

Trading in shares of a Company undergoing CIRP- Whether Restricted?

*-By Mr. Rohit Dubey, Advocate, Company Secretary, Senior Associate JMVD Legal and
Mr. Yash Hegde, Associate JMVD Legal*

Investors tend to react upon sudden corporate actions, news or events. The quantum of reaction majorly depends upon the level of impact that the said action, news or event may cause. An example of such an event can be initiation of Corporate Insolvency Resolution Process of a listed company. In such an event, the retail shareholders generally try to sell their stocks (to the extent possible) under a fear of the extent of exit payments they will get when the company is under insolvency and the creditors are awaiting their recoveries. In some cases, even the non-public shareholding is also sold and a market based exit route is taken.

To put it simple, equity has the last claim over any assets of a company, after dues to the government, financial institutions, other creditors and bondholders are paid off. The Insolvency and Bankruptcy Code, 2016 ("IBC") puts financial institutions and workers' dues at the top of the list, before statutory dues, but equity shareholders stay at the bottom. Hence, here what needs to be seen is that, does selling off of shareholdings by public and non-public shareholders construe receipt of payments in priority to other creditors or is somewhere restricted under the IBC regime? This issue will be dealt with in this article.

With respect to the price to be paid to shareholders, in line with the objective of the IBC it is clear that the exit to shareholders will be at price which is not less than the liquidation value as determined under Regulation 35 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 ("CIRP Regulations") after paying off dues in accordance with Section 53 of the IBC. In this regard it is pertinent to note that often times, in case of a company undergoing CIRP, the liquidation value due to shareholders would be NIL and hence, shareholders may not be paid any amount as exit price. Promoters play an important role in the functioning of a company. They are the one who come up with the idea of creating the company and incorporate there innovative idea into the company. The promoters stand in a fiduciary relationship with the company and by virtue of this relationship they owe a duty of loyalty, care and protection towards the company. However, despite this there are times when the company fails to stand strong and repay its obligations and thereby goes into debt. Now when a company makes a default in payment of dues CIRP is initiated to revive the company, failing which it goes for liquidation.

The IBC and the CIRP Regulations, doesn't specifically bar trading in securities of a listed company during its CIRP. A connected provision can be found in Section 28 of the Code, wherein the sub-section (1) (d & i) mandatorily requires the Resolution Professional (RP) to take prior approval (66 percent) of the COC before recording any change in the ownership interest of the corporate debtor, and before disposing of or permitting disposal of shares of any shareholders of the corporate debtor or their nominees to third parties. Accordingly, sale of substantial portion of shareholdings by the Promoter/Promoter Groups may qualify as change in ownership interest of corporate debtor, and will surely qualify to be a disposal of shares by shareholders of the corporate debtor. But here what needs to be analyzed further is that whether the sale of shares by the Promoter/Promoter Groups/Directors falls within the ambit of Section 28 (1).

Now let's analyze section 28. The section starts with a non-obstante that "*Notwithstanding anything contained in any other law*", thereby giving Section 28 overriding powers over all other laws in force. The Section then proceeds further, and restricts power of the Resolution Professional to act without COC's prior approval in relation to certain actions listed in Sub-Section (1). Further, the Sub-Section (2) requires Resolution Professional to convene meeting of COC and seek votes prior to taking of any of the actions under (1). Further, the Sub-Section (4) declares that any action taken without following procedure under the Section, shall be void. And finally Sub-Section (5) entitles COC to report any action of RP in contravention to Section 28, to the Board.

As far as the Section 28(1)(d) is concerned, the RP is only under duty to take prior approval of COC in recording change in ownership interest. But, when the corporate debtor is a listed entity and its share are traded freely in dematerialized form, also the recording of transfer of shares (or maintaining register and index of beneficial owners) is also done by the Depository under Section 11 of the Depositories Act, 1996 R/w. Section 88 (3) of the Companies Act, 2013. However, as a prudent practice the RP should intimate the RTA along with the depository about such transactions in detail thereby also apprising them upon the provisions of Section 28(1)(d) of the Code.

As far as the Section 28(1)(i) is concerned, the RP is only under duty to not permit disposal of shares of the corporate debtor without prior COC approval. As defined by the Hon'ble Supreme Court in *CST v. Thomas Stephen & Co. Ltd.* [(1988) 2 SCC 264], the word "Disposal" means transfer of title in the goods (including shares) to any other person or to transfer or alienate any property. But practically in such sale, neither a permission has been sought from RP and nor the RP has given any permission to the promoters.

As it can be understood by reading Section 28(1)(i), that there is a restriction on Resolution Professional to not dispose or permit disposal of shares, but at the same time the Section nowhere restricts any person other than the Resolution Professional to sell/dispose its holdings.

Now the question that arises is that, whether being in knowledge of such shares being sold can the RP be deemed to have provided the permission for disposal of shares? In order to answer this question, first we need to observe that the Section 28(1)(i) requires a two level clearance for a person (who disposes the shares after obtaining permission of the RP) for disposal of shares of any shareholder to third parties, **one being approval** from COC and **other being permission** from RP. The words "approval" and "permission" had been defined by the Hon'ble Supreme Court in *LIC v. Escorts Ltd.* [(1986) 1 SCC 264], "**in 'approval' the act holds good until disapproved, while in 'permission' it does not become effective until permission is obtained.**" This appears to be the reason behind use of word "prior" before the word "approval" in Section 28, so as to impose compulsory taking of approval before doing an act. **Hence, until the permission has been granted, the RP cannot be deemed to have given any such permission.**

Additionally, in case of a listed entity, its share are traded freely in dematerialized form also the recording of transfer of shares (or maintaining register and index of beneficial owners) is also done by the Depository under Section 11 of the Depositories Act, 1996 R/w. Section 88 (3) of the Companies Act, 2013. Hence, the RP cannot be said to have permitted any such transfers.

Now moving towards other duties of RP. A RP is required under Section 20 of the Code, to make every endeavour to protect and preserve the value of property of the corporate debtor and manage the operations of the corporate debtor as a going concern, and under Section 25 to preserve and protect the assets of the corporate debtor and to prefer

application for avoidance transaction if found. But, the transactions of sale by shareholders of the company cannot be treated as being detrimental to assets of debtor.

Apart from the above, until date there hadn't been any law that directly curbs trading in shares of the company in CIRP. The Securities Exchange Board of India (SEBI) in May 2018 issued the "**Discussion Paper on Compliance with SEBI Regulations by listed entities undergoing Corporate Insolvency Resolution Process under the Insolvency and Bankruptcy Code, 2016**", therein in Annexure A-10 the SEBI has showed its view on the **trading of shares** in the following manner:-

"Trading in stock exchange - In addition to assessment of risk-reward trade-off, liquidity of the investment is also an important factor for an investor evaluating investments in equity. Deep and reliable secondary market for purchase and sale of shares is one of the vital elements of securities market. As such, continuation of trading in the scrip of listed corporate debtor would facilitate transparency and better price discovery and would therefore, be in the interest of investors. However, continued trading on the stock exchanges would depend on such companies meeting the listing standards of the exchanges. Accordingly, comments are sought on whether it is desirable to impose any fetters on the transferability of shares of listed corporate debtors by introducing restrictions on trading in stock exchange.

But, any regulation/ circular/ guidance on this aspect is awaited from the side of the SEBI.

However, a restriction with respect to the transfer of shares by promoters of the corporate debtor can be out of the loan/security creation documents of the Corporate Debtor with its lenders, wherein the mandatory covenants accepted by the promoters/guarantors of corporate debtor usually contain a restriction on transfer of the shares without prior permission of the lender. But some more clarity in such situations is yet to come.