mellon, *Supra* note 238.

[250] *See* Jaiprakash Associates, *Supra* note 144 and Rojer Mathew, *Supra* note 162.

[251] *See* Chitra Sharma, *Supra* note 54; and Jaiprakash Associates, *Supra* note 144.

[252] Surendra Trading Company, *Supra* note 7 and 88.

[253] Arcelormittal India, *Supra* note 13 and 62.

4. The expression "control" in Section 29A(c) denotes only positive or proactive control, as opposed to mere negative or reactive control, which means that mere power to block special resolutions of a company cannot amount to control. "Control", as contrasted with "management", means *de facto* control of actual management or policy decisions that can be or are in fact taken.[255]

5. Section 29A(c) is a see-through provision, great care must be taken to ensure that persons who are in charge of the corporate debtor for whom such resolution plan is made, do not come back in some other form to regain control of company without first paying off its debts.[256]

6. In the light of the object, Section 29A(i) will have to be read as a disability which corresponds to Section 29A(f) in view of the antecedent conduct on the part of the person applying as a resolution applicant in a jurisdiction outside India.[257]

7. "Connected person" in Explanation I of clause (ii) to Section 29A(j) would also cover a person who is in management or control of the business of the corporate debtor during the implementation of a resolution plan.[258]

8. Persons who act jointly or in concert with others are connected with the business activity of the resolution applicant.

[254] *Ibid.*
[255] *Ibid.*
[256] *Ibid.*
[257] *Ibid.*
[258] Swiss Ribbons, *Supra* note 19 and 40.

Similarly, all categories of persons mentioned in Section 5(24A) show that such persons must be "connected" with the resolution applicant within the meaning of Section 29A(j).[259]

9. A resolution applicant who applies under Section 29A(c) has no vested right to apply for being considered as a resolution applicant.[260]

10. Under Section 29A(e), a person may be disqualified to act as a director under the Companies Act, 2013, if he has not furnished necessary financial statements on time.[261]

11. The rationale for excluding micro, small and medium enterprises from the eligibility criteria laid down in Section 29A(c) and 29A(h) is because *qua* such industries, other resolution applicants may not be forthcoming, which then will inevitably lead not to resolution, but to liquidation.[262]

12. Allottees/home buyers were included in Section 5(8)(f) with effect from the inception of the Code and any one of the allottees has got the power to invoke the resolution process.[263]

13. Home buyers/allottees give advances to the real estate developer and thereby finance the real estate project at hand, are really financial creditors.[264]

[259] *Ibid.*
[260] *Ibid.*
[261] *Ibid.*
[262] *Ibid.*
[263] Pioneer Urban, *Supra* note 27 and 117.

14. The explanation added to Section 5(8)(f) of the Code by the Amendment Act of 2018 does not in fact enlarge the scope of the original Section as home buyers/allottees would be subsumed within Section 5(8)(f) as it originally stood.[265]

15. The object of dividing debts into two categories under the Code, namely, financial and operational debts, is broadly to sub-divide debts into those in which money is lent and those where debts are incurred on account of goods being sold or services being rendered. That real estate developers fall squarely within the object of the Code as originally enacted insofar as they are financial debtors and not operational debtors.[266]

16. The Code is a beneficial legislation which can be triggered to put the corporate debtor back on its feet in the interest of unsecured creditors like allottees, who are vitally interested in the financial health of the corporate debtor, so that a replaced management may then carry out the real estate project as originally envisaged and deliver the flat/apartment as soon as possible and/or pay compensation in the event of late delivery, or non-delivery, or refund amounts advanced together with interest.[267]

17. If a Section 7 application is admitted in favour of an allottee, and if the management of the corporate debtor is in fact a strong and stable one, nothing debars the same erstwhile management from offering a resolution plan, subject to Section 29A

[264] *Ibid.*
[265] *Ibid.*
[266] *Ibid.*
[267] *Ibid.*

of the Code, which may well be accepted by the CoCs in which home buyers now have a voice.[268]

18. The precise language of Section 5(8)(f), first and foremost, the sub-clause does appear to be a residuary provision which is "catch all" in nature. This is clear from the words "any amount" and "any other transaction" which means that amounts that are "raised" under "transactions" not covered by any of the other clauses, would amount to a financial debt if they had the commercial effect of a borrowing.[269]

19. Remedies that are given to allottees of flats/apartments are concurrent remedies, such allottees of flats/apartments being in a position to avail of remedies under the Consumer Protection Act, 1986, the Real Estate (Regulation and Development) Act, 2016 as well as the triggering of the Code.[270]

20. Sub-clause (f) of Section 5(8) thus read would subsume within it amounts raised under transactions which are not necessarily loan transactions, so long as they have the commercial effect of a borrowing.[271]

21. The Real Estate (Regulation and Development) Act, 2016 is to be read harmoniously with the Code, as amended by the

[268] *Ibid.*
[269] *Ibid.*
[270] *Ibid.*
[271] *Ibid.*

Amendment Act of 2018. It is only in the event of conflict that the Code will prevail over RERA.[272]

22. Allottees, being individual financial creditors like debenture holders and fixed deposit holders and classified as such, show that they within the larger class of financial creditors.[273]

23. Section 29A has been enacted in the larger public interest and to facilitate effective corporate governance.[274]

24. The provisions of Section 29A are intended to ensure that among others, persons responsible for insolvency of the corporate debtor do not participate in the resolution process.[275]

25. Section 30 of the Code, as amended, also clarifies that a resolution plan of a person who is ineligible under Section 29A will not be considered by CoCs.[276]

26. The failure of Appellant to pay agreed amount in pursuance to the Orders of NCLAT and Supreme Court, amounts to contempt of the Court. Contempt of the Court needs to be purged by payment of the agreed total sum with interest by Appellant.[277]

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[272] *Ibid*.
[273] *Ibid*.
[274] Chitra Sharma, *Supra* note 54.
[275] *Ibid*.
[276] *Ibid*.
[277] Reliance Communications, *Supra* note 71.

27. Application under Section 9 of the Code would be maintainable even without the consent of the Central Government in terms of Section 16G of the Tea Act, 1953.[278]

28. The proceedings under Section 9 of the Code shall not be limited and/or restricted to winding up and/or appointment of receiver only.[279]

29. The entire CIRP as such cannot be equated with winding up proceedings. Section 238 of the Code, which is a subsequent Act to the Tea Act, 1953, shall be applicable and the provisions of the Code shall have an overriding effect over the Tea Act, 1953 and that no prior consent of the Central Government before initiation of the proceedings under Section 7 or Section 9 of the Code would be required and even without such consent of the Central Government, the insolvency proceedings under Section 7 or Section 9 of the Code initiated by the operational creditor shall be maintainable.[280]

30. Once a resolution plan is approved by CoCs, the statutory mandate on Adjudicating Authority under Section 31(1) of the Code is to ascertain that a resolution plan meets the requirement of sub-sections (2) and (4) of Section 30 thereof.[281]

[278] Duncans Industries, *Supra* note 73.
[279] *Ibid*.
[280] *Ibid*.
[281] Maharashtra Seamless, *Supra* note 78.

31. The Adjudicating Authority could not reassess a resolution plan approved by the CoCs, even if the same otherwise complies with the requirement of Section 31 of the Code.[282]

32. The High Court ought to interfere, under Article 226/227 of the Constitution, with an Order passed by NCLT in a proceeding under the Code, ignoring the availability of a statutory remedy of appeal to NCLAT when the NCLT did not have jurisdiction to entertain an application.[283]

33. Fraudulent initiation of CIRP cannot be a ground to bypass the alternative remedy of appeal provided in Section 61 of the Code.[284]

34. Though NCLT and NCLAT would have jurisdiction to enquire into questions of fraud, they would not have jurisdiction to adjudicate upon disputes such as those arising under Mines and Minerals (Development and Regulation) Act, 1957 and the rules issued thereunder, especially when the disputes revolve around decisions of statutory or quasi-judicial authorities, which can be corrected only by way of judicial review of administrative action.[285]

35. Once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been

[282] *Ibid.*
[283] Embassy Property Development, *Supra* note 81.
[284] *Ibid.*
[285] *Ibid.*

received by the operational creditor or there is a record of dispute in the information utility.[286]

36. So long as a dispute truly exists in fact and is not spurious, hypothetical or illusory, the adjudicating authority has to reject the application.[287]

37. The confirmation from a financial institution that there is no payment of an unpaid operational debt by the corporate debtor is an important piece of information that needs to be placed before the adjudicating authority, under Section 9 of the Code.[288]

38. A dispute does truly exist in fact between the parties, which may or may not ultimately succeed.[289]

39. In relation to an operational debt, the provision contained in Section 9(3)(c) of the Code would be directory in nature but not mandatory.[290]

40. A demand notice of an unpaid operational debt can be issued by a lawyer on behalf of the operational creditor and the notice sent on behalf of an operational creditor by a lawyer would be in order.[291]

[286] Mobilox Innovations, *Supra* note 93.
[287] *Ibid.*
[288] *Ibid.*
[289] *Ibid.*
[290] Macquarie Bank Limited, *Supra* note 98.
[291] *Ibid.*

41. The *non-obstante clause* contained in Section 238 of the Code will not override the Advocates Act, 1961 as there is no inconsistency between Section 9, read with the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 and Forms, and the Advocates Act, 1961.[292]

42. Since there is no clear disharmony between the two Parliamentary statutes (Code and the Advocates Act, 1961) which cannot be resolved by harmonious interpretation, it is clear that both statutes must be read together.[293]

43. Directors, *simpliciter*, are not the subject matter of the proviso to Section 21(2), but only directors who are related parties of the corporate debtor.[294]

44. Resolution Professional may be directed to provide all relevant documents including the insolvency resolution plans in question to Appellant.[295]

45. Every participant is entitled to a notice of every meeting of the CoCs.[296]

46. The principle of fairness engrafted in Section 30 of the Code is that the plan should make a provision for repayment of debts of operational creditors having regard to the value, which

[292] *Ibid.*
[293] *Ibid.*
[294] Vijay Kumar, *Supra* note 104.
[295] *Ibid.*
[296] *Ibid.*

shall not be less than what is prescribed by the Insolvency Board, repayable in the event of liquidation, spelt out in Section 53.[297]

47. The applicant is to bear expenses incurred by the Resolution Process, which shall then be reimbursed by CoCs to the extent such expenses are ratified.[298]

48. Resolution Plan of the corporate debtors has to be approved by requisite percent of voting share of the financial creditors and in absence of any alternative resolution plan presented within the statutory period of two hundred seventy days, the inevitable sequel is to initiate liquidation process under Section 33 of the Code.[299]

49. In view of Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016, the NCLAT could not utilize the inherent power recognized by Rule 11 of the National Company Law Appellate Tribunal Rules, 2016 to allow a compromise before it by the parties after admission of the matter.[300]

50. NCLAT to dispose of the matter as expeditiously as possible after affording an opportunity of hearing to the parties.[301]

51. A Trade Union is an operational creditor for the purpose of the Code.[302]

[297] Rahul Jain, *Supra* note 114.
[298] S3 Electricals, *Supra* note 142.
[299] K. Sashidhardia, *Supta* note n 155.
[300] Lokhandwala Kataria Construction, *Supra* note 159.
[301] Jai Balaji Industries Limited, *Supra* note 165.

52. A trade union is certainly an entity established under a statute – namely, the Trade Unions Act, and would therefore fall within the definition of "person" under Sections 3(23) of the Code.[303]

53. An "operational debt", meaning a claim in respect of employment, could certainly be made by a person duly authorised to make such claim on behalf of a workman.[304]

54. By virtue of Section 35AA, the insolvency resolution process can be initiated under the Code only with the authorization of the Central Government and no such directions can be issued in this regard without the authorization of the Central Government.[305]

55. If a specific provision of the Banking Regulation Act, 1949 makes it clear that the RBI has a specific power to direct banks to move under the Code against debtors in certain specified circumstances, it cannot be said that they would be acting outside the four corners of the statutes which govern them, namely, the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949.[306]

[302] JK Jute Mill Mazdoor Morcha, *Supra* note 170.
[303] *Ibid.*
[304] *Ibid.*
[305] Dharani Sugars, *Supra* note 176.
[306] *Ibid.*

56. Parallel proceedings with respect to the main issue cannot take place in the High Court.[307]

57. Operational Creditors cannot use the Code either prematurely or for extraneous considerations or as a substitute for debt enforcement procedures.[308]

58. The Code cannot be invoked in respect of an operational debt where an arbitral award has been passed against the operational debtor, which has not yet been finally adjudicated upon.[309]

59. The effect of Section 14(1)(a) of the Code is that the arbitration that has been instituted after the moratorium is *non est* in law.[310]

60. Secured Creditor has a right to file a winding up petition after obtaining a decree from the DRT. Such cases to be decided by balancing the interest of creditors to whom money is owing, with a debtor company which will now go in the red since a winding up petition is admitted against it.[311]

61. Article 137 of the Limitation Act, 1963 will apply on the applications filed under Section 7 of the Code.[312]

[307] Anand Rao Korada, *Supra* note 185.
[308] K. Kishan, *Supra* note 190.
[309] *Ibid*.
[310] Alchemist Asset Reconstruction Company, *Supra* note 195.
[311] Swaraj Infrastructure, *Supra* note 198.
[312] Sagar Sharma, *Supra* note 208.

62. A winding up proceeding is a proceeding *'in rem'* and not a recovery proceeding, the trigger of limitation, so far as the winding up petition is concerned, would be the date of default.[313]

63. Time of limitation of application under Section 7 of the Code would begin running for the purposes of limitation only on and from the date on which the Code was brought into force.[314]

64. An application which is filed under Section 7 would fall only within the residuary Article 137 of the Limitation Act.[315]

65. High Court cannot refuse to transfer the winding-up proceedings pending before it to the NCLT.[316]

66. Section 14 of the Code, which provides for a moratorium for the limited period mentioned in the Code, would apply to a personal guarantor of a corporate debtor on admission of an insolvency petition.[317]

67. The Code will override anything inconsistent contained in any other enactment, including the Income-Tax Act, 1961.[318]

68. The moratorium imposed under Section 4 of the Maharashtra Relief Undertakings (Special Provisions Act), 1958

[313] Jignesh Shah, *Supra* note 211.
[314] Gaurav Hargovindbhai, *Supra* note 214.
[315] *Ibid*.
[316] Jaipur Metals, *Supra* note 220.
[317] State Bank of India, *Supra* note 227.
[318] Pr. Commissioner of Income Tax, *Supra* note 230.

cannot clash with the moratorium to be issued under Sections 13 and 14 of the Code.[319]

69. Section 238 of the Code, *non-obstante* clause of the Parliamentary enactment will also prevail over the limited *non-obstante* clause contained in Section 4 of the Maharashtra Relief Undertakings (Special Provisions Act), 1958.[320]

70. The Maharashtra Relief Undertakings (Special Provisions Act), 1958 cannot stand in the way of the Corporate Insolvency Resolution Process under the Code.[321]

71. The dismissal of the application for Reference under Section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 by the authorities of the Board for Industrial and Financial Reconstruction is within the jurisdiction.[322]

[319] Innoventive Industries, *Supra* note 233.
[320] *Ibid.*
[321] *Ibid.*
[322] Bank of New York Mellon, *Supra* note 238.

NATIONAL GUIDELINES FOR RESPONSIBLE BUSINESS CONDUCT AND THEIR IMPORTANCE IN REMODELING BUSINESS RESPONSIBILITY AND ACCOUNTABILITY

Bhumesh Verma[1], Anoushka Ishwar and Sana Sarosh[2]

ABSTRACT

The Government of India released a set of principle guidelines called the National Guidelines on Responsible Business Conduct (NGRBC) in 2018 with an aim to assist businesses to perform their regulatory compliances. Broadly, these guidelines comprise of nine thematic pillars of business responsibility. They have been formulated in a manner so that all businesses, irrespective of their ownership, sector, structure or location are required to abide by these guidelines. In this article, the authors explore the origin of these principles and its subsequent development. The aim is to analyse the nature of these guidelines and assess their applicability in the Indian scenario. In order to achieve this, authors analyze the features of these guidelines in comparison with international business conduct standards and make propositions in order to determine whether they can be considered truly binding or merely persuasive on the conduct of Indian businesses. The article also tries to highlight the situation of corporate social responsibility and its diverging fields in the Indian market.

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INTRODUCTION

Former Prime Minister, Dr. Manmohan Singh in his address at the National Conference, 2007 of the Confederation of Indian Industry ("CII") for Inclusive Growth introduced the Ten Point Social Charter ("Charter").[3] This compilation of principles which advocated for inclusive labour with employment practices, encouraged businesses to explore innovative and environment friendly avenues. This Charter proved to be a groundbreaking step as it necessitated that businesses acknowledge their socio-environmental impact on the society[4] and formed the foundation of the National Guidelines on Responsible Business Conduct" ("NGRBC").[5] Broadly, the NGRBC comprises of principles requiring businesses and their various stakeholders in the value chain to act in a responsible and sustainable manner. In this article, the authors begin the first part by attempting to explore in depth, the background and the reasons behind the genesis of the NGBRC, while simultaneously analysing its wider contribution to the current business responsibility scenario in India. In the next part, the author

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[3]Press release, Manmohan Singh, Prime Minister's Office, Ten Point Social Charter for Inclusive Growth Outlined- India has made us. We must make Bharat: PM (2007), https://pib.gov.in/newsite/erelcontent.aspx?relid=28178.

[4] SUSTAINABLE BUSINESS LEADERSHIP FORUM, NATIONAL VOLUNTARY GUIDELINES: CREATING A CONDUCIVE POLICY ENVIRONMENT FOR RESPONSIBLE BUSINESS AND RESPONSIBLE INVESTMENT IN INDIA, 6, (JULY, 2011)http://sblf.sustainabilityoutlook.in/file_space/NVG%20Genesis%20Document.pdf ["NVG"].

[5] MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA, NATIONAL GUIDELINES ON RESPONSIBLE BUSINESS CONDUCT, 3 (2018).

aims to discern the possible rationale and purpose of the Ministry of Corporate Affairs ("MCA"), behind introducing the NGBRC.

Following which each of the principles set forth by the NGBRCs is analysed and categorised to quantify its impact on the pre-existing domestic legal framework. Lastly, an effort has been made to study the current and possible futuristic impact of the NGBRCs on the current domestic corporate governance norms as well as, India's international obligations as under the United Nations Guiding Principles on Business and Human Rights ("UNGPs").[6]

I. BACKGROUND

Through the introduction of the Charter, the Government was hopeful that businesses would become conscious of their responsibility towards holistic national development, and would prioritize sustainable form of economic growth.[7] Additionally, the government identified the need for a policy change which would compel enterprises to create a responsible and transparent business setup.

Against this backdrop of initiatives focused on creating global standards for Environmental, Social and Governance ("ESG")

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[6] UN HUMAN RIGHTS OFFICE OF THE HIGH COMMISSION, GUIDING PRINCIPLES ON BUSINESS AND HUMAN RIGHTS IMPLEMENTING THE UNITED NATIONS "PROTECT, RESPECT AND REMEDY" FRAMEWORK, Principle 17, (2011), https://www.ohchr.org/documents/publications/GuidingprinciplesBusinesshr_eN.pdf ["UNGP"].

[7] MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA, NATIONAL ACTION PLAN ON BUSINESS AND HUMAN RIGHTS- ZERO DRAFT (2018) ["NAPBHR"].

management and disclosure[8] such as the Global Reporting Initiative, the London Principles of Sustainable Finance, market interest in incorporating ESG metrics in business decision making peaked.[9] This concurrence of governmental and market interests led to a homegrown initiative to regulate and promote responsibility among business enterprises with regard to environmental and social factors.

Pursuant to this concurrence, the Indian Institute of Corporate Affairs ("IICA"), a think tank established by the MCA created specifically for the promotion of inclusive growth and sustainable development, entered into a formal agreement with Deutsche Gesellschaft für internationale Zusammenarbeit ("GIZ") in 2007. The primary aim of this four-year collaboration was to introduce sustainable business practices in the Indian market which not only met the internationally established standards but also enabled Indian businesses to engage with their foreign counterparts in a holistic fashion.[10]

The first phase of development of business guidelines began with steps to formalize the process of drafting the guidelines for which the IICA established an Expert Group ("EG") in 2008. EG, under the aegis of the collaboration between IICA and GIZ, set their focus on "developing a set of guidelines on social, economic and

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[8] KPMG, The KPMG Survey of Corporate Responsibility Reporting 2017 (2017), available at https://home.kpmg/xx/en/home/insights/2017/10/the-kpmg-survey-of-corporate-responsibility-reporting-2017.html.

[9] NVG, supra note 2, at 7.

[10] AJOY DATTA ET. AL., PROMOTING BUSINESS RESPONSIBILITY IN INDIA, 15 (2013) ["DATTA"].

environmental responsibilities for companies to adopt with a system of voluntary disclosure".[11]

It was noted in 2009 that the work of EG needed to be streamlined and thus the guidelines sub-committee was reformulated as the Guidelines Drafting Committee ("GDC"). GDC's early version of the draft was presented to the MCA under the title, "National Voluntary Corporate Social Responsibility Guidelines" or the "GDC Draft Guidelines".[12] These were then renamed on account of technical additions to "National Voluntary Corporate Social Responsibility Guidelines".[13] The members of the GDC intentionally tried to draft the guidelines in a manner which enabled businesses to accomplish more than their regulatory requirements. In July 2011, the MCA released National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business ("NVGs") consisting of a set of nine principles, which functioned as a catalyst for the promotion of responsible business conduct.[14]

The NVGs were formulated with the goal to create a relevant and comprehensive framework for businesses in India to measure, manage and disclose the impact of their operations on economic, social and corporate governance metrics, which constitutes the basis

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[11] Id., at 16.
[12] Id., at 24.
[13] Id.; MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA, CORPORATE SOCIAL RESPONSIBILITY VOLUNTARY GUIDELINES (2009).
[14] MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA, NATIONAL VOLUNTARY GUIDELINES ON SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS (2011).

of sustainable practices.[15] The NVGs introduced a mechanism to mainstream disclosure/reporting on these metrics. This disclosure mechanism was reflected in the Business Responsibility Report Framework ("BRR") released by the Securities and Exchange Board of India ("SEBI") in July 2012. SEBI announced in November 2011 that the top 100 companies in terms of market capitalization were mandated to submit business responsibility reviews as part of their annual reports, and in order to enforce compliance for the same followed an 'Apply or Explain' mechanism.[16] This was extended to the top 500 companies in FY 2015-16.[17] Following this, SEBI released a circular on August 13, 2012 mandating business enterprises to prepare and submit business responsibility reports as part of their annual reports from December 2012.[18]

Initially, the government intended the NVGs to serve as an indicator of what responsible businesses should focus on, however with increasing national and international need for business accountability towards the society, the government introduced Section 135 to the Companies Act, 2013[19] and Corporate Social

[15] NVG, supra note 2, at 7.
[16] Id.
[17] SECURITIES AND EXCHANGE BOARD OF INDIA, SEBI/HO/CFD/CMD/CIR/P/2017/10, INTEGRATED REPORTING BY LISTED ENTITIES (2017).
[18] SECURITIES AND EXCHANGE BOARD OF INDIA, CIR/CFD/DIL/8/2012, BUSINESS RESPONSIBILITY REPORTS, (2012)
[19] Companies Act, 2013 § 135.

Responsibility Rules, 2014.[20] This inclusion enabled the second phase in developing the requisite guidelines.

Soon thereafter, a need was felt to create a robust and comprehensive set of guidelines to enhance the corporate governance framework in India, which stemmed from the consultations with relevant stakeholders including Union Ministries, the National Human Rights Commission, SEBI, domain experts, and other notable practitioners, including representatives from industry associations wherein issues pertaining to business and human rights were deliberated upon.[21] This process was initiated in September 2015, which resulted in formulation and release of the final guidelines in the public domain in 2018 under a revamped title, i.e. NGRBC. As mentioned before, it comprises of principles requiring businesses and their various stakeholders in the value chain to act in a responsible and sustainable manner.

II. RATIONALE AND PURPOSE

The purpose behind the introduction of this set of voluntary guidelines was to help businesses adopt and introduce in their operations, including their value chains, a social, environmental and corporate governance friendly approach. Such a conscious effort towards responsible business practices is termed as the 'triple bottom line' approach.[22] The main goal of the MCA was to provide

[20] The Companies (Corporate Social Responsibility Policy) Rules, 2014
[21] NAPBHR, *supra* note 3, at 12.
[22] MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA, NATIONAL GUIDELINES ON THE ECONOMIC, SOCIAL AND ENVIRONMENTAL RESPONSIBILITIES OF BUSINESS, 11 (2018) ["ECERB GUIDELINES"]

indigenous business enterprises a platform to better engage with the foreign competition.

Hence, it was need of the hour to reformulate and develop a comprehensive set of home-grown guidelines which offered guidance on the core areas of sustainable growth, methods of implementation and the benefits the various stakeholders in the enterprise and the value chain would receive on consciously adopting them.[23] Especially in light of several international ESG metrics, such as UN Global Initiative, GRI, the EG developing the NVGs thought it to be even more important to develop an 'India-specific' angle to a set of guidelines, using the aforementioned ones only as references. This unique tailoring, the EG believed would ensure greater compliance and uniformity, as it would prevent 'shopping' around for guidelines in the global market.[24]

In its public release, the MCA notes that the UN Guiding Principles on Business and Human Rights, and the Sustainable Development Goals ("SDGs") acted as key drivers towards the reforms in the NVGs.[25] In the global community, the due diligence obligation of transnational enterprises with regard to human and environmental rights has gained considerable importance and the need to comply

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[23] SURYA DEVA, ETHICAL TRADING INITIATIVE, BACKGROUND PAPER FOR INDIA'S NATIONAL FRAMEWORK ON BUSINESS AND HUMAN RIGHTS, 9 https://www.ethicaltrade.org/sites/default/files/shared_resources/india_national_framework_bhr_background.pdf ["SURYA"].

[24] DATTA, supra note 6, at 26.

[25] Press release, Press Information Bureau, MCA releases national guidelines on responsible business conduct, MINISTRY OF CORPORATE AFFAIRS GOVERNMENT OF INDIA (2019), https://pib.gov.in/Pressreleaseshare.aspx?PRID=1568750.

with them is felt worldwide. In order to comply with India's obligations as a signatory to the United Nations Human Rights Council, and to better equip smaller enterprises and Micro, Small and Medium Enterprises ("MSMEs") to enhance their performance, the NVGs were updated five years after their release.

In the annexure provided along with the public release,[26] the EG has clearly laid out how each principle corresponds with its counterpart in the SDGs as adopted by the United Nations General Assembly. These SDGs in its 2030 Agenda for Sustainable Development, list the social and environmental benchmarks which countries must attempt to attain by 2030.

A considerable portion of the recently amended guidelines, finds its origins and inspiration from the UNGPs and the ILO Core Conventions 138 and ILO Core Convention 182, to which India is a signatory.[27] The ILO is the internationally recognized body established to extensively deal with international labour standards and promote fundamental rights of workers, as is recognised in the ILO 1998 Declaration on Fundamental Principles and Rights at Work.[28] The MCA claims to have relied upon these core ILO documents while remaking the guidelines, and the same can be evinced by their comprehensive questionnaire under BRR.[29]

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[26] Id.
[27] NGBRC, supra note 16, at 13.
[28] International Labour Organisation, Declaration on Fundamental Principles and Rights at Work (1998) https://www.ilo.org/wcmsp5/groups/public/---ed_norm/-declaration/documents/normativeinstrument/wcms_716594.pdf.
[29] SECURITIES AND EXCHANGE BOARD OF INDIA, CIR/CFD/CMD/10/2015, FORMAT FOR BUSINESS RESPONSIBILITY REPORT (BRR) (2015).

For instance, Principle 3, which deals with the bulwark of ILO obligations, seeks to encompass guidelines on number of employees hired on temporary/contractual/casual basis, permanent women employees, permanent employees with disabilities and complaints against the business on grounds of child labour, forced labour, involuntary labour, sexual harassment complaints in the last financial year and pending, as on the end of the financial year.[30]

In order to implement the UN's 'Protect, Respect and Remedy' framework, the Human Resource Commission endorsed the Guiding Principles as prepared by the Special Rapporteur John Ruggie on the interplay between business enterprises and human rights and obligations of the State. The Guiding Principles seek to clarify the obligations of business enterprises in furtherance of the negative impact caused on society and environment, in the last few decades.[31]

Keeping this objective of UN's 'Respect' principle in the forefront, the NGRBC's Principle 5 tries to encompass policies required of a company in order to safeguard human rights. However, it remains unclear whether the businesses are required to extend this to group or joint ventures, suppliers, contractors or NGOs they work with. The government also tried to bring into the ambit of Principle 5 stakeholder complaints that were lodged against a particular

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[30] NATIONAL HUMAN RIGHTS COMMISSION, HUMAN RIGHTS MANUAL FOR DISTRICT MAGISTRATE (1st ed.) (2007).

[31] John Ruggie (Report of the Special Representative of the Secretary General on the issue of human rights and transnational corporations and other business enterprises) A/HRC/17/31, 3-4 (2011) ["RUGGIE"].

business in the preceding financial year and how many of these complaints were satisfactorily resolved by the management.

Another reason behind India's drive towards such principles was its obligations towards Paris Agreement on Climate Change of 2015. India, being a signatory has started taking steps to ensure that businesses are in compliance with their environmental obligations. Subsequently, the principles also address that businesses must take precautionary and preventive steps to minimize the risk of environmental damage that often accompanies economic development.

The Indian government by introducing the NGBRCs have done the bare minimum it needs to do to meet its international obligations under several treaty bodies, however the next part of this article examines if these principles are compatible with the domestic laws of India and are in line with the developing international standards for responsible business conduct.

III. PRINCIPLES AND THEIR LEGAL COMPATIBILITY

The NGRBC were promulgated in 2019, with the aim to promote an environment of mutual trust between the businesses and stakeholders, and improve business advocacy and consultation in policy measures. Though the biggest criticism these voluntary guidelines face is that they lack legal enforceability, the NGRBCs were intentionally drafted to be wide and all-encompassing with the intent of complementing the already existing national jurisprudence and to provide business enterprises flexibility in adhering to them.[32]

These principles were formulated as a means of initiating dialogue amongst the business and their respective value chains, including the affected members of the community and relevant ministries. Blind introduction of these guidelines in a code of conduct shall not suffice as appropriate adoption of the same. Rather, businesses are expected to recognise and prioritise core elements of each guideline, integrate them into the business strategy by mapping policies and formulating targets in line with the NGBRCs, while disseminating the same across all points of engagement in the value chain.[33]

Each of these principles, inspired from leading global frameworks[34] propagating the same can be divided into three basic groups, responsible business conduct owed, (A) towards the economy, (B) members involved in the value chain and consumers as well, and finally, (C) towards the community at large, which also includes the employees.

A. TOWARDS THE ECONOMY

Business enterprises owe a set of responsibilities to the aforementioned parties in order to promote sustainable growth and

[32] NVG, supra note 2, at 16.
[33] NGBRC, supra note 16, at 29 (Annexure 1).
[34] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES, (OECD PUBLISHING 2011 ed.); United Nations Global Impact Initiative, https://www.unglobalcompact.org/what-is-gc/participants/93951-Global-Impact-Initiative.

development of the economy within which it is operating.[35] The very cornerstone of responsible business conduct is found reflected in the first principle of these recent Guidelines, which espouses three core traits that all business enterprises are required to embody in their procedures, structures and functions, in whatever capacity possible. These being namely "Accountability, Transparency and Ethics".[36] This includes conduct ranging from creating a safe market environment free of unethical and anti-competitive practices, to engaging with government facilities in a non-discriminatory and responsive manner.[37] Businesses, due to the repository of resources they hold, are automatically assigned a position of influence over the government's economic policies and development agenda. This responsibility to collaborate for sustainable growth and equitable development of the economy must be treated with great caution, and only routed through the appropriate channels for fear of unfair competition.

While promoting the larger goal of economic stability in a particular geographic region, businesses must keep in mind the socio-economic impact their operations have on the local communities which form its market base, and thus take preventative measures to address and mitigate it. Business have the paramount responsibility to divert their large financial resources towards the development of unique processes and techniques which help reduce over-

[35] NGBRC, supra note 16, at 29 [Principle 8(2)].
[36] NGBRC, supra note 16, at 14 [Principle 1].
[37] NGBRC, supra note 16, at 27 [Principle 7(3)].

consumption, maintain market factors at static, stable levels in order to avoid unnecessary economic skirmishes.[38]

The core principles of transparency and accountability find themselves reflected in most national provisions, for example in Section 135 of the Companies Act, 2013 which requires companies to be responsible for its actions while striving to have a positive impact on the environment, consumers, employees, communities and other stakeholders.[39] Being formulated to act in sync with national legal mechanisms, this substantial increase in number of guidelines regulating socio-economic conduct of businesses demonstrate a revolutionary change in the way businesses are now approaching their obligations towards their consumers, employees, environment and the society at large.

B. TOWARDS THE STAKEHOLDERS

Decisions taken by business enterprises affect a diverse group of interested parties. This means the business enterprise is required to act responsibly towards the numerous actors involved across the various levels of the production cycle, such as the investors, stakeholders in the value chain and finally the consumers.[40]

In order to avoid conflict across the needs and interests of members involved at the various stages of the production process, businesses must engage in consultations with the stakeholders, as well as

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38 NGBRC, supra note 16, at 29 [Principle 8(3)].
39 Companies Act, 2013 § 135.
40 NGBRC, supra note 16, at 9.

investors, at regular intervals, in order to make the process of decision making more inclusive, and transparent.[41]

A transparent and accountable system of functioning is reflected through an appropriate disclosure mechanism which provides access to material information to the aforementioned interested parties.[42] The business is not required to disclose any information which imposes an administrative or financial strain on them, rather compliance procedures, performance reports and, policies and decisions of their enterprise.[43] Within it, relevant information also consists of non- financial metrics such as social and environmental risk assessments,[44] compliance with local customs in cases of intellectual property surrounding traditional knowledge,[45] fair and equitable mechanisms for grievance redressal in relation to displacement, and other adverse impacts upon the local community,[46] etc. A relevant and well-adjusted disclosure framework not only assists shareholders and investors improve their economic decisions,[47] but also helps consumers exercise appropriately their right of free choice.[48]

[41] NGBRC, supra note 16, at 21 [Principle 4(2)].
[42] NGBRC, supra note 16, at 15 [Principle 1(4) and Annexure 1].
[43] OECD, supra note 30, at 31.
[44] Id. at 31, ¶ 33; NGBRC, supra note 16, at 25 [Principle 6(3)].
[45] NGBRC, supra note 16, at 29 (Principle 8(6)); Nagoya Protocol on Access to Genetic Resources And The Fair And Equitable Sharing Of Benefits Arising From Their Utilization To The Convention On Biological Diversity, Article 12, UNEP/CBD/COP/10/27, (Oct. 20, 2010).
[46] UNGP, supra note 34, at 10, 32 [Principle 30, 8(5)].
[47] OECD, supra note 30, at 31.
[48] NGBRC, supra note 16, at 31 [Principle 9(2)].

Consumers and consumer satisfaction form the most integral part of the production life cycle of any business enterprise. Hence, the majority of energy employed in providing effective responsible services must be diverted towards the consumers and their related interests. These include introducing appropriate mechanisms for procurement, processing, collection and dissemination of consumer data, providing non-discriminatory forums for grievance redressal and actively propagating consumer education. Consumer education has come to the forefront with growing awareness amongst the market base and increasing complexity of markets.[49] Hence, business enterprises must prevent misleading any consumers by providing sufficient information regarding the product life cycle, the practices and materials employed, the risks involved, through the labelling or advertising procedure.[50] If a contravention or a blatant lack of these aforementioned requirements is found it shall lead to litigation under the Consumer Protection Act, 1986 which in addition to imposing huge costs, negatively affect the existing goodwill in the market. Thus, to avoid this, businesses must adopt at least an administrative, non-judicial redressal mechanism which provides an in-house mechanism to address consumer complaints.[51]

C. TOWARDS THE COMMUNITY

Due to the interconnectedness between the local community, which either encompasses the market base for the enterprises or the manpower employed in it, and the environment in which both them

[49] OECD, supra note 30, at 56, ¶ 89.
[50] NGBRC, supra note 16, at 31 [Principle 9(3), 9(6)].
[51] NGBRC, supra note 16, at 31 [Principle 9(7)].

and the business reside, it becomes absolutely pertinent for business enterprises to address their needs and interests. Also, in line with the precarious and rather all-encompassing nature of such obligations, businesses ought to pay a larger degree of care and caution to embody, as far as possible, responsible holistic conduct amongst its value chain partners and stakeholders alike. The core tenant to be maintained while being compliant across all three platforms, environmental rights and human rights, including the rights of the employees, is implementing 'risk based due-diligence'.[52] Inspired largely from the UNGPs, this tenant of due diligence requires businesses to recognise any risks or areas of risks in their value chain which can potentially amount to human or environmental rights, then take appropriate steps to prevent such violations, and if it has unwittingly occurred mitigate the adverse impact and redress satisfactorily any grievance arising from the same.[53] The business enterprises can hardly shrug of liability by claiming little to no involvement or knowledge, as the UNGPs clearly imposes responsibility on the business structure to educate and inform its stakeholders and its agents of the relevant policy measures to avoid human and environmental rights violations.[54]

Due diligence represents the basic conditions, largely preventative, a business governance is required to fulfil in furtherance of their obligations. This primarily consists of abiding by the basic proponents of human and employee rights, like the United Nations

[52] UNGP, supra note 34, at 18, 19 [Foundational Principle 11, 13].
[53] UNGP, supra note 34, at 22 [Operational Principle 17].
[54] UNGP, supra note 34, at 23 [Operational Principle 18]; NGBRC, Supra note 16, at 23 [Principle 5(4)].

Declaration of Human Rights, the International Covenant on Civil and Political Rights, the International Covenant on Economic, Social, and Cultural Rights, the 1977 ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.[55] The governance structure is required to develop strategies in consultation with the labour unions, and the potentially affected members of the community, for the implementation of satisfactory grievance administrative redressal mechanisms,[56] sound environmental management systems,[57] and non-discriminatory periodic evaluations and skill -training for the manpower involved.[58] In light of the recent debate surrounding, and instances of complicity of transnational corporations in human and environmental rights violations, business must focus their resources on building innovative solutions for assessing the adverse impact their operations can potentially have on the biodiversity and community, and employees alike.[59]

It is not surprising to find most of the above suggested voluntary guidelines reflected in more concrete forms in various national laws, such as the Environment (Protection) Act of 1986, and Public Liability Insurance Act of 1991. This is backed by Sections 252 to 323 of Companies Act, Clause 36 of the SEBI, Section 7 and Section 9 of Environment (Protection) Act, 1986 which requires persons handling industry operations to not allow emissions or

[55] UNGP, supra note 34, at 18 [Foundational Principle 12].
[56] NGBRC, supra note 16, at 19, 23 [Principle 3(3), 5(5)].
[57] NGBRC, supra note 16, at 25 [Principle 6(2)].
[58] NGBRC, supra note 16, at 19 [Principle 3(9)].
[59] NGBRC, supra note 16, at 25 [Principle 6(6)].

discharge of environmental pollutants in excess of the standards established, and furnish information to authorities and agencies in certain cases. These laws not only lay down the model of conduct to be followed by businesses, but also lay down consequences in case of non-compliance with the statutory requirements. Especially the employee guidelines find support in a variety of labour regulations, such as the Industrial Disputes Act of 1947, Trade Union Act of 1956, Equal Remuneration Act of 1976, Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act of 1995 which prescribe sanctions of plenary nature for contravention of basic provisions like equal pay, maternity leave, child or bonded labour, lack of appropriate disciplinary proceedings, etc.

This inevitably raises questions upon the contribution of these voluntary guidelines to the improvement in general business conduct and economic environment. However, voluntary guidelines that are in sync with the company's Corporate Social Responsibility ("CSR") obligations have proved important in providing companies with a prescriptive road-map though are not necessarily developed for regulatory or contractual use.[60]

IV. ANALYSING THE CURRENT SITUATION AND THE WAY AHEAD

Upon a detailed understanding of these guidelines, naturally, questions arise upon its importance and contribution to the enhancement of the existing corporate governance framework. This

[60] Bilaspur v. JSPL, Kharsia Road, Raighagh (CG), 2018 SCC OnLine ITAT 148.

especially crops up in light of pre-existing sufficiently functioning mandatory legal compliance mechanisms, as seen above. Further, upon taking into consideration India's dismal participation in the Working Committee Conferences hosted by HRC, and lack of reports submitted since 2011,[61] one can legitimately fear that the NGBRCs were framed by the MCA as mere vehicles of showcasing India's compliance to the international community. However, the author dissents against the notion that the recent guidelines are mere conversation pieces, and rather tries to establish in the following analysis why something more meaningful is at play.

The MCA rationale behind drafting the NGBRCs to be so wide and all-encompassing has been clearly discerned, as a means to raise awareness and initiate a crucial discussion amongst governance structures about the impact of responsible business behaviour. It can, thus, be argued against most individuals' criticisms that introduction of a set of voluntary guidelines by the MCA establishes an authoritative point to establish dialogue, informal or otherwise, amongst businesses and their stakeholders, which is one of the crucial aims of the UNGPs.

The UNGP, OECD, and other treaty bodies did not establish any hard and fast rule for implementation of their respective guidelines,

[61] The Working Committee conducts surveys among member states in hopes of collecting, processing and analysing the data with relation to the guidelines established to measure the progress made with relation to compliance of business and human rights. As evinced from the surveys published on the official OHCHR website, India has failed to participate in this process since 2011, up to even 2019, post the publication of the various voluntary Guidelines. See supra note 20, at 9.

rather focused on enhancing corporate responsibility by emphasising on best efforts to be taken by the countries.[62] Instead of a piecemeal approach to specific areas, countries have leeway in ensuring that businesses are doing basic rudimentary requirements that ensure that the society at large is not negatively affected. This can be achieved by way of legislation, action plans, guidelines, indicators, or any other mechanism the government deems fit enough to bring about a change.[63]

A large number of interesting initiatives by independent organisations and states, as well as creation of a platform for dialogue on business and human rights would have been impossible, had the UNGPs not set the ball rolling by providing such a solid bedrock.[64] The OECD Due Diligence Guidance for Responsible Business Conduct which are currently being implemented by 48 countries, is a perfect example of this.[65] The Organisation for Economic Co-operation and Development (OECD) adopted these guidelines, which much like the NGRBCs aim to cover all sectors of the economy including business operations, supply chains, human rights, labour, the environment and corruption.

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[62] UNGP, supra note 34, at 4 [Principle 3].

[63] RUGGIE, supra note 27, at 5, ¶14, 15.

[64] Directorate-General for External Policies Policy Department, Implementation of the UN Guiding Principles on Business and Human Rights, EUROPEAN PARLIAMENT (2017), 18, http://www.europarl.europa.eu/RegData/etudes/STUD/2017/578031/EXPO_STU(2017)578031_EN.pdf.

[65] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, DUE DILIGENCE GUIDANCE FOR RESPONSIBLE BUSINESS CONDUCT, (OECD PUBLISHING, 2018) ["OECD"].

Countries like Colombia, Lithuania, Argentina, Egypt, Kazakhstan, Morocco, Tunisia and Ukraine are also adherents to these guidelines which primarily deal with government-backed standard for corporate due diligence on responsible business conduct.[66]

As the international forum provides abundant room for flexible implementation, various countries have taken different mechanism to incorporate these in their legislation. While France has adopted legislation for corporations to abide by their duty to prevent human rights violations in global supply chains,[67] other countries like Germany,[68] United States of America,[69] and South Africa have

[66] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, PROGRESS REPORT ON NATIONAL CONTACT POINTS FOR RESPONSIBLE BUSINESS CONDUCT, C/MIN(2019)7 (May 13, 2019), http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=C/MIN(2019)7&docLanguage=En; ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, RESPONSIBLE BUSINESS CONDUCT AND THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2015); ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, ANNUAL REPORT ON THE OECD GUIDELINES OR MULTINATIONAL ENTERPRISE, (OECD PUBLISHING, 2014).

[67] European Coalition for Corporate Justice, France adopts corporate duty of vigilance law: a first historic step towards better human rights and environmental protection, Corporate Justice, http://corporatejustice.org/news/393-france-adopts-corporate-duty-of-vigilance-law-a-first-historic-step-towards-better-human-rights-and-environmental-protection.

[68] National Action Plans on Business and Human Rights, Germany's NAP, https://globalnaps.org/country/germany/.

[69] OFFICE OF COMMERCIAL AND BUSINESS AFFAIRS, U.S. NATIONAL ACTION PLAN ON RESPONSIBLE BUSINESS CONDUCT, U.S. DEPARTMENT OF STATE OFFICE OF COMMERCIAL AND BUSINESS AFFAIRS (16th December, 2018), https://2009-2017.state.gov/documents/organization/265918.pdf.

committed to monitoring company implementation of due diligence as part of their national action plans on business and human rights.

India on similar lines has made the NGRBCs broad enough to be compliant with legislation, which in effect make these guidelines more indicative of the legislative scheme of India. Despite these guidelines lacking enforceability, Indian courts have held that guidelines based on a recognized set of basic objectives help promote holistic development and therefore best efforts should be made to comply with them.[70] These guidelines allow the Indian government facilities, and business enterprises alike, to adjust and modify their priorities and future course of action as required, ensuring efficiency in policy achievement across various levels.

The UNGPs have proved to be an essential starting point for improving awareness and enhancing business frameworks with regard to the adverse transnational effects business enterprises have on disadvantaged local communities. Ideally, though precarious, a combination of mandatory rules as well as a voluntary code of conduct that operate in conjunction shall assist in establishing a concrete base for human and environment rights due diligence.[71] As stated by Professor Umakanth Varottil, "The mandatory rules may lay down the basic minimum inviolable standards, while the voluntary code of conduct may build upon the basic foundation in order to set out standards of good desirable conduct."[72] In 2014,

[70] C. Venkatachalam v. Ajitkumar C. Shah, (2011) 9 SCC 707.
[71] U. Varottil, India's Corporate Governance Voluntary Guidelines 2009: Rhetoric or Reality?, 22(2), 16 NATIONAL LAW SCHOOL OF INDIA REVIEW (2010).
[72] *Id*.

such steps to lend more credence to the intentions behind UNGPs were taken with the establishment of an open-ended Intergovernmental Working Group in favour of which India had also voted.[73] This Working Group was established upon the multiple requests by South Africa and other Latin American countries, with the mandate to "elaborate on an international legally binding instrument to regulate the activities of transnational corporations and other business enterprises."[74]

The UNGPs, as Special Rapporteur Ruggie so succinctly put it, a floor and not the ceiling,[75] merely a guide to what is the minimum a country could do in terms of due diligence with respect to human rights, environmental protection, labour rights. In furtherance of this, several counties have not only adopted detailed development plans that delineate mandatory due diligence requirements including conducting social and environmental impact assessment,[76] but have

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[73] SURYA, supra note 20, at 19.

[74] Human Rights Council, Promotion and protection of all human rights, civil, political, economic, social and cultural rights, including the right to development at Twenty-sixth session, U.N.Doc. A/HRC/RES/26/9, (Jul. 14, 2014).

[75] Prof. John Ruggie (Special Representative of the Secretary-General on Human Rights and Transnational Corporations and Other Business Enterprises), 63rd session of the General Assembly Third Committee Agenda Item 64 (b): "Promotion and protection of human rights: Human rights questions, including alternative approaches for improving the effective enjoyment of human rights and fundamental freedoms (Oct. 27, 2008), https://www.business-humanrights.org/sites/default/files/reports-and-materials/Ruggie-statement-UN-General-Assembly-27-Oct-2008.pdf.

[76] Meetings Coverage and Press Releases, Delegates Discuss Guidelines for Content of Environmental Impact Assessment Reports, as Negotiations on New High Seas Treaty Enter Second Week, UNITED NATIONS,

also donated a portion of their profits to the beneficial causes in society.[77] Along similar lines, India not only has multiple due diligence requirements underlined under its various statutory provisions which mandate companies engaging in certain kinds of activities to adhere to the side of abundant caution but also requires companies to make financial contributions towards the societal upliftment of the general populace.

With the overall broad objective of making the businesses responsible towards the society, Indian government has recently amended the provisions of the Companies Act 2013 relating to the CSR requirements under Section 135 which now provides for a three-year jail term if the new CSR norms are not followed. This move only enables the government to ensure that the companies follow throw their responsibility to society. The government has identified the social causes and action plans to which the CSR funds would be redirected which include Swachh Bharat Kosh, Clean Ganga Fund, and the Prime Minister's National Relief Fund, among others.[78]

https://www.un.org/press/en/2019/sea2098.doc.htm; Responsible Business Conduct Abroad, THE CANADA, https://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/other-autre/csr-rse.aspx?lang=eng; OECD, supra note 62.

[77] Crane, Andrew, Dirk Matten, Abagail McWilliams, Jeremy Moon, Donald S. Siegel, and Wayne Visser, Corporate Social Responsibility in Developing Countries, In The Oxford Handbook of Corporate Social Responsibility (OXFORD UNIVERSITY PRESS, 2008).

[78] The Companies Amendment Bill, 2019, Bill No. 189, Acts of Parliament, 2019 (India).

Corporate Affairs Minister Nirmala Sitharaman stated that this amendment was brought in to "ensure more accountability and better enforcement to strengthen corporate governance norms and compliance management in the corporate sector".[79] The impact of this amendment in the field of corporate governance can only be ascertained over time.

India has tried to achieve the international standard on article however the implementation is found to be lagging, due to laches such as lack of awareness, resources and overall disalienation on behalf of the business enterprises.[80] The effects and real time changes are yet to be determined which would paint us a clearer picture on whether the country has met the international standards.

V. CONCLUSION

All aforementioned principles, are symbiotic, and operate together to achieve the best outcome and therefore businesses should endeavor to implement them in a holistic manner. If businesses promote application of these guidelines, they should be mindful to the true essence and respect their individual characteristics, like gender, ethnicity, age, race, community, religion, socio-economic

[79] ET Bureau & Agencies, Companies Bill aims to cut NCLT load, tighten CSR compliance, THE ECONOMIC TIMES, https://economictimes.indiatimes.com/news/politics-and-nation/companies-amendment-bill-introduced-in-lok-sabha/articleshow/70378945.cms.

[80] Directorate-General for External Policies Policy Department, Implementation of the UN Guiding Principles on Business and Human Rights, 58, EUROPEAN PARLIAMENT (2017), http://www.europarl.europa.eu/RegData/etudes/STUD/2017/578031/EXPO_STU(2017)578031_EN.pdf.

status or sexual orientation. The burden lies on the government and on prominent businesses for adoption of these principles, which will encourage smaller enterprises to follow lead. Despite them being legally unenforceable, they can have significant impact if government changes their nature to semi-mandatory and semi-voluntary, and businesses take adequate self-initiative. The NGBRC principles shall prove to be an important reference point and stepping stone to the development of India's National Action Plan on Business & Human Rights (NAP), which is scheduled to be released in 2020.

One way of making the NGBRCs more authoritative in law would change the nature of these guidelines from voluntary to mandatory rules as well as introducing a comprehensive compliance questionnaire report that companies would be required to submit on an annual basis to the relevant authority. The mandatory rules should highlight the basic and core inviolable standards which cannot be abstained from and would attract legal sanctions for non-compliance. It will be a difficult task for the government to identify the balance between mandatory and voluntary nature of the guidelines. Future developments must include revamping and introducing comprehensive guidelines accompanied with an indicative module which guides businesses on how to comply with the guidelines along with a comprehensive questionnaire which they will be required to submit on a regular basis.

However, these principles have definitely proved to be groundbreaking, for they have paved the way for reigniting the discussion on corporate governance frameworks in India. This is because they have highlighted the essentiality of sustainable and all-encompassing growth, alongside amassing financial returns.

INCLUSION OF WOMEN IN THE BOARDROOM – *A REALITY OR A MIRAGE?*

Annapurna Sinharay *

ABSTRACT

Gender bias by discrimination against women is a problem which haunts our society till date. In a commendable move, the company legislation in India was overhauled and a provision was made for appointment of at least one woman director in certain class of companies. However, the issue of gender diversity is yet to be foregone. Various incidents have revealed that women are still struggling to make an impact; their inclusion in the boardroom has been reduced to a mere box ticking exercise. This article aims to review the provisions regarding the inclusion of women directors in the Companies Act, 2013 and discusses the multitude of challenges faced by women in the boardroom. To level the playing field, this article strongly advocates appointment of women as independent directors and invites appropriate legislative amendments to that effect.

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INTRODUCTION

The problem of discrimination on the basis of gender has followed us even into the 21st century. Like a sore it has festered over the ages. In the corporate sector, gender discrimination is particularly heightened.[1] On an average, women in India make up to 50% of the workforce of an organization but account for less than 4% of top executives in the nation.[2] Various sources have revealed that women directors are welcomed in pompously but when they voice their ideas, they are often snubbed off or disregarded. From an early stage, they are made aware that their appointment was made pursuant to a legal requirement and that they have authority in name only.[3]

Unbeknownst to the world, women have contributed significantly in rapid economic and social development processes globally. However, their acumen is hardly acknowledged. In a study conducted on gender disparity,[4] India was ranked 108 out of 136 countries in the world. Nevertheless, owing to widespread social unrest in some parts of the world, there has been a significant transformation in the mindset of the society regarding women and

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[1] 1 DEBORAH L. RHODE & BARBARA KELLERMAN EDS, WOMEN AND LEADERSHIP: THE STATE OF PLAY AND STRATEGIES FOR CHANGE, JOSSEY-BASS (1st ed. 2007).

[2] 5 DELLOITE GLOBAL CENTRE FOR CORPORATE GOVERNANCE, WOMEN IN THE BOARDROOM: A GLOBAL PERSPECTIVE 12 (5 ed. 2013).

[3] Deepika Nath, *Gently Shattering the Glass Ceiling: Experiences of Indian Women Managers*, 23 WOMEN IN MANAGEMENT REVIEW 24, 20-115 (2000).

[4] World Economic Forum, *The Gender Gap Report*, 2018 (February 23, 2019, 10:04 AM) http://reports.weforum.org/global-gender-gap-report-2018/shareable-infographics/.

their prospects. As a result, a handful of erudite women have been able to rightfully claim much coveted positions in the higher echelons of some of the most renowned corporations.[5]

The appalling apathy for gender diversity in the corporate sphere is reflected by India's company legislation which did not do much to promote gender diversity till 2013 even though the disparity was unmistakable. The Companies Act, 1956 was bereft of any legal mandate to companies to provide for entry to a minimum number of women as directors in the boardroom. Recently, however, amendments have been made. The new law, Companies Act, 2013, *inter alia*, provides for appointment of at least one woman director in certain class of companies.[6] However, the issue of gender diversity is yet to be foregone. Various incidents have revealed that women are still struggling to make an impact; their inclusion in the boardroom has been reduced to a mere box ticking exercise.[7] This article aims to review the position regarding the inclusion of women directors in the Companies Act, 2013 and discusses the multitude of challenges faced by women in the boardroom. To level the playing field, this article strongly advocates appointment of women as independent directors and invites appropriate legislative amendment to that effect.

[5] David A. Matsa & Amalia R. Miller, *A Female Style in Corporate Leadership? Evidence from Quotas*, 5(3) AM. ECON. J. APPL. ECON.138, 136-169 (2013).

[6] Section 149(1), Companies (Amendment) Act, 2013, Acts of Parliament, No.16 ["Companies Act"].

[7] Torchia, Mariateresa, Andrea Calabrò, & Morten Huse,*Women Directors on Corporate Boards: From Tokenism to Critical Mass*, 2 JOURNAL OF BUSINESS ETHICS 304 ,299-317 (2011).

I. SCENARIO IN OTHER JURISDICTIONS

Jurisdictions around the globe have secured the presence of women in their boardrooms by enacting legislation best suited to their socio-corporate milieu. For instance, in 2003, Norway made a headway into this trend by becoming the first country to enforce a gender quota requiring almost 500 firms including 175 firms listed on the Oslo Stock Exchange to raise the proportion of women on their Boards to 40%. Though the acquiescence to this stipulation was voluntary, in 2006 the Norwegian Parliament went a step ahead and made it mandatory, thereby fortifying the position in law, and imposing a penalty for the noncompliance of the law.[8]

Other countries in the Eurozone have also followed suit. In 2010, France reserved 40% seats for women on boards compulsorily for all its companies, irrespective of whether they were listed or not and it was stipulated that a breach of the said provision would entail suspension of the director's fees.[9] Along similar lines, Italy in 2011, introduced a legislation insisting state owned companies to have at least 33% of each gender on their boards (executives and non-executives) by 2015 (with a target of 20% for the transitional period).[10]

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[8] Aagoth Storvik & Mari Teigen, *Women on Board: The Norwegian Experience*, FRIEDRICH EBERT STIFTUNG, Jun. 2010.

[9] Portuges, Catherine, *French Women Directors Negotiating Transnational Identities*,115 YALE FRENCH STUDIES 52 , 47-63 (2009).

[10] EUROPEAN COMMISSION, National Factsheet Gender Balance in Boards,

In contrast, the United States of America has no quota requirement at the federal level and still has 22.5% women directors.[11] The California Senate, in 2013, approved a resolution formally encouraging gender diversity, which urges every Californian public company to have one to three women on its board of Directors by the end of 2016, depending on the size of the board.[12] The United Kingdom also has a fair women representation in its boards without any quota. However, developed Asian countries like China and Japan have only 8.4% and 2% of women representation respectively in the boardrooms, and have no quota requirement on the Boards.[13]

II. WOMEN IN THE INDIAN BOARD ROOM

In India, the erstwhile Companies Act, 1956 was the statute that enabled regulation of the formation, financing, functioning, and winding up of companies. It had been in existence for over 50 years, and was proving to be ineffective while handling complex issues in the context of the evolving requirements of India. Therefore, it was repealed in 2013 and the new Companies Act was enacted. The new Act has been the harbinger of change. It has ushered in radical modifications in the Indian corporate law regime. In a significant departure from the old act, the Companies Act of 2013 has

[11] YARON NILI, BEYOND THE NUMBERS: SUBSTANTIVE GENDER DIVERSITY IN BOARDROOMS,UNIVERSITY OF WISCONSIN LAW SCHOOL, LEGAL STUDIES RESEARCH PAPER SERIES PAPER (2018).

[12] DAVID A. KATZ, WACHTELL, LIPTON, ROSEN & KATZ, DEVELOPMENTS REGARDING GENDER DIVERSITY ON PUBLIC BOARDS, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (2013).

[13] Corporate Women Directors International, *2014 CWDI Report- Women Board Directors of Fortune Global 200*, 234, 200-245 (2014).

introduced a provision for mandatory inclusion of at least one woman on the Board of Directors in certain class or classes of companies. Section 149(1) of the Companies Act, 2013 provides that every listed public company shall have at least one third of the total number of directors as independent directors. It says:

"*Every company shall have a Board of Directors consisting of individuals as directors and shall have:*

a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

a maximum of fifteen directors: Provided that a company may appoint more than fifteen directors after passing a special resolution.

Provided further that such class or classes of companies as may be prescribed shall have at least one woman director."

Thus, the second proviso to Section 149(1) provides that a class or classes of companies shall appoint minimum one woman director on its Board. The said class or classes of people are explained in Rule 3(i) of the Companies (Appointment and Qualifications of Directors) Rules, 2014.

According to this Rule every listed company shall appoint at least one woman director within one year from the commencement of the second proviso to Section 149(1) of the Act. Every public company other than the listed companies, having a paid up share capital of Rs. 100 crore or more or turnover of Rs. 300 crore or more as on the last date of latest audited financial statements, shall also appoint at least one woman director within one year from the commencement of second proviso to Section 149(1) of the Act.[14] A period of six months from the date of the company's incorporation has been provided to enable the companies incorporated under Companies Act, 2013 to comply with this requirement. Existing companies (registered under the previous Companies Act) have to comply with the above requirements within one year. Further, if there is any intermittent vacancy of a woman director, then, it shall be filled up by the board within three months from the date of such vacancy or not later than the immediate next board meeting, whichever is later. This provision has been inserted in order to ensure that women get suitable opportunities to be appointed as directors in the company and to ensure gender diversity in the board. The need for introducing this important provision was felt due to the underrepresentation of women at the senior executive level in the corporate world.

A. ENSURING COMPLIANCE

The effectiveness of the above mentioned section depends on how capably it is administered. In order to ensure the compliance of the provision in the new Companies Act, it should be strictly enforced. However, the liability for non-compliance of this provision can be seen under section 450 of the Companies Act, 2013 which enshrines that:

[14] The Companies (Appointment and Qualification of Directors) Amendment Rules, 2014.

"If a company or any officer of a company or any other person contravenes any of the provisions of this Act or the rules made there under, or any condition, limitation or restriction subject to which any approval, sanction, consent, confirmation, recognition, direction or exemption in relation to any matter has been accorded, given or granted, and for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person shall be punishable with fine which may extend to ten thousand rupees, and where the contravention is continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues."

Along with the provisions of the Companies Act, 2013 the companies to be listed under the Securities and Exchange Board of India (SEBI) also have to comply with the provisions of Clause 49 of the Equity Listing Agreement.[15] Through a circular dated April 17, 2014, the SEBI released the amendments to Clause 49 of the Equity Listing Agreement.[16] The revised Clause 49 brings the Listing Agreement at par with the changes brought out in corporate governance in the Companies Act, 2013. The amended Clause 49 of the Listing Agreement includes the Composition of the Board of Directors under which, it is mandatory to have at least one woman director.[17] The non-compliance of any of the clauses of the Listing

[15] Securities and Exchange Board of India, Circular, CIR/CFD/POLICY CELL/2/2014.
[16] Securities and Exchange Board of India, Circular, CIR/CFD/POLICY CELL/7/2014.
[17] Indian Boards Database, *Clause 49-Listing Agreement* (23 February, 2019 12:23 P.M) http://indianboards.com/files/clause_49.pdf.

Agreement would result in disciplinary actions against the company which may include suspension or delisting of the securities.[18]

B. BENEFITS OF WELCOMING WOMEN DIRECTORS ON BOARD

The importance of having women in such vital positions cannot be overstated. As Zia Mody, Managing Partner at AZB & Partners, puts it "women have more patience, a higher emotional quotient, stated willingness to learn rather than 'pretend to know it all' and they are more inclusive".[19] It has been proved that women have a mellowing effect on driving board consensus and fostering innovation.[20] Ensuring the presence of women at the higher executive positions adds new perspectives to the discussions and further paves the way for increasing female leadership across all levels. [21]

A number of studies[22] reveal that companies with women on their board of directors demonstrate better cost-effectiveness, and are less likely to have cases of unethical behavior. A 2007 study by

[18] Securities and Exchange Board of India, *Issue of Capital, Memorandum to the Board* (22 February, 2019 9:23 P.M) http://www.sebi.gov.in/boardmeetings/132/issueofcapital.pdf.

[19] Philip Ljee, Rica Bhattacharyya & Kala Vijayaraghavan, *How Women Have to Work Harder and Smarter To Claim Their Rightful Space on Indian Corporate Boards*, 2 ECONOMIC TIMES BUREAU 123, 120-167 (2014).

[20] Vaibhavi Tadwalkar, Soundarya Lahari Vedula, *Representation of Women on the Board of Directors under Companies Act, 2013*, 4 CHRIST UNIVERSITY LAW JOURNAL 198, 190-231 (2015).

[21] *Ibid*.

[22] Burke, Ronald J., *Women on Corporate Boards of Directors: A Needed Resource*, JOURNAL OF BUSINESS ETHICS: 909-15 (1997); Burgess, Zena, & Phyllis Tharenou, *Women Board Directors: Characteristics of the Few*, JOURNAL OF BUSINESS ETHICS 45, 39-49 (2002).

McKinsey on the largest European companies found that those companies with at least three women on their executive committees significantly outperformed their competitors in terms of average return on equity by about 10% while operating profit was nearly twice as high.[23] This shows that women have a positive effect on the functioning and management of the affairs of the companies. Morgan Stanley Capital International ("MSCI") also found that companies with fewer women on board had more than average governance related controversies.[24] Diverse boards have lower volatility, better performance and invest more in research and development. Great diversity on the board increases a company's comparative advantage relative to firms with less diversity.[25]

However, in order to reap the benefits of a gender diverse board, three or more women are needed to create a 'critical mass'. In social studies, 'critical mass' refers to a sufficient number of adopters of an innovation in a social system so that the rate of adoption becomes self-sustaining and creates further growth. Section 149 falters in the creation of this critical mass. By prescribing

[23] McKinsey & Company, *Women Matter 2013 - Gender Diversity in Top Management: Moving Corporate Culture, Moving Boundaries*, Nov., 2013.

[24] Yu Liu, Zuobao Wei & Feixue Xie, *Do Women Directors Improve Firm Performance in China?*, 28 JOURNAL OF CORPORATE FINANCE 123, 120-140 (2014); Meggin Thwing Eastman, *Women on Boards: Progress Report 2017* (MSCI); Carolyn Wiley & Mireia Monllor-Tormos, *Board Gender Diversity in the STEM&F Sectors: The Critical Mass Required to Drive Firm Performance*, 3 JOURNAL OF LEADERSHIP & ORGANIZATIONAL STUDIES 12, 1-18 (2018)

[25] Campbell, K., & Mínguez-Vera, A., *Gender Diversity in the Boardroom and Firm Financial Performance*, JOURNAL OF BUSINESS ETHICS 340, 331-360 (2008).

appointment of 'at least one woman director', it fails to guard against the possibility of tokenism – a problem which is bound to fester in a male chauvinist society. At present, statistics show that public sector undertakings have two or less women on their directorate board. Therefore, they can still be considered as tokens. There is, thus, a need to reach 'critical mass' so as to prevent gross underutilization of female talents. Thus, the number of women on a board makes a difference. While a lone woman can and often does make substantial contributions, and two women are generally more powerful than one, increasing the number of women to three or more enhances the likelihood that women's voices and ideas are heard and that boardroom dynamics change substantially.[26]

C. PERCEIVED CHALLENGES ENCOUNTERED BY WOMEN DIRECTORS

Although the mandatory provision in the Companies Act, 2013, regarding appointment of women directors, has been a valuable intervention, considerable groundwork still awaits fruition. The full intended benefits of the law are yet to kick in as nearly 25% of the women appointees on boards are family members of the owners.[27]

The driving motive behind introducing reservation for women was to secure their better representation in the corporate sector and

[26] Torchia, Mariateresa, et al, *Women Directors on Corporate Boards: From Tokenism to Critical Mass*, JOURNAL OF BUSINESS ETHICS ,299–317 (2011).
[27] Dibyendu Ganguly, *Challenges that women directors on company boards face*, ECONOMIC TIMES BUREAU (July 7, 2016 8:45 P.M), https://economictimes.indiatimes.com/magazines/panache/challenges-that-women-directors-on-company-boards-face/articleshow/53095329.cms.

benefit them socially.[28] However, in an ironic twist of fate the said reservation instead of furthering the cause of these women tends to render them as pawns in the hands of their male relatives. This quota might be abused by promoters to ensure the domination and control of their family.[29] For example, Reliance Industries Limited inducted Nita Ambani, wife of Chairman Mukesh Ambani,[30] as a director and other companies like Godfrey Phillips India (Bina Modi, wife of K.K. Modi), Raymond (Nawaz Gautam Singhania, wife of Gautam Singhania), Asian Paints (Amrita Amar Vakil) and Kirloskar Oil Engines (Gauri Kirloskar) also appointed their own family members as directors in order to meet the requirements of the legislation.[31]

Another possibility of abuse can arise wherein the promoters might resort to the practice of 'window dressing', in order to comply with the provisions of the legislation, if the reservation is made strict and mandatory to all companies. In such a case, a situation similar to Norway might emerge in India. The Norwegian companies, in order to comply with the provisions of reservation promoted many

[28] Zhang, Jason Q., Hong Zhu & Hung-bin Ding. *Board Composition and Corporate Social Responsibility: An Empirical Investigation in the Post Sarbanes-Oxley Era.* 3 JOURNAL OF BUSINESS ETHICS 385, 381-92 (2013).
[29] Terjesen, Siri, Ruth V. Aguilera & Ruth Lorenz. *Legislating a Woman's Seat on the Board: Institutional Factors Driving Gender Quotas for Boards of Directors.* JOURNAL OF BUSINESS ETHICS 240, 233-51(2015).
[30] Press Trust of India, *Nita Ambani becomes first woman director on Reliance board*, BUSINESS TODAY (Jan. 21, 2019 4:35 A.M), https://www.businesstoday.in/current/corporate/nita-ambani-becomes-first-woman-director-on-ril-board/story/207364.html.
[31] Vaibhavi Tadwalkar, Soundarya Lahari Vedula, *Representation of Women on the Board of Directors under Companies Act, 2013*, 4 CHRIST UNIVERSITY LAW JOURNAL 198, 190-231 (2015).

women, with much less experience than their predecessors, to the position of the directors.[32] If this happens, it would certainly compromise the efficiency and would result in the reduction of the corporate productivity/profits.

III. WAY FORWARD- WOMEN AS INDEPENDENT DIRECTORS

The obstacles beleaguering the path of women directors are complex and abundant but they are not insurmountable. Due intervention, however, has to be initiated by the Legislature or other statutory authority to set things right in a chauvinist corporate environment. A possible panacea to this conundrum can be to reserve more seats for women on the Board[33] (preferably, three or more) and also to elevate some women to the status of 'independent director'.

The concept of 'independent directors' was discovered in the wake of mega scandals, which invited much soul searching in the corporate world. At last, a consensus was reached that large companies must be subjected to increased non-management supervision and among various ideas that were mooted, the concept of 'independent directors' emerged as a forerunner.[34]

[32] Kivisto, Peter, "*Diversity and the Eurosphere*" ETHNICITIES 581, 577-91(2014).
[33] Carolyn Wiley & Mireia Monllor-Tormos, *Board Gender Diversity in the STEM&F Sectors: The Critical Mass Required to Drive Firm Performance*, 3 JOURNAL OF LEADERSHIP & ORGANIZATIONAL STUDIES 12, 1-18 (2018).
[34] Madhuryya Arindam, *The Independent Director: Has it Been Indianised Enough*? NUJS LAW REVIEW 123, 120-29 (2013).

Section 149 in the Companies Act has attempted to bring the concept of independent directors into the legislative domain. It prescribes every public listed company must have at least one-third of its board as independent directors. It lays down an overarching subjective requirement of integrity, expertise and experience.[35] A major aspect of this provision is that it lays down the test of independence. An individual will not be considered independent if any of his relatives have had pecuniary relations or transaction with the company or with entities or individuals associated or affiliated with the company within two preceding financial years. Also, an individual will be barred if any of his relatives holds or has held a key managerial position, or is or has been an employee of the listed company during the preceding three years. The prohibition also applies if the proposed independent director or any of his relatives is or has been an employee, proprietor or partner of a firm of auditors, company secretaries or cost auditors of the listed company within the three preceding years. There is a similar restriction on employees, proprietors or partners of law firms or consultancy firms which have material business relationships with the listed company.

The concept of independent directors was introduced so as to protect various stakeholders within the company against the excesses of a self-serving management. It assumes significance in the present context because most companies invite women to the board perfunctorily, merely as a box ticking exercise. Often family members or near kith and kin are appointed so as to consolidate

[35] Section 149, Companies Act, 2013.

and further family domination. Such practices, firstly, compromise on the quality of human capital and secondly, interfere with the ability of these women to function autonomously. In contrast, inviting women to join the board as independent directors not only guards against the above-mentioned possibilities but also presents significant advantages. Firstly, it ensures the appointment of duly qualified, deserving women to the board whose soft skills, interpersonal abilities and creative gusto may bring new ideas to the table.[36] Secondly, this move will also ensure that a women director's opinion does not go unheeded. Thirdly, a number of studies[37] show that independent female directors have a positive impact on a firm's ethical behavior. Whereas a gender-imbalanced board signals that the management is less independent and more entrenched.

Measures to implement the above proposition are already underway. The Securities and Exchange Board of India ("SEBI") in its board meeting has decided that there should be at least one woman independent director in the top 500 listed entities by market capitalisation by April 1, 2019. Also, it has added that there should be at least one woman director in the top 1,000 listed entities, by April 1, 2020.[38] This was pursuant to a recommendation made by

[36] Hoogendoorn, Sander, Hessel Oosterbeek, & Mirjam Van Praag, *The Impact of Gender Diversity on the Performance of Business Teams: Evidence from a Field Experiment*, 7 MANAGEMENT SCIENCE 59, 1514-528 (2013).
[37] Steffensmeier, Darrell J., Jennifer Schwartz, and Michael Rochea, *Gender and Twenty-First Century Corporate Crime: Female Involvement and the Gender Gap in Enron-Era Corporate Frauds*, AMERICAN SOCIOLOGICAL REVIEW 450, 448-76 (2013).
[38] THE INDIAN EXPRESS, *SEBI to listed firms* (Feb. 12, 2019, 10:08 PM), https://indianexpress.com/article/business/business-others/sebi-to-listed-firms-split-cmd-post-6-independent-directors-must-on-board-5171954/.

the Kotak Committee on Corporate Governance.[39] The existing requirement of at least one-woman director was meant to bring in gender diversity in the board room. However, to achieve the true intent of the law, this amendment is necessary. It is hoped that following this a large section of competent human resources that remained hitherto untapped will now rightfully occupy the director positions.

IV. CONCLUSION

Like in most industries, scarcity of women is more prevalent in the upper echelons. Male-dominated industries are often 'designed by men, for men'. However, is the absence of women CEOs and directors something that can really be resolved politically? Is enforcing a quota on companies the right way to go about bridging the gender gap? My belief is that something drastic needs to happen to help redress the balance, be it aggressive government policies such as quotas, a swift transformation in corporate culture or a change in the way women view themselves, their prospects and confidence in the workplace. By systemically excluding a segment of society's talent from boards on the basis of gender, enterprises set themselves up for mediocrity by functioning at a sub-optimal level. Thus, any measure aimed at promoting gender diversity is set to benefit not only women but also the corporate sphere. The positive discrimination in favour of female boardroom appointments and provision for their appointment as independent directors are both

[39] SECURITIES AND EXCHANGE BOARD OF INDIA, *Kotak Committee Report on Corporate Governance* (Feb 11, 2019 12:39 pm))https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate-governance_36177.html.

instances of progressive intervention undertaken by SEBI. However, while the stepping stones of gender equality have been laid, there is, clearly, a long way to go before there can be a level playing field between a Sundari and a Sundar Pichai.

DEFINING CONTOURS OF ENFORCEABILITY IN NON-COMPETE CLAUSES IN EMPLOYMENT CONTRACTS

Purbasha Panda and Shambhavi Srivastava*

ABSTRACT

In the contemporary business matrix, non-compete clauses are a significant part of employment contracts. The scope and extent of non-compete clauses is always defined with respect to the doctrine of restraint of trade. This article attempts at analyzing judicial trends on enforceability of non-compete clauses, especially post-termination restrictive clauses across jurisdictions. It further attempts to highlight the difference between the approaches of English courts and Indian courts in terms of outlining the exceptions to the doctrine of restraint of trade. It revisits applicability of the "test of reasonableness" often discussed in judicial precedents and raises questions about the settled Indian legal position with respect to its applicability. In the article, we have argued about the inadequacies of Section 27 of Indian Contract Act, 1872, especially with reference to the statutory exception mentioned in the section. We further argue that an unbending jurisprudence of Indian courts also creates inconsistencies especially with reference to enforceability of garden leave clauses in employment contracts.

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INTRODUCTION

The employee-employer relationship is ever evolving, involving a myriad of facets and one of the most vexed questions pertaining to this relationship occurs at the stage of termination of the employee-employer relationship. Employment contracts have always incorporated restrictive covenants, whether in the form of non-compete clauses, non-solicitation clauses or confidentiality clauses, largely to protect their interests which can be hampered by an independent alternative employment of an ex-employee. The most tendentious of such clauses has been the "non-compete clause". Non-compete clause is basically a clause in an employment contract that restrains an employee from entering into a similar trade or competitive business for a certain period of time, primarily during his notice period and sometimes beyond the termination of his employment contract. The contentious nature of this is largely attributed to the fact that it involves questions of restraint of trade, the exceptions and limitations to restraint of trade, freedom of employment, anti-competitive practices, abuse of bargaining power and freedom of labour.

English employment law, previously known as law of master-servant emerged from medieval systems based on a feudal idea of status and land ownership, has since evolved over the centuries and has become solidly grounded in the law of contracts.[40] Traditionally, English courts adopted a very rigid interpretation of the doctrine of restraint of trade and refused to grant injunctions in favour of

[40] Greg T. Lembrich, *Garden Leave: A Possible Solution To The Uncertain Enforceability Of Restrictive Employment Covenants,* 102 COLUM. L. REV 2306 (2002).

employers and to enforce a restrictive covenant. Gradually, this position got diluted over a period of time by numerous factors namely evolving trade relations, judiciary devising new doctrines to decide on newly arising legal conditions. The Indian Law with respect to restrictive covenants is dealt by Section 27 of the Indian Contract Act, 1872.[41] It basically provides that an agreement in restraint of trade is void, however it provides one exception to this above rule mandated under the section. The Indian judiciary has been rather strict in obedience of the said provision. The possibility of other exceptions apart from this statutory exception to doctrine of restraint of trade has been enquired upon in the latter sections of the article, especially with respect to the effect of this rigid interpretation of the provision on some modern versions of non-compete clauses.

I. NON-COMPETE CLAUSES IN EMPLOYMENT CONTRACTS: A JUDICIAL PERSPECTIVE

A. NON-COMPETE CLAUSES: THE INDIAN JUDICIAL APPROACH

Indian courts have adopted a rigid approach and have held post-termination restrictive covenants to be in restraint of trade, however covenants during the term of agreement have been held to be

[41] § 27- Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.
Exception 1: Saving of agreement not to carry on business of which goodwill is sold-One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein, provided that such limits appear to the court reasonable, regard being had to the nature of the business.

enforceable. In the case of *Percept D' Mark (India) Pvt. Ltd v. Zaheer Khan & Ors.*,[42] famous cricketer Zaheer Khan had entered into an agreement for promotion and advertisement of a particular product with one company for a certain period of time, post which he entered into a similar agreement with another company, again for promotion and advertisement of their product. However, the first company filed a petition before the Bombay High Court under Section 9 of the Arbitration and Conciliation Act, 1996 ("Arbitration Act") for an interim order and injunction against Zaheer with respect to the agreement for promotion that he entered into with the second company. The agreement with the first company basically contained a post termination non-compete clause. The Supreme Court ruled on the validity of such non-compete clauses. The question of law before the Apex Court was, whether such a restrictive covenant sought to be enforced beyond the term of agreement amounts to an unlawful restraint provided under Section 27 of Indian Contract Act, 1872?

When the single judge bench of the Bombay High Court granted the interim injunction, the respondent filed an appeal and the Division Bench of Bombay High Court found the non-compete clause in the first contract to be void under Section 27 of the Indian Contract Act, 1872.

The court extensively discussed applicability of the "test of reasonableness". The court held that while construing the provisions of Section 27 of Indian Contract Act, 1872 neither the

[42] Percept D' Mark (India) Pvt. Ltd v. Zaheer Khan & Ors. (2006) 4 SCC 227, ¶67.

test of reasonableness nor principle of restraint being partial is applicable. Unless it falls under the exception engrafted under Section 27, any clause in restraint of trade is void. It is pertinent here to mention that though Section 27 provides that any agreement by which a person is restrained from exercising a lawful profession, trade or business of any kind is to that extent void, the exception being those agreements pertaining to businesses where goodwill is sold. It basically provides that a person selling goodwill of a business may agree with the buyer to refrain from carrying a similar business within specified local limits, provided that such limits appear reasonable to the court. The court in this case clearly ruled that the present set of facts do not fall under the exception engrafted under Section 27 and thus it is clearly in restraint of trade. The court ruled three very important points with respect to this case and held that:-

(a) A restrictive covenant extending beyond the term of contract is void and unenforceable.

(b) The doctrine of restraint of trade is not applied during the continuance of a contract of employment and it is only applied when the contract comes to an end.

(c) This doctrine is not just applicable to employment contracts, rather it is applicable to other contracts also.

In the case of *Gujarat Bottling v. Coca Cola,*[43] where this doctrine was used with respect to a franchise agreement, the court while acknowledging the growing trend to regulate distribution of goods

[43] Gujarat Bottling Ltd. v. Coca Cola (1995) 5 SCC 545, ¶31.

and services, held that an agreement which incorporates the clause that a franchise should not deal with competing goods and services is not in restraint of trade. This case was also referred in the *Percept D' Mark (India) Pvt. Ltd v. Zaheer Khan*.[44] As has been discussed in the next section of this article, it is seen that the concurring opinion of Justice A.P. Sen in *Superintendence Company of India (P) Ltd. v. Krishan Murgai* was not affirmed in this case.[45]

In the case of *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co. Ltd.,*[46] the court held that in employment contracts, all negative covenants are not in restraint of trade; for example, a requirement to maintain confidential information after the period of contract is not void if subject to certain qualifications.

B. SCOPE OF TEST OF REASONABLENESS ON RESTRAINT OF TRADE

Post-termination covenants and their enforceability has been clearly discussed by the Hon'ble Supreme Court in the case of S*uperintendence Company of India (P) Ltd. v. Krishan Murgai.* [47] Justice A.P. Sen, in his detailed opinion, has given a brief insight into the enforceability of restrictive covenants post-termination of contracts. In this case, one of the parties argued that, "it is not correct to say that all post-service restrictive covenants if it was reasonable, qualified or limited in operation, both in point in time and areas

[44] *Supra* note 3, ¶22.
[45] *Supra* note 4, ¶11.
[46] Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co. Ltd. (1967) 2 SCR 378, ¶17.
[47] *Supra* note 4, ¶7.

doesn't amount to any restraint of trade." Another argument submitted on justifiability of post-termination restrictive covenant was on the lines that a covenant, even if it is in restraint of trade would be effective if it satisfies the "test of reasonableness" as laid down by Lord Macnaghten in *Nordenfelt Case*[48] and is therefore enforceable despite Section 27 of the Indian Contract Act, 1872.

One of the important aspects of the "test of reasonableness" is that the onus rests upon the covenant to prove that the restraint is reasonable. The court observed that Section 27 does not address the distinction adopted by English law between partial restraints and total restraints, rendering all contracts falling within the terms of section void unless they fall within exceptions. However, the court resorted to a literal interpretation of the provision in the sense that, whenever there is a positive enactment of Indian legislature, the proper course is to examine the language of the statute, uninfluenced by any consideration derived from previous state of law or the English law upon which it was founded. The court ruled that when there is a legal provision, restrictive covenants post termination would be in restraint of trade and the "test of reasonableness" will not be applicable.

Though the decisions of Indian courts have clearly crystallized the position of law in these cases, diverging opinions do exist on applicability of the "test of reasonableness" with respect to restraint of trade. An argument in this respect has been made by Professor

[48] Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.Ltd., [1894] L.R. A.C.535.

Stephen Smith.[49] He has argued that the common law distinction of the tests into two stages of reasonableness and restraint is highly rigid and can be impractical. The decision whether a particular contract is a restraint or not, cannot be made without looking at the "test of reasonableness".[50] The English courts have gradually relaxed their approach with respect to restraint of trade. In the case of *Mitchell v. Reynolds*,[51] the court differentiated between general and partial restraints, it held that though all general restraints were void, partial restraint can be made enforceable in certain circumstances. It is in the *Nordenfelt Case*,[52] that the court rejected this distinction and resorted to the "test of reasonableness". The court relied on the test of reasonableness and it focused on whether the restraint is reasonable or not, it did not rely on the general and partial test. However, the question remains whether a rigid statutory interpretation adopted by Indian courts fulfills the contractual needs.

C. SECTION 27 OF INDIAN CONTRACT ACT, 1872: AN ANTIQUATED PROVISION?

The thirteenth Law Commission Report[53] observes that Section 27 follows the New York Draft Code and has described the code as the evil genius of the Indian Contract Act, 1872. The report has

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[49] S.A. Smith, *Reconstructing Restraint of Trade*, 15(4) OJLS 565 (1995).
[50] *Ibid*.
[51] Mitchell v. Reynolds [1711] 1 PMas 161.
[52] *Supra* note 9.
[53] Law Commission of India, *13th Report on Contract Law*, MINISTRY OF LAW AND JUSTICE (January 12, 2019 12:54 AM) http:// lawcommissionofindia.nic.in/1-50/Report13.pdf.

observed that the section does not reproduce the English Common Law. The section was enacted at a time when trade relations in India were underdeveloped.[54] It has been highlighted that there is a need to amend this provision[55] in order to update it, so that it can fulfill the contractual needs of an India where trade relations have significantly changed since the time this law was added. The report states that in terms of trade and finance, India does not lag behind anymore and there is no reason for not adopting a liberal approach towards interpreting this section. Due to heavy bargaining power of the employers, the Indian courts have generally ruled in favour of the employees, thus employees have always had this judicial safeguard. However, in case of contracts other than employment contracts courts, have ruled slightly differently. In the case of *GEA Energy System India Ltd v. Germanischer Lloyd Aktiengesellschaft*,[56] the Madras High Court has made certain observations with respect to restrictive covenants in joint venture agreements. In this case, the plaintiff wanted to restrain the defendant from establishing similar business in India on the ground that it would be prejudicial to its business interests. The court ruled that parties in this agreement have equal bargaining power and that the clause disallowed the defendant only to the extent of carrying on similar business in India. The High Court allowed the interim injunction restraining the other party from getting into similar business.

[54] *Ibid*.
[55] *Supra* note 14, ¶7.
[56] GEA Energy System India Ltd v. Germanischer Lloyd Aktiengesellschaft (2009)149 CompCas 689 (Mad), ¶21-22.

II. GARDEN LEAVE CLAUSE IN EMPLOYMENT CONTRACTS: A NEW VARIANT OF NON-COMPETE CLAUSE?

In the recent years, much discussion has been going around on incorporation of "garden leave clauses" in employment contracts, a very modern adaptation of non-compete clause. Having its root in English law, it is basically aimed at restraining the exiting employee in competing activities (including employment) for a certain period of time. The employee promises to provide the employer with a relatively long period of notice before terminating the employment and moving on to a competitor. In return the employer agrees to pay the employee's full salary and benefits during this period without requiring the employee to come to work.

There are two kind of garden leave clauses; one which remains effective during the notice period and another one which extends beyond the term of employment. This arrangement has been called "garden leave" because it assumes that the employee will stay home usually without being required to perform any official work while remaining financially secure.[57] One essential feature of this arrangement is that during this time the employees usually do not have access to any kind of employer's confidential information. Additionally, the confidential information in his possession becomes obsolete. A key difference between the post-termination restrictive covenants and garden leave clauses is not just that the employee is paid during the notice period, but, also the fact that he remains an employee of his previous employer.

[57] *Supra* note 1.

The validity of such a "garden leave clause" was first examined in the Bombay High Court case of *VFS Global Services Pvt. Ltd. v. Suprit Roy.*[58] The facts of this case pertained to the defendant who was an employee at plaintiff's company. He started out with the post of Senior General Manager and was later on transferred to another department at the post of General Manager. Additional terms and conditions were added in the contract, which mandated that the employee cannot participate with any other company carrying on similar business and shall not commence similar business during the period of employment or for a period of two years thereafter. The suit was filed seeking damages as well as interim relief in the form of injunction, against the employee. The case basically pertained to the operation of a garden leave clause post-employment. The plaintiff argued that such a clause is enforceable on the ground that the company is ready to pay the employee compensation, equal to three months' remuneration last drawn by the employee at the time of termination of resignation. The defendant argued that it is settled position of law in India that any restrictive covenant post-termination of agreement would be in restraint of trade.

However, in the case of *Kouni Travel Pvt. Ltd. v Asish Kishor,*[59] the existence of garden leave clause was upheld as it was for a limited time period to obviate any loss that may be caused to the plaintiff. It was further highlighted that restrictions in restraint of trade can be invoked to ensure the protection of trade secrets post-employment termination. Similarly, in the case of *Tapas Kanti*

[58] VFS Global Services Pvt. Ltd. v. Suprit Roy (2008) 2 Bom CR 446, ¶10.
[59] Kouni Travel Pvt. Ltd. v Asish Kishor (2007) (6) ALL MR 808, ¶4-5.

Mandal v. Cosmo Films Ltd.,[60] it was held that if the court finds it reasonable, the garden leave clause can be invoked for the interest of the plaintiff.

A. GARDEN LEAVE CLAUSE: AN ENGLISH PERSPECTIVE

Traditionally, the English courts have held post-termination non-compete clauses to be in restraint of trade until a 1986 case where, the English judicial approach underwent a dramatic shift with respect to employment contracts. The origin of garden leave clauses is often credited to the landmark case of *Evening Standard Co. Ltd v. Henderson*,[61] this case represented remarkable shift in how courts viewed employer-employee relationship with respect to restrictive covenants and restraint on trade.

In this case, the plaintiff was seeking to restrain its employee from taking up employment with another competing company during the garden leave period. The court granted an injunction against the employee on the ground that the defendant basically had two choices in this case, one is to go back and work for the employer and the other one is to not go back and to receive his consideration in the form of salary, thus being restrained from engaging with competitive entities. Though the court upheld the validity of the "garden leave clause" in the employment contract, it held that the injunction must not force the defendants to work for plaintiff and it must not reduce him to the condition of starvation. Basically, the

[60] Tapas Kanti Mandal v. Cosmo Films Ltd. (2018) 6 Bom CR 142, ¶46.
[61] Evening Standard Co. Ltd v. Henderson [1987] I.R.L 64.

court decided to enforce what would have been previously an unenforceable restrictive covenant.

Several cases followed after this, which judicially recognized a "garden leave clause" in an employment contract. In the case of *Provident Financial Group v. Hayward,*[62] the employee worked for the plaintiff and he resigned from his position in the company. The employee's employment contract mandated him to provide a year's notice prior to termination of agreement. It also required him to not be employed with any other competitor during the period of employment. The contract also had a clause which allowed the employer any time to refrain the exiting employee from entering the business premises or to suspend him from his duties. Nevertheless, in such circumstances he would be receiving his full salary. Post submission of the resignation, both the parties agreed to shorten the notice period to six months; he was made to stay out of the business premises, largely to restrict any flow of confidential information to him. After a short interval of time during his notice period, he informed his company that he is about to join another company within two days. After receiving the notice, the company decided to file a suit for injunction against him to prevent him from taking up his new job. The court did not allow the injunction, however it did make very crucial observations about employer-employee relationships and opined that inordinately long garden leave periods (in this case around twelve months) can actually give rise to scope of abuse in the hands of the employer by restricting the employee from finding an alternative employment. The court

[62] Provident Financial Group v. Hayward [1989] 3 All E.R. 298.

also observed that the proper remedy in these kinds of circumstances could be damages instead of injunction.

In the case of *JA Mont (UK) Ltd. v. Mills,*[63] which dealt with similar facts, the court provided limitations to garden leave clause. The panel found that while granting injunction, the factor of continued existence of employment relationship is of great importance. An employee owes his employer an implied duty of fidelity that prevents him from harming his employer by working for a competitor.[64] The limitations of garden leave were further extended in the case of *William Hill Organization Ltd v. Tucker*.[65] In this case, the civil division court of appeal held that employees cannot be placed on garden leaves unless there is a specific contractual provision allowing the employers to do so. In this case, an injunction was refused in favour of the employer on the ground that in absence of a garden leave clause in the employment contract, an employer could not place the employee on garden leave. Garden leave clauses, though are very recent, but the law relating to it is developing very organically. In the case of *Credit Suisse Asset Management Ltd v. Armstrong*,[66] the court held that it is basically the uncertainty with respect to restrictive covenants that actually led to the introduction of garden leave clauses.

B. GARDEN LEAVE CLAUSE: AN AMERICAN PERSPECTIVE

[63] JA Mont (UK) Ltd. v. Mills [1993] IRLR 172.
[64] *Supra* note 1.
[65] William Hill Organization Ltd v. Tucker [1998] IRLR 313.
[66] Credit Suisse Asset Management Ltd v. Armstrong [1996] ICR 882.

American courts have always viewed restrictive covenants with suspicion, especially those covenants which restrict the freedom post-employment of employees. The hostility is largely a result of certain concerns that the courts have showed with respect to enforcement of these kinds of covenants. The primary concern has been deprivation of ability to earn; which is contrary to America's general principle of promotion of free labor. There has also been a view that restrictive covenants are the products of unequal bargaining power between employers and employees and lastly, American courts have also viewed restrictive covenants as anti-competitive.[67]

In United States, non-compete agreements are lawful in most states and their enforceability depends on many factors. A valid non-compete clause must protect legitimate business interests, while customers goodwill is also a "protectable interest" in most jurisdictions. A non-compete clause post termination is considered valid only in exchange of payment of a certain consideration. The non-compete clause is also required to be reasonable with respect to time, geographical area and scope. Courts in the United States will generally not enforce a non-compete clause merely to prevent an employee to bring basic skills to a competitor. The employee might have become skilled or might have trained under his previous employer, however this does not constitute "protectable interests" required to enforce a non-compete clause.[68]

[67] *Supra* note 1.
[68] Todd A. Newman, *Is your Noncompete Agreement Enforceable*, AMERICAN BAR ASSOCIATION (Mar. 3, 2019, 4:45 PM),

The thirteenth amendment to the United States Constitution[69] prohibits involuntary servitude, so courts will not order specific performance of personal service agreements such as employment contracts. This restraint creates a dilemma for many employers. The cost of acquiring and developing human capital can be very high, especially when it involves extensive training, the revelation of confidential information, or exposure to key customers. An employer endures much of this expense before it can begin recouping its investment.[70]

III. CONCLUSION

Courts across jurisdictions, have viewed restrictive covenants with a great deal of suspicion. The crystallized legal position has been that restrictive covenants during the term of agreement are enforceable and restrictive covenants beyond the term of agreement are void. However, there is an essential need to examine whether the legal doctrines or judicial decisions relied on to arrive at this position are actually unerring or whether there is a need to revisit them. In the course of the article, the authors have also raised clear doubts about this settled legal position of non-reliance on the "test of reasonableness" while deciding on enforceability of restrictive covenants and the strict departure of Indian courts from common law in respect of applicability of this specific test.

https://www.americanbar.org/groups/gpsolo/publications/gpsolo_ereport/2015/october_2015/is_noncompete_agreement_enforceable/.

[69] U.S. Const. Amend. XIII, § 1.

[70].Maureeb C. Callahan, *Post-Employment Restraint Agreement: A Reassesment*, 52 UNIV CHIC LAW REV 703, 703 (1985).

The very idea of treating the statutory exception provided under Section 27 of the Indian Contract Act, 1872 as the only exception to the doctrine of restraint of trade and the straight rule developed by the Indian courts of rejecting the other common law exceptions needs to be seriously examined. Section 27 is the result of a foregone law, which is incapable of catering to the present contractual needs especially with respect to employment contracts. "Garden leave clauses" are a new form of the traditional restrictive covenants or the non-compete clauses but have met the same fate by becoming a victim of unbending jurisprudence. There is a serious need to revisit Section 27 and find out whether the exceptions provided under it cover the variety of contractual disputes that might arise with respect to restrictive covenants especially in employment contracts. A possible amendment to this provision might also give arise to the possibility of more incorporation of garden leave clauses in the employment contracts in India, in a way that it protects the interests of the employers and at the same time does not encroach upon the freedom of the employee to seek alternate employment.

HOSTILE TAKEOVERS AND DEFENCE MECHANISMS

Abhinav Srivastava*

ABSTRACT

What sets a hostile takeover apart from other forms of takeovers is the fact that it is 'hostile' in nature. The target company does not want to be acquired by the acquiring company. Yet, the buyer, or the acquiring company, in an attempt to gain control, forces the target company to agree to sell its undertakings. Hostile takeovers, by their very nature, are very difficult to pull off successfully and combined with various regulatory roadblocks and defence mechanisms available to a target company results in a situation where such takeovers are more of an exception rather than the norm. This article attempts to analyse – both the legal validity and efficacy – of various hostile takeover defences available to the management of a company in India. It will begin by analysing the underlying intent behind M&A transactions, and then explain precisely how each of the defences thwarts these intentions or makes it unfeasible to pursue them. It will then elucidate upon the various takeover defences that are used commonly around the globe, looking at the relevant provisions of various Indian laws to understand whether such a move would be legally permissible in India. It will conclude by putting forth an argument for one of the defence mechanisms as being best suited for the Indian legal system – both from a legal and economic perspective.

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INTRODUCTION

The terms 'merger' and 'acquisition' are used quite interchangeably, though there does exist a minute difference between the two. The term 'merger' generally refers to consolidation of two or more companies, while 'acquisition' is understood as purchase of one company by another. An acquisition transaction can be structured as a business/asset purchase or acquisition of shares of the company. Often, the difference between the two is that of degree.[1]

A takeover bid is an acquisition of shares carrying voting rights in a company in a direct or indirect manner with a view to gain control over the management of the company. Such takeovers either take place through friendly negotiations or in a hostile manner. A friendly transaction is one where the management of the target company recommends the offer of the bidder to the target's shareholders.[2] On the other hand, a hostile offer, as the negative connotation attached to its name suggests, is an offer that is unwelcome to the management of the target (for whatever reason).[3]

Companies in general take several different measures in order to repel hostile takeovers. This research article aims to elucidate the various defence mechanisms and ascertain which would work best under the Indian legal system. Takeover defences can be separated into four broad categories, mainly: *first*, those that make the target

[1] DONALD M. DE PAMPHILIS, MERGERS, ACQUISITIONS AND OTHER RESTRUCTURING ACTIVITIES 15 (9th ed. 2017).
[2] TIMOTHY J. GALPIN, THE COMPLETE GUIDE TO MERGERS AND ACQUISITIONS 8 (3rd ed. 2014).
[3] *Id.* at 9.

look unattractive; *second*, by counter-attacking the raider by bidding to take over the raider itself; *third,* by negotiations with the bidder to put an end to the takeover; and *fourth*, by asking a third party for help.

Despite experiencing M&A waves (and booms) like any other economy, India has faced a peculiar problem regarding the market for corporate control. Over the past few years, the Indian market has only seen a handful of hostile takeover bids – in fact, apart from the recent hostile acquisition of Mindtree by L&T, only six bids come to mind: Swaraj Paul-Escorts/DCM; Raasi Cements-India Cements; Gesco Corp & Abhishek Dalmia; Reliance-L&T; BAT-ITC; ICI-Asian Paints. This can largely be attributed to three main reasons:[4]

(I) Controlling shareholders are extremely prevalent in Indian corporations; in addition, financial institutions also hold significant stakes in these companies, and these tend to side with the controllers generally.

(II) It is necessary to obtain governmental approvals for financial acquisitions and due to the burdensome nature of this process, hostile takeovers are extremely difficult.

(III) The provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("SEBI Takeover Code")[5]

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[4] Umakanth Varottil, *Comparative Takeover Regulation and the Concept of 'Control'*, SING. JLS 208-231 (2015).

[5] Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, F. No. LAD-NRO/GN/2011-12/24/30181.

(especially the ones concerning creeping acquisitions) are extremely favourable to the existing controlling shareholders.

However, over the last few months, there have been positive developments with the L&T-Mindtree saga unfolding. One needs to recognize that this was nothing less than a signal for a new era in the Indian M&A landscape.

I. WHY ACQUISITIONS HAPPEN?

Before delving into the various defence mechanisms available against hostile takeover bids, it is important to answer a very preliminary question, why exactly do acquisitions or mergers take place? There are always two kinds of buyers/bidders in any M&A transaction, the strategic investor and the financial investor. The strategic investor would look to create synergy through an acquisition or a merger and would acquire the target solely for a strategic purpose – such as to create an economy of scale, save up production costs or diversify its portfolio or interests (as was the case in the recent L&T-Mindtree hostile takeover saga). On the other hand, a financial investor would have profit as his sole guiding motive in a transaction – most hedge funds and private equity firms would fall under this category. Although the motives are different, one common feature is that only those corporations that are underappreciated become a target for acquisitions. In other words, the raider or the acquirer believes that the market value of the target is much less than the true value. The main objective of any hostile takeover defence mechanism, therefore, is to ensure that the market value (or essentially the value that the acquirer ends up paying for the target) is so high that the acquirer gets discouraged.

II. DEFENCE MECHANISMS

There are several different defences available to a target in order to shield itself from the bidder. The essence of most takeover defence mechanisms is to make the company less attractive to potential bidders or to make the company more difficult to take over. A dichotomy exists in the kinds of defence mechanisms available to the management of a company – that is, a mechanism may be either pre-emptive or reactive. A pre-emptive or pre-bid mechanism (such as a poison pill or a golden parachute) would be resorted to in the event of a perceived threat, to ensure that no takeover offers are made in the near future. On the other hand, a reactive or post-bid defence mechanism (such as a crown jewel or white knight defence) is usually resorted to after a takeover bid is made.

A. GOLDEN PARACHUTES

In M&A parlance, golden parachutes are employee severance arrangements that are triggered whenever a change in control takes place. For the purpose of a golden parachute, 'change in control' is usually defined as an investor acquiring more than a fixed percentage of the company's voting stock. Golden parachutes have a dual purpose – first, they help stagger hostile acquisitions to a certain extent by creating an obligation on the target company to offer attractive severance packages to its executives if another entity acquires a pre-determined proportion of the shares or a change in control is effected; and second, they help align the interests of the shareholders with the board of directors/management in the event of a friendly acquisition, as the management would be more receptive to a friendly offer that would benefit them as well by giving them a lump-sum payment. Although the severance payments make the acquisition more expensive for the bidder (and therefore less attractive), it should be kept in mind that very often such severance packages are little more than a 'drop in the ocean' when compared to the actual cost of the takeover, thereby limiting its efficacy.

Section 196, and more broadly, Chapter XIII of the new Companies Act, 2013 ("the Act")[6] covers the appointment of managing and whole-time directors [for the corresponding provision under the previous Act (1956) one may refer to the erstwhile Section 269].[7] Furthermore, Section 197(1) of the Act limits the maximum permissible amount that may be paid in compensation to 11% of the net profits. However, Section 202 of the Act governs the 'golden parachute' agreements under Indian law. The only requirements under Section 202 are that it must be shown that there exists consent amongst the shareholders and that the resolution was passed in a general meeting, with sufficient prior notice.

However, the golden parachute defence tactic does not work as well in India as it does in other jurisdictions, such as those of the United States of America ("US") and the United Kingdom ("UK"). On a careful perusal of Section 202, one notices that it has a very important limitation. It reads, "A company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as

[6] Companies Act, 2013, Acts of Parliament No.16 ["Companies Act"], Section 196.
[7] Companies Act, 1956, Act of Parliament No. 62, Section 249.

consideration for retirement from office or in connection with such loss or retirement". The words "not to any other director" signify that Section 202 is limited to only managing or whole-time directors and not the entire senior level management as in several prominent cases in other jurisdictions such as the US. For example, in 2017, $55 million as a 'golden parachute' payment was made to Yahoo's Chief Executive Officer Marissa Mayer upon her termination post a takeover by the telecommunication giant, Verizon. This was over and above the $150 million she received in salary and stock awards since joining. Additionally, the Act places the limitation that 'golden parachute' payments cannot be made to directors that choose to resign themselves, thereby ensuring that Section 202 only applies to cases of forced exit.

B. POISON PILLS

This tactic owes its inception to prominent lawyer Martin Lipton in the 1980s to defend against a takeover bid aimed at El Paso Natural Gas Company. A 'poison pill', which is the nickname for a shareholders' rights plan, is a defence mechanism wherein rights to acquire securities are issued to stockholders. These rights can be exercised only once a certain 'triggering event' takes place (for example, a takeover attempt or tender offer for a certain percentage of the share capital) and it may be redeemed by the company at a nominal price until the occurrence of such event. This defence makes it difficult and costly to acquire the issuer/target, by providing existing shareholders with the right to purchase additional shares at a discount, thereby diluting the ownership of the acquirer.

Poison pills are generally adapted by the board of directors without shareholders' approval. The rights provided in a shareholder rights plan/poison pill are alterable and redeemable by the board of directors any time after the triggering event takes place. Although the success of a poison pill in prohibiting a takeover completely is not guaranteed, however, studies indicate that a poison pill mechanism not only ensures that shareholders get a fair price for their stakes during a takeover bid, but it also raises the percentage of premium received by shareholders.

Rights plans typically include both 'flip-in' and 'flip-over' features. Another variant of the poison pill is the Lobster Trap defence mechanism. The plan's flip-in feature comes into play when a raider triggers the rights plan by acquiring the percentage of the target's common stock specified in the plan. When this happens, each right then outstanding (other than those held by the buyer) flips-in and gives each holder the right to purchase shares of the target's common stock with a market value equal to twice the exercise price of the right.

In a flip-in plan, the existing shareholders of the target company, except for the acquirer, are given rights to purchase additional shares of the targeted company at a discounted price. What a flip-in provision does is deter the buyer from crossing the ownership threshold that will trigger the rights plan by confronting it with the prospect of substantial dilution. Since every holder except the buyer will be able to purchase new shares at a certain discount to current market, the buyer's ownership interest will be diluted if the flip-in provision of the rights plan kicks in. The actual amount of that dilution will depend on the exercise price of the rights, but it is almost invariably going to be quite substantial – substantial enough to make triggering the rights economically unviable.

In contrast, a flip-over plan is a tactic that gives existing shareholders of the targeted firm the rights to purchase shares of the acquiring company at a discounted price. This right only goes into effect when a takeover bid arises. In this plan, each common stockholder receives for each share owned a right to purchase shares of the surviving corporation upon the occurrence of a triggering event. Triggering events are typically the acquisition by a single purchaser or group of a specified amount of stock or the commencement of a tender offer for a specified percentage of the company's stock. Following the occurrence of a triggering event, the company issues certificates to stockholders that allow them to exercise and trade their rights. Because the rights issuance is in the nature of a dividend, it does not generally require shareholders' approval, although company by-laws may mandate this.

A flip-over plan should also include a provision that a transaction approved by the directors will not result in the stockholders' rights becoming exercisable even though the triggering events have occurred. Such a provision allows the company to seek a white knight.[8]

C. CROWN JEWEL/SCORCHED EARTH

[8] A white knight is an individual or a corporation that acquires a company which is on the verge of being taken over by an unfriendly acquirer or bidder. For more insight on white knights in hostile takeovers, refer to the part of the Article that discusses it.

The crown jewel defence is the sale of particularly attractive assets by the target company to dissuade a bidder from pursuing its takeover attempt. Such sales may also give the company flexibility and resources to fend off a bidder by generating capital and/or reducing costs. On the other hand, if a bidder is interested in a specific asset, such as a subsidiary, and is willing to acquire the entire company for it, the asset may be very valuable to the company as well, and its sale may be detrimental over the long term.

A variation of this defence is the 'scorched earth' defence wherein a company agrees to liquidate or destroy any and all valuable assets that it may hold, in order to make itself unattractive to the acquirer by diminishing its worth to as much extent as possible.

However, several financial experts and analysts state that this defence can prove to be counter-productive to the target company, since even in a best-case scenario, if it survives the takeover bid, it ends up losing its most-prized assets (often at an unfavourable price since potential buyers will take advantage of the target's vulnerable position and acquire their assets at prices lower than they usually would have paid). Even if the funds raised by the sale are used to repurchase stock, this would mean that the shareholders would end up having a stock at an inflated price and with little to no real assets – in short, a shell of a company. This tactic is one of the most disadvantageous defence tactics to a shareholder and rather than helping create value, as other defence tactics usually do, only ends up diminishing it.

In the Indian legal system, Section 180 of the Act restricts the powers of the board by requiring that any sale of an undertaking must be preceded by a special resolution which obtains the consent of the company concerned. Furthermore, the SEBI Takeover Code prohibits the sale, transfer, encumbrance and disposal of any material asset by the target company once the acquirer has made a public offer.[9] Hence, the crown jewel defence is not viable for a company operating in India.

D. PAC-MAN

The name for the strategy comes from the famous arcade game of the 1980s and the first instance of a Pac-Man defence being used was the instance involving Martin Marietta Corporation and Bendix Corporation – where Martin Marietta's actions were labelled as resembling "Pac-Man" in retrospect.[10]

In the event that a company discovers that it is about to be the subject of a takeover bid, it may choose to tender an offer for the would-be buyer itself, thereby turning the tables on the original acquirer. This tactic attempts to scare the original acquirer by making it known that it is also vulnerable to a takeover and must cease its takeover bid in order to survive. Such a defence is feasible in situations where the management of the original target believe that the amalgamation or merger of the companies will indeed create synergy and therefore be desirable, however they believe that they should be the people in charge (i.e. the surviving corporation). A Pac-Man defence may also be suited in situations where the target's cash-flow or assets are much more than the acquirer's.

[9] *Supra* note 7.
[10] Sandra Salmans, *Tumultuous Takeover Saga Ends: Allied and Bendix agree to merge*, NEW YORK TIMES 25 September 1982, at 5.

The disadvantages of the Pac-Man defence are that the original target company's stockholders will not receive any premium (the original target company may actually give the other company's stockholders a premium), it is very costly, and it may damage the company, even if successful.

E. GREENMAIL/TARGETTED SHARE REPURCHASE (BUYBACK)

A greenmail is nothing but a targeted share repurchase (called a 'buyback' in layman terms – though the term 'buyback' is usually indicative of a repurchase using excess of cash available to a corporation) aimed at buying out a hostile shareholder who has a significant shareholding in the company. It consists of a payment to buy back shares at a premium price in exchange for the acquirer's agreement to not undertake a hostile takeover. The promoters of Mindtree were considering the application of this defence tactic to fend off L&T's interest before the hostile takeover culminated. In exchange for the payment, the potential acquirer is required to sign a standstill agreement, which typically specifies the amount of stock, if any, that the investor can own, the circumstances under which the raider can sell stock currently owned, and the term of the agreement.

However, a greenmail is not the best tactic when it comes to defending against hostile takeovers and it is a fairly inefficient tactic – as other greenmailers may come to the forefront once they see that the company has succumbed once by paying a price much higher than the market price to repurchase the shares.

The Act also regulates buyback of shares through Sections 68-70. One of the main requirements that must be fulfilled for a buy-back to be valid is the passing of a special resolution. There are several other restrictions on buybacks, and this is one of the aspects of the securities market that SEBI governs closely. A buyback can only be financed via the free reserves of a company and it cannot be made by utilizing the proceeds of an earlier issue of the same kind of shares. In addition, the company is required to make a full disclosure of the relevant facts and the reason for the buyback. One drawback to a buyback as a defence is that it cannot be withdrawn unlike a public offer; therefore, in the event that the acquirer withdraws his offer in the near future, the target company would still have to carry out the buyback. An additional requirement exists if the buyback is sought to be carried out while the public offer is still in force, that is, the buyback must comply with the requirements of a 'competitive bid'.

F. SHARK-REPELLENTS

Also known as anti-takeover amendments, 'shark repellents' is an umbrella term used to refer to several different types of takeover defences that can be adopted by amending either a corporate charter or its by-laws. Usually the main objective of having a shark repellent is to ensure that the control of the board is maintained. In the 1980s, when the proxy fight tactics were made a popular medium of acquiring companies in a hostile manner, shark repellents were devised in order to combat this issue. There are several variations of shark repellents available to a company, however some of the most important ones are – staggered board elections, anti-greenmail provisions, supermajority provision amendments, fair-price provisions, super voting stock and restrictions on shareholder actions. Supermajority provision amendments generally involve amendments to the Articles of Association ("AOA") of the company, stipulating that takeovers must be approved by an unusually large majority of shareholders – usually kept at above 80% [Though generally a supermajority provision is accompanied by a clause empowering the board to waive this requirement in cases of friendly bids]. Anti-Greenmail provisions are special provisions in the company's charter which prohibit its board from approving greenmail payments. As the name suggests, fair price provisions seek to amend the AOA of the company and mandate that all shareholders are paid the same price across the board. The concept of super voting stock is a form of differential voting right, wherein ordinary shareholders are provided shares with only one vote per share, while on the other hand the founders or the promoters receive shares that have multiple votes, which ensures that control primarily stays with the founders, thereby negating the risk of a hostile takeover significantly. However, studies indicate that the most effective of anti-takeover amendments is a staggered board, where the members of the board are divided into different classes, only one of which is up for re-election every year.

For example, for a board consisting of 12 members, the directors may be divided into four classes, with each director elected for a four-year period. In the first year, the three directors, designated as Class 1 directors, are up for election; in the second year, Class 2 directors are up for election; and so on. Now, even if an activist shareholder/hostile shareholder gains control of a significant stock of the company, he would have to wait three-four years to be able to gain control of the board – a task that makes the takeover more expensive and cumbersome.

Bringing a shark repellent into effect, at least in India, is not a difficult task. The Act, through Section 14, allows for the alteration of the AOA through a special resolution, provided that it meets the relevant restrictions and limitations. Under the 1956 Act, for a staggered board, the former Section 255 stated that only one-third of the directors of a company would retire every year.[11] Although staggered boards are considered highly effective in the USA and UK (even other European markets for corporate control), it is not a very feasible defence mechanism for India. This is due to the existence of Section 169 of the Act, which states that a director may be removed before the expiry of the period of his office merely by an ordinary resolution. Hence, a staggered board is rendered redundant in India.

G. WHITE-KNIGHT

In various situations, it may so happen that the target company does not want to be acquired by a specific acquirer/bidder and in such situations, the target will usually look for a third company, a white knight, that is considered a more attractive and desirable suitor for the company. Such an alliance would also be a friendly one as opposed to the hostile takeover threat that the target would usually face. In order to ensure that a transaction with a white knight goes

[11] *Supra* note 7.

smoothly, the white knight must be willing to offer a better deal to the target – although not always necessarily in terms of a higher premium or share price. The better deal, for example, may be in the form of retaining the senior-level management of the target etc. A variation of this tactic is called the 'white squire', wherein the target company sells a block (less than a majority) of shares (usually convertible preferred with special voting rights) to a friendly third-party in order to thwart a hostile bid.

However, both these defences are left vulnerable to the 'Lady MacBeth strategy' – named as an ode after the famous character in Shakespeare's MacBeth, it refers to a situation where a company pretends to be white knight but later discloses itself to be either a hostile acquirer or sells over the acquired shares to the original acquirer or raider.

In order to ensure that the white knight does not get caught up in a bidding war with the original acquirer, the white knight will usually ask for a lock-up provision which may include the ability to acquire shares at a fixed price or acquiring certain assets of the target at a price lower than the market value. The white knight strategy is heavily used, with some of the biggest transactions, such as Google-Motorola in 2011[12] and Fiat-Chrysler in 2009 being a result of the white knight mechanism.[13] The bid by a white knight must comply

[12] Evelyn M. Rusli & Claire Cain Miller, *Google to Buy motorola mobility for $12.5 Billion*, THE NEW YORK TIMES August 15, 2011 at 11.
[13] Michael Reynard, Fiat Deal with Chrysler seals swift 42 day overhaul, THE NEW YORK TIMES June 10, 2009 at 4.

with the requirements listed for a 'competitive bid' if it is made after public offer by the acquirer, as per the SEBI Takeover Code.

III. CONCLUSION: PICKING THE IDEAL DEFENCE MECHANISM

What we have observed, and what is clear is that the market for corporate control in India is much softer than in the US and the UK – and takeovers happen in a more restrained and less aggressive manner. Further, the kind of M&A vocabulary used in Western media (terms such as white knight, greenmail and poison pills) are absent from the Indian market. The ownership and control of the corporations in the Indian market are also much more promoter-centric than their counterparts in UK and US. Although the L&T-Mindtree episode provides optimistic signals for India's hostile takeover market, the problem is probably deeper-rooted than just governmental policy. As mentioned previously, most companies in India are extremely promoter-centric, in the sense that the control is usually concentrated within a few people instead of being scattered. India's family-dominated management boards do not help in this regard either. Even in cases where a single entrepreneur builds up a company, there is an attachment to the very company that he built up, sometimes to the extent that they are extremely hesitant when it comes to relinquishing control of the same. These are some reasons why the number of hostile takeovers in India is far less than other countries.

Although the various defence mechanisms offer varying levels of success for companies that have attempted to fend off takeovers, one must remember that in such scenarios there can never be a 'one size fits all' defence. The defences must be picked keeping in mind the different circumstances of each transaction and the relative difference between the corporations/companies involved.

Before venturing onto which defence mechanism is best suited for Indian market, one must note that there are certain existing drawbacks. In more ways than one, the current legislations essentially handicap management seeking to protect themselves from a hostile bidder. While the legislations allow for a mechanism to structure golden parachutes, they limit the amount that can be paid, along with restrictions in relation to who it may be paid to, essentially making the defence tactic toothless in practice. Although companies can employ buybacks to defend against unwanted offers, it can prove to be a costly choice in the future should they be successful – since the current law restricts rescinding of such offers. Staggered boards, which see widespread use in other jurisdictions as anti-takeover mechanisms are made futile by the inclusion of Section 169 of the Act.

Perhaps due to a lack of alternatives or due to the legal and regulatory handicaps attached to other anti-takeover measures, under the Indian legal regime, the best takeover defence available is the 'poison pill' defence. There is a two-fold explanation to this. *First*, there were multiple studies to determine the effects of takeover defence mechanisms on shareholder and bondholder value and to determine whether defences actually serve a purpose or not.[14] Most studies indicated that using a poison pill defence was

[14] Mohit Chawla, *Antitakeover Defense: Efficiency & Impact on Value Creation*, 4 HEC MGMT. J 345 (2015).

beneficial – even though it did not ward off potential suitors every time, it did increase the amount of gains made by the shareholders by at least 4 to 6 percent.[15]Additionally, the kind of defences a firm employ – that is, whether post-bid or pre-bid also affects its performance in an IPO. *Second*, most of the other strategies and mechanisms of defence are rendered redundant due to the promoter-friendly nature of the SEBI Takeover Code and the Act and the limitations & restrictions placed on the exercise of various corporate strategies. The shortcomings in the discussed defence strategies – such as golden parachutes only being limited to managing and whole time directors and not being available to senior management; or the members of a staggered board being disposable at the mere passing of an ordinary resolution – means that Indian companies do not have a lot of defences available to them.

This can be justified by the fact that since India is an underdeveloped market for corporate control; perhaps as the corporate control market develops and gathers steam and hostile takeovers increase in number, the government will finally take notice and bring in amendments to make certain defences available in the near future. The ideal point for the government to begin would be to allow for 'shark repellents' to be used in India. They are a robust mechanism in themselves and would not only fulfil the role of anti-takeover measures, but also allow the shareholders greater control over the company. Further, it would be a good step to incorporate an exception to the buyback provisions, which state that in cases where a company is threatened with a change of

[15] *Id.,* at 347.

control and initiates a buyback to avoid the same; this offer may be rescindable in the event that such change of control is averted. The focus should be on creating a special exemption for share buybacks in hostile scenarios. Perhaps under different circumstances, Mindtree could have successfully fended off L&T's advances and maintained its independence.

INNOVATION AS A YARDSTICK IN MERGER CONTROL ANALYSIS: A STUDY OF AGROCHEMICAL, TELECOMMUNICATION AND PHARMACEUTICAL SECTORS

Manal Shah and Husna Fayaz*

ABSTRACT

Antitrust authorities worldwide, have been increasingly assessing innovation effects in merger control analysis. Innovation, though present in antitrust laws, has seen rare use in past. In the long run, innovation or lack of innovation thereof can have significant impact not only on competition but also on consumer welfare. Using innovation as a yardstick in combination assessments can have a wide impact (positive and negative) depending upon the scope of the assessment. Innovation analysis is pertinent in ensuring that research and development is not hampered. However, the same needs to be analysed within certain boundaries to avoid it from becoming encroaching in nature. The European Commissioner for Competition in her recent speech titled "Competition: the mother of invention", emphasized the importance of innovation analysis. While this view been concurred, a weighted balance is required and contours need to be set.

This article first traces innovation as a yardstick in merger control analysis from antitrust laws of European Union, India and the

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United States (geographical focus of the article). It then attempts to explain the recent trend that emphasizes on innovation analysis by way of case studies of notable merger decisions in three sectors: agrochemical, telecommunication and pharmaceutical sectors.

INTRODUCTION

"When we look at high-tech mergers, we do not just look at whether they might raise prices, we also assess whether they could be bad for innovation" **– *Margrethe Vestager***

The above words set the tune for the European Competition Commissioner Margrethe Vestager's speech titled '*Competition – the mother of invention*' whereby she also added that one of the basic jobs of competition enforcers is to ensure that companies do not abuse their power to hold back innovation.[1]

When two players in any relevant market come together, there is a decrease in the number of players in such market. However, the significance of this statement depends on the number of players in that relevant market as well as the market share of the merging players. While several standard factors need be analyzed while assessing whether a merger would have appreciable adverse effect on competition ("AAEC"), innovation as one has not been given due regard until very recently. Innovation is an important scale for technological progress and pertinent for human welfare in a society

[1] Margrethe Vestager, European Commissioner for Competition, Keynote speech on the Occasion of European Competition and Consumer Day: Competition: The Mother of Invention (April 18, 2016).

that is changing constantly. Merger of two or more innovators who have pipeline products and presence in various innovation spaces, has recently concerned competition regulators globally. These concerns include a situation where both merging parties have parallel research lines for a product or process, and post-merger one line would be dropped for reasons of cannibalization or otherwise. This concern was viewed to cause a likely negative impact on innovation thereby adversely impacting competition. The article analytically traces the starting point of this ripple effect to its present position with case studies in three market sectors: Telecom, Agrochemical and Pharmaceuticals.

Margrethe Vegstager's words, followed by the publicity of 'innovation theory of harm' followed further by important mergers such as Bayer-Monsanto, Dow and DuPont and Pfizer-Hospira which have global stronghold have led a trend of innovation analysis as an integral part of merger control.

The European Commission ("EC") in Vestager's terms (2014 - Present) saw a radical shift in its policy pertaining to innovation effects of merger. The Dow-DuPont Merger saw an illustrious emphasis on 'innovation theory of harm' wherein the EC gave notable weightage on the negative innovation effects that a merger of innovators entails.

European Commission in Dow-DuPont decision – *"The merger between (two firms) will result in internalization by each merging party of the adverse effect of the R&D projects on […] the other merging party; hence, […] it will reduce investment in the competing R&D projects. The innovation competition effect [of a merger] follows the basic logic of unilateral effects, which* *is equally applicable to product market competition and to innovation competition.'*[2]

Technological progress contributes significantly to consumer welfare. Competition law aims to achieve the same and in the long run, they complement each other. In case of invented products, the marginal cost of production is insignificant.[3] On the other hand, the cost incurred is high for research and development ("R&D") and invention of new technology along with ancillary expenditure incurred in bringing up the product in the market.[4]

Joseph Schumpeter in his '*Theory of Monopolies leading to Invention*' argued that:

"Competition that counts [is] competition from the new commodity, the new competition, the new sources of supply, the new type of organization…competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives."[5]

Kenneth Arrow and some others criticized Schumpeter's argument that monopolies were under constant challenge from newer technologies as a result of which, those monopolies that did not innovate well were likely to be replaced by new monopolies that

[2] European Commission Decision, Case M.7392. Dow/DuPont (2017) Annex IV.
[3] ABIR ROY & JAYANT KUMAR, COMPETITION LAW IN INDIA 506 (2d ed. 2018).
[4] *Id.* at 511.
[5] J.A. SCHUMPETER, CAPITALISM, SOCIALISM AND DEMOCRACY 84 (3d ed. 1950).

were more effective innovators.[6] Arrow was of the view that a monopolist would have no incentive to create a new or superior product if the profits from that product would eat into the profits of the monopolist's current products.[7]

It is put forth that innovation analysis should attempt to identify both positive and negative innovation impacts of mergers and that innovation analysis should depend on case to case basis. The authors have attempted to analyze, by way of case-studies, the outcome of several important mergers in the agrochemical, pharmaceutical and telecommunication sectors with focus on innovation analysis by the EC, the Competition Commission of India ("CCI") and the Federal Trade Commission ("FTC").

For the purpose of studying innovation effects of consolidations, preferably, a sector by sector approach should be applied. Lemley was of the opinion that while evaluating innovation efficiencies, competition law must analyze the effects of the same, either positive or negative, in each relevant sector separately.[8]

Crop protection products improve yields and ensure the availability, quality and affordability of crops to the benefit of farmers and consumers. Innovation for these products matters: farmers benefit from improved yields; consumers, from safer products; and the

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[6] *Supra* note 3, at 512.

[7] KENNETH J ARROW, ECONOMIC WELFARE AND THE ALLOCATION OF ACTIVITY: ECONOMIC AND SOCIAL FACTORS 611-12 (1962).

[8] Mark A. Lemley, *Industry-specific Antitrust Policy for Innovation, Colum. Bus. L. Rev.* 637, 637-53 (2011).

environment, from reduced toxicity of products.[9] Innovation in the crop protection industry therefore has a key part to play in sustainably feeding a growing population in an increasingly challenging context of changing climatic conditions and consumption patterns.[10] Thus, the article *firstly* studies two of the biggest mergers of recent times in the agricultural sector.

Secondly, the article studies the telecommunication sector in light of its contemporary trends globally. Recently, India also witnessed the largest merger in the telecom sector which completely changed its telecom market structure. Consolidations in the telecom sector always lead to innovation and welfare effects.

Thirdly, the article studies the pharmaceutical sector. Global evolution of understanding of old and new medical conditions and the development of novel techniques as well as innovation in medicine has historically been vital. However, R&D is time and cost intensive. The need to research and innovate in this sector is critical to human health.

I. REGULATORY FRAMEWORK

A. INDIAN REGULATORY FRAMEWORK

Indian Competition law,[11] similar to competition laws globally, rests on the premise that it is designed to be a comprehensive charter of

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[9] Alexandre Bertuzzi et al., *Dow/DuPont: protecting product and innovation competition*, COMPETITION MERGER BRIEF (January 12, 2019 11:33 AM) https://ec.europa.eu/competition/publications/cmb/2017/kdal17002enn.pdf.
[10] *Ibid.*
[11] *Supra* note 3, at 41.

economic liberty aimed at preserving free and unfettered competition as the rule of trade, and that unrestrained interaction of competitive forces will yield the best allocation of economic resources of the country, the lowest prices, the highest quality and greatest material progress.[12]

Combinations, unlike anti-competitive agreements are not illegal *per se*, but are regulated by CCI. While exercising its regulatory power and as per Section 29 of the Competition Act, 2002 ("the Act") if the commission *prima facie* finds that the merger has or is likely to have an AAEC, it can mandate the parties to disclose more details regarding the prospective combination. CCI after collecting all relevant information including objections from the public or the aggrieved, if any, ultimately investigates the case in detail, per the provisions under Section 31 of the Act. It is noteworthy that the Indian regulatory framework encompasses innovation as a factor in merger control analysis.

The CCI takes into consideration various factors while investigating a combination. Section 20(4) of the Act requires the CCI to give due regard to all or any of the fourteen factors prescribed therein while determining whether a merger is likely to have an AAEC in the relevant market. The enlisted factors such as "actual and potential level of competition",[13] "extent of entry barriers",[14] and

[12] A. Douglas Melamed, Principal Deputy Asst. A.G., Antitrust Division, Address at Fourth International Symposium on Competition Policy: Antitrust At The Turn Of The Century (Dec. 7, 1999).
[13] Competition Act, 2002, No. 12, Acts of Parliament, 2003, Section 20(4)(a). ["Competition Act, 2002"]
[14] Competition Act, 2002, Section 20(4)(b).

"level of combinations"[15] that find presence therein have been rightly used by the CCI time and again to gauge AAEC. It is worth mentioning that, among these factors, the nature and extent of innovation also finds place although it has not gained any light until recently.[16]

Section 19(4) of the Act also requires the CCI to give due regard to 'the promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.' This shows the legislative intent to analyze innovation effect as a factor in merger control. Furthermore, Section 4 of Act also prohibits dominant players from impeding technical or scientific development. Section 31 of the Act empowers the CCI to allow the merger unconditionally if it finds that there is no likelihood of AAEC in India.[17] However, if the CCI finds any irregularity, it may either approve the combination after requiring modifications in the merger arrangement or it may choose to reject it unconditionally.[18] Divestment has been the most common modification made and implemented.

[15] Competition Act, 2002, Section 20(4)(c) .
[16] Competition Act, 2002, Section 20(4)(l).
[17] Section 27(a) of the Competition Act requires that after inquiry into agreements or abuse of dominant position, if the CCI finds that the merger agreement is in contravention of Section 3 or Section 4, it has the power to pass an order directing such merged entity to discontinue and to not re-enter such agreement or discontinue such abuse of dominant position.
[18] The Raghavan Committee Report had also recommended that the Regulatory Authority be empowered to advise a demerger on the lines of Sections 27, 27A and 27B of present MRPT Act 1969 with suitable modifications.

B. EUROPEAN REGULATORY FRAMEWORK

The EC, while evaluating combinations, started giving attention to innovative efficiencies and incentives only recently. However, the EC merger guidelines for both horizontal and non-horizontal mergers have long contained innovation analysis. Section 8 of the EC Horizontal Merger Guidelines ("the HM Guidelines") contains certain benefits to the customers which the commission aims to protect; or prevent mergers from becoming depriving to customers. [19] In fact, one of the benefits, the HG Guidelines strive to protect is innovation. Innovation effects are given the same anti-competitive importance as 'price increase' or 'quality'. Section 8 of the HM Guidelines makes it clear that the EC is mandated to consider innovation effect while making merger control decisions. Moreover, Section 38 of the HM Guidelines talks about the interplay between innovation and mergers. [20] It observes that innovative efficiencies can be brought about by mergers due to the collaboration of resources. It also takes note of a mergers' ability to impede innovation when two competing innovators with 'pipeline' products merge. Similarly, the EC non-horizontal merger guidelines have also long prescribed an assessment on a merger's ability to impact innovation.

[19] Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings of January 20, 2004, Section 8, 2004 O.J (C 31),6.
[20] *Ibid.*

Section 10[21] of the Non-Horizontal Merger Guidelines ("the NHM Guidelines") provide a framework similar to that of Section 8 of the HM Guidelines, it basically says that while deciding merger cases innovation effects should be considered by the commission along with parameters such as price, output and quality. According to Section 26 of the NHM Guidelines, EC conducts a comprehensive investigation only under certain circumstances in the case of non-horizontal mergers.[22] One of the circumstances provided therein, involves the merger of a company which has made a recent innovation that may lead to a substantial growth. The HM and NHM Guidelines have acknowledged both, negative and positive innovation effects even before the EC started focusing on it while implementing merger control.

Furthermore, the European Union Merger Regulations (EUMR) mandates EC to consider "*the development of technical and economic progress*".[23]

C. AMERCIAL REGULATORY FRAMEWORK

There is a lacuna in the United States ("US") regulatory framework for merger control with regards to innovation effects. It fails to cover the effects of mergers on innovation incentives of other players in the market and innovation effects in general. However, US Horizontal Merger Guidelines encourages the competition

[21] Guidelines on the assessment of non-horizontal mergers under the Council Regulation on the control of concentrations between undertakings of October 18,2010, Section 10, 2008 OJ (C 265/6),2.
[22] *Ibid.*
[23] Council Regulation No. 139/2004, 2004 OJ (I 24/1).

authorities to analyze whether a merger has the likelihood of impeding innovation, as per Section 6.4 of these guidelines. Furthermore, it observes that "competition often spurs firms to innovate".

II. CASE STUDIES

A. AGROCHEMICAL SECTOR

Agrochemical companies sell formulated products. The essential component of a formulated product is the Active Ingredient ("AI"), which is the result of innovation efforts made by R&D agrochemical companies over a long period of time. Innovation is a two-step process involving discovery and further development of AI to prepare formulated product.

1. *Dow Chemical Company (Dow) – E. I. Du Pont de Nemours and Company (DuPont)*

Dow and DuPont were two major crop protection and seeds R&D players; both global science and technology companies incorporated in the USA. Dow was then, inter alia, active in chemical, plastic, agricultural products (including crop protection products and seeds) health care and personal care whereas DuPont was active in agriculture (including crop protection products and seeds), electronics and communication, nutrition and health, chemicals and performance materials. Post-merger, DowDuPont Inc. is the holding company whereas Orion Sub is the wholly owned subsidiary of DowDuPont which merged into DuPont such that DuPont is the surviving company. Similarly, Diamond Merger Sub which was wholly owned subsidiary of DowDuPont, pursuant to the terms of MA, Diamond Merger Sub merged into Dow such that Dow continues as the surviving company.

CCI while assenting the merger on June 08, 2017 noted that the parties were involved in manufacture and sale of products relating to the broader segments of agriculture, specialty chemicals and material sciences in India and identified the overlaps between the products. It observed that considerable R&D activities of the Parties related to crop protection products occurs outside India. Post-combination, this may lessen innovation consequently causing AAEC in the Indian Crop Protection market. In this regard, the Parties assured the EC, of a global divestiture of its activities relating to: (i) herbicides, (ii) insecticides and (iii) R&D. The Divestiture package also included certain field biology and regulatory employees to maintain the pipeline products. The rationale being that the purchaser would benefit from a stand-alone innovation organization which will aid creation of pipeline of molecules in fungicides, herbicides and insecticides. For this, they entered into a definitive agreement with FMC Corporation (a United States based entity).

The European Commission conducted a detailed study and investigation into the activities of the merging parties in pesticides. It identified concerns that related to a large extent, to standard unilateral effects on prices of existing overlapping products of the parties. It raised the concerns relating to negative innovation effects that the merger would have on the pesticides industry by analyzing the early pipeline products and lines of research, as well as the likely reduction in the overall innovation efforts post-merger. The commission conducted an in-depth assessment of innovation based on the following elements:

i) Market features and structure

The EC observed that in the agrochemical industry, innovation was an important parameter of competition, barriers to entry were high and the number of integrated innovative players was limited. It went on to observe that an integral part of competition was to bring out new and more effective pesticides to the market, which allows companies to defend their existing sales and capture new market shares from competitors. The main component of pesticides, an Active Ingredient (AI), is a lengthy process following several relatively fixed (yet time consuming) stages. The whole process takes approximately ten years. The average overall cost of one new AI is also very high. To launch new AI, agrochemical companies require complex R&D organization and specific assets, equipped not only to discover new molecules but also to perform field tests and studies necessary to obtain regulatory approval in different jurisdictions. Hence, barriers to entry and expansion are very high in terms of discovery and development. Further, regulatory hurdles add to the difficulties.

The need to innovate arises in light of the resistance that pests develop over time which leaves the product under the threat of becoming obsolete. EC, however, noted that these factors were insufficient to prevent significant negative innovation effect resulting from the structural change in the post-merger R&D landscape.[24]

The pesticides industry is oligopolistic with only five integrated R&D players who are not all active in every segment of the industry. The previous waves of consolidation was observed to have been certainly accompanied with reduction in the innovation intensity and output, as demonstrated by a lower R&D spending and introduction of fewer AIs.[25]

ii) Important innovator status

The merging parties were recognized as important innovators in the EU having higher influence on competition than their market share or what their R&D expenditure demonstrated as found on basis of various past and forward-looking indicators. These indicators included the parties' expertise and assets, target in terms of their R&D efforts, new AIs as well as track record of bringing new AIs into the market and the strength of their patent portfolios.[26]

iii) Closeness of competition

The EC while assessing the closeness of competition in innovation, observed the importance of considering overlaps within and across stages of innovation process (including in discovery and early/late development). The EC thus assessed the risk of cannibalization in this merger to be present since merging parties were in direct and close competition in several important innovation spaces in

[24] Case COMP/ M.7932, Dow/DuPont Case, 2017 O.J. C356/17.
[25] *Ibid.*
[26] *Ibid.*

herbicides, insecticides and fungicides and had overlapping discovery targets/lines of research/ pipelines at both, discovery and development stage.

iv) Likely effects on innovation

EC notably considered, *firstly,* that the merger would have reduced the parties' incentive to continue R&D in relation to their existing overlapping innovation project and *secondly,* that in the longer run, the merger would reduce the incentives for the parties to invest in R&D efforts in relation to new pesticides in those areas where the parties had significant overlapping R&D capabilities. The first effect would manifest itself in the likely discontinuation, delay or re-orientation of the parallel early pipeline products and lines of research due to the risk of cannibalization. Some of those projects were still at their inception and their individual probability of success was uncertain.

With regard to the first effect, it was notably observed that while the outcome of any given innovation effort might be uncertain, it does not naturally imply that competition concerns in relation to innovation efforts are unwarranted. The second effect was specifically confirmed by concrete evidence (significant planned cutbacks in the parties' innovation efforts in terms of planned R&D inputs, R&D spend, FTEs number etc. and output target) compared to the combined pre-merger plans.[27]

[27] *Ibid.*

The EC observed that the "other competitors" would be unlikely to compensate for the lost innovation competition. After the merger, only three global integrated players i.e. BASF, Bayer and Syngenta would remain competent with the merged entity in this industry with its high entry barriers. These competitors, EC noted were also not uniform in their presence in every innovation space. The concentration level in many innovation spaces was higher than the overall industry level; more than two thirds of European pesticide sales being served by four or fewer of the global R&D integrated players. The EC dived deep into the competitors' pipelines and related innovation capabilities. The non-integrated companies, though active, were found not comparable to the five global R&D integrated players due to lack of their capabilities.

The EC concluded that the mere presence and R&D efforts of competitors were insufficient to prevent a loss of innovation competition after the merger. EC surveyed the economic literature on the possible impact of merger on innovation and rebutted the theoretical arguments brought forward by the merging parties on the basis of the same. The EC, in its decision, supported its detailed factual investigation of the likely impact of the transaction. It did not, however, establish a general conclusion that horizontal mergers harm consumers through adverse effect on innovation.

The EC, after a structured and in-depth research and investigation, concluded that the merger would harm innovation laying emphasis on the importance of innovation competition. To address EC's innovation concerns, the parties divested most of DuPont's global R&D organization in pesticides including pipelines at the discovery stages, R&D facilities and employees, with the exception of a few limited assets to support the retained business.

2. *Bayer-Monsanto*

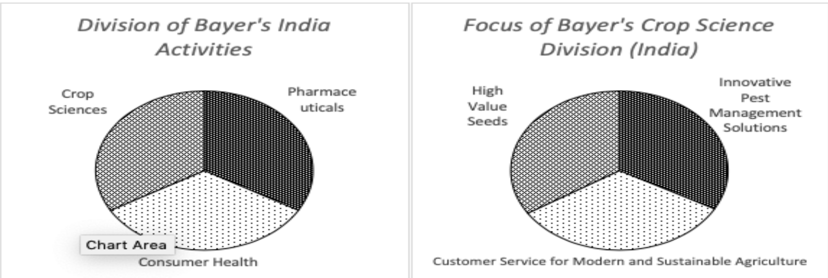
The CCI on June 14, 2018 cleared the merger of Agrochemical giants Monsanto and Bayer after ratifying the Proposal of Modification to their initial Merger Agreement.[28] The CCI conducted a detailed study of the merger involving Bayer's acquisition of Monsanto (through its wholly owned subsidiary KWA Investment Co.). The triangular merger involved a 'merger sub' merging with and into Bayer as the surviving entity and making Monsanto, a subsidiary of Bayer. Monsanto is globally, the largest supplier of seeds which generates most of its sales in the United States and Latin America. It also supplies glyphosate which is globally, the most used pesticide, for controlling weeds. Bayer is a German company, standing second as the largest pesticides supplier for several crops. Hence the merger, in this case, created the largest global integrated seed and pesticide player at that time.

The CCI observed the vertically integrated nature of the merging agrochemical companies and their presence in the entire value chain of agricultural inputs like crop protection, seeds and traits as well as digital farming solutions. It further noted the horizontal and vertical overlaps resulting from the merger and the possible conglomerate effects due to the parties' complementary product portfolios. In this

[28] Notice under sub-section (2) of Section 6 of Competition Act, 2002 given by Bayer AG, Combination Registration No. C-2017/08/523 (Competition Commission of India June 14, 2018) (Order under Section 31(7) of the Competition Act, 2002).

regard, CCI observed that the combination had the potential to create one of the largest vertically integrated players in the agricultural market globally. While analyzing AAEC in this merger, the CCI considered innovation as a significant factor and directed necessary divestments on the innovation front.[29]

Diagram 1



Bayer's Crop Science Division (India) focuses on business markets with a broad range of herbicides, insecticides, fungicides, seed dressings and plant growth regulators.

The following paragraphs highlight CCI's focus on innovation in reference to this matter. It recognized six broad relevant product markets:

[29] CCI considered the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 pursuant to which Bayer had made a public announcement of its 26% purchase of the fully diluted voting equity share capital of Monsanto India Ltd. Vide its powers under Section 29 of the Competition Act 2002, CCI issued a Show Cause Notice to the parties to satisfy itself that the merger is not likely to cause AAEC in the relevant market in India.

With reference to one of the relevant market sectors i.e. Non-Selective Herbicides, Monsanto was selling *Roundup* (glyphosate formulations) while Bayer sold *Basta* (glufosinate ammonium). It was observed that there were three AIs in this sector in India, all of which were of patents with various generic manufacturers supplying formulations based on two ingredients: glyphosate and paraguate. Formulations based on glufosinate ammonium were sold solely by Bayer and the brands of merging parties are in direct and close competition.

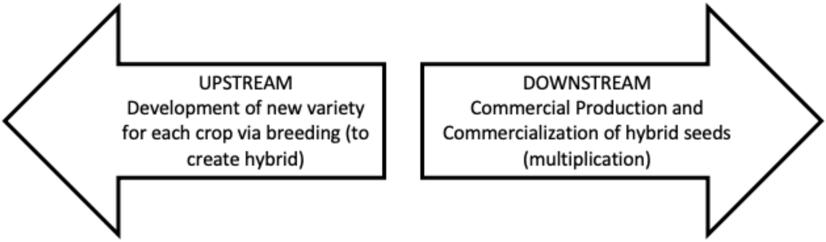
The CCI noted that, in this sector, there were very few integrated R&D players with an actual ability to undertake research, discovery, development and registration of the new AI coupled with access to pan-India distribution network (i.e Bayer, DowDuPont, BASF, Syngenta and Monsanto). Only these entities had the ability to develop and market new molecules and products in the crop protection segment. Many small players sustained on licensed IPs. On observing the ongoing R&D and pipeline products for new AI development in this sector and noting that except the merging parties only Syngenta was an integrated R&D player, CCI concluded limitations on the innovation front. It observed that the merger was likely to eliminate important competitive constraints in this market with a harmful effect on future innovation efforts. CCI also concluded that the merger would have a negative innovation effect.

With reference to another relevant market sector i.e. Herbicide Tolerant Traits/Technology Licensing, it was noted that Monsanto owned Roundup Ready Technology (based on AI Glyphosate) to provide resistance against non-selective herbicides for cotton, corn, canola and soybean and Bayer owned Liberty Link Technology (based on AI Glufosinate ammonium) to provide resistance to plants such as cotton, corn, canola and soybean against herbicides. These were developed to allow the crops to survive the application of non-selective herbicides which cannot distinguish between crop and weeds, hence killing both. Though these were not yet available or sold in India due to lack of regulatory approvals, both parties were in process of seeking requisite approvals for traits and as and when the approvals would be granted, these parties would be in direct competition. The merger would have had the likelihood of reducing incentive to the merged entity to introduce competing traits/technologies, effecting a complete elimination of competition between them. CCI emphasized that R&D traits are characterized by high barriers to entry and the limited number of integrated players which would have the capacity and resources to compete in trait innovation (which is time and cost intensive coupled with the regulatory uncertainty), creates deterrence for other players to enter the market. It also held that the parties being significant competitors, the merger would have eliminated the threat to Monsanto from Bayer's innovation thus, reducing the incentive to innovate in order to protect its business.

With reference to yet another market sector, i.e. agricultural crops, also called broad acre crops (includes cotton, mustard, millet, corn, soyabean, wheat, rice, canola, sorghum etc.) require large parcels of land for farming. Both parties were active in development, production as well as sale of various agricultural seeds globally as well as, in India. Both were also present in licensing of parental lines/hybrids as well as in commercialization.

They also overlapped in terms of commercialization of rice, cotton and millet. The seed industry was a two staged one -

Diagram 2



CCI concluded that these stages mark distinct relevant product markets and so does each crop. It further recognized hybrids of a particular crop to constitute a single relevant product market.

CCI observed that secondary seed companies did not have a sufficiently developed breeding capability to develop new varieties of crops, lack the production capability and were also dependent on integrated seed companies or public institutes (either in terms of production or for supply of varieties developed by other entities). CCI noted the high investment costs in R&D for seeds and the lead time (more than five years) create a substantially high degree of entry barrier in the market for both types of seeds.

Monsanto was active in both upstream as well as downstream market for Bt Cotton (the only GM seed available in India) while Bayer was active only in the downstream market under license from

Mahyco Monsanto Biotech (India) Ltd. (MMBL).[30] Monsanto owned controlling stake in its joint venture with MMBL.

Besides Monsanto, JK Seeds, Nath Seeds, Metahelix and Central Institue of Cotton Research ("CICR") compete in the upstream market. Bt. Cotton technologies are of two type i.e., single gene and two gene and while all the players including Monsanto offer two gene cotton technology, Monsanto (through MMBL) was the only player offering two gene Bt. Cotton technology which is considered more effective against pests and having sub-licensing agreements with the other players for this technology. The technology sub-licensed by MMBL was already the most significant player in the relevant market.

Competitors are unable to provide effective competitive constraints and consumers are dependent on it. Monsanto was also in process of obtaining regulatory approvals for launching its Bollgard III ("BGIII", a three gene Bt. Cotton technology). It was noted that outside India, Bayer offered similar products too i.e. Twin Link (two gene Bt. Cotton technology) and Twin Link Plus (a three gene Bt. Cotton technology). It was observed that these products would

[30] It was noted that Monsanto Investment India Private Limited (MIIPL), a wholly owned subsidiary of Monsanto had 26% equity shareholding which accords it the power to block any special resolution and at the time, it had three members on the Board of Mahyco (another active entity in the seed sector in India). In this regard, the CCI held the view that Monsanto had joint control over Mahyco along with other shareholders, and noted that MIIPL and Mahyco had a 50:50 Joint Venture MMBL.

have been in direct competition with each other. Parties were major players in the GM cotton seed market with Monsanto's stronghold in herbicide tolerant and insect resistant transgenic traits. In the US Bayer was the only other competitor with both these traits in cotton.

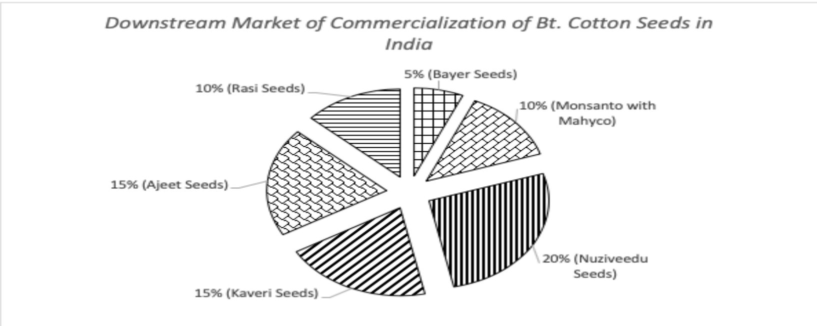
The CCI held the view that Bayer being one of the few potential competitors had the capacity to effectively constrain Monsanto in the market, and that the absence of the merger would have left Bayer with the incentive to introduce both two and three gene technology while Monsanto would have had the incentive to introduce BGIII technology in India. The CCI thus viewed the negative innovation impact of the merger as a means of strengthening the existing significant position of Monsanto in the market.

The GM technology was also observed to have a rigorous R&D, testing processes and regulatory uncertainty coupled with high cost and significant entry barriers. Saving DowDuPont (with its competing technology WideStrike in process of obtaining regulatory approvals) all other competitors are yet in process of developing two gene technology. Thus, the CCI again saw negative innovation impact as a factor while considering the AAEC

The CCI further analysed the global nature of R&D in seeds. It noted that R&D activities in seeds and traits with facilities of both merging parties were located globally and successful products were introduced in India per Indian conditions. Globally, the merging parties had overlapping R&D for several products. Apart from their stronghold in GM traits, the parties had strong R&D activities related to non-GM traits.

Besides, both merging parties led germplasm and genome libraries, and held strong position in traits (both GM and non-GM) which would have provided the merged entity with significant competitive advantage in the application of genome editing and big data technologies, thus entrenching their leading position in agricultural biotechnology and affecting the incentives of future entrants in the industry. The CCI observed the result would create a world leader in seeds and genetic traits.

Diagram 3



The CCI factoring the innovation impact, held that the merger was '*likely to negatively impact the innovation of* new *products'* as it was '*likely to negatively impact innovation and development of new GM as well as non-GM traits and licensing industry*'.[31] It went on to say that the merger would have led to innovation loss by reducing product variety and quality. CCI noted that both parties had overlapping R&D activities in

[31] *Supra* note 28, at 43.

seeds and traits and would have continued competing in R&D efforts, thus the combination hampered new and alternative products for ultimate consumers, especially farmers. CCI thus factored the likelihood of the merger to result in a reduced rate of innovation at which products are launched, thus resulting in AAEC.

In order to address the CCI's above raised concerns regarding innovation impact, a Proposal of Modification was put forth by the parties. Bayer accordingly divested its Glufosinate ammonium business and part of its broad acre seeds and traits business to BASF according to its agreement with BASF dated October 13, 2017 in order to address the potential competition concerns raised by antitrust authorities globally.[32]

In the relevant market for 'Upstream segment for licensing of cotton traits and technology in India and the related downstream segment for production and/or sale of cotton seeds', Bayer divested its stake as mentioned above. Furthermore, it also divested its vegetable seed business. Additionally, the divestment laid down the norms for licensing by the merged entity and prescribed these for the purpose of maintaining and restoring effective competition in the market by strengthening the agricultural input suppliers in India who will be able to innovate and launch new products for the benefits of the farmers, thus producing welfare effect. This remedy was also expected to suppress the negative effects of the merger on competition in the agricultural inputs supply market.

[32] *Id.* at 50.

After an in-depth investigation and assessment of more than 2000 different product markets and reviewing 2.7 million internal documents, the EC raised concerns that this merger would have strengthened Monsanto's dominant position on certain markets where Bayer was an important challenger of Monsanto.[33] In response, Bayer committed to grant license of its entire global digital agriculture product portfolio and pipeline products to ensure continued competition in the emerging market. The EC after satisfying itself that the divestment package enables a suitable buyer to sustainably replace Bayer's competitive effects and continue to innovate for the benefit of European farmers and consumers, granted this merger a green flag.[34]

B. TELECOMMUNICATION SECTOR

The CCI has not dealt with innovation effects in the telecom sector. The EC on the other hand considers choice, quality and innovation as the three vital parameters of competition in the telecom and digital markets. It is vastly evident in the EC's merger decisions. It evaluated the effect of mergers on innovation in various cases like Telefonica UK/Vodafone UK/Everything Everywhere Joint Venture,[35] Hutchison 3G UK/Telefónica Ireland Joint Venture[36] and Telefónica Deutschland/E-Plus Joint Venture[37] to name a few.

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[33] Foo Yun Choo, *EU Approval for Monsanto $62.5 billion*, REUTERS (January 21, 2009 11:34 PM) https://www.reuters.com/article/us-monsanto-m-a-bayer-eu/bayer-wins-eu-approval-for-62-5-billion-monsanto-buy-idUSKBN1GX14U.

[34] Case COMP/M.8084, Bayer/Monsanto, 2017 O.J. C222/17.

[35] Press Release, *Mergers: Commission clears the creation of a mobile commerce joint venture by UK mobile operators Telefónica, Vodafone and*

The EC has analysed the likelihood of advancement of innovation post-merger. There have been instances where they have denied mergers which offer innovative efficiencies on the ground that it does not outweigh the consumer harm and anti-competitive elements. This shows that the EC gives higher weightage to welfare. On the other hand, the EC has allowed mergers that have positive innovation effects as well. Like in the case of TomTom/TeleAtlas,[38] EC observed that this specific merger could offer innovation efficiencies which could benefit the consumers without having any anti-competitive effects. The following section analyses few such mergers.

C. VODAFONE- IDEA[39]

Vodafone India Limited ("VIL"), Vodafone Mobile Services Limited ("VIMSL") and Idea Cellular Limited ("Idea") on 31st August 2018 finalized their merger of the telecommunication service business as per the provisions of Sections 230 to 232 of the

Everything Everywhere, EUROPEAN COMMISSION (January 12 4:45 PM)https://ec.europa.eu/commission/presscorner/detail/en/IP_12_938.

[36] Press Release, *Mergers, Commission opens in-depth investigation into Hutchison 3G UK's acquisition of Telefónica Ireland*, EUROPEAN COMMISSION (January 12 4:00 PM) https://ec.europa.eu/commission/presscorner/detail/en/IP_13_1048.

[37] Press Release, *Mergers: Commission opens in-depth investigation into Telefónica Deutschland's acquisition of E-Plus*, EUROPEAN COMMISSION (January 12 3:09 PM) https://ec.europa.eu/commission/presscorner/detail/en/IP_13_1304.

[38] Reuters, *TomTom CEO has no regrets about Tele Atlas buy*, REUTERS (12 January 12, 2019 12:45 AM)https://www.reuters.com/article/idUSWEA868520090224.

[39] Competition Commission of India, Combination Registration No. C-2017/04/502 (2018), Order dated October 3, 2017.

Companies Act 2013, launching India's largest mobile operator. The parties received the final approval from the government on July 26 2018 for the merger which will displace Bharti Airtel from its decade long number one position. Vodafone-Idea holds about 35% market share and has almost 480 million subscribers.[40]

The merger was a result of the fierce tariff war caused by the arrival of Reliance Jio which left Idea and Vodafone India with a massive combined debt. Out of the 22 telecom circles in India, Vodafone-Idea will hold the leading revenue market share position in nine telecom circles. Vodafone Idea holds revenue market share of 32.2%. Both partners have equal rights and they have reached an accord on the procedure by which they will subsequently equalize their shareholdings. Currently, Vodafone group holds a stake of 45.2% while Aditya Birla group gets 26% and both the parties will jointly control and manage the merged entity. [41]

The CCI after closely examining the resources and size of the competitors present in the telecom market, expressed in its order allowing the merger, that the existing competitors are capable enough to take on the merged entity and employ sufficient competitive constraints. After Vodafone India and Idea merged there were six telephone service providers in the relevant market which included Bharti Airtel, Jio, Tata, Reliance Telecommunication, Aircel, BSNL/MTNL and then the merged entity.

[40] Devina Sengupta, *Airtel may have become number one by revenue market share*, ECONOMIC TIMES, April 30, 2019 at 5.
[41] ET Bureau, *Idea merges with Vodafone to create world's largest telecom company*, ECONOMIC TIMES, September 12, 2017 at 4.

This merger would result in India's telecom industry being dominated by three telecom giants namely Bharti Airtel, Jio and the merged entity. The merger is expected to spur the pace of the telecom industry. Through this merger, Vodafone-Idea aspired to overcome their debts and the adverse financial situation of the telecom industry primarily caused by the entry of Reliance Jio. It was expected that the merger would enable the parties to save a substantial amount of operational costs and other expenditures, which would in turn, aid in providing better services and quality of performance.

The National Company Law Tribunal, while sanctioning the aforementioned merger, took various reasons into consideration; mainly the advantages of the business expansion which benefits the shareholders, reduction of operational costs and maintenance expenses resulting from the unification which gives rise to the optimum use of resources, de-duplication of work, equipment and infrastructure, availability of high spectrum, synergies in all sections and increase in quality of service and performance, among others.

The CCI on the other hand for the purpose of competition assessment identified the following product segments of the parties on the basis of their overlaps:-

Retail Mobile Telephone Services	Enterprise Services	Internet Service Providers ("ISP Services")

National Long Distance Services ("NLD Services")	International Long Distance Services ("ILDS Services")	Provision of Passive Infrastructure services though telecom towers
Provision of Passive Infrastructure services over Fibre Optic network	Intra Circle Roaming Services ("ICR Services")	Mobile Wallet Services

The CCI after identifying the different service segments conducted a detailed competition assessment taking into consideration the market shares of the competitors and market share of the merged entity in every service segment, including the size and resources of competitors to rule out any likelihood of AAEC by the merged entity.[42] CCI maintained that if the merged entity's market share exceeds 50% in a service area post-merger, entity after the approval of the merger should minimize its market share to 50% within a period of one year. But is the case of spectrums, a telecom service provider can only hold 25% of the total spectrum available in a specific band. The merger would have resulted in breaching of the caps, in order to address CCI's concerns, the parties agreed to comply with the caps as given in the guidelines. Finally, the CCI commented on the concerns raised generally regarding consolidation as it has a likelihood of monopolization and

[42] Ministry of Telecommunication, *Telecommunication Merger Guidelines*, GOVERNMENT OF INDIA (January 12, 2019 3:34 AM) https://dot.gov.in/relatedlinks/guidelines-merger-acquisitions-2014.

cartelization due to the lesser number of competitors in the market and pointed out that, out of the 220 countries, 213 countries have only 4 Telecom service providers ("TSPs") and that only India has more than 5 TSPs.

Every merger, especially mergers in the telecom industry are executed with the objective of enhancing geographical reach, reducing operational costs, benefiting from synergies, increased profitability and better technology. The CEO of Vodafone Idea, Balesh Sharma claim,[43] that the merged entity is committed to offer to their customers a worthy experience by introducing new services, products and solutions to meet the evolving digital and connectivity demands. Vodafone Idea targets over 840 million 3G and 4G customers in India with a broadband network of 340,000 sites. It also proposes to provide about 200,000 GSM sites, making it India's biggest voice network which has 92% population coverage (i.e. over 1.2 billion Indian citizens).

Vodafone Idea promised to deliver consumer benefits primarily by providing innovative products and attractively priced services which includes high quality international and notional roaming experience and it claims to provide the largest broadband capacity and voice network. The merged entity also offers better services for enterprises. Despite the promising nature of innovation in the merger as mentioned above, the CCI's analysis made no mention of the same.

[43] Idea Cellular Limited, *Corporate Presentation*, ADITYA BIRLA GROUP (Nov. 15, 2018 11:45 AM) www.ideacellular.com/content/dam/ideaselfcare/merger/investorpresentation/Investor-Presentation-January-26th.pdf.

Historically, mergers had both negatively and positively impacted welfare and innovation. The instant merger between Idea and Vodafone largely contributes in digitalizing India and provides huge consumer benefits while increasing competition which drives its competitors to increase quality and give attractive consumer benefits. However, almost every merger hits the employees negatively due to the reduction of employee count to avoid duplication of resources. The present merger was responsible for almost 5000 employees losing their jobs because the company strives to save on costs and increase efficiency. The company in its struggle to maintain higher cost efficiency for improved earnings per share ("EPS") and to reduce debt to equity could also refrain from providing promotions and increments to its employees.

D. TELEFONICA UK/VODAFONE UK/EVERYTHING EVERYWHERE[44]

In this case the EC evaluated the possibility of negative impact on innovation by a joint venture ("JV"). Telefonica UK, Vodafone UK and Everything Everywhere are three out of the four mobile network operators present in the UK. The three telecom giants wished to create a joint venture for the purpose of generating a mobile-wallet or E-wallet platform. The EC conducted a comprehensive investigation to evaluate the likelihood of negative effect of innovation on mobile payment platforms of upcoming or existing players. In this instant case, the EC was concerned that the parent companies could act as a barricade to other competitors as they could deny these capable entrants access to their SIM cards.

[44] *Supra* note 35.

SIM cards are important for these entrants as the sensitive information of customers used for the purpose of online payment can be stored in it. The EC while making its decision in phase two of the procedure considered the following two factors; whether the joint venture would have the capability to completely bar new entrants who wish to start a mobile-wallet and secondly, whether there is a likelihood of the parent companies blocking access to their SIM cards using technical or industrial measures. While addressing these questions, the EC came to the conclusion that this JV is unlikely to have a negative impact on innovation of potential entrants primarily because there already exists other equivalent means of storing sensitive information of mobile payment users which can be used instead of a SIM-card and that there is no convincing evidence to show that the parent telecom companies would take measures to block these potential entrants from accessing their SIM-cards. The EC for merger control cleared this JV unconditionally in phase two stating the above observations.

E. HUTCHINSON 3G UK- TELEFONICA IRELAND[45]

The EC had a different approach for merger control in this case.

In this more recent case the EC noted that the mergers would generate innovative efficiencies and benefits which includes high quality and speed, larger network coverage and increased research and development from the combining entities which would result in more efficient product/technology. However, the EC while deciding this case observed that the takeover would have a negative

[45] *Supra* note 36.

impact on certain providers known as virtual providers in the market who do not have a network of their own. In order to offer their services, they make use of another entity's network. In the instant case, both the companies who wish to merge host virtual providers or have network sharing agreements with these providers. Consolidations in the market would result in fewer competitors and would make it difficult for the virtual providers to attain a willing network service provider host which would largely mitigate their market power. In addition to this, another concern that came to the notice of the EC was that the merged entity would be familiar with the network arrangements of the remaining players, which the EC observed will pose negative impact on innovation in the telecom market and is anti-competitive.

In response to the concerns, Hutchison proposed to alleviate the issues by proposing certain remedies which included the firm assuring to host not more than two virtual providers post-merger.[46] The EC while making the decision, acknowledged the innovative efficiencies that could be introduced by this merger. However, it concluded that these innovative efficiencies are limited and not merger-specific. It also added that these innovative efficiencies of the merged entity cannot outweigh the anti-competitive elements including, the likelihood of the merger negatively affecting innovation in the telecom market and new technologies like 5G. The EC also dismissed the remedies proposed by Hutchison stating that it would only make the providers "technically and commercially

[46] Gibson Dunn, *Anti-Trust merger enforcement update*, GIBSON DUNN (January 13, 2019 12:54 AM) https://www.gibsondunn.com/2015-antitrust-merger-enforcement-update-and-outlook/.

dependent".[47] Stating the above reasons, the EC refused to clear the above combination.

III. PHARMACEUTICAL SECTOR MERGERS

A. NOVARTIS/GLAXOSMITHKLINE[48]

In this particular case, Novartis was in the process of developing two drugs which demonstrated substantial progress. The drugs, for the treatment of skin and ovarian cancer had reached phase III and were in the process of final stages of clinical trials and the same drugs had reached only phase I and phase II for the treatment of other cancers and were in the early stages of clinical trial.[49] Novartis' acquisition of GlaxoSmithKline's oncology segment which already possessed developed drugs with the same traits as of the drugs being developed by Novartis posed great apprehension to the EC. It feared that Novartis' research and development on these two drugs which showed great promise might be abandoned by it. Interestingly, the EC was not only concerned about the clinical trial program which reached phase III but was also concerned with the phase I and phase II pipelines. Moreover, it observed that allowing the merger would give rise to duopoly since Roche and the merged entity would be the only two players in the market for ovarian and skin cancer drugs. The EC, stating the above mentioned reasons, cleared the merger only conditionally by ordering divestiture

[47] *Ibid*.

[48] GlaxosmithKline, *Agreement to acquire Consumer Health Care business of Novartis signed*, GSK (4:09 AM 12:45 PM) https://www.gsk.com/en-gb/media/press-releases/gsk-reaches-agreement-with-novartis-to-acquire-full-ownership-of-consumer-healthcare-business/.

[49] *Ibid*.

remedy.[50] The seriousness with which the EC views innovations is thus evident. Even in the early stage of drug development, the EC in this case tried its best to prevent mergers from impeding innovation.

B. PFIZER/HOSPIRA[51]

This is another merger which was conditionally approved by the commission by ordering divestiture remedy. Pfizer was in the process of developing a biosimilar drug which would substantially help in the treatment of an autoimmune disease. The drug Pfizer was developing was ingenuous and it would result to be of considerable value once it gets fully developed. This is because it is a biosimilar drug which possesses the same therapeutical trait of the original patented drug that is already available in the market. Biosimilar drugs are not like generic drugs as they are not exact copies of the original and the primary reason for its importance is that it can be manufactured cheaply. This is a substantial positive innovation and welfare effect because it simplifies and relaxes access to medicines due to the price reduction. For the above mentioned reasons the EC saw a great threat to innovation when Pfizer wanted to acquire Hospira. In her speech, Margarethe Vestager, Chief of EC said that "…*we looked at a merger between the drug company Pfizer and its rival, Hospira. We only approved the deal after Pfizer agreed to sell the European rights to an arthritis drug it was developing. One concern was that Hospira already had a competing drug on the market,*

[50] Case M.7872, Novartis/ GSK, 2015 O.J C9710.

[51] Pfizer, *Pfizer completes acquisition of Hospira*, PFIZER (January 11, 2019 12:56 PM) https://www.pfizer.com/news/press-release/press-release-detail/pfizer_completes_acquisition_of_hospira.

and we thought Pfizer might stop work on its own drug if the deal went ahead as planned. Which would have meant less of the innovation that we depend on as patients".[52] Hospira, which was a competitor, also possessed a similar drug. When Pfizer wanted to acquire Hospira, the EC apprehended that this would hinder the development of the innovative biosimilar drug or worse, abandon research which would have negatively affected patients' welfare worldwide.

C. JOHNSON & JOHNSON/ACTELION[53]

The EC emphasized on innovation on June 9, 2017, in its order determining potential effects of the merger of Johnson & Johnson (J&J) with Actelion. While Actelion was developing Dual Orexin Receptor Antagonist ("DORA") for primary and secondary insomnia (compound name "ACT-541468", currently in phase II). This pipeline was to be transferred to the newly created company Idorsia. J&J was developing a selective Orexin-2 antagonist compound ("JNJ-7922") for the treatment of primary insomnia and depression. The compound is currently in phase II and is being co-developed with Minerva Neurosciences, Inc. (Minerva).

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[52] Agence France Presse, *EU Approves Merger Of Pfizer Off-patent Unit And Mylan*, BARRONS (January 31, 2019 12:34 AM)https://www.barrons.com/news/eu-approves-merger-of-pfizer-off-patent-unit-and-mylan-01587576904.

[53] Actelion, *Johnson & Johnson to acquire Actelion for $30 billion with spin-out of new R&D company*, ACTELION (December 11, 2018 5:09 PM) https://www.actelion.com/media/media-releases?newsId=2073570.

In light of the limited competition in the global development of the pipeline products (development of Orexinantagonist products for insomnia treatment), the EC found that there was a risk to innovation in competition stemming from possible discontinuation, delay or reorientation of any of its pipeline products. This could be by way of targeting specific therapeutic indication(s) or patients' groups of insomnia in order to avoid making two pipelines compete directly. Additionally, if one of the pipeline products compared to the other had the likelihood of capturing significant revenues, it would have increased the incentive to discontinue, delay or re-orient the other one.

If JNJ-7922 and ACT-541468 were competitively developed, they would be close and direct competitors without much competitive constraints from other products. Thus, making it economically viable for discontinuation of ACT-541468 in threat of the likely cannibalization of JNJ-7922's sales. The chances of J&J doing the same were also similar.

The order recognized the harmful effects on consumers by loss of product variety and reduced intensity of future product market competition where new products would have been introduced, but for the merger. The merger was viewed to have a negative innovation effect and it received a green flag from the EC only after required divestments.

D. THORATEC CORPORATION/ HEARTWARE INTERNATIONAL INC.

When Thoratec Corporation and HeartWare International Inc. intended to proceed with their merger, the FTC took stride and raised that the merger agreement was in violation of Federal Trade Commission Act[54] and Clayton Act.[55] According to FTC, the merger threatened the US Left Ventricular Assist Device ("LVAD") market. LVAD is a life-sustaining technology for treating end-stage heart failure patients who have failed other courses of treatment and are at a high risk of death in near future or are ineligible for a heart transplant.

FTC noted that Thoratec's flagship product, HeartMate II, and its first gen LVAD, the HeartMade XVE, are the only LVADs approved for commercial sale by the U.S. Food and Drug Administration ("FDA"). It was observed that a very small number of companies are developing this technology and even smaller number of companies are permitted by the FDA to sell these limited amount, pursuant to Investigational Device Exemptions.[56]

It was noted that HeartWare played a role in incentivizing Thoratec to innovate through HVAD system (an LVAD which offers a novel design that promises superior reliability with fewer surgical complications) and was still in its clinical trials, the intensity was expected to increase with FDA approval to HeartWare. FTC noted that the merger would substantially lessen competition and incentive to innovate in the relevant markets. It would also have

[54] Federal Trade Commission, In the Matter of Thoratec Corporation and HeartWare International, Inc, Administrative Complaint Docket No. 0910064.
[55] *Ibid.*
[56] *Supra* note 54, at 8.

negative welfare effect on consumers due to resultant price rises. Eventually, the merger failed.

IV. ANALYSIS

It has to be noted that the presence of innovation effects is one of the factors prescribed by the law in India. Similarly, The EU's legal framework for merger control explicitly addresses a merger's effects on innovation – either positive or negative – in line with the economic principles of contestability and synergies. This shows that the legislative intent backs the premise that innovation affects competition.

There have been credits and criticisms to this interpretation and outlook with the basic premise evaluating appropriateness of innovation as a subject of assessment for merger control. From the case studies in this research, it has been observed that, no matter how significant the innovation effects, the competition regulators globally have almost always preferred modifications over a complete rejection.

Notable economists[57] have opined that mergers may even positively impact innovation and welfare since the merged entity can shut down repetitive research leading ultimately to substitutes (like in the Vodafone-Idea case mentioned above).[58] This streamlining can have positive impacts and even increase the overall probability of the invention fructifying.

[57] Denicolo, Vincenzo and Polo, Michele, *The Innovation Theory of Harm: An Appraisal*, 3 RAND JOURNAL OF ECONOMICS 123, 120-149 (2018).

[58] *Ibid*.

In the agrochemical sector, there is an obvious need to innovate considering development of resistance by pests, weeds etc. and thus a merger of significant players, where the number of innovators with capacity to do valuable research are already limited, innovation had to and was rightly analysed by the competition regulators.

The EC has conducted an in-depth study in this regard. Indeed, the scale of research and analysis was commendable. Specifically, the EC weighed in the market conditions specific to Europe and kept the European consumers' welfare in mind, which is something the CCI should strictly follow. For instance, he merger of Dow Chemicals with Du Pont De Nemors was analysed to have significant negative impacts on the European competition market. The Indian competition analysis in this regard is notable but significantly influenced by that of the EC.

Vidisha Vyas and K. Narayana while addressing effects of M&A on R&D observed that acquisitions appear to have a negative impact on R&D intensity. They also observed that the firms in the Indian pharmaceutical sector are using resources meant for R&D to absorb the know-how acquired through M&A.[59]

Merger of two innovating competitors may increase innovative capacity of the merged entity however, reducing the overall innovation in the sector. The authors have inferred that while there are negative impacts on innovation such as reduction in overall competition and costs as well as regulatory hurdles. Thus, making it

[59] Vidhisha Vyas, Krishnan Narayanan &. Ramanathan, *Determinants of Mergers and Acquisitions in Indian Pharmaceutical Industry*, EURASIAN JOURNAL OF BUSINESS AND ECONOMICS 9(5), 79-102 (2012).

difficult for other firms to innovate, but there are also positive impacts of a merger such as economies of scale and scope of operations.

If technological spillovers are high and merger allows internalization of the same, then the R&D investment increases, leading to a positive impact. Hall (1990) while studying the impact of corporate restructuring on industrial research spending, concluded a permanent decline in R&D intensity of acquiring firms.[60]

According to the result of a "weighted least squares regression analysis", there is a slight positive impact on R&D intensity in the first year followed by a subsequent negative impact in two years following it and in aggregate in these three years, basically reflecting that the immediate benefits are exploited by acquirer firms from target firms' R&D capabilities. However, in subsequent years the reduction is a result of influence of bureaucratic hurdles, restructuring cost, integration issues and disruption of established organizational and R&D routines in both target and acquirer firms. The analysis of the Indian scenario revealed that the economies of scale and synergies do not work in a typical way. In J&J's merger with Actelion, the EC noted that from innovator's perspective the expected loss of profits on the products of the other party adds to the opportunity of cost of innovating, making it more likely that an early pipeline product is discontinued with.

[60] HALL. B, THE IMPACT OF CORPORATE RESTRUCTURING ON INDUSTRIAL RESEARCH AND DEVELOPMENT (1990).

It may be noted that horizontal mergers are actually not as bad for innovation as apprehended because familiarity would increase innovation, rather than vertical mergers where the firms do not have any overlapping pipeline products but several different research projects.

The competition regulators globally have attempted to solve innovation issues by requiring divestments. However, the regulators have failed to trace the source of innovation in companies, with respect to whether the assets of an entity being transferred to a merging party would lead to an increase in innovation or the death of a possible product.

The EU while analyzing innovation impacts of the aforementioned case studies, also considered that consolidation of competitive innovators can affect price and quality. Divestiture as a remedy attempts to protect competition in the market and to ensure a wider choice for consumers. However, it must be ensured that such remedies do not defeat their own purpose by doing the same in a disproportionate or intrusive manner.

In the Vodafone-Idea merger, for example, the CCI order discussed competition analysis, market share and a comparison between market players, however it did not touch upon innovation effects. Whereas the merging entities had drawn innovation efficiency conclusions as well as welfare benefits. When the CCI found there would be an adverse impact of the merger on the market, a remarkable remedy was given. CCI required the merged entity to reduce its spectrum share to 25% post-merger. Thus, CCI looked at remedies other than divestment during its merger control analysis to determine the most appropriate remedy on case by case basis.

The EC on the other hand, in the case of Hutchinson 3G UK-Telefonica Ireland completely rejected the remedy proposed by the parties to host not more than two virtual providers post-merger. The EC held that innovation efficiencies resulting from the merger cannot make up for the negative welfare effect caused by it.

A. CHANGE IN STAND

All of the aforementioned case studies demonstrate a resonance with Margrethe Vestager's 'innovation-based approach' to merger analysis, which seems to have influenced global competition regulators. The Dow and Du Pont merger was the first where the CCI considered innovation analysis seriously and thus, seems to have relied upon EU's recently altered stance. Similarly in the US, while the earlier decisions do not reflect innovation analysis e.g. Hospira-Pfizer Merger. However, recent mergers like Thoratect-Heartware (though very few in comparison to the EU) do follow the trend.

B. CONTOURS

In the authors' opinion, there needs to be a well-defined, if not a watertight, limit on what should form part of an innovation analysis in merger control. The significance and relevance of innovation analysis is recognized and undebated by the authors, however, the extent and usage in different types of cases where it should be done remains open to further research.

V. CONCLUSION

This article, through a detailed assessment of the mergers studied in three sectors (viz. agrochemical, telecommunication and pharmaceutical), observed the recent trend recognizing the significance of utilizing 'innovation analysis' in assessing mergers – a phenomenon rarely recognized, but present in antitrust laws of almost all jurisdictions. The article attempted to examine the methodology applied in 'innovation analysis' by the EC which was relied upon in later decisions by the CCI as well as the FTC. The position of 'innovation analysis' is unbalanced, in that, the competition regulators have either not attempted to analyse impact on innovation or have become intrusive by prescribing widely disproportionate remedies till now. The authors conclude that the presumption of negative impact (*per se rule*) on innovation or sectoral spaces can be harmful to competition in some cases. Further, while assessing innovation impact of mergers, negative impacts should be weighed alongside positive impacts. Lastly, we conclude that innovation is a valuable yardstick in assessing competitive constraints, however the exact contours of competition analysis may be left for future research.

GOOD FORUM SHOPPING IN CROSS BORDER INSOLVENCY: HAMPERED BY THREE-MONTH-LOOK-BACK-PERIOD AND GIBBS PRINCIPLE

Nitesh Jindal and Shiphali Patel*

ABSTRACT

Due to the effects of globalisation and relative ease of doing business, a corporate debtor often has a myriad of options to enter into bilateral agreements with different creditors situated in different parts of the world. When a corporate debtor becomes insolvent or to-be-insolvent, stakeholders i.e. debtors and creditors would always wish to initiate proceedings in a jurisdiction which will benefit them. While hunting for such a jurisdiction, stakeholders may end up finding jurisdiction of a country where corporate debtor's Centre of Main Interest (COMI) does not lie. This will lead debtors and creditors (through mutual agreement) to forum shop to the laws of such country which will have a better ecosystem for such proceedings. This article examines firstly, that whether the three-month-look-back-period which is incorporated under the draft on cross-border insolvency to curb abusive forum shopping will end up hampering good forum shopping. Secondly, the authors analyse the infamous Gibbs principle and its repercussions on good forum shopping as it was recently upheld by the Court of Appeal in England. This highlights that Gibbs principle, which although centuries old, is still in fashion. This

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article concludes by asking whether Indian courts would recognise a distinction between good and bad forum shopping and whether Gibbs principle would touch the boundaries of the Indian jurisdiction.

INTRODUCTION

Interdependency of world economies has time and again been demonstrated by numerous epoch making events. Whether it was the economic crisis of 1997[1] or global financial crisis of 2008, it has been shown that no company, howsoever large, is immune from global risk and even multinational companies can go insolvent.[2] One of the factors responsible for such interdependency is cross-border private investment,[3] as it results in a multitude of creditors around the globe for a debtor. Hence, cross-border insolvency occurs when a debtor, while having creditors in more than one country, ventures into financial difficulty.[4]

Broadly, there are three principles to deal with the treatment of financially distressed debtors. *Firstly,* the 'territoriality principle' which is based upon the idea of state sovereignty and which emphasises that each jurisdiction will only apply its own laws over

[1] Anthony M. Vassallo, Jeff Carruth, John A. Barett, Jr., Dario U. Oscos Coria and Paula E. Garzon, *Cross-Border Insolvency and Structural Reform in a Global Economy*, 34 THE INTERNATIONAL LAWYER 533, 533 (2000).
[2] AK Sikri, *Cross Border Insolvency: Court-To-Court Cooperation,* 51 JOURNAL OF THE INDIAN LAW INSTITUTE 467, 467 (2009).
[3] Garzon, Paula E., *Cross-Border Insolvency and Structural Reform in a Global Economy*, 34 THE INTERNATIONAL LAWYER 533, 533 (2000).
[4] Look Chan Ho, *Anti-Suit Injunctions in Cross-Border Insolvency: A Restatement,* 52 THE INTERNATIONAL AND COMPARATIVE LAW QUARTERLY 697, 697 (2003).

assets situated within it.[5] The implication of such a principle is that each jurisdiction has to initiate its own insolvency proceedings without giving regard to the recognition of foreign insolvency proceedings. *Secondly*, the 'universality principle', states that a single court will carry out all insolvency proceedings and other jurisdictions will give recognition to such proceedings. *Thirdly,* and most importantly is the 'principle of modified universalism' where jurisdictions try to cooperate with each other to find out the relevant jurisdiction to conduct proceedings.[6] There is broad consensus among many jurists and practitioners that modified universalism is the way forward in cross-border insolvency.[7]

When a business enterprise with assets and creditors in multiple jurisdictions goes insolvent or wishes to reorganise itself, then the problem regarding cooperation among multiple jurisdictions arises. To address this problem, on May 30 1997, United Nation Commission on International Trade Law ("UNCITRAL") adopted the Model Law on Cross-Border Insolvency ("Model Law"), based on the principle of modified universalism. This principle lies at the

[5] *Supra* note 2, at 467.
[6] Ran Chakrabarti, *India's Proposed Cross Border Insolvency Regime: Will It Trump The Gibbs Rule?*, MONDAQ (Mar. 5, 2019, 1:25 AM), http://www.mondaq.com/india/x/721994/Insolvency+Bankruptcy/Indias+Proposed+Cross+Border+Insolvency+Regime+Will+It+Trump+The+Gibbs+Rule.
[7] Kannan Ramesh, *The Gibbs Principle: A Tether on the Feet of Good Forum Shopping*, 29 SINGAPORE ACADEMY OF LAW JOURNAL, 42, 43 (2017).

core[8] of the Model Law and the European Union's Council Regulation, 2015 ("EIR Recast").[9]

Based upon the Model Law, the Insolvency Law Committee ("Committee") in India released a report on cross-border insolvency ("Report") in October 2018.[10] Along with the Report, the Committee annexed a draft on cross-border insolvency ("Draft").[11] To rescue the corporate debtor from the financial difficulties, the Draft recognises foreign main proceedings and foreign non-main proceedings. The foreign main proceeding must be commenced where the debtor's COMI lies. It has the principal responsibility to adjudicate upon the debtor's insolvency or reorganisation proceeding, irrespective of the countries in which the corporate debtor has its assets and creditors.[12] To ensure speed and convenience of proof, a rebuttable presumption was laid down in the Model Law that a corporate debtor's registered office is its COMI, in absence of the proof to the contrary.[13] This presumption could be rebutted on the grounds of location of the "central

8 *Id*., at 42.
9 Commission Regulation 2015/848 of May 20, 2015, Regulation Of The European Parliament and Of The Council On Insolvency Proceedings O.J. (L 141). ["Regulation"]
10 Report of Insolvency law committee on Cross border insolvency, (October 8, 2018), http://www.mca.gov.in/Ministry/pdf/CrossBorderInsolvencyReport_22102018.pdf. ["Report"]
11 *Id*. at 50, 70.
12 Guide to enactment and interpretation of the UNCITRAL Model law on Cross Border Insolvency, (Jan. 2014), 12, https://www.uncitral.org/pdf/english/texts/insolven/1997-Model-Law-Insol-2013-Guide-Enactment-e.pdf.
13 Report, Section 14(1), at 57.

administration" of the company.[14] The Committee accepts that this presumption may lead to abusive forum shopping.[15] However, it forgets to mention that it will hamper good forum shopping. To curb this potential abusive forum shopping, the committee incorporated three-month-look-back-period which, this article argues, will have serious repercussions on the Indian creditors and debtors.[16]

This article argues that on one hand, the Report fails to differentiate between good and bad forum shopping, and on the other hand, it has introduced the measure of three-month-look-back-period which does not curb bad forum shopping but surely hinders good forum shopping. To add to the misery, there is a century old principle i.e. the Gibbs Principle which says, that a debt will be discharged only if the law governing the debt discharges that debt.[17] This principle represents territorialism, entirely opposite to the modified universalism on which most of the cross-border insolvency laws are based. In 2018, it was upheld by the Court of Appeal of England that courts below the Supreme Court are still bound to this archaic law. This principle creates complicated problems for the creditors whose contract or a part of the contract is governed by the English law.

This article is an attempt to show the complications which the upcoming Indian law on cross-border insolvency is going to face

[14] Report, Section 14(3), at 58.
[15] Report, Section 11(3), at 32.
[16] Report, Section 14(2), at 58.
[17] *Supra* note 7, at 44.

and how the three-month-look-back-period and the Gibbs Principle are going to put Indian debtors and their right to forum shop in troubled waters. It begins by providing a brief introduction to forum shopping with an attempt to differentiate between bad forum shopping and good forum shopping (Part II). It then vehemently supports good forum shopping in next two parts and argues that bona fide forum shopping is being hampered. This article critiques the three-month-look-back-period which comes in the way of exercise of legitimate right of the creditors and debtors to forum shop (Part III). Further, the authors elaborate on the Gibbs Principle and how it will hamper good forum shopping by endowing jurisdiction upon English courts, even where debtors and creditors do not wish so (Part IV). This article concludes by arguing that in this age of globalisation, modified universalism is the way forward and this principle ought to be incorporated in modern legislations (Part V).

I. FORUM SHOPPING

In order to do justice to this article it is pertinent to have a good understanding of the word "forum shopping". In simplest words, it is described as "*An exploration; for a jurisdiction (the forum) which is more favourable*."[18] Another definition suggests that forum shopping is *"The search by a plaintiff for the international jurisdiction most favourable to*

[18] A. Adl Rudbordeh, *Forum Shopping in Insolvency Law Amersfoort, The Netherlands*: Celsus juridische uitgeverji 78 (2016). ["Rudbordeh"]

his claims involving merely the optimisation of procedural possibilities".[19] Thus, when a debtor or creditor has the ability to choose among forums that may have jurisdiction, the party will want to go to a forum which offers the best options with respect to both procedural and substantive law.[20]

Forum shopping is undertaken in two major strategies. In the first strategy, the corporate debtor can move its registered office to another country whose jurisdiction it desires. This is because of the presumption in the Article 3 of the EIR Recast, which is also mirrored by Section 14 (1) of the Draft, which says that the place of incorporation of a company would be its COMI, until the contrary is proved. Thus, relocation of registered office would lead to change in jurisdiction of the applicable insolvency law. This strategy can be witnessed in the transformation of *Deutsche Nickel AG*[21] from being a German public limited company to transforming into an English private limited company by shifting its registered office to United Kingdom ("UK").[22]

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[19] Ruiz-Jarabo Colomer, Opinion of Advocate General Colomer, (March 2, 2019, 7:52 PM), 715, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:62004CC0001&from=EN.

[20] Joseph A. Caneco, *Insolvency Law and Attempts to Prevent Abuse and Forum Shopping in the EU*, LAW SCHOOL STUDENT SCHOLARSHIP (Mar 2, 2019, 8:15 PM), https://scholarship.shu.edu/cgi/viewcontent.cgi?article=1839&context=student_scholarship.

[21] Deutsche Nickel AG [2013] EWHC (Ch) 68.

[22] Wolf-Georg Ringe, *Insolvency Forum Shopping, Revisited*, HAMBURG LAW REVIEW 38, 41 (2017).

The second strategy, given in Section 14(3) of the Draft and in the Recital (30) of the EIR Recast, stipulates that the COMI of a company can be shifted by simply moving the effective central management and 'head office functions' of a company abroad. It means that COMI of a company can be shifted without moving its registered office. This kind of COMI shift has been witnessed in *Hellas Telecommunications (Luxembourg) II SCA*, [23] where the English courts held that the COMI of Hellas Telecommunications had been effectively transferred from Luxemburg to England despite the fact that the company's registered office remained in Luxembourg.[24] This concept is not of new origin. There have been cases where a company going through financial crises found laws of another country more flexible and friendly than the laws of the country in which it has been incorporated.

For example, in the case of *Re Rodenstock GmbH,*[25] a German registered company Rodenstock GmbH, in Munich, was moving rapidly towards insolvency. The company wanted to undergo debt restructuring but at that time its domestic laws did not allow restructuring. The company did not consider insolvency as its best option and decided to restructure its debt via the English jurisdiction, which allowed for restructuring and had a better ecosystem. Notably, such a change in COMI was permitted by the English courts. Hence, we can conclude that when the creditors and

[23] Re Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC (Ch) 3199.
[24] *Supra* note 22.
[25] Re Rodenstock GmbH [2011] EWHC (Ch) 1104.

debtors choose a jurisdiction which they find suitable to support their claims, they are said to have engaged in forum shopping.

A. WHAT IS GOOD FORUM SHOPPING?

Good forum shopping has been rightly described as, "*Where a particular forum is selected for insolvency or restructuring because, in the view of the debtor or the creditors, that* jurisdiction *possesses an insolvency ecosystem - comprising both regulatory and soft infrastructure - that will best promote the economic survival of the debtor or achieve the best possible outcome for creditors…. It is carried out for a bona fide purpose and is therefore properly characterised as "good forum shopping".*"[26] Therefore, if the intention is bona fide and forum shopping is being carried out for the benefit of organisation by debtor and creditors as a whole, only then can it be said that the company has undertaken good forum shopping.

Besides the debtor, the parties most affected by the unpaid insolvency are the creditors. The main idea behind insolvency is that all the assets are equally distributed among the creditors and if creditors themselves desire a jurisdiction for the proceedings then it ought to be respected and endorsed. This is not merely because the creditors desire it but also because they understand how the assets of a failing company can be maximized and how it can serve their best interests, which is one of the objectives of insolvency law.[27]

[26] *Supra* note 7, at 60.
[27] *Id.* at 59.

In the case of *Re Apcoa Parking Holdings GmbH* ("Apcoa"),[28] nine body corporates wanted to restructure their debt in order to avoid descending into insolvency. They applied to obtain English jurisdiction which according to Justice Hildyard, "*tested the boundaries of a jurisdiction which was by its nature potentially exorbitant*".[29] Nonetheless, he granted the jurisdiction on the ground that the scheme favoured the interest of not only the debtor but also of the creditors as a whole and was evident from their majority vote.[30] It is evident that definition of good forum shopping would likely be a factual assessment differing from case to case, but in each case the unanimous or close to unanimous view of the creditors will always be given utmost importance. This can be seen as a measure of whether the forum shopping is abusive or not.[31]

Hence, good forum shopping is said to be done when a jurisdiction is chosen by both debtors and creditors to satisfy their claims with a bona fide purpose. Albeit, the choice of the creditors is paramount. The jurisdiction is chosen so that the value of the assets of the insolvent or to-be insolvent company can be maximized and both creditors and debtors can benefit from the flexible and friendly laws of that jurisdiction.

B. GOOD FORUM SHOPPING VIS-À-VIS BAD FORUM SHOPPING

[28] Re Apcoa Parking Holdings GmbH [2014] EWHC (Ch) 3849.

[29] *Id*. at 205.

[30] *Id*. at 244.

[31] Rudbordeh, *supra* note 18.

To understand what is 'bad' or 'abusive' forum shopping, we only need to go as far as Recital (5) of EIR Recast. The recital states:

"*It is necessary for the proper functioning of the internal market to avoid incentives for parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable* legal *position to the detriment of the general body of creditors (forum shopping).*"

Hence, it is clear from this recital that any shift of jurisdiction which leads "*to the* detriment *of the general body of creditors*" is abusive or bad forum shopping.

Appreciating the difference between good and bad forum shopping, former Advocate General of European Court of Justice Ruiz-Jarabo Colomer states that any forum shopping leading to "*unjustified inequality between the* parties *to a dispute with regard to the defence of their respective interests*" is abusive or bad forum shopping.[32] Likewise, in the *Seagon* case,[33] he suggested that the *"opportunistic* and *fraudulent use of the right to choose a forum"* is very different from the practice of forum shopping. This is why the practice of forum shopping should not be demonised, but be encouraged at appropriate times.

The Impact Assessment of the Commission Staff Working Document while talking about COMI shifting highlights that forum shopping is not always an abusive process. It says that, *"A genuine relocation to another Member State is an exercise of the right to freedom of*

[32] *Supra* note 19, at 716.
[33] Case C-339/07, Seagon v. Deko Marty, 2009 E.C.R I-00767.

movement and establishment and justifies the application of the insolvency regime of that other country; a sham move does not".[34]

"*Forum shopping generally gets a bad press.*"[35] In fact, it is often regarded as a manipulative move by way of which debtor or creditor, may curb each other's interest. However, this is not the case always; a debtor may forum shop to increase the value of its assets so that it can maximize returns to its creditors.[36] Requirements for a legitimate attempt of forum shopping are efficiency, legal certainty and welfare of the collective.[37]

Thus, forum shopping is legitimate or good if it meets the aforementioned requirements. A company should have a right to move and shift, especially when it is doing so for the benefit of both the debtor and the creditor. Such an action must not be confused with an abusive one, where the shift of jurisdiction has been made only to manipulate or limit the interests and rights of either party. It has been established that not all forum shopping is bad and when done with the consent of the creditors, to benefit creditors and debtors, it constitutes good forum shopping and must be encouraged.

[34] European Commission, SWD (2013) 531, Commission Staff Working Document on Impact Assessment, http://ec.europa.eu/environment/archives/air/pdf/Impact_assessment_en.pdf.
[35] Jennifer Payne, *Cross-Border Schemes Of Arrangement And Forum Shopping*, 14 EUROPEAN BUSINESS ORGANISATION LAW REVIEW 563, 563-589 (2013).
[36] *Id.* at 30.
[37] Rudbordeh, *supra* note 18.

II. GOOD FORUM SHOPPING HAMPERED BY THREE-MONTH-LOOK-BACK-PERIOD

A. WORD ON THE THREE-MOTH-LOCK-BACK-PERIOD

The Model Law does not provide any mechanism to curb abusive forum shopping. Therefore, the Committee considered the obligations under the EIR Recast to determine if COMI should be decided against the presumption.[38] The fact that only abusive forum shopping is harmful, led EIR Recast to include some measures to curb such abuse. These measures are:-

i. that the COMI presumption should be rebuttable under certain circumstances;

ii. that national courts should, of their own motion, verify that the debtor's COMI is indeed located within their territory;

iii. that the COMI presumption does not apply during a suspension period of three (or, in the case of individuals, six) months before the request for opening proceedings is filed; and

iv. that any creditor or debtor must have an effective remedy under national law against the decision to initiate insolvency proceedings.[39]

We would be specifically dealing with measure (iii) in this article. The goal of the EIR Recast is to single out abusive forum shopping and the measures (i), (ii) and (iv) as listed above stand out as

38 Report, *supra* note 10, at Section 14(2).
39 Regulation, *supra* note 9, at Art.4.

improvements which would support achieving this goal. However, if we look at measure (iii), the three-month-look-back period seems to target all COMI shifting, in the months prior to filing for insolvency, rather than specifically combating only abusive forum shopping. Consequently, this three-month-look-back period acts as an impediment to the normal COMI relocations, which would be beneficial and value-creating for all the participants.[40]

Inspired from Article 3 of the EIR Recast, the Committee incorporated a presumption in the draft. It states that, "*In the absence of proof to the contrary, the corporate* debtor's *registered office is presumed to be the corporate debtor's centre of main interests for the purpose of this Part*."[41] This presumption is rebuttable, on the ground that the corporate debtor's registered office is shifted within the three month period prior to the filing of insolvency proceeding in a new jurisdiction.[42] Hence, if a company shifts its registered office to another country and within three months of such shift, files an application for insolvency proceeding in that new country then the above stated presumption would not hold ground.

B. THREE MONTH LOOK BACK PERIOD COMING IN THE WAY OF GOOD FORUM SHOPPING

The three-month-look-back period was inserted to prevent abusive forum shopping but, as mentioned above, it will hinder the creditors and debtors of a company in shifting their COMI to a

[40] *Supra* note 22, at 44.
[41] Report, *supra* note 13.
[42] Report, *supra* note 16.

favourable jurisdiction. The three-month-look-back period has been severely criticised for its inability to curb abusive forum shopping. The first criticism generally levelled against it is that this measure is "*under-inclusive.*" As is obvious from Section 14(1) of the Draft, which explicitly talks about "the corporate debtor's registered office", it can be inferred that the three-month-look-back period applies only if the company's head office is shifted to the jurisdiction of another country. As stated above, the second strategy to shift COMI, forum shopping can be done by ways other than shifting the registered office like by moving the head office or central administration of a company. Thus, these situations can also lead to forum shopping, especially since the three-month-look-back period does not cover the shift of central administration.[43] Hence, the provision exposes a serious gap.[44]

The second criticism is that the three-month-look-back period is "*over-inclusive*". This measure fails to differentiate between good forum shopping and bad forum shopping, as a result of which it discourages even the benefits of good forum shopping which would help both debtor and creditors. This is because the three-month-look-back period does not distinguish between the COMI shift which has taken place by mutual agreement (which would be beneficial) between the stakeholders or taken as a unilateral decision by the debtor to manipulate the proceedings. It is only the latter that the Draft should attempt to target.[45]

[43] Report, *supra* note 14.
[44] *Supra* note 22, at 48.
[45] *Id.*

This three-month-look-back-period can be seen as a tool for establishment of a more reliable COMI, rather than quick relocation of assets or business. However, by setting a temporal requirement for company re-incorporations, the Committee is forcing one to conclude that a reincorporation of less than three months prior to the application for insolvency proceedings is abusive forum shopping. This conclusion strongly questions 'freedom of establishment'.[46]

We take the example of a recently established company which applies for insolvency shortly after its establishment. Such a company has a right to forum shop to a jurisdiction with more flexible insolvency laws but a three-month-look-back period would only make such forum shopping burdensome. The company would have to wait for this period to get over, and till then would have to bear the brunt of economic distress. Therefore, forum shopping, howsoever effective and efficient, would become less appealing because of the three-month-look-back-period. Thus, this three-month-look-back period is indifferent towards whether a COMI shift is abusive or not.

Through this argument, the authors would like to draw attention towards a lacuna in the Draft. The Draft states that COMI of any company must be presumed at the place of its registered office and if the presumption is rebutted, then the COMI must be assessed by the central administration of the company. It must be pointed out that not a single clause in the Draft talks about the right or will of

[46] Rudbordeh, *supra* note 18, at 51.

the debtors and creditors to move to a favourable jurisdiction, for a bona fide benefit of both the parties. The Committee made no efforts in differentiating between good and bad forum shopping.

III. GOOD FORUM SHOPPING HAMPERED BY GIBBS PRINCIPLE

Amongst many archaic common law rules, Gibbs Principle still remains firmly rooted despite a plethora of dissenting views by various authors.[47] The Court of Appeal in the case of *Antony Gibbs and sons v. La Société Industrielle et Commerciale des Métaux* ("Antony Gibbs") laid down the principle.[48] Recently, in the case of *OJSC International Bank of Azerbaizan v. Sberbank of Russia & Frankline Global Trust* ("IBA Case"),[49] the Court of Appeal held that the ruling in Antony Gibbs is still a fundamental tenet of English insolvency law[50] and is not swayed by modern cross border insolvency regulations. This part focuses on how this contentious principle would affect good forum shopping, and concerned *bona fide* creditors and debtors.

A. GIBBS PRINCIPLE

[47] *Supra* note 7 (Kannan Ramesh has described Gibbs Principle as a principle that plagues the cross border restructuring and its practice).
[48] Antony Gibbs and sons v La Société Industrielle et Commerciale des Métaux [1890] QBD 25 at 399 ["Antony Gibbs Case"].
[49] OJSC International Bank of Azerbaizan v. Sberbank of Russia & Frankline Global Trust [2018] EWCA (Civ) 2802.
[50] Adam Gallaghar, Katharina Crinson, *The Rule In Gibbs Fights Another Day,* FRESHFIELDS BRUCKHAUS DERINGER (Mar. 4, 2019, 6:24 AM), http://knowledge.freshfields.com/en/Global/r/3879/the_rule_in_gibbs_fights_another_day.

As mentioned, this English common law principle dates back to the case of Antony Gibbs in 1890. The facts of the case were as follows: a contract, governed by the English law, was entered between the parties wherein the plaintiff agreed to supply copper to the defendant (a trading company created according to the French law).[51] The company went into liquidation in France. After this, the defendants gave notice to the plaintiffs that they will not accept any copper.[52] This prompted the plaintiff to initiate a claim. The liquidator rejected the claim on the ground that no such claim was admissible as the French law provided that the vendors had to deliver the goods to the liquidator and ask for a price, but the plaintiff did not do so.[53]

The plaintiff, Antony Gibbs, commenced proceedings in England seeking an award with regard to the loss sustained as a result of reselling the copper. The defendant argued that judgment on liquidation by the French Tribunal would operate as discharge of defendants from an action on the contract and would therefore, operate as a bar on proceedings in England.[54] The plaintiff, on the other hand, argued that defendants were not discharged under French law and even if they were discharged, there was no bar on the stay of proceedings in England. The plaintiff went on to argue that these contracts were English contracts, made and to be performed in England.[55] There is no authority to show that a party

[51] Antony Gibbs Case, *supra* note 48, at 399-400.
[52] *Ibid.*
[53] Antony Gibbs Case, *supra* note 48, at 401.
[54] *Ibid.*
[55] Antony Gibbs Case, *supra* note 48, at 403.

to a contract, governed by English law, can be discharged by foreign law.[56] Therefore, the plaintiff was not bound by the French law.

Lord Esher established that the contracts were English contracts. He did so with the help of two rules: *first*, that the contracts were made in England and *second* that they were to be performed in England. Therefore, a contract will be governed by the laws of a country if it were made in it or was to be performed in it.[57] Lord Esher further discussed the discharge of a contract by a foreign court. He held that a contract is said to be discharged by the bankruptcy law of a foreign country only when the contract is governed by the law of that country.[58]

Thus, the Court of Appeal unanimously rejected the arguments of the defendant and held that the parties to the contract never agreed to be governed by the French law and since the contract was governed by the English law, no bar would operate on the proceedings in England. The court also gave due credence to the '*converse doctrine'* which provides that discharge of a contract by the law of a place where the contract was not made or was not meant to be performed, will not be valid.[59]

With the evolution of this principle, English courts have carved out an exception to it i.e. if the relevant creditor submits to the foreign

[56] *Ibid.*
[57] Antony Gibbs Case, *supra* note 48, at 405.
[58] Antony Gibbs Case, *supra* note 48, at 405-406.
[59] *Id.*, at 408.

insolvency proceedings; creditor is taken to have accepted that his contractual obligations are to be governed by the law of the foreign insolvency proceedings.[60] However, it often would be the case that dissenting creditors would never agree to foreign insolvency proceedings and this exception would remain inapplicable, This will give a chance to creditors to take the benefit of Gibbs Principle.

B. GIBBS PRINCIPLE STILL A GOOD LAW

On 18 December 2018, the English Court of Appeal in the IBA Case,[61] reiterated that Gibbs Principle has always been a good law and all courts below the Supreme Court are bound by it by the rule of precedent.

In this case, the applicant was the foreign representative ("FR") of the OJSC International Bank of Azerbaijan ("IBA"). IBA fell into financial difficulties and consequently entered into restructuring according to the Azerbaijan law. The plan that was put forth by the IBA was approved by the majority of creditors and as a matter of Azeri law it became binding on all the affected creditors, including those who did not vote or who voted against the plan. English creditors ("Respondents") whose claims were governed by the English law did not participate in this restructuring.

Sberbank of Russia ("Sberbank") and Franklin Templeton were the English creditors in this case. The FR successfully applied to the

60 *Supra* note 49.

61 *Ibid.*

English court for recognition of the foreign main proceeding and obtained an order for automatic stay under Article 20 of the Cross-Border Insolvency Regulations, 2006 ("CBIR"), which would continue till the restructuring was fully implemented and would lapse thereafter. Meanwhile, the Azeri Parliament made an amendment which enabled Azeri court to prolong restructuring proceedings indefinitely. The question therefore was: whether the English courts have the power, on the request of the FR, to direct the substantive claims of the English creditors to be stayed indefinitely? The stay on the proceeding is a temporary and procedural remedy, asking it to continue after the proceedings would make it substantive.

Regarding the prolonging of an indefinite stay, Henderson J stated that, "*the reconstruction plan is being kept alive artificially (through Azeri amendment), but as insolvency* proceeding *it has served its purpose and run its course.*" He also said that Article 21 CBIR is procedural and had it meant substantive right to override procedural rights, Article 21 CBIR would have explicitly provided so. Therefore, the court accepted Respondent's arguments and rejected IBA's plea for indefinite stay and upheld Gibbs Principle by permitting English creditors to initiate their claims, governed by English law.

Now we will turn our discussion towards the criticism levelled against Gibbs Principle, and how this principle will pose a serious threat to the stakeholders' choice of forum shopping.

C. GOOD FORUM SHOPPING HANDICAPPED BY GIBBS PRINCIPLE

Gibbs Principle has been criticised heavily not only by authors but by courts also. The Court of Appeal in the IBA case, despite upholding the rule propounded in Gibbs Principle, highlighted the criticism levelled against it. The criticisms were two-fold. *Firstly*, this rule is considered as archaic in a world where modified universalism underpins cross border co-operation. *Secondly*, the rule sits rather uneasily with established principles of the English law which expect foreign courts to recognise foreign insolvency proceedings.[62] Accordingly, these criticisms affect the purpose for which proceedings commence in the first place.

The rationale behind initiation of insolvency or reorganisation proceedings is to make sure that assets are preserved and afterwards distributed in a fair and orderly manner.[63] As argued by one of the authors, "*in some instances the debtor may be driven by a desire to utilise a form of proceedings in a particular jurisdiction with a view to maximising returns to creditors*."[64] Therefore, if it is the informed desire of debtors and creditors to be governed by a particular set of rules and procedures, to take the benefit of jurisdiction of those courts which would serve their best purpose, then courts should not come in the way of such liquidation or reorganisation even if it is prima facie evident that forum has been chosen for that purpose and none other.

The main question, therefore is, "*Why should good forum shopping become bad forum shopping simply because the law of the debt is not the law of*

[62] *Supra* note 49.
[63] *Supra* note 7, at 59.
[64] *Supra* note 35.

the forum?"[65] The question is a significant one and goes to the root of the Gibbs Principle. While applying this principle, a court will not recognise the discharge of debt by foreign insolvency or reorganisation where discharge of such debt is not governed by foreign law.

In the IBA Case the court said that had the contracts been governed by Azeri Law, the English courts would have recognised the effect of the restructuring.[66] Therefore, it can be concluded that IBA's reorganisation did not affect the English court's jurisdiction to hear the English creditors' claim governed by English law. In the same vein, even if creditors (barring those who have not submitted their claim to the proceeding) and debtors, for the benefit of their company, choose the jurisdiction of another country for the purpose of liquidation or reorganisation in a bona fide manner, Gibbs Principle would still be applied by the English courts. As a result, claims of creditors could be brought again for adjudication before English courts. Consequently, forum shopping carried out for the benefit of stakeholders will get trammelled by Gibbs principle.

There is one contradictory approach in forum shopping that has been followed by English courts. According to Look Chan Ho, English courts are marked by a "particular inconsistency" in the application of Gibbs Principle. English courts, on one hand espouse opening of English insolvency proceedings[67] (as a result of forum

[65] *Supra* note 7, at 60.
[66] *Ibid*.
[67] *Supra* note 25.

shopping) but on the other, refuse to recognise foreign insolvency proceedings.[68] Professor Ian Fletcher goes on to say that this inconsistency in English insolvency law is "reflective of double standards."[69] This problem is real and there is a dire need for reform. The authors argue that consistency can very well be achieved by English courts by recognising foreign proceedings where majority creditors have voted in its favour.

In India, jurisprudence regarding cross-border insolvency has not developed much and there is not even a single instance where Indian courts have dealt with the Gibbs Principle as such. It would be interesting to see whether Indian courts will also be swayed by this "inconsistency" or not. The authors are of the view that Gibbs Principle, if followed in India, would have serious repercussions and genuine debtors and creditors who are in financial difficulties would never be able to achieve what they initially wished for. This is because that this principle comes in the way of good forum shopping and would continue to pose problems to creditors and debtors who have entered into contracts, governed by English law.

IV. CONCLUSION

In this article the authors have tried to wipe off the black spot which comes with the name of forum shopping. They have tried to establish that it's not necessarily a deliberate move of a debtor or

[68] Look Chan Ho, CROSS-BORDER INSOLVENCY: PRINCIPLES AND PRACTICE VIII (Sweet & Maxwell 2016).
[69] Ian Fletcher, THE LAW OF INSOLVENCY, ¶29.063-29.069 (4th ed. Sweet & Maxwell 2009).

creditor to hamper each other's interests; rather it can be a progressive move to benefit both parties. The Draft needs to accept and encourage forum shopping as a practice and distinguish between good and bad forum shopping as done in the EIR Recast. Therefore, it would be interesting to see whether Indian courts would make a distinction between good and bad forum shopping when such a distinction has been ignored while making of the Draft. The authors have narrowed down two practices in the world which pose a threat to good forum shopping, which are the "Three-Month-Look-Back Period" and the "Gibbs Principle".

The three-month-look-back period was introduced as a measure to curb abusive forum shopping. It can be said that this measure has failed in its task. It does not completely curb bad forum shopping due to it's over and under inclusive nature, and it surely is a hurdle in the way of good forum shopping. It is an impediment to the companies who want to choose a jurisdiction for their insolvency proceeding for mutual benefit. It also creates a temporal barrier for such companies in shifting their COMI irrespective of their intentions. In this way, the measure of three-month-look-back period is a failure as it does not curb abusive forum shopping.

The second barrier is the century old Gibbs Principle, which was established by English courts. This principle was strongly criticised due to its striking contrast with the widely accepted 'modified universalism'. English courts have been marred by inconsistency wherein they grant jurisdiction to their courts in the instances of good forum shopping and at the same time deny recognizing jurisdiction of foreign courts in the same matter. At this place of inconsistency, English courts take the shelter of the archaic Gibbs Principle, which is not in conformity with the contemporary society. This principle hampers good forum shopping to the extent of defeating the very purpose of the cross-border insolvency law i.e. to serve the best interest of the debtors and creditors. For these reasons, it is imperative to disregard this principle and promote a 'modified universalism' approach.

THE HOT "SEAT" CONFLICT IN INDIAN DOMESTIC ARBITRATION: EXPLORING THE "PROPER COURT" RULE UNDER S. 2(1) (E) OF THE ARBITRATION ACT

*Anubhav Khamroi

ABSTRACT

Arbitration is the most sought-after dispute resolution mechanism in modern commercial arena. Under "Enforcing Contracts" segment, India currently ranks 163 among 190 countries in the World Bank's "Ease of Doing Business" rankings. Although, there have been several executive efforts at improving the alternate dispute resolution framework of India, the unpredictability and inconsistency of judicial pronouncements continue to haunt us. This article tries to bring out the inconsistencies in judicial interpretation of the expression- "Court" in Section 2(1)(e)(i) of the Arbitration and Conciliation Act, 1996. There have been divergent opinions on the "proper court" rule under the Act and the issue of competence of courts at the arbitral seat to exercise supervisory jurisdiction. In September 2012, when the Constitution Bench penned the BALCO judgement, it was construed as a significant development, strengthening investor confidence and stabilising judicial behaviour towards arbitration. BALCO adopted a reasonable middle-ground approach and clarified the legislative intent underlying the Act, which is to grant jurisdiction to the court at the arbitral seat along with other competent court(s) clothed with subject-matter jurisdiction. However, within half a decade, there has already been a judgement by the Supreme Court as well

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as several High Court decisions. This has resulted in resurrection of the extreme positions which existed in the pre-BALCO era. The article critically scrutinizes the correctness of Datawind (Supreme Court) and Debdas Routh (Calcutta High Court), while also highlighting the possible errors and oversights made in those judgements, in light of the provisions and principles underlying the Act as well as the authoritative ruling of BALCO. In conclusion, this article emphasises the need for certainty and predictability in judicial decision making, which is a 'sine qua non' of any established legal system, and finally attempts at simplifying the current legal position by using three hypothetical factual scenarios. Finally, the article analyses a sudden "Plot Twist" brought about by the Supreme Court in BGS v. NHPC (Dec, 2019).

INTRODUCTION

This article attempts to clarify the meaning and import of the expression "Court" under Section 2(1)(e)(i) of the amended Arbitration and Conciliation Act, 1996,[1] ("the Act") which has recently been brought into limelight by several conflicting Supreme Court and High Court decisions. It may also be noted that this question of law is currently pending before the Supreme Court, in *Devas Multimedia Private Limited v. Antrix Corporation Limited*, vide Special Leave Petition No. 028434-/2018. Although, there is a twist to the story which is examined in the latter parts of the article.

At the outset, to begin with the fulcrum of this issue, Section 2(1)(e)(i) of the Act reads as follows:-

[1] The Arbitration and Conciliation Act, 1996, No. 26 of 1996 [as amended by The Arbitration and Conciliation (Amendment) Act, 2015].

"**(e) Court means —**

(*i*) in the case of an arbitration other than international commercial arbitration, the principal Civil Court of original jurisdiction in a district, and includes the High Court in exercise of its ordinary original civil jurisdiction, having jurisdiction to decide the questions forming the subject-matter of the arbitration if the same had been the subject-matter of a suit, but does not include any Civil Court of a grade inferior to such principal Civil Court, or any Court of Small Causes" [**Emphasis added**]

Now, in order to appreciate the relevance of a precise definition of "Court" under the Act, we must refer to Section 42 of the Act, which reads:

"**42. Jurisdiction.—** Notwithstanding anything contained elsewhere in this Part or in any other law for the time being in force, where with respect to an arbitration agreement any application under this Part has been made in a Court, that Court alone shall have jurisdiction over the arbitral proceedings and all subsequent applications arising out of that agreement and the arbitral proceedings shall be made in that Court and in no other Court." [**Emphasis added**]

Therefore, it is imperative for commercial parties to know and strategize which court(s) to approach at both pre-arbitral and post-arbitral stage, with regard to commencement of the arbitral proceedings, granting of interim measures, conduct of the arbitration, setting aside and enforcement of the award. This issue gains even more significance against the backdrop of Government of India's continuing efforts to improve India's position in the "*Ease of Doing Business*" ranking released by World Bank. According to the World Bank's reports in 2018 and 2019, under the "Enforcing Contracts" segment, India was ranked 164 in 2017 and 163 in 2018 among 190 countries.[2] While India has indeed improved in other aspects such as, "Construction Permits", "Trading Across Borders", "Starting a business", and "Getting Credit", India has made negligible or marginal improvement in creating a suitable legal framework for timely enforcement of contracts and resolution of contractual disputes.

Therefore, in Part I of the article, I briefly discuss the three judicial positions that exist on the interpretation of the expression "Court" in Section 2(1)(e)(i) of the Act. In Part II, I analyse the divergent opinions that existed in the pre-BALCO era, both the restrictive and expansive understanding of the arbitral seat, which I claim created a hyper-confused state in Indian domestic arbitration jurisprudence. Such a puzzling position of domestic arbitration law was significantly impacting foreign investment, investor confidence and overall growth of the Indian economy. In that light, in Part III, I attempt a legal as well as a policy-based examination of the BALCO judgement and explain how it brought about a necessary stability in judicial behaviour towards arbitral proceedings.

Regrettably, the stability did not last long, as within 6 years of BALCO, we again have conflicting judgements on an issue which is

[2] Press Information Bureau, *India Improves Rank by 23 Positions in Ease of Doing Business*, MINISTRY OF COMMERCE & INDUSTRY (October 31, 2018, 10:00 AM), http://pib.nic.in/newsite/PrintRelease.aspx?relid=184513.

not even *res integra*. Therefore, in Part IV, I shall critically analyse the Supreme Court's decision in *Indus Mobile Distribution Private Limited v. Datawind Innovations Private Limited* ("Datawind"),[3] and point out the four possible errors or oversights made by the Supreme Court and other High Courts relying on *Datawind*. Moreover, in the process, I shall attempt to distinguish between the values of "desirability" and "legality" in judicial decision-making.

Furthermore, I shall also examine the correctness of the position taken by the Division Bench of Calcutta High Court in *Debdas Routh and Ors.* v. *Hinduja Leyland Finance Ltd.*,[4] ("Debdas Routh"), while criticizing *Datawind*, and whether the principle in *Hakam Singh*[5] can be directly imported into Part I of the 1996 Act.

Finally, in Part V, I shall conclude by highlighting the importance of judicial discipline, certainty and consistency in judicial decision making and reiterate the unquestionable position of BALCO in Indian arbitration law, with regard to the "Proper Court" rule or the issue of competence of courts to exercise supervisory jurisdiction over arbitral proceedings. For benefit of the readers, I have also provided 3 hypothetical illustrations (using two imaginary places in India – X and Y) and indicated which court will have jurisdiction in a specific context. Also, the 'Plot Twist' is explained at the end.

[3] Indus Mobile Distribution Private Limited v. Datawind Innovations Private Limited, (2017) 7 SCC 678.
[4] Debdas Routh and Ors. v. Hinduja Leyland Finance Ltd., (2018) 4 CalLT 57 (HC).
[5] *See infra* note 9.

I. EXISTING JUDICIAL POSITIONS ON SECTION 2(1)(E)(I)

Unfortunately, there exists no clear opinion in Indian domestic arbitration jurisprudence, as to which court is the proper forum, and there have always existed three judicial positions on the interpretation of Section 2(1)(e)(i) of the Act:

Position 1: Multiple courts can exercise supervisory jurisdiction over the arbitral proceedings and any related or associated action arising out of the arbitration agreement, which include - **(i)** the court having subject matter jurisdiction, following the classic rules of the Civil Procedure Code, 1908 ("CPC"); and **(ii)** the court at the arbitral seat. Both the courts would exercise concurrent jurisdiction. One does not subsume the jurisdiction of the other. This was held in the Constitution Bench judgement of the Supreme Court in *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*[6] ("BALCO")

Position 2: In the event that the arbitration agreement designates a seat of arbitration, it operates similar to an exclusive jurisdiction clause, even if the court at the arbitral seat may not have jurisdiction otherwise i.e., *neither* any part of cause of action arises at the seat *nor* Sections 15-20 of the CPC are applicable. Therefore, the question of having subject matter jurisdiction under rules of CPC is

[6] Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc., (2012) 9 SCC 552, ¶96.

immaterial and of no consequence. This was the holding of the Supreme Court in *Datawind*.[7]

Position 3: The court at the place of arbitral seat can exercise jurisdiction, *only if* such court is otherwise clothed with requisite jurisdiction, "*if the same had been the subject-matter of a suit*", under Section 2(1)(e)(i) of the Act read with Sections 15-20 of the CPC; or Clause 12 of the Letters Patent (if applicable). Therefore, mere designation of seat has no juridical relevance and does not give rise to any separate cause of action. This was held by a division bench of the Calcutta High Court in *Debdas Routh*,[8] relying on *Hakam Singh* v. *Gammon Limited* ("Hakam Singh").[9]

It shall be my endeavour to discuss each of these positions *in seriatim* and trace their path of development in Indian domestic arbitration. For the sake of convenience and simplicity, I shall refer the aforesaid positions as **Positions 1, 2** and **3**, while attempting to trace their roots and underlying legal rationale. However, at the outset, I would like to state that **Positions 2** and **3** are untenable and contrary to the principles of modern arbitration law and the Act itself. Admittedly, the Act can very well be legislatively amended to change the law to **Positions 2** or **3**, *however*, till then we have to interpret the law *as it exists*. In my opinion, the desirable interpretation of Section 2(1)(e)(i) is reflected in **Position 1**.

[7] Indus Mobile Distribution Private Limited v. Datawind Innovations Private Limited, (2017) 7 SCC 678, ¶19-20.
[8] Debdas Routh and Ors. v. Hinduja Leyland Finance Ltd., (2018) 4 CalLT 57 (HC), ¶60.
[9] Hakam Singh v. Gammon Limited, (1971) 1 SCC 286.

II. PRE-BALCO ERA: HYPER-CONFUSED STATE OF JURISPRUDENCE

A. RESTRICTIVE JUDICIAL UNDERSTANDING OF THE "ARBITRAL SEAT"

Before the Constitution Bench's decision in BALCO, the Delhi High Court had at several occasions (as shown below) held that-unless a court is clothed with subject matter jurisdiction as per the rules of CPC, that court cannot exercise supervisory jurisdiction over the arbitral proceedings. Or, in other words, the designation of the seat of arbitration does not confer any jurisdiction on the courts of such place where the seat is located.

In October 1983, the Delhi High Court in *Gulati Constructions Co. v. Betwa River Board* ("Gulati Constructions"), authored by Justice B.N. Kirpal (*as he then was*),[10] considered the interpretation of the expression "Court" in Section 2(c) of the Arbitration Act, 1940.[11] In that case, the parties did not designate an arbitral seat, but the sole arbitrator decided to conduct the proceedings in Delhi.[12] The issue before the court concerned the territorial jurisdiction of the Delhi courts to entertain matters associated with the arbitral proceeding. The Delhi High Court held :-

"*Furthermore, the factum of the arbitration proceedings having been conducted here and award being filed here is also not relevant for the purposes of deciding as to which is the court of competent jurisdiction….Merely because the arbitrator*

[10] Later, he became the 31st Chief Justice of India.
[11] The Arbitration Act, 1940 [Act No. 10 of 1940].
[12] Gulati Constructions Co. v. Betwa River Board, AIR 1984 Delhi 299, ¶12.

chooses to hold the proceedings in a place, where admittedly no suit could be instituted, and chooses to make and publish an award at that place it would not give the courts of that place territorial jurisdiction to decide the matters arising under the Arbitration Act."[13] [**Emphasis added**]

In December 2005, the Delhi High Court reiterated its "restrictive position" in *Apparel Export Promotion Council* v. *Prabhati Patni* ("Apparel Export"),[14] while holding that the "*situs of arbitration does not confer jurisdiction*", and the concerned court must have subject matter jurisdiction, if a suit had been filed instead of invoking the arbitration clause. Further, it was also observed that the interpretation of "Court" given by *Gulati Constructions* in context of Section 2(c) of the 1940 Act, also applies to Section 2(1)(e) of the Arbitration and Conciliation Act, 1996, as both the provisions are not materially different.[15]

Relying on *Gulati Constructions* and *Apparel Export,* another Delhi High Court decision, in 2006, in *GE Countrywide Limited* v. *Surjit Singh Bhatia* laid down a three-step test to decide the proper court:-[16]

i. Determine the subject-matter of the arbitral proceedings;

[13] *Ibid*.
[14] Apparel Export Promotion Council v. Prabhati Patni, 2005 (3) ARBLR 518 (Delhi), ¶19-20.
[15] *Ibid*, ¶20.
[16] GE Countrywide Limited v. Surjit Singh Bhatia, 129 (2006) DLT 393, ¶6-7; *See also*, Inox Air Products Ltd. v. Rathi Ispat Ltd., AIR 2007 Delhi 5.

ii. In light of that subject-matter, the court ought to commence with the presumption that there exists no arbitration clause;

iii. Upon such determined presumption, then the court ought to decide whether a suit can be filed, with identical subject-matter, at a place which the parties have designated to be the arbitral seat.

III. EXPANSIVE JUDICIAL UNDERSTANDING OF THE "ARBITRAL SEAT"

Nine years before the Supreme Court decided *Datawind*, there was a similar decision pronounced by the Andhra Pradesh High Court in *Paramita Constructions Pvt. Limited* v. *UE Development India (P) Ltd.*[17] In that case, there was a "Subcontract Agreement" between UDIPL and PCPL for completion of work of a road project. Clause 45.4.2 of the agreement indicated "Bangalore" as the seat of arbitration. The issue before the High Court was which court will have jurisdiction to hear matters pertaining to the arbitral proceedings.

The High Court held that Bangalore courts would have exclusive jurisdiction, in following terms:-

"***17.*** *The law, therefore, is that when parties choose a particular State/City, as place of arbitration, it is an important factor in deciding "the Court" for the purpose of Section 9 and Section 34 of the Act*.

[17] Paramita Constructions Pvt. Limited v. UE Development India (P) Ltd., 2008 (3) ALT 440.

***18.** There is no dispute that in terms of Clauses 45.4.2 of Main contract, which forms part of subcontract, the parties agreed to "Bengaluru" as place of arbitration for all other/related disputes, other than the disputes arising out of concession agreement. When the parties agreed Bengaluru as a place of arbitration, impliedly parties also agreed Principal Civil Court of Bengaluru as "the Court" for the purpose of Section 9 and Section 34 read with Section 2(e) of the Act. Therefore, Hon'ble CJ of A.P. High Court or any person designated by him, has no jurisdiction to entertain application.*" [**Emphasis added**]

This principle of mere designation of arbitral seat indicating *implied choice* of parties to grant exclusive jurisdiction to the courts at the seat, echoes the legal maxim "*expressio unius est exclusio alterius*", as was outlined by the Supreme Court in *A.B.C. Laminart.*[18] In other words, the express mention of one, leads to the exclusion of another. However, India was yet to gain clarity on the legal status of "Seat".

IV. BALCO: ADOPTING A MIDDLE-GROUND

Amidst the two aforesaid extreme legal positions, there was a need for the Supreme Court to adopt a middle ground. And, BALCO came to our rescue. The issue before the Constitution Bench of the Supreme Court concerned the applicability of Part I of the 1996 Act to foreign seated arbitrations. However, in context of domestic arbitrations, one of the holdings of the Supreme Court in BALCO, at paragraph 96, holds immense significance:

"*In our view, the legislature has intentionally given jurisdiction to two courts i.e. the court which would have jurisdiction where the cause of action is located and*

[18] A.B.C. Laminart Pvt. Ltd. v. A.P. Agencies, (1989) 2 SCR 1, ¶21-22.

the courts where the arbitration takes place. This was necessary as on many occasions the agreement may provide for a seat of arbitration at a place which would be neutral to both the parties. Therefore, the courts where the arbitration takes place would be required to exercise supervisory control over the arbitral process….In such circumstances, both the Courts would have jurisdiction, i.e., the Court within whose jurisdiction the subject matter of the suit is situated and the courts within the jurisdiction of which the dispute resolution, i.e., arbitration is located." [**Emphasis added**]

Although, it is possible to argue that there are certain internal contradictions in BALCO, but the above language is self-evident and unassailable. We must remember that BALCO was interpreting the 1996 Act, *as it existed,* and not trying to concoct a legal position that seemed most desirable to the Bench. Agreeably, the Supreme Court adopted a very progressive yet reasonable view and granted the arbitral seat its 'deserved legal status', while also upholding the right of parties to approach other competent courts. Such progressive judicial decisions indeed go a long way in demonstrating India's potential to the global community to be a global arbitration hub, while also upholding the sanctity of the existing Act.[19] Any contrary interpretation would make negligible commercial sense and would vitiate the overarching policy of making India an investor friendly economy.[20]

[19] Bibek Debroy & Suparna Jain, *Strengthening Arbitration and its Enforcement in India – Resolve in India,* NITI AAYOG (October 31, 2018, 10:00 AM), https://www.niti.gov.in/writereaddata/files/document_publication/Arbitration.pdf.

[20] *Ibid.*

The judgement in BALCO, was globally considered to be India's statement about its desire to promote arbitration in India.[21] On that note, let us consider an illustration to understand the policy rationale behind BALCO. For example, a multi-national company enters into an agreement, with an arbitration clause designating Mumbai as the 'arbitral seat', however, the subject matter of the agreement is a property in Ghaziabad. Naturally, it would want the arbitration as well as any related court process to be limited to Mumbai only, rather than 'toing and froing' from Ghaziabad and back. However, it must also be noted that the right of parties to move a court at Ghaziabad, where a part of cause of action arises, cannot be taken away. Even if such a position is the most desirable one for a few. As persons trained in law, we must have the ability to differentiate between "desirability" and "legality" (explained in Part IV).

Moreover, **Position 1** as articulated in the BALCO judgement, can also be well explained by relying on the 2013 division bench judgement of the Bombay High Court in *Konkola Copper Mines (PLC) v. Stewarts and Lloyds of India Limited*,[22] authored by Justice D.Y. Chandrachud, wherein it was held that BALCO, "*is declaratory of the position of law*" as it always existed. Therefore, the court of the seat indeed exercises supervisory jurisdiction along with the court where the cause of action arose.

[21] Vivekananda N, *Lessons from the BALCO dicta of the Supreme Court*, SINGAPORE INTERNATIONAL ARBITRATION CENTRE (October 31, 2018, 10:00 AM), http://www.siac.org.sg/2013-09-18-01-57-20/2013-09-22-00-2702/articles/196-lessons-from-the-balco-dicta-of-the-indian-supreme-court.

[22] Konkola Copper Mines (PLC) vs. Stewarts and Lloyds of India Limited, 2013 (4) ARBLR 19 (Bom), ¶17.

Although, in the pre-BALCO era, Delhi High Court through decisions such as *Gulati Constructions, Apparel Export,* and *GE Countrywide Limited* held the position that arbitral seat is immaterial to the issue of competence of courts and the concerned court must be clothed with subject-matter jurisdiction under the rules of CPC, however, it is significant to note that BALCO brought an unquestionable and necessary change in the legal position.

This shift in the legal position was recognised by the Delhi High Court itself in a 2016 decision, in *Air Liquide North India Pvt. Ltd. v. Shree Shyam Pulp and Board Mils Ltd.*[23] At paragraph 10 of the judgement, the Court held :–

"*The decisions in Inox Air Products Ltd. v. Rathi Ispat Ltd. (supra) and GE Countrywide Consumer Financial Services Limited v. Mr. Surjit Singh Bhatia (supra) were rendered prior to the decision of the Supreme Court in Bharat Aluminium (supra); therefore, the view that situs of arbitration would not confer jurisdiction on the courts having territorial jurisdiction over the situs of arbitration proceedings, is no longer good law*."[24] [**Emphasis added**]

V. POST-BALCO: RESURRECTION OF THE HYPER CONFUSED STATE

Over 5 years after BALCO, we are back to square one with courts deviating from BALCO and taking extreme positions i.e., **Positions 2** and **3**. Although, the Supreme Court made an attempt at bringing

[23] Air Liquide North India Pvt. Ltd. v. Shree Shyam Pulp and Board Mils Ltd., 233 (2016) DLT 275, ¶7,10.

[24] *See also* Ion Exchange (India) Ltd. v. Panasonic Electric Works Co. Ltd, 208 (2014) DLT 597 (DB).

stability in Indian arbitration law through a detailed and comprehensive judgement in BALCO, it seems to be going all in vain.

A. DESIGNATION OF ARBITRAL SEAT "AKIN" TO EXCLUSIVE JURISDICTION CLAUSE: DESIRABILITY VS. LEGALITY

I shall start with briefly summarising the facts of *Datawind*. The respondent had its registered office in Amritsar and was engaged in supplying goods to the appellant in Chennai, via New Delhi. There was a contract signed between the two parties, which stipulated the seat of arbitration to be "Mumbai" and also chose to grant exclusive jurisdiction over all contractual disputes to the "courts of Mumbai" via a forum selection clause. This fact holds immense significance in the entire discourse. Also, it is significant to note that Mumbai in this case, was truly a "neutral venue". A "neutral venue", in context of commercial arbitration, means any place mutually agreed by parties and where none of them have any registered office or establishment.

The Supreme Court, in its final holding, considered the mere designation of the arbitral seat to be synonymous to a forum selection clause. To quote the relevant part from the judgement:

"*In arbitration law however, as has been held above, the moment "seat" is determined, the fact that the seat is at Mumbai would vest Mumbai courts with exclusive jurisdiction for purposes of regulating arbitral proceedings arising out of the agreement between the parties.*"[25] [**Emphasis added**]

[25] *Supra* note 6.

The position taken by *Datawind* and several other High Court decisions following *Datawind*,[26] suffers from four possible errors or oversights:

It would run contrary to the very principle of "party autonomy" that *Datawind* hinges on. Commercial parties are free to decide a court within the forum selection clause, subject to its competency under CPC, which is different from the court at the arbitral seat. *Datawind* leads to an undesirable elimination of parties' choice to approach other competent and proper courts under Section 2(1)(e)(i). It also attempts to do away with the concept of a "forum selection clause" in a contract, which has an arbitral seat. Let us explore this further by way of an illustration. For example, the parties execute a contract in Kolkata, while choosing the 'arbitral seat' to be Mumbai. Some obligations under the contract are to be fulfilled in Delhi, and therefore the Parties have included a forum selection clause in their contract stating that "*courts of Delhi would have exclusive jurisdiction*". Now, if we apply Datawind to the given illustration, we would suffer from an incurable problem of having '<u>two courts with exclusive jurisdiction</u>' – Mumbai as per *Datawind* and Delhi as per the forum selection clause in the Contract.

It might violate the purpose of Section 42 of the Act, which recognises the jurisdiction of multiple courts to entertain actions arising out of the arbitral proceedings or the arbitration agreement. Over a year after Datawind was decided by the Supreme Court, a

[26] Mechon Services v. Predominant Engineers & Contractors (P) Limited, MANU/WB/0987/2017, ¶4-5; Rites Limited v. Government of National Capital Territory of Delhi, (2018) SCC Online Del 8227.

division bench of the Delhi High Court in *Antrix Corporation Limited v. Devas Multimedia Private Limited*,[27] rightly held that:

"*Section 42 of the Act presupposes that there is more than one competent forum to hear applications under the Arbitration Act, and hence to ensure efficacy of dispute resolution, this provision enacts that the court, which is first seized of any such application under the Act, would be the only court possessing jurisdiction to hear all subsequent applications. If seat were equivalent to an exclusive forum selection clause in Part-I arbitrations, then every time parties would designate a seat that would, in effect mean that Section 42 would have no application*." [**Emphasis added**]

The most authoritative statement of law in India in this regard is the Constitution Bench's judgement in BALCO, which held that multiple courts can have jurisdiction under Section 2(1)(e) – **(i)** court(s) within whose jurisdiction cause of action arises or has subject matter jurisdiction; and **(ii)** court at the seat of arbitration. According to the 'rule of precedents' laid down by the Constitution Bench of the Supreme Court in *Central Board of Dawoodi Bohra Community* v. *State of Maharashtra*,[28] :- "*The law laid down by this Court in a decision delivered by a Bench of larger strength is binding on any subsequent Bench of lesser or co-equal strength*." Therefore, Datawind, in the way it is being currently construed, runs contrary to the express ruling in BALCO.

[27] Antrix Corporation Limited v. Devas Multimedia Private Limited, (2018) SCC Online Del 9338, ¶53.

[28] Central Board of Dawoodi Bohra Community and Ors. vs. State of Maharashtra and Ors., (2005) 2 SCC 673, ¶12.

In any event, at the most, the Supreme Court judgement in *Datawind* can be considered an authority in cases, where the parties have designated the same place as the seat of arbitration and also mentioned it in the forum selection clause. In that case, both, the seat as well the forum selection clause mentioned Mumbai and courts in Mumbai respectively. It is a well-established rule that parties can grant exclusive jurisdiction to one court, if it otherwise had the competency to decide the concerned action/matter and oust the jurisdiction of other competent courts.[29] Therefore, in my opinion, Datawind is actually *sub-silentio* on the question - "whether mere designation of seat, without a forum selection clause, can grant exclusive jurisdiction to the court of the seat". The law on *sub-silentio* was laid down by the Supreme Court in *Municipal Corporation of Delhi v. Gurnam Kaur*:[30]

"*A decision passes sub silentio, in the technical sense that has come to be attached to that phrase, when the particular point of law involved in the decision is not perceived by the court or present to its mind. The Court may consciously decide in favour of one party because of point A, which it considers and pronounces upon. It may be shown, however, that logically the court should not have decided in favour of the particular party unless it also decided point B in his favour; but point B was not argued or considered by the court. In such circumstances, although point B was logically involved in the facts and although*

[29] A.B.C. Laminart Pvt. Ltd. v. A.P. Agencies, (1989) 2 SCR 1, ¶18; A.K. Surekha and Ors. v. The Pradeshiya Investment Corporation of U.P. Ltd, AIR 2003 Delhi 376; Mr. Mahesh Chand Gupta v. Assistant Collector, Sadar Bazar, Delhi, AIR 2004 Delhi 101.
[30] Municipal Corporation of Delhi v. Gurnam Kaur, (1989) 1 SCC 101, ¶12.

the case had a specific outcome, the decision is not an authority on point B. Point B is said to pass sub-silentio." [**Emphasis added**]

If we critically analyse the decision, Datawind tried to bring about a change in the existing legal position and it is possible to argue that such a position could attract more foreign arbitrations. However, such a change in the "law *as it exists*" might have a claim to "desirability", but not necessarily to "legality". In my opinion, a judicial interpretation attempting to make policy changes, such as in Datawind, can be simultaneously desirable yet untenable in law.

Therefore, Datawind, to the extent that it states mere designation of seat grants exclusive jurisdiction to the courts of such place, has no binding effect under Article 141 of the Constitution of India and for the reasons stated above, it is arguable that reliance on the ratio of Datawind by other courts for holding such a proposition may be incorrect.

VI. SEAT VS. CPC JURISDICTIONAL RULES: ANALYSING THE PRINCIPLE IN DEBDAS ROUTH

Division bench of the Calcutta High Court in *Debdas Routh,* took the old view that a court must have subject matter jurisdiction, under Sections 15-20 of CPC or Clause 12 of the Letters Patent. Interestingly, the expression "subject matter" in Section 2(1)(e) was interpreted by BALCO, wherein it was held that:-

"*It has a reference and connection with the process of dispute resolution. Its purpose is to identify the courts having supervisory control over the arbitration* *proceedings. Hence, it refers to a court which would essentially be a court of the seat of the arbitration process.*"[31] [**Emphasis added**]

In my opinion, the Calcutta High Court focused on the subject matter of the substantive contract. Whereas, under the doctrine of separability, the arbitration agreement is distinct from its underlying contract, and the subject matter of such arbitration agreement is resolution of disputes in accordance with a mutually agreed procedure. The main elements of the doctrine of separability were well summarised by the Bombay High Court in *Mulheim Pipecoatings GmbH. v. Welspun Fintrade Limited.*[32]

Section 2(1)(e) must be read with Section 42 (*quoted above*) of the Act, which stipulates that if any application is made in a court "*with respect to an arbitration agreement*", that Court shall exercise exclusive jurisdiction over the arbitration and "*all subsequent applications arising out of that agreement*". Therefore, the focus of the Act while discussing jurisdictional issues is on the arbitration agreement, as distinct from the underlying contract.

In that light, the subject matter of the arbitration agreement being the right and obligation to arbitrate, cause of action with respect to the arbitration agreement arises within the jurisdiction of the court at the arbitral seat. Accordingly, the court of the seat will exercise *either* sole *or* concurrent jurisdiction over the arbitral proceedings, subject to the facts of a particular case.

[31] *Supra* note 6, ¶96.
[32] Mulheim Pipecoatings GmbH. v. Welspun Fintrade Limited, 2014 (2) ABR 196, ¶31.

Moreover, the reliance on *Hakam Singh* is also misplaced, as the decision was passed in light of Section 41 of the 1940 Act, which outlined the power and procedure to be followed by a Court.[33] The relevant portion of the section reads:-

"Subject to the provisions of this Act and of rules made thereunder:

(a) the provisions of the Code of Civil procedure, 1908, shall apply to all proceedings before the court, and to all appeals under this Act."

Therefore, the 1940 Act itself provided the Supreme Court in *Hakam Singh* the legal basis to hold that, "*the CPC in its entirety applies to proceedings under the Arbitration Act*."[34] However, in absence of such a provision in the 1996 Act (*as amended*), reliance cannot be placed on *Hakam Singh* for a similar proposition under the amended Act.

As per the Supreme Court decision in *S. Mohan Lal v. R. Kondiah*,[35] it is a well-established principle of statutory interpretation that sourcing the meaning of an expression from one statute to interpret the same expression in another statute is not permissible, unless the two statutes in question are cognate in nature. It was held:

"*3 …. Neither the meaning, nor the definition of the term in one statute affords a guide to the construction of the same term in another statute and the sense in which the term has been understood in the several statutes does not necessarily throw any light on the manner in which the term should be understood generally.*

[33] *Supra* note 9.
[34] *Id* at ¶3.
[35] S. Mohan Lal vs. R. Kondiah, (1979) 2 SCC 616, ¶2-3.

On the other hand, it is a sound, and, indeed, a well-known principle of construction that meaning of words and expressions used in an Act must take their colour from the context in which they appear." [**Emphasis added**]

Although, the subject matter of the 1940 Act and the 1996 Act is similar, in absence of any provision in the 1996 Act which mirrors the effect of Section 41 in the 1940 Act, the principle in *Hakam Singh* cannot be blindly imported into the current domestic arbitration framework under the 1996 Act.

VII. CONCLUSION AND THE "PLOT TWIST": NEED FOR CONSISTENCY AND CERTAINTY IN JUDICIAL PRONOUNCEMENTS

This article has tried to trace the evolution of the "Proper Court" rule under Section 2(1)(e) of the 1996 Act, over the last two decades. In the pre-BALCO era, India has witnessed several inherent clashes between different High Courts trying to formulate their self-designed positions on the issue of competence of courts to exercise supervisory jurisdiction over any arbitral proceeding. Through BALCO, as already discussed, the Supreme Court tried to stabilise the domestic arbitration regime in India and adopted a middle-ground approach. Unfortunately, within a few years, the Indian judiciary again began their attempt at resurrecting the old extreme positions on competence of courts. The value of predictability and certainty has been undermined in this process.

As was well articulated in the Constitution Bench judgement in *Union of India (UOI) and Ors. v. Raghubir Singh (Dead) by Lrs:-*[36]

"*The doctrine of binding precedent has the merit of promoting a certainty and consistency in judicial decisions, and enables an organic development of the law, besides providing assurance to the individual as to the consequence of transactions forming part of his daily affairs.*" [**Emphasis added**]

Justice V.R. Krishna Iyer, while writing on behalf of the Constitution Bench in *Ganga Sugar Corporation Ltd. and Ors. v. State of Uttar Pradesh*,[37] reminded us of the importance of judicial discipline, in the following insuperable words:-

"And we cannot lose sight, of the All-India impact when the law is laid down under Article 141, Judgments of this Court are decisional between litigants but declaratory for the nation." [**Emphasis added**]

Therefore, in my opinion, BALCO holds an unquestionable position in the Indian arbitration regime and is binding on all courts, including the Supreme Court (bench of lesser than five judges), under Article 141 of the Indian Constitution and as per *Central Board of Dawoodi Bohra.*[38]

[36] Union of India (UOI) and Ors. v. Raghubir Singh (Dead) by Lrs. and Ors., (1989) 2 SCC 754, ¶9. *See also*, Prabhat Pan v. The State of West Bengal, AIR 2015 Cal 112, ¶17.
[37] Ganga Sugar Corporation Ltd. and Ors. v. State of Uttar Pradesh, AIR 1980 SC 286, ¶6; *See also*, Krishena Kumar v. Union of India, (1990) 4 SCC 207.
[38] Central Board of Dawoodi Bohra Community and Ors. v. State of Maharashtra and Ors., (2005) 2 SCC 673, ¶12.

To summarise, Courts are generally faced with the following three factual situations:

Situation 1: Seat is designated by parties, but the contract has no forum selection/exclusive jurisdiction clause.

Situation 2: The contract stipulates the arbitral seat as X but also contains a forum selection clause, which mention courts at Y.

Situation 3: The arbitral seat and the court indicated in the forum selection clause, both stipulate X respectively.

In light of the above discussion, in Situation 1 both the court, at the place of the arbitral seat and the court having subject matter jurisdiction would be able to exercise jurisdiction over the arbitral proceedings. Whereas, in situation 2, *prima facie* both courts X and Y would be "proper courts" *per se*, however, the jurisdiction of courts at X would be ousted due to the forum selection clause and therefore, courts at Y would have exclusive jurisdiction. *Finally*, in situation 3 (*similar to the facts in Datawind*), the courts at X would exercise exclusive jurisdiction.

Now, coming to the much awaited "Plot Twist". I had sincere hopes that the Supreme Court would reinstate the desired stability in this regard, when they sit to decide the case of *Devas Multimedia Private Limited* v. *Antrix Corporation Limited*, vide Special Leave Petition No. 028434-/2018, and shall uphold the *law* laid down in BALCO. However, there has been an interesting development. On 10 December, 2019, a three-judge bench of the Supreme Court in

BGS v. NHPC Ltd.,[39] has overruled the Delhi High Court judgement in *Antrix Corporation,*[40] on the question of the "proper court rule", which was already pending in appeal before another division bench of the Supreme Court. Now, it remains to be seen whether the initial appeal from the Delhi High Court judgement has become infructuous or are the legal questions still alive.

In any event, let us analyse what the Supreme Court did in *BGS v. NHPC*. It rightly pointed out that there are certain internal contradictions in BALCO and those may make one doubt the concurrent jurisdiction principle under Section 2(1)(e)(i) of the Act. However, it made a grave error while making the following statement:-[41]

"*the subsequent paragraphs (referring to Para 96) in BALCO, which clearly and unmistakably state that the choosing of a "seat" amounts to the choosing of the exclusive jurisdiction of the Courts at which the "seat" is located.*" [**Emphasis added**]

By subsequent paragraphs, they meant paragraphs 110, 116, 123 and 194 of BALCO. Let us look at what each of these paragraphs *individually* talk about.

At paragraph 110, BALCO did nothing but refer to an English decision in *Roger Shashoua & Ors. v. Mukesh Sharma*,[42] which had

[39] BGS SGS SOMA JV v. NHPC LTD, 2019 SCC OnLine SC 1585, ¶61.
[40] *Supra* note 27.
[41] *Supra* note 39, ¶59.
[42] Roger Shashoua & Ors. v. Mukesh Sharma [2009] EWHC 957 (Comm), ¶23.

held that mentioning of an arbitral seat in the shareholders agreement may be "akin to an exclusive jurisdiction clause". However, the holding was in a completely different context, it was an international arbitration involving multiple countries i.e. France and the U.K. Undoubtedly, the 'concurrent jurisdiction principle' flowing out of paragraph 96 cannot be applied to an international arbitration with multiple foreign courts exercising supervisory jurisdiction.

At paras 116 and 123, BALCO reiterates that, "*choice of another country as the seat of arbitration inevitably imports an acceptance that the law of that country relating to the conduct and supervision of arbitrations will apply to the proceedings*" and thus, the courts at the arbitral seat shall exercise exclusive supervisory jurisdiction. However, again the context must be analysed before reaching any conclusion. The Supreme Court was referring to foreign decisions, dealing with the question of "seat" in an international arbitration. Such a legal position is undeniably inapplicable in cases of purely domestic arbitration within the territory of India.

At paragraph 194, BALCO concluded by holding that "*Part I of the Arbitration Act, 1996 would have no application to international commercial arbitration held outside India.*" I fail to understand the relevance of this paragraph while understanding the competence of courts to exercise supervisory jurisdiction in domestic arbitrations.

In light of the aforesaid paras in BALCO, which in my opinion is immaterial to the issue at hand, the three-judge bench of the Supreme Court overruled *Antrix Corporation*. Such decisions also impact judicial discipline, as the concerned High Court decision was already pending in appeal before another bench of the Supreme Court. I believe the time has come for the Chief Justice of India to set up another Constitution bench to settle this issue, once and for all, and preferably bring back the position laid down in BALCO. I would leave at that, with immense hope in my heart, that the readers shall choose their positions wisely on the question of the "Proper Court" rule under the Act.

TEETH TO THE TRIBUNAL…IS THE CONTROVERSY SETTLED?

*Rajvansh Singh & Atif Ahmed

ABSTRACT

Interim relief is an important tool to ensure that interest of the parties is safeguarded and the enforcement of arbitral award remains effective. The regulation and practice of tribunal-ordered interim relief within the field of arbitration has been a subject of debate for many years. The reason for this is the interventionist judicial approach adopted in the field of arbitration in India with regards to interim relief. This is normally in exercise of the power under Section 9 of the Indian Arbitration and Conciliation Act, 1996 ("the 1996 Act").

This article seeks to gain an understanding of the power vested with the arbitral tribunal to grant interim relief and attempts to balance the jurisdiction of the court and arbitral tribunal during the course of arbitration. Initially, as per the Arbitration Act, 1940, the arbitral tribunal had no power to grant interim relief and it solely vested with the courts. Later, in the 1996 Act, the arbitral tribunals had a limited power under Section 17 to grant interim relief. The power to grant interim relief by the arbitral tribunal was limited due to the lack of enforceability of the order of the tribunal and the overlapping jurisdiction of the civil courts. Sections 9 and 17 were amended in 2015 which essentially signalled a paradigm shift to create an arbitration process with minimal intervention from the judiciary. This was done by setting a limitation on the

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time frame in which a party could approach the court for seeking interim relief along with providing teeth to the interim orders passed by the tribunal. The amendment also provides that courts may only be approached when the interim relief ordered by the tribunal is not efficacious. The ambit of the term "inefficacious" is a source of controversy as the term is vague and expansive. To address this weakness of the term, the authors have attempted to confine its scope by studying the concept of "inefficacious" orders.

INTRODUCTION

The Arbitration and Conciliation Act, 1996,[1] ("the Act") is based on the UNCITRAL Model law, 1985 ("the Model Law") in order to create a legal regime in India that is pro-arbitration, something which the Arbitration Act of 1940,[2] ("the 1940 Act") failed to achieve. This objective seems to have been diluted to a certain extent as the Indian courts have adopted the approach of an 'interventionist', in matters related to regulation of arbitration proceedings. This approach is evident even in the initial stages of arbitral proceedings where arbitrators are appointed and when the disputes are referred to arbitration. As one of the main incentives for choosing arbitration is to minimize the intervention of civil courts, it becomes imperative to restrict the intervention of courts and balance it with the party's choice.

The main purpose of interim measures is to protect the interests of parties, which is not only utilised by courts but also by arbitral

[1] The Arbitration and Conciliation Act, 1996, No. 26 of 1996 [as amended by The Arbitration and Conciliation (Amendment) Act, 2015].
[2] The Arbitration Act, 1940 [Act No. 10 of 1940].

tribunals ("tribunal"). Until a final decision is reached, the parties' rights are regularly subject to significant risks such as tampering of evidence, dissipation of assets or the subject matter of the arbitration may also be placed beyond reach causing irreparable harm to a party. Thus, interim measures are and should be available to prevent a party from frustrating the effective enforcement of the final award, so that the rights of both the parties are safeguarded. In order to function in a fair and effective manner, it is of paramount importance that tribunals possess broad powers to grant interim measures. Traditionally, the legislature has been reluctant to vest arbitrators with this power. This is because there was no amendment or insertion of a provision to allow the arbitrator to grant interim relief vide the 1940 Act. It was later, in the 1996 Act, where a trend in favour of vesting arbitrators with power to grant interim relief emerged.

Two adjudicatory bodies, the tribunal and the court, possess the power to order interim relief under the 1996 Act. Section 9 of the Act bequests the courts with the power to pass interim order in relation to arbitral proceedings, whereas, the tribunal has the power to order interim measure with respect to the subject-matter of the dispute under Section 17 of the 1996 Act. Notably, Section 9 as well as Section 17 have been adopted from Article 9 and Article 17 of the Model Law.

Prior to the Arbitration and Conciliation (Amendment) Act, 2015 ("the Amendment Act"), the language of Section 17 allowed the tribunal to issue interim measures. Nevertheless, jurisdiction of the tribunal to grant interim orders was limited. The limitations of arbitral tribunal to grant interim orders, compelled the parties to approach the court for interim measure, which continued the judicial involvement in the arbitral process. The Amendment Act addressed the said infirmities and provided 'teeth' to the tribunal. The objective of this article is to understand the complexities of the power vested with the tribunal to issue interim orders in the 'pre' and 'post' amendment era and seeks to balance the jurisdiction of the court with the tribunal in this regard.

I. THE CONUNDRUM OF ENFORCEABILITY

According to the authors, Section 17 was poorly drafted. It empowered the tribunal to grant interim order but failed to provide the tribunal with any authority to enforce its orders. The enforcement of such orders was dependent on the goodwill of the parties.[3] However, an act of the party failing to abide by such interim orders was given weightage in the award passed by the tribunal, especially in quantifying the extent of compensation.[4] *Per contra*, the court had coercive power to enforce an order under Section 9.[5] Where a tribunal's order is not honored, the party requesting the interim measure would have to apply to the courts under Section 9 for a court-ordered interim measure, which is a result that does not exactly promote dispute resolution by arbitration.

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[3] *See* PETER BINDER, INTERNATIONAL COMMERCIAL ARBITRATION AND CONCILIATION IN UNCITRAL MODEL LAW JURISDICTIONS (3d ed. 2002).

[4] B.P. SARAF, LAW OF ARBITRATION AND CONCILIATION 312 (6th ed. 2012).

[5] Benoit Le Bars & Tejas Shiroor, *Provisional Measures in Investment Arbitration: Wading Through the Murky Waters of Enforcement*, 6 IJAL 24, 30 (2017).

The Hon'ble Supreme Court summed up the scope of Section 17 in *M.D. Army Welfare Housing v. Sumangal Services Pvt. Ltd.*,[6] where it observed:-

"…under S. 17 of the 1996 Act the power of the arbitrator is a limited one… Even under S. 17 of the 1996 Act, no power is conferred upon the Tribunal to enforce its order nor does it provide for judicial enforcement thereof." [7]

Another landmark judgement is *Sundaram Finance Ltd. v. NEPC India Ltd,* [8] wherein the court said, "*though section 17 gives the tribunal the power to pass orders the same cannot be enforced as orders of a Court*." This is the reason why the court was given the jurisdiction to issue any interim order during arbitral proceedings.[9]

The High Court of Delhi in *Sri Krishan v. Anand* [10] departed from the law put forth in *M.D. Army* and *Sundaram*. The court held that any party violating interim orders issued by the tribunal will be held in contempt under the provisions of Section 27(5).[11] This stance of the court was put forth in the following words:-

[6] (2004) 9 SCC 619.
[7] *Id.* at ¶58.
[8] (1999) 2 SCC 479.
[9] *Id.* at ¶11.
[10] (2009) 3 Arb LR 447.
[11] Section 27(5), The Arbitration and Conciliation Act, 1996– "*Persons failing to attend in accordance with such process, or making any other fault, or refusing to give their evidence, or guilty of any contempt to the tribunal during the conduct of arbitral proceedings, shall be subject to the like disadvantages, penalties and punishments by order of the Court on the representation of the tribunal as they would incur for the like offences in suits tried before the Court.*"

"*Any person failing to comply with the order of the tribunal would be deemed to be 'making any other default' or 'guilty of any contempt to the tribunal during the conduct of the proceedings'. Thus, the remedy of the other party is to apply to the tribunal for making a representation to the court to meet out such punishment, penalty to the guilty party, as would have been incurred for default in or contempt of the court. Naturally, the tribunal would make such a representation to the court only upon being satisfied that the party/person is in default or in contempt.*"[12]

The position of law in the abovementioned case was solidified in another case of the Delhi High Court.[13] Therefore, it becomes clear that, to acquire a remedy for non-compliance of an order made by the tribunal, the aggrieved party is required to convince the tribunal to approach the court for imposition of punishment.[14] The non-compliance of an order made under Section 17 is to be treated as if it was in contempt of a court order. This contempt shall be dealt by the Contempt of Courts Act, 1979 or under the Civil Procedure Code, 1908 ("the CPC").

The authors believe that the purpose behind Section 17 was to empower the tribunal to be a complete forum not only for the final adjudication of disputes, but also to pass interim measures of protection to ensure justice is served. Thus, vexing the court and

[12] *Supra* note 1, at ¶11.
[13] Indiabulls Finance Services Ltd. v. Jubilee Plots and Housing (P) Ltd., (2010) (4) LW 312 (Mad).
[14] Sanjeev Kapoor & Anushka Sharda, *Interim orders in international commercial arbitrations – an Indian perspective*, INTERNATIONAL LAW OFFICE (Feb 11, 2019, 10:00 AM) https://www.internationallawoffice.com/Newsletters/Arbitration-ADR/India/Khaitan-Co/Interim-orders-in-international-commercial-arbitrations-an-Indian-perspective.

the tribunal for a similar relief at the cost of time and expenses i.e. by filing a petition under Section 9 after interim measures granted under Section 17, defeats the purpose and intent of the legislature completely.

A need was felt to decrease the burden on the courts since the tribunals are equally competent to grant interim relief in this regard. The 246th Law Commission Report ("the Report") mentions that the efficacy of Section 17 is compromised, as there is no proper statutory mechanism to ensure that interim orders of the tribunal are enforced.[15] The Report emphasized on the importance of "providing teeth" to interim orders given by the tribunal by providing for their enforcement. [16]

Pursuant to this suggestion, the legislature amended Section 17, which states:

"Subject to any orders passed in an appeal under section 37, any order issued by the tribunal under this section shall be deemed to be an order of the Court for all purposes and shall be enforceable under the Code of Civil Procedure, 1908 (5 of 1908), in the same manner as if it were an order of the Court."[17]

The abovementioned provision, implies that any interim order passed by the arbitral tribunal will be enforceable like a court order. This provision was amended, in consonance with the amendment in

[15] 246th Law Commission of India Report, Amendments to the Arbitration and Conciliation Act, 1996 (Aug. 2014) (last visited Feb. 22, 2019) http://lawcommissionofindia.nic.in/reports/report246.pdf.
[16] *Id.* at ¶49.
[17] Section 17(2), The Arbitration and Conciliation Act, 1996.

the Model Law in 2006.[18] Apart from statutory recognition, the Hon'ble Supreme Court interpreted the scope of Section 17 in *Alka Chandewar v. Shamshul Ishar Khan*.[19] It was of the opinion that Section 17(2) was introduced to simplify the complex procedure resorted to under Section 27(5) in case of non-compliance of an interim order by the tribunal. For this the court relied on the Report that stated 'there is a need to go one step further than what was provided in Section 27(5) as construed by the Delhi High Court (in Sri Krishan's case).'[20]

Despite the Amendment Act, a conundrum regarding the enforceability still exists as to whether the party intending to enforce the interim order needs to approach the court of law for its enforcement. A recent judgement of the Kerala High Court,[21] postulates that for an interim order to be made enforceable, it is necessary for a party to approach the court. This law put forth by the court thwarts the purpose behind the Amendment Act, as a party will have to approach the court for enforcement thereby paving the way for unnecessary judicial intervention.[22] On the other hand, the Hon'ble Supreme Court,[23] made it clear that Section 17(2)

[18] Nikhil J. Variyar, *Tribunal-Ordered Interim Measures and Emergency Arbitrators: Recent Developments Across the World and in India,* 4 IJAL 33, 36 (2015).
[19] Alka Chandewar v. Shamshul Ishar Khan, (2017) 16 SCC 119.
[20] *Id*. at ¶9.
[21] Pradeep K.N. v. Station Officer, (2006) 2 AIR 714 (Ker).

[22] Ajar Rab, *Arbitration & Conciliation Amendment Act, 2015 - Enforcing Interim Orders, where is the Relief?,* 4 NLUD Student Law Journal 89, 95 (2017).
[23] *Ibid*.

is a "complete solution" to the problems related to the enforceability of orders. It also noted that parties need not approach the court for contempt, as they are treated on equal footing with orders of a civil court which can be enforced under the CPC.[24]

II. THE DILEMMA OF CONCURRENT JURISDICTION

The jurisdiction of the court under Section 9 can be invoked at three stages:[25]

- The first stage, that is, before the commencement of arbitral proceedings.
- The second stage, that is, during arbitral proceedings.
- The third stage, that is, "at any time after the making of the award but before it is enforced in accordance with Section 36."[26]

Likewise, the jurisdiction of the tribunal may be invoked at two stages that is 'during' and 'after'.[27] Therefore, the jurisdiction of the court and the tribunal appears to be concurrent and somewhat overlaps during the arbitral proceedings[28] and once the award has been passed but before it is enforced. The question that persists is

[24] *Supra* note 22, at ¶49.
[25] *Supra* note 5.
[26] Ultratech Cement Limited v. Rajasthan Rajya Vidyut Utpadan Nigam Limited, (2017) (2) SCALE 96, at ¶7.
[27] M. Ashraf v. Kasim V.K, (2018) SCC Online 4913 (Ker).
[28] *Supra* note 5.

which body is to be approached when there is an overlap of the jurisdiction of the tribunal and the court.

Judicial intervention is anathema to arbitration.[29] The Report realized that it was necessary to reduce unnecessary judicial intervention, since the tribunal is equally competent to grant interim order. Now, it is recognized that in most cases it is the tribunal that is the best choice to ascertain the proper specific interim measure in each case. As per Dr. Peter Binder,[30] it is easy obtaining an interim measure from the tribunal as "it is much better acquainted with the facts and circumstances, and in general, with the case at hand".[31] Thus, it is the tribunal which is most suited to understand which applications for interim measures have been applied for dilatory tactics rather than pursuing a legitimate interest. As it is the arbitrators who are far more "acquainted with the facts" since they follow the case "from start to finish".

A. BEFORE 'THE ARBITRATION PROCEEDINGS'

It is a widely accepted notion that interim relief under Section 9 is the most efficacious remedy before the tribunal has been constituted. Till the constitution of the tribunal takes place, it cannot order interim relief and therefore cannot exercise power vested with it. Nevertheless, measures may be needed and it becomes impractical to wait till the time the tribunal has been

[29] *Supra* note 18.
[30] *Supra* note 1.
[31] Sarthak Malhotra & Sujoy Sur, *Standards applicable to interim reliefs in India: A Comprehensive Analytical Investigation*, 5 IJAL 183, 195 (2016).

constituted. Therefore, the only remedy available to the parties is to seek interim measures from the court.

B. DURING 'THE ARBITRATION PROCEEDINGS'

The desire of the parties to have their disputes settled by arbitration will be made impossible if civil courts are vested with undue power to provide interim relief. In some cases, it is the interim measure that effectively decides the dispute. Therefore, court ordered interim reliefs carry the risk of removing the dispute from the control of the tribunal.

Prior to the Amendment Act 'during' the arbitral proceedings, the jurisdiction of the court and tribunal, seems to be overlapping.[32] Thus, for an interim measure a party had the discretion to approach the courts as well as the tribunal. This approach was in tune with the free choice model which is inherent in party autonomy. In other words, recourse to Section 17 is not a substitute for Section 9 but is an enabling additional recourse,[33] whereby it does not oust the jurisdiction of the court. Thus, the courts have the power to issue orders under Section 9 notwithstanding the pendency of arbitral proceedings.[34]

The non-enforceable nature of the interim order issued by the tribunal often compelled the parties to approach the court which in turn sparked another debate with respect to extent of the Court's

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[32] DR. P.C. MARKANDA, LAW RELATING TO ARBITRATION AND CONCILIATION 447 (9th ed., 2016).
[33] Escorts Finance Ltd. v. Mohd. Hanif D Khan, (2001) V AD (Del) 392, ¶3.
[34] Atul Limited v. Prakash Industries Ltd., (2003) (2) RAJ 409, ¶2.

intervention under Section 9 in interim applications.[35] In an attempt to make India an arbitration friendly jurisdiction, the Amendment Act made a departure from a "free choice model"[36] under the Model Law, and has transferred the sovereign powers of a civil court to a private forum, consensually designed to adjudicate disputes between parties.[37]

The aim was to make the tribunal the default forum for granting interim relief pending arbitration proceedings.[38] However, the jurisdiction of court to grant interim relief does not automatically get barred after the tribunal has been constituted. Following the Amendment Act, the role of the court is reduced to subsidiary and supportive. The Amendment Act introduced Section 9(3) which is read as follows:-

"Once the tribunal has been constituted, the Court shall not entertain an application under sub-section (1), unless the Court finds that circumstances exist which may not render the remedy provided under section 17 efficacious."

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[35] Prakhar Deep & Nandita Chauhan, *Relegation of Application for Interim Measures by Court to Tribunal under the Arbitration & Conciliation (Amendment) Act, 2015*,4 RGNUL FMLR, 25, 26 (2017).

[36] Parties have the choice of either applying to courts or tribunals for interim reliefs during an arbitration, which was the pre-amendment position under the Act.

[37] Rajendra Barot & Sonali Mathur, *Laying Old Ghosts to Rest, Or Not? - The 'Section 9' Enigma Continues...,* 5 IJAL168, 177 (2016).

[38] JUSTICE R.S. BACHAWTA, LAW OF ARBITRATION & CONCILIATION 861 (6th ed., 2018).

'During' arbitral proceedings, the Court is mandated to adopt a strict approach in entertaining an application received under Section 9. The party who approaches the court at this stage shall satisfy the court that "*circumstances exist which may not render the remedy provided under section 17 efficacious*"[39] on the merits of the case.[40] Therefore, any application made to the court for interim relief suffers from the two-fold problem of:

- Delay in the arbitral proceedings as the court is required to examine the merits of the case to determine whether the order of the tribunal is not 'efficacious'.
- As the scope of the term 'inefficacious' is not defined, the parties have a free hand in approaching the court for an interim order under the pretext of an inefficacious interim order of the tribunal.

C. AFTER 'THE ARBITRATION PROCEEDINGS'

Section 32 of the Act mentions that once the award has been passed the arbitral proceedings shall be terminated, along with the mandate of the tribunal. After the award is signed and informed to the parties the mandate of an arbitrator become *functus officio* and thereafter, the tribunal has no jurisdiction to entertain any application seeking interim relief.[41] The position of law was confirmed in 2004, the Hon'ble Supreme Court in *Firm Ashok v.*

[39] *Supra* note 1, Section 9(3).
[40] Energo Engineering Products Ltd. v. TRF Ltd., (1977) SCC Online 6560 (Del), ¶34.
[41] Satwant Singh Sodhi v. State of Punjab, (1999) AIR 2040 (SC), ¶11.

Gurumukhdas Saluja,[42] wisely held that Section 17 will only operate when the tribunal is in existence. Thus, if a party intends to seek interim measure during 'pre' and 'post' arbitration proceedings, the jurisdiction of the court under Section 9 has to be invoked.[43]

The above-mentioned position of law seems to be diluted as the Amendment Act provides that a "party at any time after the making of the arbitral award, but before it is enforced in accordance with section 36"[44] can approach the tribunal to seek interim measure. This implies that the court and tribunal will have concurrent jurisdiction at any time after the award has been given. There seems to be a direct conflict between Section 17 and Section 32 with respect to when the tribunal ceases to exist.[45] Therefore, an important amendment was required in Section 32 to address this conflict so that existence of the tribunal is extended till the enforcement of the award. It makes one wonder how a party will be able to seek interim relief from the tribunal after the award has been given. In such a situation, it would be apt for the court to accept an application under Section 9 as the interim measure under Section 17 will be inefficacious once the tribunal has ceased to exist.[46]

III. CONCLUSION

The Amendment Act is definitely a step in the right direction as a number of infirmities of the 1996 Act were addressed. This stand of

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[42] (2004) AIR 1433 (SC), ¶18.
[43] *Supra* note 33.
[44] Section 17(1), The Arbitration and Conciliation Act, 1996.
[45] *Supra* note 6.
[46] Bishnu Kumar Yadav v. M.L. Soni & Sons, (2016) SCC Online Cal 1420.

legislature bolsters the aim of India in building an efficient arbitration environment. However, there are certain aspects that are untouched and couched in vague and expansive terms.

The most important time to apply for an interim measure is often at the outset of the dispute. To apply for interim relief at such a stage, a party would have no option, other than to approach the courts. To avoid the trouble of court intervention, is reason why arbitration is chosen. Therefore, to restrict the intervention of courts before the tribunal has been constituted, emergency arbitration is considered to be the solution to the parties' problem. Albeit, the Report recommended to incorporate the said concept but the Amendment Act failed to do so.

The enforcement of interim orders under the CPC as per the Amendment Act has failed to acknowledge the reality of litigation in India. Not particularly a lacuna in the act, but the Amendment Act could offer a more efficient form of enforcement by creating a complete code, granting the tribunal with powers sufficing for enforcement as well as punishment.

The arbitral framework put in place by the Amendment Act, has substantially eliminated interference from civil courts. By adding the term 'inefficacious', the Amendment Act sought to reduce the interference of courts until it was absolutely necessary. However, the term 'inefficacious' mentioned should have been given a narrow scope. The term is subjected to different views and includes an undesired degree of uncertainty.

In an attempt to limit the term 'inefficacious', the authors feel that the term should be construed as:

- An "urgent requirement" to preserve evidence or assets. An example of an urgent requirement would be when the delay in the meeting of the tribunal would prejudice the applicant or when the relief prayed for under Section 17 would become infructuous by the time the application is filed.[47]

- The tribunal "lacks the power to act effectively" as its existence is derived from a contractual agreement and therefore lacks the power to give directions to third parties and statutory bodies. For example, the tribunal lacks the authority to appoint a court receiver.[48]

  Similarly, Article 17J of the Arbitration Act of South Africa[49] enumerates the situations wherein the court is allowed to grant interim relief:

- The tribunal is "not competent" to grant the order.

- It is impractical to approach the tribunal due to the underlying existence of any urgency.

The Amendment Act, by providing teeth to the tribunal and creating a jurisdictional balance between the court and the tribunal

[47] SREI Equipment Finance Limited v. Ray Infra Services Private Limited, (2016) SCC Online Cal 6765, ¶7.
[48] Shakti International Private Limited v. Excel Metal Processors Private Limited, (2017) 3 ArbLR 388, ¶20.
[49] Arbitration Act 42 of 1965.

has set the ball rolling in the right direction. This will further bolster the use of arbitration in commercial matter and will attract parties to submit their matter to arbitration. However, the Indian courts need to exercise judicial maturity in order to maintain a balance between judicial intervention and efficacious orders.

NON-PERFORMING ASSETS AND THE INDIAN BANKING INDUSTRY, ADDRESSING CHALLENGES TO NPA REALISATION

Yash Mittal*

ABSTRACT

Mounting Non-Performing Assets ("NPAs") in the Indian banking sector is a recurring activity which results in low-profitability for the banks. The impaired balance sheets of the banks pose a myriad of challenges before the government and the Reserve Bank of India ("RBI") of setting objectives of cleaning out NPAs, recapitalizing banks and modifying current banking practices in order to restore profitability and execute such methods or techniques which result in a drastic reduction in NPAs. For smooth functioning of the Indian banking system, various norms were introduced by the Committee on Financial System set up in 1991, which covered things such as capital adequacy, income recognition, and provisioning for bad debts. These norms were introduced with the objective of improving the productivity, profitability, and efficiency of commercial banks in India. However, fragile economic growth and heightened economic volatility in the market puts severe constraints on the rate of recovery of bad loans while also acting as a termite on the balance sheets of

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the banks. Over the last two decades, several measures have been adopted by the government and RBI to solve the problem of NPAs like the enactment of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest ("SARFAESI") Act, 2002; establishment of Lok Adalats in the year 1987 and the Debt Recovery Tribunal in 1993, the result of which does not deserve much appreciation. Apart from implementing new instruments to fight against the mounting NPAs there is a considerable need of involving corporate governance in the boards of banks, which must be strengthened through the induction of quality professionals as independent directors and managers so as to effectuate transparency and accountability in decision making.

The main focus of this research work is to address; firstly, the draconian nature of the NPA problem; secondly, the challenges faced in its recovery, thirdly, whether new instruments that are applied to curb NPAs would be beneficial and lastly, how sound corporate governance practices provide conducive disposal of NPAs by deliberating structural changes and strengthening bank boards.

INTRODUCTION

The banking system in India has undergone peculiar changes over the last 25 years. The Indian economy being a closed economy prior to the year 1991, had no scope for its expansion and growth but since the implementation of liberalization, privatization &

globalization reforms, popularly known as the LPG model, the Indian banking sector has taken a long leap ranging from structural reforms to improved credit creation mechanism. The banking industry plays a dominant role in the Indian financial system, which is supported by the fact that more than two-thirds of households' savings are channeled through the banking system, which accounts for nearly 90% of the commercial credit in the country.[1]

In an economy dominated by banks, large NPAs on the books of the banks, especially the Public Sector Banks ("PSBs") bear a blot on the banking sector. This is due to the balance sheet problems through which the economic activities become sluggish, which in turn resemble the shape of an economic crises. The lack of revival of bank credit rate raises serious concerns over the effectiveness of the monetary policy. Higher NPAs put constraints on the disbursement of bank credit, thus obturating the basic objectives of the banking system. The mounting NPAs could have several averments[2] i.e., *firstly*, NPAs lead to the shrinking of banking resources owing to the non-receipt of previous installments, *secondly*, prudential guidelines compel banks to provide for NPAs, putting additional pressure on available funds and *thirdly*, psychological factors related to overall pessimism and lack of confidence in an

[1]Pravarkar Sahoo, *Here is what will affect banks returns to assets ratio, sustained income*, FINANCIAL EXPRESS, (June 22, 2019, 3.43 AM), https://www.financialexpress.com/industry/banking-finance/here-is-what-will-affect-banks-returns-to-assets-ratio-sustained-income/730034/

[2] Amaresh Samantaraya, *Procyclical Credit Growth and Bank NPAs in India*, ECONOMIC AND POLITICAL WEEKLY, (Jul. 22, 2019, 10:00 AM), https://www.epw.in/system/files/pdf/2016_51/12/Procyclical_Credit_Growth_and_Bank_NPAs_in_India_0.pdf.

environment of growing impaired assets dent sanctioning of fresh loans or expansion of existing facilities.

The perplexing balance sheets of the banks result in emaciation of loan recovery rates. Deterioration in loan recovery has attracted substantial attention and has come to occupy center stage in policy deliberations. Especially so, in an environment of fragile economic growth, heightened volatility in financial markets and weaknesses in corporate balance sheets.[3] There is a requirement to strengthen banks' credit appraisal system, else the liquidation would force banks to face the burden of higher NPAs and limit their lending capacity, thus diminishing their profitability and stability.

According to the official statistical data of the RBI,[4] banks' NPAs have grown from Rs. 2.6 lakh crore in 2013-14 to an estimated Rs. 10 lakh crore in March 2018. The reason for such a large increase in NPAs of the banks is non-resolution of NPAs and piling up of interest. Lack of capital, in turn, has caused loan growth at PSBs to slow down and this has impacted the overall commercial bank credit growth. The overall credit growth at PSBs since 2014-15 has shown a decrease at an average rate of 9.6% compared to an

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[3] Rekha Mishra, *Determinants of Recovery of Stressed Assets in India-An Empirical Study*, ECONOMIC AND POLITICAL WEEKLY, (Jul. 22, 2019,10:00AM) https://www.epw.in/system/files/pdf/2016_51/43/Determinants_of_Recovery_of_Stressed_Assets_in_India_0.pdf.

[4] *Banks' gross NPA increased to whopping Rs 10.3 lakh crore in FY18, says CRISIL*, FINANCIAL EXPRESS (Jun. 5, 2018, 07:11 PM), https://www.financialexpress.com/industry/banking-finance/gross-npa-in-fy18-increased-to-whopping-rs-10-3-lakh-crore-says-crisil/1194684/.

average growth of 16.6% in the preceding four years.[5] Similarly, in 2017-18, overall bank credit growth rate stood at 10.4%, with PSBs credit growing at the rate of 6.3% while private banks credit growth stood at 21.3%, which again depicted poor revenue and profit growth, and thus, the downward spiral at PSBs.[6]

The Asset Quality Review ("AQR") is conducted during August-November by RBI, where bank books are inspected as a part of its Annual Financial Inspection ("AFI") process. Such inspection by the RBI is usually done with the view of clearing up balance sheets of the banks, resulting in a spike of NPA ratios and provisioning requirements. This was deemed necessary as RBI believed that asset classification was not being done properly and banks were resorting to ever-greening of accounts. The impact of AQR resulted in losses for the full financial year, as almost all the PSBs were impacted, except a few private sector banks.[7] Notably, RBI's Prompt Corrective Action ("PCA") lists out 11 out of 21 PSBs, who are facing a severe problem of mounting NPAs.[8] Under PCA, banks

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[5] *Financial Stability Report June 2019*, RESERVE BANK OF INDIA, (20 July, 2019, 09:00 AM), https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/06FSRCHAPTER24945D69340154F559C8A68A24FE5377E.PDF.

[6] T T Ram Mohan, *What Is the Plan for Public Sector Banks?*, ECONOMIC AND POLITICAL WEEKLY, (Jul. 22, 2019, 10:00 AM), https://www.epw.in/system/files/pdf/2018_53/28/CL_LIII_28_140718_HTP_TT_Ram_Mohan.pdf?0=ip_login_no_cache%3D2452ec6ccba6edf49fc5d7d236a6ab48.

[7] Manojit Saha, *Asset Quality Review and its Impact on Banks*, THE HINDU (Jul.17, 2016, 11:10 PM) , https://www.thehindu.com/business/Industry/Asset-Quality-Review-and-its-impact-on-banks/article14494282.ece.

[8] *Financial Stability Report: RBI warns of further rise in NPAs*, THE INDIAN EXPRESS (June 27, 2018, 01:07 AM),

face various restrictions. These include a freeze on recruitment and branch expansion, limits on exposure to risky loans and higher provisioning requirements. The objectives of PCA are intended to restore the health of banks. The RBI's Financial Stability Report[9] (June 2018) warned that gross non-performing assets of troubled banks are likely to rise further under the current macro-economic scenario estimates from 21% in March 2018 to 22.3 % by March 2019. Further, the report suggests that the system-level Capital to Risk-weighted Assets Ratio ("CRAR") may come down from 13.5 % to 12.8% during the period, with 6 PSU banks likely to experience a capital shortfall.[10]

I. DECODING THE PROBLEM OF NPAS IN THE INDIAN BANKING SYSTEM: AN OVERVIEW

In India, RBI's Master Circular on Prudential Norms on Income Recognition, Asset Classification, and Provisioning Pertaining to Advances, dated 1 July 2015, delineates extant guidelines for asset classification and provisioning of NPAs.[11] According to this, an asset or loan of a bank is treated as non-performing when the repayment of principal installment and interest by the borrower

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https://indianexpress.com/article/business/banking-and-finance/financial-stability-report-rbi-warns-of-further-rise-in-npas-5234700/.

[9] *Financial Stability Report June 2018,* RESERVE BANK OF INDIA, (20 July, 2019, 09:00 AM), https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/PR3374CDE581AFD1F14E2F93E0512FD695F248.PDF.

[10] *Ibid.*

[11] *Master Circular on Prudential Norms on Income Recognition, Asset Classification and Provisioning-Pertaining to Advances,* RESERVE BANK OF INDIA, (July 22, 2019, 10:00 AM), https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?Id=449&Mode=0.

becomes overdue, and it ceases to generate income. The guidelines stipulated in the circular states that an asset can be treated as an NPA, if interest and/or installment of principal remains overdue for a period of more than 90 days for a term loan.[12] A similar norm is applied for bills purchased and discounted or if securitization and derivative transactions are undertaken. Further, within NPAs an asset can be categorized as *firstly*, "substandard" if it remained an NPA for less than 12 months, *secondly,* a "doubtful" asset, if it remained beyond 12 months and *thirdly,* a "loss" asset, which is identified as a loss by the bank itself or by the auditors or the RBI, provided the amount is not written off wholly by the bank.[13]

In our banking system, two metrics are used to measure the scale of the NPA:- the ratio of NPAs to Gross Domestic Product ("GDP") and the ratio of NPAs to total loans.[14] The NPA to GDP method measures the potential losses in relation to the size of the economy. This method is useful in comparing the severity of NPA crises with other competent economies, but it does not indicate whether banks are able to handle the NPAs with their own resources i.e., their capital. The second metric i.e., the NPA to loans ratio suggests that the problem can be solved through denominator management – by growing the loan books to make the NPA ratio smaller but this is not reliable since it is based on the assumption that the source of

[12] *Ibid*.
[13] *Supra* note 11.
[14] Harsh Vardhan et al., *The Severity of the NPA crises,* LIVE MINT (May 30, 2017, 08:07 AM), https://www.livemint.com/Opinion/8ISpQAo5B5Twan0fkPw46J/The-severity-of-the-NPA-crisis.html.

the NPA problem is external to the banking system and not in the weaknesses of the lending processes.

A high level of NPAs is certainly a cause of worry for a developing country like India, which could possibly create a crisis situation. However, if the banks have adequate provisions of capital needed to reimburse for the losses, then it could at least substitute the losses of the banks caused due to NPAs. Hence, bank capital is a key factor in resolving banking crises. A bank's ability to withstand NPAs is best measured in relation to capital.

If the scale of NPAs is measured in proportion to loans, then the current crisis is less severe than the crises that existed in the late 1990s. However, when NPAs are measured in relation to bank capital, then the present crisis is worse.

To make it more evident, we may examine the growth rates of NPAs, Capital and Loans from 1997-2001, which were 8.5% and 9.8%, respectively. During this period, bank capital grew 13.14% and bank loans grew 15.87%. The situation is more drastic when compared to the Gross NPA and Net NPA growth rates for the period 2011-2015 which were 45.9% and 54.9% respectively.[15]

From the above-mentioned statistics, it is pertinent to mention that during the previous NPA crises, bank capital grew at a higher rate than NPAs. The NPA to loans ratio was higher, and banks were not undercapitalized. Hence, they were in a better position to withstand the NPA crises. But in contrast to the previous NPA crises, the

[15] *Ibid.*

current NPA crises represents greater ailments, as the growth rate of the NPAs has been considerably higher than that of bank capital, further underscoring the previous severity of the crises.

The consequence of NPA does not only reduce the profitability of the banks but it also puts an additional burden on their provisioning requirements, wherein separate provisions are made for NPAs by setting aside a part of their income from other assets.[16] For example, for the "loss" assets, banks have to make 100% provisioning, the same provisioning is required for "doubtful" assets and for "substandard" assets, 15% general provisioning on total outstanding.

The loan recovery mechanism should be strengthened in order to resolve the problem of NPA, as the rising stress on banks assets and a low level of recovery could pose a problem for the financial system, which would certainly disrupt the pace of economic growth. The more NPAs get resolved, the more the effective credit appraisal and monitoring initiatives that could be taken by the bank, thus safeguarding the financial system and the economy.

The Government and the RBI have taken several initiatives to curb the menace of rising NPAs, which includes setting up of Debt Recovery Tribunal ("DRT"), enactment of the SARFAESI Act, introduction of Corporate Debt Restructuring, the establishment of Asset Reconstruction Companies ("ARCs"), the Credit Information Bureau ("CIB") and the newly introduced Insolvency and Bankruptcy Code, 2016, which are going to act as significant

[16] *Supra* note 11.

instruments to extricate the problem of NPAs in the banking system.

II. RECOVERY OF NPAS AND EFFECTIVENESS OF THE DEBT RECOVERY TOOLS

The rising concerns over the recovery of NPAs has attracted substantial attention in a phase of strident economic growth depicting a slowdown. That is likely an outcome of the implementation of demonetization of specified bank notes ("SBNs") in November 2016 which impacted the banking sector's performance transitorily in the form of a surge of low-cost deposits and an abundance of liquidity in the system.[17] The consequence of which was a reduction in interest rates and alteration of banks' balance sheet.[18] Hence, in order to address the existing crises of non-recovery of NPAs, developing a sound recovery mechanism is crucial for facilitating smooth functioning of banks and achieving sustained growth.[19] Various micro and macro factors have been identified as determinants of recovery of stressed assets, i.e. the size of the company, the state of the business cycle, and growth in GDP and loan supervision, but in contrast the Indian perspective on

[17] *Operations and Performance of Commercial Banks*, RESERVE BANK OF INDIA, (23 July, 2019, 11:00 AM), https://www.rbi.org.in/scripts/PublicationsView.aspx?Id=18061.

[18] *Report on Trend and Progress of Banking in India 2016-17*, RESERVE BANK OF INDIA, (July 22, 2019, 10:00 AM), https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/5CHA52017BAE3CF27FF964325B9E3F0C9BE74FEF0.PDF.

[19] Rekha Mishra et al., *Determinants of recovery of stressed assets in India, An Empirical Study*, ECONOMIC & POLITICAL WEEKLY, (July 22, 2019, 10:00 AM), https://www.epw.in/system/files/pdf/2016_51/43/Determinants_of_Recovery_of_Stressed_Assets_in_India_0.pdf.

recovery of bad loans was found to be positively associated with secured loans, term loans and banks' exposure to real estate.[20] According to the figures provided by the RBI Governor Urijit Patel before the Parliamentary Standing Committee on Finance, a reduction in NPAs amounting to Rs. 1,50,960 crore was mainly through write-offs. Table 1 summarizes the reduction of NPAs in PSBs and private sector banks.[21]

Table 1

	Public Sector Banks	**Private Sector Banks**
New Accretions to NPAs	2,37,475	60,800
Total NPA reductions	1,50,960	46,091
Reduction in NPAs due to up-gradation	25,297	11,103
Reduction in NPAs due to write-offs	84,272	18,571
Reduction in NPAs due to actual	41,391	15,752

[20] *Supra* note 18.
[21] Sharad Raghavan & Shobhana Nair, *Low Recoveries of NPAs: RBI data*, THE HINDU (12 June, 2018, 10:24 PM), https://www.thehindu.com/business/Economy/rbi-data-show-low-npa-recovery/article24146708.ece.

recoveries		
Gross NPAs	7,77,280	1,07,796

All figures as in Rs. crore, as of December 2017.

According to Table 1, PSBs saw Rs. 1,50,960 crore reduction in their NPA levels from the start of financial year 2017-18 till 31 December, 2017, of which about 55% or Rs. 84,272 crore was due to write-offs. The data also shows that during that period Rs. 2,37,475 crore of loans were added to the NPA list, thereby worsening the situation of NPAs. It is interesting to note that only Rs. 41,391 crore, or 27%, of the reduction in NPA level was due to actual recoveries, and additionally Rs. 25,297 crore worth of loans were reduced due to upgradation from NPA status. Also, most importantly Gross NPAs with PSBs stood at Rs. 7,77,280 crore at the end of December 2017, up from Rs. 5,39,968 crore on 31 March, 2016.

As far as private banks are concerned, nearly 40.2% of the reduction in their NPA levels was due to write-offs. Actual recovery accounted for 34.2% of the reduction, while upgradation accounted for 24.1% of the reduction. Gross NPAs accounted for Rs. 1,07, 796 crore, up from Rs. 55,853 crore as on 31 March, 2018.

The above-mentioned figures delineate the draconian period that the banks seemed to be passing through, and therefore the reduction of NPAs to a level that can be easily manageable is critical for instilling confidence in the sustainability of the banking system, for reducing disruption in the financing of real sector activities and for containing any possibility of macroeconomic instability.

The rate of recovery of NPAs of Scheduled Commercial Banks ("SCBs") is not comforting since the recovery through various channels (Lok Adalats, Debt Recovery Tribunal and SARFAESI Act) has fallen drastically from 22% at the end of March 2013 to 9.8% at the end of March 2017.[22] With a stagnant recovery rate of NPAs (which are rather growing at a faster rate) and where much of the reduction is a result of compromises or write-offs, banks gain little to nothing.[23]

A. RECOVERY OF NPAS THROUGH SARFAESI ACT

Effective from 21 June 2002, the SARFAESI Act has been a major development in evolving institutional infrastructure for financial regulation. The legislation empowers the banks to recover the loans from the institutions without the intervention of the court. For instance, if any borrower fails to discharge the liability in repayment of any secured debt within 60 days of notice from the date of notice by the secured creditor, the secured creditor has the power to take possession of the secured assets of the borrower, with the help of the person appointed for such purpose by the bank.[24] It also established the Securitization Companies/Reconstruction Companies (SCs/RCs) for the smoother realization of long-term

[22] C.P. Chandrasekhar et al., *The banking Conundrum, Non-performing Assets and Neo-Liberal Reform,* ECONOMIC AND POLITICAL WEEKLY, March, 2018, at 130.
[23] *Ibid.*
[24] *Supra* note 19.

assets, managing the problem of liquidity, curbing asset-liability mismatch and improving recovery - by exercising powers to take possession of security, selling them and also reducing NPAs by adopting measures for recovery or reconstruction within the framework of the SARFEASI Act.

Table 2

Year	Cases Referred (in No.)	Involved Amount (in crore)	Recovered Amount (In crore)
2010	78,366	14,249	4,269
2011	1,18,642	30,604	11,561
2012	1,40,991	35,300	10,101
2013	1,90,537	68,100	18,500
2014	1,94,707	94,602	24,402
2015	1,75,355	1,56,800	25,600
2016	1,73,582	80, 100	13,200

Source: RBI Reports in trends and Progress of Banking in India.[25]

Table 2 showing the data for the period from 2010 to 2016, provides an insight on NPAs recovery by SARFAESI Act 2002 of

[25] *Supra* note 18.

PSBs. The number of cases referred under the Act was 78,366 in 2010 and increased to 1,73,582 in 2016. The above table also exhibits that the amount involved was Rs. 14,249 crore in 2010 and increased to Rs. 80,100 crore in 2016. But regarding the recovery of the NPAs, the trends were not as good as in 2010, where Rs. 4,269 crore was recovered which is 30% of the total involved amount, whereas the rate of recovery in 2016 reduced drastically. It is observed that only Rs. 13,200 crore was recovered, merely 16.50% of the total involved amount.

B. RECOVERY OF NPAS THROUGH DEBT RECOVERY TRIBUNAL

The enactment of the Recovery of Debts Due to Banks and Financial Institutions Act ("RDDBFI"), 1993, led to the establishment of DRTs to assist the banks in a speedy resolution of matters relating to recovery of NPAs of Rs. 10 lakh and above. The DRT grants time to the borrowers/applicant to make payment, and subject to such payment the banks' action under SARFAESI is stayed. As per Section 17(5), an appeal under SARFAESI shall be disposed of within 60 days of the date of filing, but this is not followed strictly. Also, as per the RDDBFI Act,[26] the cases are to be disposed within six months, but in some cases, the next date of hearing itself is given after six months to one year. It is pertinent to note that when an appeal is filed in the Debt Recovery Appellate Tribunal ("DRAT") against the order of the DRT, the banks have to deposit 75% of the total amount due as a precondition for

[26] Rebecca Furtado, *Recovery of Money Under The Recovery of Debts Due to Banks And Financial Institutions Act, 1993*, BLOG IPLEADERS (Feb. 27, 2017, 10:00 AM), https://blog.ipleaders.in/recovery-of-money-under-the-recovery-of-debts-due-to-banks-and-financial-institution-act-1993/.

admission of appeal. It is the discretion of the DRT to not insist on deposits if such a prayer is sought by the banks.[27]

Table 3

Year	Cases Referred (in no.)	Involved Amount (in crore)	Recovered Amount (in crore)
2010-11	12,872	14,092	3,930
2011-12	13,365	24,100	4,100
2012-13	13,408	31,000	4,400
2013-14	28,258	55,300	5,300
2014-15	22,004	60,400	4,200
2015-16	24,537	69,300	6,400

Source: RBI Reports in trends and Progress of Banking in India.[28]

Table 3 shows the data on the recovery of NPAs by SCBs through DRT from the period of 2010-11 to 2015-16. It is clear from the above-mentioned Table 3 that the referred cases for NPAs recovery to DRTs during this period has significantly increased. Similarly, the amount involved has also shown increment, but when it comes to the rate of recovery, it has been disappointing. This is because in

[27] *Supra* note 19.
[28] *Supra* note 18.

2010-11 the recovery rate was 27.89%, but massively slipped to 9.20% in 2015-16.

C. RECOVERY OF NPAS THROUGH LOK ADALATS

Established under the Legal Services Authorities Act, 1987, the Lok Adalats facilitate compromise or settlement of disputes between the parties. The idea behind establishing Lok Adalats was to deal with the high pendency of cases in the courts, as they can be an efficient and alternate way of judicial settlement. In Lok Adalats, the cases which are pending before any court in India can be settled as per the prescribed monetary ceiling. Presently, civil disputes that can be settled under this mechanism are restricted to Rs. 20 lakh, but the parties should bear in mind that the offences which are not compoundable under any law cannot be brought within the purview of the Lok Adalats.[29]

Table 4

Year	**Cases Referred (in No.)**	**Involved Amount (in crore)**	**Recovered Amount (in crore)**
2010-11	6,16,018	5,254	151
2011-12	4,76,073	1,700	200
2012-13	8,40,691	6,600	400

[29] *Supra* note 19.

2013-14	16,39,957	23,200	1,400
2014-15	29,58,313	31,000	1,000
2015-16	44,56,634	72,000	3,200

Source: RBI Reports in trends and Progress of Banking in India[30]

Table 4 shows the recovery of NPAs by SCBs through Lok Adalats from the period of 2010-11 to 2015-16. From Table 4, it is also clear that the number of cases referred and the amount involved show a considerable increase. Although the rate of recovery of NPAs has also shown an upward trend, if analyzed w.r.t. percentage of recovery then it appears to be quite fluctuating. Evidently, the percentage of recovery of NPAs in this situation is much lesser than through other recovery channels. Due to such inefficiency, banks should consider alternative options to strengthen the NPA recovery process.

The above analysis exhibits that the traditional instruments for the recovery of the NPAs have become obsolete and failed to improve the weak recovery mechanism of the NPAs. The performance of most recovery channels in India has not been very encouraging.

In this context, the Central Government has adopted three approaches apart from traditional tools to strengthen the recovery of NPAs.[31] They are summarized as follows:-

[30] *Supra* note 18.
[31] A Vasudevan, *Engineering banking Sector Recovery and Growth*, ECONOMIC AND POLITICAL WEEKLY, March 2018, at 141.

(i) There should be a focus on strong recovery and growth plans with indicative targets, which could pave the way for pursuing structural reforms in the short to medium term.

(ii) Recapitalization in the banks should be done in such a manner that the NPAs are sharply reduced. Here, the Government will not directly recapitalize the banks but would take the support of market borrowings through the issuance of bonds. This mechanism compulsorily demands the implementation of recovery and growth plans so that banks do not accumulate NPAs in the future.

(iii) The bailout amounts should be utilized in such a manner that it would not erode public trust from commercial banks.

The first approach as mentioned could turn out to be advantageous if plans are bank-specific and correctly understood by the bank employees who are empowered to process a loan application. When it comes to the structural reforms in banks, the plans to improve the performance are regularly discussed but not implemented with the full force due to a lack of incentives for the bank staff. In this regard, the government had decided to appoint a three-member committee sitting together i.e., the management of the bank in question, the Government and the RBI – to critically examine the progress made towards recovery of NPAs and reporting it to the specified government authorities.[32]

[32] *Ibid.*

III. PRIVATIZATION AND RECAPITALIZATION: ARE THEY BETTER INSTRUMENTS TO REDUCE NPAS?

The approach to recapitalize the banks could be a welcome move by the Government but is certainly a temporary solution. Especially where the financial sector is not well developed and where avenues for saving financial assets are not many. This is because the Net Present Value ("NPV") of capital infused by the government in PSBs would be well over Rs.10 lakh crore. Is capital infusion the permanent solution? and if it is so, then why is it happening again and again? The idea behind recapitalization is to meet the minimum capital requirement by the banks to keep their day to day business afloat.

The reason for recurrence of capital infusion in the SCBs could be attributed to two major issues – governance and regulatory framework. The thoughtful recommendation of the Narasimhan Committee of 1991 and 1998, wherein the tenure of the senior management was addressed.[33] It recommended that, *firstly,* the tenure of the PSBs chiefs and their managing/executive directors must have a fixed tenure of at least five years. *Secondly,* it advocated for a guide to structure the salary of senior management. *Thirdly,* it suggested that professionalization through lateral entry should only be restricted to the level of general managers and not to the position of Managing Director/Executive Director of the bank. *Fourthly,* the

[33] Ashvin Parekh et al., *Will Bank Recapitalization fix NPAs?*, THE HINDU (Nov. 09, 2017, 11:35 PM), https://www.thehindu.com/opinion/op-ed/will-bank-recapitalisation-fix-npas/article20055941.ece.

bank board's should consist of professional directors rather than politically associated nominees. *Lastly,* it recommended for tougher action against the senior management for non-performance.

Table 5

Government's Capital Infusion into Scheduled Commercial Banks	**Rs. (in crore)**
2011-12	12,000
2012-13	12,517
2013-14	14,000
2014-15	6,990
2015-16	25,000
2016-17	25,000
2017-18	2,11,000

Source: Economic and Political Weekly, ed. March, 2018.[34]

This article argues that recapitalization as an instrument for the reduction of NPAs should be a last resort. Given above, Table 5 studies the capital infusion into SCBs from 2011-12 to 2017-18, which shows that there was a capital infusion every year. In fact, the

[34] *Supra* note 31.

biggest ever capital infusion was witnessed in 2017-18, in which SCBs were capitalized. This involved infusion of Rs. 2,11,000 crores of new equity into PSBs, of which Rs. 1,35,000 crores would be new money from the government, financed with recapitalization bonds. Further, Rs.18,139 crores would be covered under the governments ambitious "Indradhanush" Plan (initiated in the year 2015) while the remaining would be mobilized by the banks from the market.[35] Implementing a plan for public bailouts would essentially provide assistance in maintaining capital requirement and eliminate friction for credit disbursal in the market.

A demand for privatizing PSBs is also emanating from the Government and RBI to address the problem of growing NPAs and the declining growth rate of PSBs. But are the government and RBI confident that the privatization of PSBs will provide solutions to emerge from this crisis? The conventional arguments for privatization emphasize on bad decision making, unsound banking environment and the absence of due diligence, which have resulted in accumulation of NPAs in the books of the banks. The only solution is to mobilize capital from the market through the sale of equity in order to dilute the government's stake in PSBs. It is pertinent to note that in 2008, when the whole world was facing financial crises, in the context of which former RBI Governor YV Reddy had pointed out that even the best Indian private banks were affected but PSBs came out unscathed.[36] However, even private

[35] *Supra* note 23.
[36] Sushma Ramachandran, *No need to Privatise Banks*, THE TRIBUNE (Mar. 06, 2018, 01:07 AM), https://www.tribuneindia.com/news/comment/no-need-to-privatise-banks/553318.html.

sector banks in India are not immune to the issues that plague public sector entities. This is because private banks too witnessed a significant rise in their accumulation of NPAs. According to the RBI Financial Stability Report (December 2017), the rate of increase of NPAs was 40.8% for private sector banks as against 17% for PSBs.[37] Therefore, it is evident that privatization is not an overarching solution for curing the ruined health of the PSBs, but rather corrective measures are required in the operations and performance of these banks. Additionally, the RBI needs to be more vigilant and ensure that auditors are fulfilling their roles.[38]

According to Viral Acharya, Deputy Governor of the RBI, the real problem is not the NPAs of banks, but the failure of private sector banks despite the liberalization of the banking sector, "You look at the last 25 years of private sector growth, the private banking sector growth is flat, which means Indian private banking hasn't raised its market share beyond 25%. In fact, it shrunk after 2007-08 crises because the depositors, especially the corporate, flew back to State Bank of India and other PSBs."[39] Therefore, surgical action is required to separate the healthy parts of the banks and sell them to private banks so that the former can shrink and the latter can expand. The money received from selling the healthier part would

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[37] *Financial Stability Report December 2017*, RESERVE BANK OF INDIA, (July 22, 2019, 10:00 AM), https://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=885.

[38] *Supra* note 36.

[39] Menaka Gandhi, *Does India need a bad bank to clean up the bad loan mess?*, BLOOMBERG QUINT (Oct. 06, 2016, 08:27 PM), https://www.bloombergquint. com/business/does-india-need-a-bad-bank-to-unchoke-growth.

be utilized in writing-off the NPAs. Thus, it would become an efficient channel for resolution of NPAs in PSBs and the goal of expanding private banking would also be achieved.[40]

For faster recovery and growth of the banks, there is a requirement for systemic structural reform ensuring banking stability and performance. One of the important questions which arise is that, if there is no commitment on the part of the banking bureaucracy and the government, then how would recovery plans be satisfactory? The P.J. Nayak Committee report titled, "The Report of the Committee to Review Governance of Boards of Banks in India",[41] ("P.J. Nayak Committee Report") draws out the idea of implementation of "Good Corporate Governance". The committee reviewing board governance has suggested measures to bring about a level playing field between public sector banks and private sector banks. The principle recommendations focus on eliminating various constraints on public sector banks as a result of their State control, which have a bearing on the quality of their governance. The recommendations given by the committee are crucial, since the State has the power to regulate the affairs of the bank boards as per the statute, thus having a large influence over lending decisions for the purposes of social and developmental activities.[42]

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[40] *Supra* note 23.

[41] PJ Nayak et al., *Report of the Committee to Review Governance of Board of Banks in India*, RESERVE BANK OF INDIA (Last visited Feb. 22, 2019) https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/BCF090514FR.pdf.

[42] Fitch: PJ Nayak Panel's Proposals to strengthen corporate governance, THE HINDU BUSINESS LINE (Feb. 22, 2019, 10:00 AM)

IV. RESOLVING BAD LOANS THROUGH FUGITIVE ECONOMIC OFFENDER'S ACT, 2018

One of the major factors for mounting NPAs in PSBs is the ease with which perpetrators of financial crimes escape to other countries after defrauding banks. In order to deter such absconders, who declare themselves to be a willful defaulter, the government introduced a new law – the Fugitive Economic Offenders Act, 2018 ("FEO Act").[43] This article, however, argues that it was perhaps not enacted with the best of intentions.

The FEO Act allows for a person to be declared as a fugitive economic offender if, *firstly,* an arrest warrant has been issued against him for any specified offences where the value involved is over Rs. 100 crore, and *secondly*, he has left the country and refuses to return to face prosecution.[44]

To ensure that the perpetrators do not leave the country, the FEO Act empowers officials to attach domestic properties of suspects even before the case is filed in a special court.[45] If the special court finds that fraud has been committed by the person then it shall order the confiscation of their assets by the Central Government for sale and settlement of dues. However, this law is only applicable to the suspects who try to leave the country, after the offence is

https://www.thehindubusinessline.com/economy/fitch-pj-nayak-panels-proposals-to-strengthen-corporate-governance/article20782423.ece1.

[43] Act No. 17 of 2018.

[44] *Id.*, Section 2(f).

[45] *Deterring Fugitives,* THE HINDU BUSINESS LINE (Mar. 9, 2018, 10:00 AM), https://www.thehindubusinessline.com/opinion/editorial/fugitive-economic-offenders-bill-2017/article23007244.ece.

committed of the value of Rs. 100 crore or above. The article claims a 'nasty intention' behind the FEO Act, because *firstly*, once the special court declares the person as a fugitive, he can be debarred from filing and defending any civil claims, thus putting a complete blanket ban which is against the principles of natural justice. Even companies cannot file a suit for civil claim, if their promoters, shareholders or key office bearers are declared fugitives. Such a provision would cause severe damage to the minority shareholders or a listed company and therefore should be immediately rectified and *secondly*, it specifies a person to be a fugitive economic offender for offences of monetary value of Rs. 100 crore or above, but what about cases involving marginally lower amount of Rs. 99 crores? Presently, there exist no clarity or guidelines on the FEO Act for this omission or even reasons for prescribing such a high threshold.

Thus, the FEO Act does not solve the problem entirely. It is likely that the offenders would seek cover through extradition treaties and disburse their assets through different mechanisms to exploit the provisions of the law. Hence, the effectiveness of this law will be only tested in the near future, where the focus would be on the recovery of NPAs from persons who are declared fugitives under the FEO Act.

V. IS CONSOLIDATION OF BANKS A BETTER IDEA?

The idea of merging PSBs is a decade old and still subsists as a solution to fix the problems of PSBs. But how viable is this idea to consolidate banks? Certainly, it is an idea which is in the realm of economic policymaking, has been debated at the highest levels, and often posited as a panacea for various policy objectives. Recently, there was a merger of four big PSBs i.e. Bank of Baroda, Punjab National Bank, IDBI Bank and Oriental Bank, thereby creating India's second largest bank, with total assets of Rs. 16.5 trillion.[46] The idea of PSB consolidation, originally recommended by Narasimhan Committee I, was first done in 1993, where Punjab National Bank ("PNB") took over the stressed assets of the New Bank of India ("NBI"), because at that time PNB was a healthy bank with a track record of profitability. However, post-merger it encountered its first loss of Rs. 96 crore in the year 1996, and thereafter remained fragile for a long time.

For such mergers, *firstly*, at least one of the two entities must be in sound financial condition i.e., it should have sufficient capital to sustain the losses of the weaker bank. It would be presumably hard to find a bank which could add value to shareholders of both the banks. Thus, merging at present will possibly only end up diverting and sapping the energy of top management and *secondly*, mergers are effected where growth opportunity is less and PSBs are unable to grow because they are starved of capital.[47] Thus, in order to ensure that banks do not reach a "too big to fail" stage, it is important to

[46] *Bank mergers: An idea whose time should never come*, THE ECONOMIC TIMES (Jun. 13, 2018, 01:00 PM), https://economictimes.indiatimes.com/markets/stocks/news/bank-mergers-an-idea-whose-time-should-never-come/articleshow/64567540.cms.
[47] *Supra* note 6.

have a concrete foundation of a regulated banking system to shoehorn the consolidation of PSBs in the future.[48]

VI. IS POOR CORPORATE GOVERNANCE A CAUSE FOR UNPRECEDENTED OPERATIONAL STRESS?

The model of corporate governance followed by banks plays a strategic role in affirming its dominance in the banking space. This is because greater coordination with all stakeholders is the solution to operational stress in banks. The P.J. Nayak Committee Report which was submitted in the year 2014 included recommendations, which if implemented, would fundamentally change the face of state-owned banks and would also provide a roadmap for incremental changes in the governance of private banks.[49] Consequently, an autonomous body, the Banks Board Bureau ("BBB") was incorporated in the year 2016. The BBB reinforces the government's commitment of extricating every possible method to reduce the operational stress of the banks. The aforementioned report majorly discusses the identification, selection and nurturing of quality leadership for PSBs, as well as the continuity of the said leadership. The responsibility for which, was entrusted to the BBB.[50]

If we talk about the present composition of the boards at PSBs, the board consists of three directors representing minority (non-

[48] K Srinivasa Rao, *Stiffer Challenges Await the New Banks Board Bureau*, ECONOMIC & POLITICAL WEEKLY, Aug. 18, 2018, at 14.
[49] *Supra* note 41.
[50] *Supra* note 48.

government) shareholders' interests; a director each represents the central government, workmen, officers, and the regulator (RBI). Subsequently, a chartered accountant is appointed as a director, the person who usually heads the audit committee of the bank. The bank also comprises of three to four whole-time directors including a Chairman and Managing Director ("CMD").

The lacunae in the above composition is in the process of identifying individuals to represent the diversity of interests. The P.J. Nayak Committee Report tactfully identified the drawback, where all the directors were non-independent, except the shareholder directors. It further objected to the election of so-called "independent" directors, who were largely nominees of the government.[51] The committee also expressed its anxiety on non-governmental shareholding, substantially held by institutions indirectly controlled by the government insurance companies, financial institutions, etc. Thus, it may be argued that the PSBs do not represent good corporate governance.

One of the suggestions of the report was to improve governance by identifying capable talent for the top positions of the bank consisting of full-time board members i.e. Chairperson, MD and CEO, and executive director.[52] The requirement of successive planning for effective leadership skills and enforcement of code of conduct, is vital to mitigate the asset quality woes and stimulate

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[51] M.S. Sriram, *Governance Reform in Banks: The Nayak Committee Report*, BUSINESS TODAY (May 20, 2014, 10:30 AM), https://www.businesstoday.in/opinion/columns/m.-.s-sriram-on-governance-reforms-in-banks/story/206375.html.
[52] *Supra* note 41.

innovative financial methods in creating a road map for the desired growth of banks.

The report also discusses the governance of private banks where the major issue identified pertains to the nature of investors. It suggested that there be a "fit and proper" criteria for institutional investors who would be eligible to appoint their representatives on the board. The would be known as Authorized Bank Investors, and a pre-investment determination of the "fit and proper" criteria for an investor, was vehemently opposed by the P.J. Nayak Committee Report.[53]

The report also provided guidelines for a fixed term for the Chairman/Managing Director and the whole-time director for the period of 5 years and 3 years, respectively.[54] Lastly, the report with its insightful, constructive and radical approach, reflects that the government has much to do in addressing issues, bringing reforms and improving the management in banks.

VII. IS AN ASSET MANAGEMENT COMPANY A SUBSTITUTE FOR INSOLVENCY AND BANKRUPTCY CODE, 2016?

To ensure transparent market-based solutions with a focus of on asset turnaround, a committee on restructuring assets under the chairmanship of Sunil Mehta, Non-Executive Chairman of the Punjab National Bank, submitted its report with the plan to fight against the menace of bad loans by incorporating an Asset

[53] *Supra* note 41.
[54] *Ibid*.

Management Company ("AMC").[55] The AMC could provide an alternative to proceedings in the National Company Law Tribunal ("NCLT") for resolution of bad loans. Since directing all bad loans to the NCLT is likely to result in delayed resolution in the light of overburdening of the tribunal. Therefore, the bank led resolution by setting up an AMC provides an opportunity to resolve some of their bad loans, without transferring the matter to NCLT.[56]

VIII. RECOMMENDATIONS AND SUGGESTIONS

(i) The initiation of reformatory practices should encompass: strengthening of bank boards; strengthening of top management; recapitalization of banks, which is backed by adequate capital infusion capable of subsuming the losses of existing NPAs; if not, then the infusion of capital is meaningless.

(ii) The induction of quality professionals as independent directors in the banks' board should be a sine qua non for undertaking onerous responsibilities and risks in the era of fragile economic growth.

(iii) The resolution of stressed assets of the banks should be undertaken in a time-bound and non-discretionary manner, so that the cash flow mismatch or liquidity issues can be resolved transparently.

(iv) The rotation of personnel among banks, from the level of a probationary officer to the post of a chairperson should be

[55] *Mehta panel submits 5-point plan to fight NPAs,* THE HINDU BUSINESS LINE (Jul.2, 2018, 10:00 AM), https://www.thehindubusinessline.com/money-and-banking/mehta-panel-submits-5-point-plan-to-fight-npas/article24314726.ece.

[56] *Ibid.*

developed as a norm. Also, adopting the practice of choosing a Managing Director from one of the executive directors should be inculcated in banks, which imparts a measure of commitment.

(v) To prevent worsening of the NPA crisis, effective NPA recognition methods should be employed. Additionally, the restructuring of loans should be the commercial decision of the board. Lastly, the banks should avail regulatory concessions for deferring the recognition of NPAs.

IX. CONCLUSION

The evolving nature of NPAs in the Indian banking sector has put pressure on the government and RBI to address the root of the problem. The accumulation of NPAs acts as a termite on the balance sheets of the banks, which should be tackled by sound risk management practices in each bank and RBI's regulatory role in such situations becomes exigent. The banks on their level should also devise a stringent loan recovery mechanism, which would closely follow the progress of each loan account. In conclusion, the health of the banking sector should be restored urgently since the current NPA problem can escalate into an economic crisis worse than that of 1991. Therefore, building adequate regulatory frameworks, comprehensive reforms, a strong resolution and supervision policy is the need of the hour to revamp the banking sector in India.

CONCURRENT DELAY - A LEGAL PANDEMONIUM

*Aakash Laad & Srishti Gupta

ABSTRACT

The term 'concurrent delay' is a boutique term mostly associated with the delay in projects related to construction. In this article, the authors have tried to analyze the real problem as to why concurrent delay in construction contracts has become a legal conundrum and how jurisdictions across the globe have dealt with it. The element of delay may give a right to the sufferer to rescind the contract but also fixes liability on the person who caused the delay, to compensate the sufferer. The difficulty, however, arises when both the parties to the contract have caused the delay and one alleges the other's acts to be the real cause of delay in the project. In such circumstances, a dominant cause is identified; however, there is an absence of parameters for the decision takers to adjudge and examine a dominant cause and its basic elements.

A 'time delay and extension clause' is a general clause, which can be found in every construction contract; however, the problems associated with the concurrent delay are not satisfactorily covered by this clause. There is a need to view this problem from a rather different, non-conventional approach, as the view from a conventional approach would show that the current situation is not a problem at all and there are a number of cases, providing clarity over the issue. However, the non-conventional approach shows

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how different cases have given birth to different approaches which ultimately lead to a chaotic situation.

To address this and remove the chaotic element, it is essential to have a wide-ranging approach including all the reasonable constituents of the varied approaches. This article, while analyzing different approaches, has also provided indigenous suggestions after emulsifying the positives of modern and traditional approaches to the problem.

INTRODUCTION

It is often heard in the construction business that, "time is money" and this is what obliges and encourages every stakeholder of a construction company to complete the allotted work in time so as to comply with their contractual commitments. The time duration for the completion of the contract has a direct reflection on the profits earned out of construction projects. However, it is the dual facets, time and money that lead to some of the most complicated and troublesome disputes around the globe. One such dispute is related to the notion of 'concurrent delay' in the industry. The issue remains *res integra* even though the regime of contract law is one of the oldest and almost every major jurisdiction has a well-drafted legal framework on the creation and operation of a contract. However, to date, there has been no clear stand by any particular jurisdiction that can be said to be a universal rule or popular practice in the context of concurrent delay.

In this article, the authors will initially discuss the theory and the concept of concurrent delay, following which, the authors will set out the limited jurisprudence, based on different approaches, available on this issue. Broadly speaking, there are five different approaches which deal with the question of concurrent delay. The courts in different jurisdictions have developed these approaches, in accordance with their municipal laws and understanding of contracts. One such approach is the 'Malmaison Approach' based on the case of *Henry Boot Construction v. The Malmaison Hotel*; and the other can be termed as somewhat similar but slightly muddied approach of 'Apportionment' developed in Scotland in the case of *City Inn Limited v. Shepherd Construction Limited.* Other approaches such as relating to causation and common sense etc. were developed in different cases of varied jurisdictions and are discussed in this article below.

The article concludes with the possible stance that the Indian courts and tribunals may take in this regard and the probable applicability, if any, of Indian Contract Act, 1872 to such a complex issue. Apart from that, the authors have also tried to provide an indigenous suggestion after briefly analyzing the traditional and modern approaches, as developed through case laws, taken into consideration for resolving the issue of liability in 'concurrent delay' cases.

I. THEORY OF CONCURRENT DELAY

The doctrine of 'concurrent delay' derives its existence from the theory of contract law that is used to curb and eliminate damages accruing from delays, on the premise that where both the parties are at fault in causing delay to the overall project, neither party is entitled to recover damages. Till date, the lack of legislative principles dealing with concurrent delay makes it *res integra* for many jurisdictions. This can be attributed to the fact that plausible answers to the issue of concurrent delay are cumbersome for the reason that it requires deliberation of various factors such as contractual provisions, legal principles, methods of proof of delay, etc.

The term "concurrent delay" can be defined as, "*a period of project overrun which is caused by two or more effective causes of delay which are of approximately equal causative potency.*"[1] The aforementioned definition was acknowledged by the Queen's Bench in the case of *Adyard Abu Dhabi v SD Marine Services.*[2]

The doctrine of concurrent delay is based upon two principles.[3] The first being the legal principle of *in pari delicto* which is applied in the event of default (such as, any form of breach of contract or any other contractual obligation) of both, the owner and the contractor. In such cases, neither party should be entitled to recover damages from the other. This principle is somewhat based on the tortious liability of wrongdoing. However, its applicability in the contract law would mean a breach of a contractual term or a change of contractual responsibility without being specified in the contract.

The second principle involves a delay caused due to any event that has already been pre-agreed by both the parties as constituting a *force*

[1] John Marrin QC, *Concurrent Delay Revisited*, 179 SOCIETY OF CONSTRUCTION LAW PAPER (Feb. 2013).
[2] [2011] B.L.R. 384.
[3] James P. Wiezel *Refining the Concept of Concurrent Delay*, 21 (2) PUBLIC CONTRACT LAW JOURNAL 161, 176 (1991).

majeure and is not a consequence of any default of either party. According to this principle, the parties to the contract may defend themselves by arguing that the time and cost incurred would have been the same, even if there were no concurrent delay committed by that party. It is basically a principle that is based on the concept of excusable delay, which is discussed in brief later. This also essentially means that there has been almost zero effect of the delay caused, on the time and cost of the concerned project.

II. THE ROADMAP IN DEALING WITH CONCURRENT DELAY

In many jurisdictions around the globe, even though a plethora of judicial decisions have been rendered on the subject matter, a working definition of concurrent delay and the procedure for practical analysis remains elusive till date. As mentioned in the previous part, the problem can be reasoned on the fact that indeed in the last one decade, there have been various definitions given by the courts and various legal authors but none have been universally agreed and accepted. Moreover, the argument also revolves around the question of whether the concurrency exists where, *"delay events begin at the same time in the project, begin and end at the same time, overlap at the same time, or need not involve delays felt at the same time"*.[4] However, the difficulty in arriving at a universally accepted definition has never been a stumbling block for the courts to analyze the issue of concurrent delay and has been dealt with differently internationally.

[4] John Hughes, Andrew Agapiou & John Blackie, *Legal Developments in Relation to Concurrent Delay: The Position of the English and Scottish Courts*, PROCEEDINGS OF THE CIB 2016 WORLD BUILDING CONGRESS (TAMPERE UNIVERSITY OF TECHNOLOGY, FINLAND) 592, 603 (2016).

A. THE DOMINANT CAUSE APPROACH

The dominant cause approach dates back to the late twentieth century.[5] The well-established common law approach was recognized by the House of Lords in the case of *Leyland Shipping Company Ltd v Norwich Union Fire Insurance Society Ltd.*[6] and can be very well summarized as, *"If there are two causes, one the contractual responsibility of the Defendant and the other the contractual responsibility of the Plaintiff, the Plaintiff succeeds if he establishes that the cause for which the Defendant is responsible is the effective, dominant cause. Which cause is dominant is a question of fact, which is not solved by the mere point of order in time, but is to be decided by applying common sense standards."*[7]

To get a better understanding of the approach it can be put into a hypothetical situation:-

For instance, if a part of work is postponed on 'x' day for a week due to the unavailability of the required equipment, then as per normal presumption the contractor shall receive the amount for postponement by the owner. Additionally, if this period of postponement is hit by heavy rains and the work further gets delayed for another one week, in that case, the question may arise that will the contractor still be liable for the compensation for the loss that has been caused? As per the 'dominant cause test', the contractor shall only be entitled to receive the amount for the

5 Sasha Baker, *Concurrently Delayed?*, HOGAN LOVELLS (Aug. 2015), https://www.hoganlovells.com/publications/concurrently-delayed.

6 Leyland Shipping Company Ltd. v. Norwich Union Fire Insurance Society Ltd., [1918] H.L.A.C. 350.

7 VIVIAN RAMSEY & STEPHEN FURST, KEATING ON CONSTRUCTION CONTRACTS 195 (10th ed., Sweet & Maxwell 1991).

postponement due to the unavailability of the equipment and not for the loss due to the heavy rains.

This approach was in use in the United Kingdom ("UK") during the 1980s, which made it mandatory to identify one event as the dominant cause of the delay in the construction disputes in order to determine the true cause of the delay.[8]

The Supreme Court of New South Wales in Australia[9] has also relied upon the dominant cause approach and cited an example to illustrate the rationale for this approach, *"if an owner caused delay of 5 days commencing on day 15 means that a contractor which would have completed the works on day 20 still has 5 days work to do, and there is a neutral delay on day 23, there is no difficulty in concluding that the time-based costs incurred on day 23 were caused by the original delay."*[10]

Even though the Australian jurisprudence on concurrent delay supports the idea of giving extension of time to the contractor for the full period inclusive of the delay caused by the neutral events, it has been overruled by another Australian case of *Armstrong Construction v. Council of the Shire of Cook,*[11] wherein, the Supreme Court was of the view that the approach adopted by the court in *Thiess Watkins White Construction Ltd v. Commonwealth* will not be

[8] Ahmed Said El Gezery, Construction Delays and Concurrent Delays (March 2018) (unpublished M.Sc. Dissertation, The British University in Dubai) (on file with the library, The British University in Dubai).
[9] Thiess Watkins White Construction Ltd. v. Commonwealth, (1992) 14 B.C.L. 61.
[10] *Ibid.*
[11] *Armstrong Construction v. Council of the Shire of Cook* (1994), Q.L.D. S.C.

applicable in situations where the dominant cause is the contractor's risk event. In such scenarios, the courts should take a more pragmatic approach and apply the "Common Sense Test" illustrated in *March v. Stramere.*[12] This test takes into consideration both the causes attributable to the delay and then decides the question after examining both on the grounds of reason.[13]

Similarly, in Scotland, the judiciary has upheld the dominant cause approach in a more pragmatic sense. In the Scottish case of *John Doyle Construction Ltd v. Laing Management (Scotland) Ltd,*[14] the court opined that whenever there is any question of causation it must be resolved by, "*the application of common sense to the logical principle of causation.*"[15] On these lines, Lord Maclean stated that, "*It is frequently possible to say that an item of loss has been caused by a particular event notwithstanding, that other events played a part in its occurrence. In such cases, if an event or events for which the employer is responsible can be described as the dominant cause of an item of loss that will be sufficient to establish liability notwithstanding the existence of other causes that are to some degree at least concurrent.*"[16]

Furthermore, Lord Drummond Young in *City Inn Ltd v. Shepherd Construction Ltd* ("City Inn case") stated that, *"it may be possible to show that either a relevant event or a contractor's risk event is the dominant cause of*

[12] (1991) 171 C.L.R. 5061.
[13] *Supra* note 1.
[14] [2004] B.L.R. 295 IH (Ex Div).
[15] *Ibid.*
[16] *Ibid.*

that delay, and in such case, that event should be treated as the cause of the delay."[17]

However, even after getting some recognition from the judiciary, the dominant cause test is not a universally accepted method to determine the liability of delay since there are few inconsistencies in this approach. For instance, in situations where the reason for the delay in a construction project is two or more concurrent events with nearly equal efficacy of causation, none can be declared the dominant cause of the delay or loss. The same problem was pointed out by the Queen's Bench in the case of *H. Fairweather and Company Limited v. London Borough of Wandsworth*[18] where it was held that it is easy to apply dominant cause approach in situations where the dominant cause can be easily identified. However, it becomes nearly impossible when there are competing events of approximately equal causation. Moreover, in the UK the test of dominant cause has been invalidated in the case of *Petroleo Brasileiro v. Ene 1 Kos Ltd.*[19]

The aforementioned inconsistency was resolved by the Scottish court in the case of *City Inn Ltd. v. Shepherd Construction Ltd.*[20] wherein, the court applied the apportionment approach for assessing the issue of concurrent delay.

B. THE APPORTIONMENT APPROACH

[17] City Inn Ltd. v. Shepherd Construction Ltd., [2010] Scot. CS CSIH 68.
[18] [1987] 39 B.L.R. 106.
[19] [2012] U.K.S.C. 17.
[20] *Supra* note 17.

The apportionment approach is generally referred to determine the portion of the liability of the parties involved in the contract who are responsible for the concurrency in delay. This approach to determine the liability of the parties was developed by the Scottish courts in the aforementioned City Inn case.[21] The factors responsible for assessing the cause of delay can be said to be twofold, "*firstly, assessing the relative causative potency and secondly, the significance of the competing causes of delay*."[22] In the City Inn case, it was held, "…*where a situation exists in which two causes are operative, one being a relevant event and the other some event for which the contractor is to be taken to be responsible, and neither of which could be described as the dominant cause, the claim for extension of time will not necessarily fail. In such a situation, which could, as a matter of language, be described as one of concurrent causes, in a broad sense, it will be open to the decision-maker, whether the architect, or other tribunal, approaching the issue in a fair and reasonable way, to apportion the delay in the completion of the works occasioned thereby as between the relevant event and the other event.*"[23] This approach was found to be helpful in the cases, where there was no dominant cause for the delay and there was a concurrent delay, then the deciding body may apportion the liability between both the parties equitably and not equally. The principle is broadly developed out of the tortious principle of contributory negligence.[24]

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[21] *Supra* note 17.
[22] Michael Stokes & Samuel Widdowson, *Concurrent Delay: A Contractor Get Out of Jail Card or Employer Windfall?*, NAVIGANT (2014), https://mosaicprojects.com.au/PDF_Papers/P011_Concurrent_Delays-4.pdf.
[23] *Supra* note 17.
[24] David Barry, *Concurrent Delay in Construction Law,* 27 (3) CONSTI. L.J. 1 (2011).

The test of apportionment, however, was criticized by the English courts, as they follow the 'Malmaison approach'. This approach means, "*if there are two competing delaying events and one is identifiable as an employer risk event under the contract, then the contractor will be entitled to an extension of time.*"[25] This approach is also dealt with separately in the article. The stance taken by the court in *Walter Lilly v. Giles Mackay and DMW Developments,*[26] criticizes the use of the 'apportionment' principle while dealing with the issue of concurrency in delay. The court said, "*the fact that the Architect has to award a 'fair and reasonable' extension does not imply that there should be some apportionment in the case of concurrent delays. The test is primarily a causation one. It, therefore, follows that, although, of persuasive weight, the City Inn case is inapplicable within this jurisdiction.*"[27] Further, holding the 'Malmaison Approach' over 'Apportionment', the court held that, "*where there is an extension of time clause such as that agreed upon in this case and where delay is caused by two or more effective causes, one of which entitles the Contractor to an extension of time as being a Relevant Event, the Contractor is entitled to a full extension of time.*"[28] Furthermore, in the English case of *Tennant Radiant Heat v. Warrington Development Corporation,*[29] the court, after apportioning the damages between the parties treated such apportionment a matter of causation and therefore, it may be said that the "*approach of apportioning has not received much support in England.*"[30] However, the approach of apportioning the liability is not unwelcomed in every

[25] *Supra* note 22.
[26] [2012] E.W.H.C. 1773 (T.C.C.).
[27] *Ibid*.
[28] *Ibid*.
[29] [1998] 1 E.G.L.R. 41 (C.A.).
[30] *Supra* note 1.

jurisdiction and in fact, the courts in Canada,[31] New Zealand[32] and Hong Kong[33] have shown indications of adopting the apportionment approach.[34]

The courts in the United States of America ("USA") initially rejected the applicability of apportionment approach in concurrent delay,[35] despite the approach being followed in the past.[36] However, the approach was followed later by the courts in the USA. In American courts, the principle of apportionment was widely recognized and is accepted "*when a clear apportionment of the delay attributable to each party has been established*."[37] This practice of apportionment of the delay was developed only after the advent of computers and therefore, systematic delay analysis was possible.[38] The kind of apportionment generally practiced in the USA is the apportionment of 'time',[39] wherein the decision maker decides the number of days of delay attributed to each party and then fixes the

[31] Tompkins Hardware Ltd. v. North Western Flying Services Ltd., [1982] 139 D.L.R. (3d.) 329; Ribic v Weinstein, [1982] 140 D.L.R. (3d.) 258; Doyron v Caisse Populaire D'Inkerman Ltee, [1985] 17 D.L.R. (4d.) 660.
[32] Day v. Mead, [1987] 2 N.Z.L.R. 443 (C.A.); Mouat v Clark Boyce, [1992] 2 N.Z.L.R. 559 (C.A.).
[33] W. Hing Construction Co. Ltd. v. Boost Investments Ltd., [2009] B.L.R. 339.
[34] *Supra* note 1.
[35] R.P. Wallace Inc. v. The United States, C.O.F.C. (2004) No. 96-222 C.
[36] Coath & Gross Inc. v. United States, 101 Ct.Cl. 702 (1944); Commerce International v. United States, 167 Ct.Cl. 529 (1964).
[37] George Sollitt Constr. Co. v. United States, 64 Fed. Cl. 229, 238 (2005); Flatiron Lane v. Case Atlantic Co., 121 F. Supp. 3d. 515, 541 (M.D.N.C. 2015).
[38] F. Mastrandrea, *Concurrent Delay in Construction – Principles and Challenges*, 31 (1) INT'L CONSTRUCTION LAW REV. 83, 107 (2014).
[39] *Supra* note 8.

liability accordingly. However, where this practice is not possible (in cases where there is no possibility of computing the time of delay caused by either party) then the practice of 'jury verdict' is followed.[40] This practice (a different type of apportionment) meant that both the parties will be liable for the delay, in proportion to the delay and loss caused by the event attributable to them, not based on time but on the basis of the significance of that delay-causing act on the whole contract. This was also approved by the Scottish court in the *John Doyle Case*.[41] The approach, though secondary to the dominant cause approach, was widely applied in the major jurisdictions including the USA, Scotland and Canada etc., as seen above.

C. THE MALMAISON APPROACH OR THE EXTENSION OF TIME APPROACH

The Malmaison approach or the extension of time approach was named after the leading English case of *Henry Boot Construction (UK) Ltd. v. Malmaison Hotel (Manchester) Ltd*.[42] In this case, there was a 'Joint Contracts Tribunal' (UK) standard form of contract which did not expressly deal with the risk of concurrent delay. In this case, Justice Dyson stated, "*it is agreed that if there are two concurrent causes of delay, one of which is a relevant event, and the other is not, then the contractor is entitled to an extension of time for the period of delay caused by the relevant event notwithstanding the concurrent effect of the other event. Thus, to take a simple example, if no work is possible on a site for a week not only because of*

[40] *Ibid.*
[41] *Supra* note 14.
[42] (1999) 70 Con. L.R. 32, Q.B.D. (T.C.C.).

exceptionally inclement weather (a relevant event), but also because the contractor has a shortage of labor (not a relevant event) and if the failure to work during that week is likely to delay the works beyond the completion date by one week, then if he considers it fair and reasonable to do so, the architect is required to grant an extension of time of one week. He cannot refuse to do so on the grounds that the delay would have occurred in any event by reason of the shortage of labor".[43]

The underlying principle for this approach is that, if the delay is caused due to two or more concurrent events wherein one of the events was at the employer's risk then the contractor is liable to get an extension of time for the overall period of delay. Thus, rendering the contractor risk event completely immaterial.

This rationale was reiterated in the case of *Royal Brompton v Hammond,*[44] where, the court opined, *"In order to obtain an extension of time a contractor must show that the relevant event caused a delay to completion, and it is not enough that it is a relevant event."*[45] In addition to this, the Malmaison approach takes into consideration the 'Prevention Principle' - a widely recognized common law doctrine. According to this principle, a party cannot ask the other to comply with the obligations laid down in the contract if that party itself has not ensured fulfillment of the obligations.

Therefore, there would have been a violation of this common law doctrine if the contractor in concurrent delay cases were not guaranteed full extension of time for the delay caused by the

[43] *Ibid*.
[44] [2001] 76 Con.L.R. 148.
[45] *Ibid*.

employer's risk event.[46] The Court of Appeal in England has shown disagreement in this regard and has stated that 'Prevention Principle' is not applicable in a dispute that arises due to concurrent delay.[47]

The Malmaison approach for the assessment of delay in the construction contract, in the general sense, would only be applicable in the case of true concurrency i.e. delay caused by the events having at least equal causative potency. However, as per the reasoning given by Justice Dyson for the assessment of concurrent delay, it can be very well seen that he did not take into account complex cases of delay. Furthermore, the courts in Hong Kong have mostly relied on the Malmaison approach for assessing a dispute of concurrent delay. However, in recent developments, the courts have moved in favor of the apportionment approach.[48]

D. THE PREVENTION PRINCIPLE

Keating on Construction Contracts,[49] dictates that the historical background of the 'Prevention Principle' is "the notion that a promisee cannot insist upon the performance of an obligation which it has prevented the promisor from performing."[50]

[46] *Supra* note 1; *See infra* note 55.
[47] Jerram Falkus Construction Ltd. v Fenice Investments Inc., [2011] E.W.H.C. 1935; *See infra* note 57.
[48] *Supra* note 33.
[49] *Supra* note 7, at 8, 14.
[50] *Infra* note 55.

The approach of 'Prevention Principle' was further developed in the English case of *Peak Construction v. McKinney Foundations*,[51] wherein it was ruled, "*If the failure to complete on time is due to the fault of both the employer and the contractor, in my view the clause does not bite. I cannot see how, in the ordinary course, the employer can insist on compliance with a condition if it is partly his own fault that it cannot be fulfilled.*"[52]

The practice of 'Prevention Principle' was also followed by the English Court of Appeal in *Trollope & Colls v. North West Metropolitan Regional Hospital Board*,[53] wherein it was held that, "*It is well settled that in building contracts, when there is a stipulation for work to be done in a limited time, if one party by his conduct, renders it impossible or impracticable for the other party to do his work within the stipulated time, then the one whose conduct caused the trouble can no longer insist upon strict adherence to the time stated. He cannot claim any penalties or liquidated damages for the non-completion in that time.*"[54]

In other words, the rationale behind this principle is that either party cannot insist on the other party for the fulfillment of a contractual obligation, if that party itself has prevented the compliance of such an obligation.

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[51] [1970] 1 B.L.R. 111 (C.A.).
[52] *Ibid.*
[53] [1973] 1 W.L.R. 601 (H.L.).
[54] *Ibid.*

Justice Jackson in *Multiplex Constructions (UK) Ltd v. Honeywell Control Systems Ltd.*,[55] set out some propositions for the application of this principle to the extension of time clause :-

"(i) Actions by the employer which are perfectly legitimate under a construction contract may still be characterized as prevention if those actions cause the delay beyond the contractual completion date.

(ii) Acts of prevention by an employer do not set time at large if the contract provides for an extension of time in respect to those events.

(iii) Insofar as the extension of time clause is ambiguous, it should be construed in favor of the contractor."

Moreover, in *Percy Bilton v. Greater London Council,*[56] the court opined that in original course of the construction contracts the contractor is liable to complete work within the stipulated time-period, breach of which shall attract the liability over him for liquidated damages to be paid to the principal. Nevertheless, giving due regard to the 'Prevention Principle' the employer shall not be liable for any liquidated damages where his acts have prevented the fulfillment of the obligation under the contract.

However, there is an ongoing debate on whether this principle will be applicable in the cases of concurrent delay. In *North Midland Building Ltd v Cyden Homes Ltd.*,[57] where, the case dealt with the construction of a house in Midlands, the contractor asked for the

[55] [2007] E.W.H.C. 447 (T.C.C.).
[56] (1982) 20 B.L.R. 1.
[57] [2017] E.W.H.C. 2414 (T.C.C.).

extension of time due to certain relevant events, which caused a delay in the work. He contested that by applying the propositions laid down by Justice Jackson in *Multiplex Constructions (UK) Ltd v. Honeywell Control Systems Ltd.*[58] and the rationale of 'Prevention Principle', the clause prohibiting the extension of time in the contract is invalid and in situations like this, "time became at large" and the liability to pay liquidated damages to the employer becomes void. The claim of the contractor was rejected completely by the court at first instance wherein it relied on the obiter dicta given in *Adyard Abu Dhabi v SD Marine Services*[59] that, "*the act of prevention must render it impossible or impractical for the other party to do his work within the stipulated time.*"[60] The justification behind this is that the 'Prevention Principle' will not be applicable in situations where the contractor is also at fault.

The court further relied upon the reasoning given by Lord Justice Coulson in *Jerram Falkus Construction Ltd v Fenice Investments Inc (No.4),*[61] and found that, "*that the prevention principle would not apply where the contractor had not actually been prevented by an employer's actions because an earlier completion date would not have been achieved in any event due to the contractor's own concurrent delay.*"[62]

E. THE DEVLIN APPROACH

[58] *Supra* note 55.
[59] *Supra* note 2.
[60] *Ibid*; *See supra* note 26.
[61] [2011] E.W.H.C. 1935 (T.C.C.).
[62] *Supra* note 57.

This approach was named after and given by the English Judge Justice Devlin in the case of *Heskell v Continental Express.*[63] He observed that, *"if a breach of contract is one of two causes of a loss, both causes co-operating and both of approximately equal efficacies, the breach is sufficient to carry judgment for the loss"*.[64]

The Devlin approach has been appreciated and followed in *Banque Keyser Ullmann SA v. Skandia (UK) Insurance Co*,[65] and in *Great Eastern Hotel Company Ltd v. John Laing Construction Ltd.*[66]

Despite getting recognition from several jurisdictions around the globe, this approach has inherent loopholes in its application. The Devlin approach is applicable on both, the contractor for the loss he suffered and on the employer for liquidates damages. However, there might arise a situation where both the contractor as well as the employer claim loss for the same period of delay, which may make room for absurdity.

III. POSITION IN INDIA

Courts in India have not handled many cases related specifically to concurrent delay. In one of the few cases, the Delhi High Court held that the occurrence of concurrent delay, wherein the dominant cause of the delay is not attributable to the contractor, the contractor is entitled to a time extension.[67] However, neither the

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[63] [1950] W.N. 210.

[64] *Ibid*; *See* R N.M. Anderson, *Analysing concurrent delays*, 24 (7) CONSTRUCTION LAW JOURNAL 549,565 (2008).

[65] [1991] 2 A.C. 249.

[66] [2005] E.W.H.C. 181.

[67] Essar Projects (India) Ltd. v. GAIL (India) Ltd., (2014) 209 D.L.T. 754.

scope of contract law relating to the issue of concurrent delay nor the scope of entitlement of time extension was dealt with by the court. This left it unclear as to how the time extension would be granted and whether or not any additional costs would be imposed on any of the parties. Further, though the 'time delay and extension clause' is generally recognized in the Indian scenario, concurrent delay issues are not specified separately.[68] Therefore, despite many case laws relating to general delays in construction contracts, there is hardly any which specifically deals with issues of concurrent delays. Since Indian laws are based on common law, Indian courts will probably take the guidance of English courts in issues relating to concurrent delay and are thus, likely to follow the Malmaison Approach.

Now, during this period, when the issue is yet *res integra,* and an illustrative and comprehensive judicial decision is awaited, the parties entering into a construction contract may draft a clearly worded clause dealing with the issue of concurrent delay. Further, they may pre-decide the conditions for the extension of time and payment of compensation, in case there is a concurrent delay and also the attributability of the delay caused.

Notably, 'delays' are categorized into two broad types – (i) excusable and (ii) inexcusable, and concurrent delay falls under excusable delay if the dominant cause of the delay is attributable to

[68] K.C Iyer, Gunesh Joshi & N.B. Chaphalkar, *Understanding time delay disputes in construction contracts*, 26 (2) INTERNATIONAL JOURNAL OF PROJECT MANAGEMENT 174, 184 (2008).

the owner.[69] However, if the dominant cause is attributable to the contractor, then it is an inexcusable delay and therefore, the extension may not be granted. In such cases, Section 55 of the Indian Contract Act may apply.[70] The provision discusses the effect of failure to perform an obligation in a contract, where time is essential. In such cases, the effect is that the contract becomes voidable at the option of the owner.[71] In commercial contracts, time is mostly of essence,[72] and since construction is one of the commercial services,[73] hence, in construction contracts, time would always be an essential feature. However, the Supreme Court in *McDermott International Inc. v. Burn Standard Co. Ltd.,*[74] held that, "*in construction contracts, the time is of essence only when a special feature exists.*"[75] The term "special feature" was not defined or expanded by the court anywhere and therefore, the scope of this holding remains unclear. However, Section 52 of the Indian Contract Act provides for fixing the time for performing the obligations. Thus, if the time of performance is pre-decided by the parties, then it may be presumed that the parties intend to make time an essence of that contract,[76] then the first part of Section 55 shall apply.[77] Therefore,

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[69] Khyati Rathod and Niharika Dhall, *India: Delays in Construction Projects*, MONDAQ (Jan. 24, 2018, 10:00 AM) https://www.khaitanco.com/Publications Docs /MondaqKCOCoverage24JanKHR.pdf.
[70] The Indian Contract Act, 1872 (No. 9 of 1872) ["Indian Contract Act"].
[71] *Ibid*.
[72] China Cotton Exporters v. Beharilal Ramcharan Cotton Mills Ltd., AIR 1961 SC 1295; Peeco Hydraulic Pvt. Ltd. v. East Anglia Plastics (India) Ltd., (1987) 1 Cal. L.T. 551.
[73] AVTAR SINGH, CONTRACT AND SPECIFIC RELIEF ACT 379 (12th ed. 2017).
[74] (2006) 11 SCC 181.
[75] *Id.,* at 218.
[76] Section 55, Indian Contract Act.

in cases of inexcusable concurrent delay, the Indian Contract Act shall be applicable, but the problem occurs when the dispute is of an excusable concurrent delay. In such cases, usually, the parties attempt to saves themselves from the liability of delay and confusion is created regarding the dominant cause. This invites disputes, litigation, arbitration, etc. and thus, there is an urgent need to clearly define the scope of applicability of provisions concerning time of performance under the Indian Contract Act, especially with respect to concurrent delay.

Though, it is clear, that the excusable concurrent delay shall result in extension of time to the contractor and the inexcusable shall result in the contract becoming voidable at the option of the owner; however, to specify the excusable and the inexcusable in itself is a very laborious task and to determine the dominant cause of delay is quite grueling. In these circumstances, a straight-jacket formula would not help. A set of comprehensive guidelines are needed to cover the relevant factors and criteria, which could specify a 'concurrent delay' as excusable or inexcusable. The real estate sector contributes significantly to the Indian Economy, and construction contracts often include hefty assets of the parties and therefore, it is imperative for the Indian legislature and judiciary to address to this issue, rather than leaving it to arbitrators. The above discussion indicates that the problem of finding a dominant cause is the root of the issue of concurrent delay. Hence, the solution needs to address this root and accordingly, the law needs to be clear on the appropriate criteria to determine a dominant cause.

[77] *Ibid*.

IV. SUGGESTION IN RESPECT OF TRADITIONAL AND MODERN APPROACHES

A. THE OLD SCHOOL APPROACH OR THE TRADITIONAL APPROACH

Traditionally, in dealing with the issue of concurrent delay, the courts have applied the rule that in cases where both contractor's event and employer's event contribute in the delay, neither of them were permitted to claim damages.[78] The basis behind this approach is that when there can be no reasonable means to determine the cause of the delay and which party is responsible for the cause then none shall be permitted to recover damages.

B. THE MODERN METHOD

With the advancement in the legal principles and approaches, courts have moved a step forward and have taken the modern method in assessing the delay. According to the modern method, either party is entitled to recover the loss only if apportionment of delay can be easily deducible to each of the parties. However, whenever there arises some difficulty to determine the delay the courts follow a traditional approach and prohibit the parties from recovering the loss.[79] The problem only arises in determining what should be the basis of an apportionment - time, fault or damages.

For centuries, various jurisdictions have used their methodologies in assessing the issue of concurrent delay, however, none of the them

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[78] United Constructors, LLC v. United States, 95 Fed. Cl. 26 (2010).
[79] Essex Electro Engrs., Inc. v. Danzig, 224 F.3d. 1283 (Fed. Cir. 2000).

have been granted universal acceptance due to their specific drawbacks. Therefore, the authors, in this respect, tend to suggest that because there is no universal approach to deal with concurrent delay disputes, the parties to a contract should be vigilant and draft the clauses of the contract in a very clear and unambiguous manner that specifies the method that the parties wish to adopt in determining the liability of the concurrent delay.

V. CONCLUSION

The issue of concurrent delay did not take an obverse position when it comes to contemporary legal problems requiring urgent solutions. There have been a number of landmark cases involving an issue of concurrent delay; however, the inconsistencies in different approaches to solve the problem has caused the issue to be a *res integra.* In the backdrop of this, it becomes imperative to strike an appropriate uniformity in different approaches to the problem of concurrent delay, as construction contracts also involve parties from two different jurisdictions and the applicability of law becomes tricky, further making the resolution of the dispute very difficult and often, more complicated.

The Scottish case of *City Inn* led to the development of the principle of apportionment, which was later modified by the courts in the USA, where the *Malmaison Case,*[80] developed the Malmaison approach and is also followed by the English courts. The principle of apportionment was a newer approach and was based on the capability of decision-makers' mental faculties. Notably, there are

[80] *Supra* note 42.

also other approaches like the Devlin approach or the Prevention Principle, which makes the resolution of a dispute over concurrent delay even more inconsistent. In the Indian context as well, as identified above, clarity on the scope of applicability of the Indian Contract Act is yet to be achieved. Therefore, there is an urgent need for legislators across jurisdictions to address the inconsistencies at the earliest by providing authoritative guidelines or directions. This would enable courts to take reasonable and appropriate decisions in claims of concurrent delays.