Calcutta High Court
Aditya Khaitan And Ors vs Il And Fs Financial Services on 12 January, 2021
ODC-3

AP/206/2020

IN THE HIGH COURT AT CALCUTTA
Ordinary Original Civil Jurisdiction
ORIGINAL SIDE

ADITYA KHAITAN AND ORS.
Versus
IL AND FS FINANCIAL SERVICES

BEFORE:
The Hon'ble JUSTICE MOUSHUMI BHATTACHARYA
Date : January 12, 2021.

(Via Video Conference)

Appearance :
Mr. Joy Saha, Sr. Adv.
Mr. Padam Khaitan, Adv.
Mr. Srinjoy Bhattacharya, Adv.

Mr. Ratnanko Banerji, Sr. Adv.
Mr. Rishad Medora, Adv.
Ms. Ramya Hariharan, Adv.
Mr. Soumava Mukherjee, Adv.

The Court : This is an application under Section 9 of The Arbitration and Conciliation Act, 1996, in which the petitioners seek to restrain the respondent from selling or dealing with 1,61,29,000 Compulsorily Convertible Preference Shares (CCPS) of the petitioner No.3, McNally Bharat Engineering Company Ltd. which were subscribed by the Respondent on a private placement basis under agreements entered into between the parties herein. The dispute touches three agreements, namely, a Share Subscription and Shareholders' Agreement, an Option Agreement and two Pledge Agreements, all of which were executed on 27th March, 2018. The trigger to the application is a notice dated 2nd July, 2020 issued by the respondent for invoking and selling the shares pledged to the Respondent.

By an order dated 30th July, 2020, the respondent had been restrained from selling any further shares which form the subject matter of the notice of invocation dated 2nd July, 2020. The order

was passed on the premise that the respondent had proceeded to sell the pledged shares and that the matter would be considered further after a complete disclosure of the relevant documents by the parties.

Since the parties have argued on the maintainability of the application, this issue is being considered first.

Mr. Ratnanko Banerji, learned senior counsel appearing for the respondent/IL & FS (Financial Services (in short, IFIN), places an order of moratorium passed by the National Company Law Appellate Tribunal (NCLAT) on 12th March, 2020 in the matter of Union of India vs. Infrastructure Leasing & Financial Services Ltd. & Ors. to urge that the present application is not maintainable. By the said order, a moratorium/stay was directed against the institution or continuation of suits and other proceedings against IL & FS and its 348 group companies in any court of law/Tribunal, etc. and in respect of any action of recovery or enforcement of any security interest created over the assets of IL & FS and its group companies. Counsel submits that the order of moratorium and other similar orders passed by the NCLAT have not been challenged and that the NCLAT is empowered to pass such orders under section 242(4) of The Companies Act, 2013.

Mr. Joy Saha, learned senior counsel appearing for the petitioners, argues that the order of the NCLAT was passed in the larger public interest and economy of the nation and interest of the company and 348 group companies and also that the restraint on institution of suits, etc. was in the context of section 241 and 244 of The Companies Act, 2013 relating to "oppression and mismanagement" which do not contain any provision for imposition of moratorium. Counsel submits that an order in the nature of a moratorium can only be passed under section 14 of The Insolvency and Bankruptcy Code, 2016 and that in any event the order is not binding on this court.

On the issue of maintainability, this court is of the view that the order of NCLAT was passed in the larger public interest which would be evident from the very first paragraph of the order in which an opinion of the Central Government on the affairs of IL & FS was referred to and the NCLAT was of the view that an order of stay on the institution of suits including actions for recovery/enforcement of any security interest in IL &FS was necessary for safeguarding the economy of the nation and the interest of IL & FS and its 348 group companies. The order of the NCLAT on which IFIN wants to rely on has been substantially diluted by a suit filed by IFIN against the petitioner no.1 herein and others being CS no.177 of 2019 seeking recovery of money from the petitioners. In any event, the order of the NCLAT makes it clear that the objective of the restraint was to protect and preserve the assets of the IL & FS in the larger public interest. Hence, an application under Section 9 of the 1996 Act for restraining IFIN from dealing with or transferring certain shares cannot be equated with the objective of the order of the NCLAT. The objection with regard to maintainability of the present application is hence rejected for the above reasons.

Whether the present application is maintainable in the absence of an arbitration clause in the Pledge Agreements The petitioners contend that the Pledge Agreements arose out of the Share Subscription Agreement and the Option Agreement executed between the petitioners and IFIN, the respondent herein. Both the Share Subscription Agreement, as well as, the Option Agreement contain

arbitration clauses and the latter provides for securing the fulfillment of all the obligations of the Option Counterparties by creation of certain securities in favour of the Investor, IFIN. According to the petitioners, the Pledge Agreements are mere instruments for securing the performance of the Share Subscription Agreement and the Option Agreement and it is immaterial that the Pledge Agreements do not contain an arbitration clause.

The contention of the petitioners has to be seen against the background of the agreements executed between the parties for securing the rights of IFIN for subscribing to the Compulsorily Convertible Preference Shares (CCPS) of McNally Bharat with regard to the facility executed by Williamson Magor as evident from the Option Agreement. The Exclusive Pledge Agreement between Williamson Magor and Company, Amritanshu Khaitan, Aditya Khaitan and IFIN dated 27th March, 2018 provides the details of all the obligations of the Option Providers i.e. Amritanshu Khaitan and Aditya Khaitan including the amounts payable under the Option Agreement. As security for the performance of the obligations of the put option providers including the amounts payable under the Option Agreement, the Pledgor (Williamson Magor and Company) pledged certain securities described in the schedule to the Pledge Agreements in favour of the IFIN, the investor.

The fact that the present dispute between the parties relates only to the Pledge Agreements would appear from the following:-

(i) In the present application, the petitioners have prayed for an injunction restraining IFIN from selling or dealing with the shares described in the Schedule to the Pledge Agreements.

(ii) The Pledge Agreements, namely the Exclusive Pledge Agreement and the Pari Passu Pledge Agreement are contracts independent of the Share Subscription Agreement and the Option Agreement, which were executed prior to the Pledge Agreements.

(iii) IFIN is admittedly exercising its right under Clause 6.2 (b) of the Exclusive Pledge Agreement and the Pari Passu Pledge Agreement for invocation and sale of shares pledged to IFIN under the Pledge Agreements dated 27th March, 2018, which would be evident from the Notice of Invocation and Sale of Shares issued by IFIN on 2nd July, 2020.

(iv) The pledge of shares has specifically been created by the two Pledge Agreements and not by the Share Subscription Agreement or the Option Agreement, which would be evident from Clause 8 of the Option Agreement, which contemplates the creation of certain securities in favour of the Investor (IFIN) together with necessary

documentation to the satisfaction of the Investor.

The question is whether IFIN would have been entitled to call for invocation and sale of the pledge shares in the absence of the Pledge Agreements and whether the sale of pledge shares could have been done solely on the basis of the Share Subscription and the Option Agreements. The answer must be in the negative since the above points clearly show that the present application has been triggered by IFIN's notice of Invocation and Sale of the pledged shares dated 2nd July, 2020. IFIN has exercised its rights under the Pledge Agreements and the issue whether the Share Subscription Agreement or the Option Agreement contain arbitration clauses is irrelevant to the issue of whether the present application is maintainable. In other words, since the Pledge Agreements do not contain arbitration clauses, the present application filed by the petitioners under Section 9 of the Arbitration and Conciliation Act, 1996, is not maintainable.

Whether IFIN has lawfully exercised its rights under the Pledge Agreements In relation to this issue, the rights and obligations of the parties arising out of the various agreements is required to be briefly stated. IL & FS Financial Services Ltd. (IFIN) being a wholly owned subsidiary of IL & FS subscribed to Rs. 1,61,29,000 Compulsorily Convertible Preference Shares (CCPS) on a premium aggregating to Rs. 999,998,000 (described as the "Facility") issued by the McNally Bharat on a private placement basis on the terms and conditions of a Share Subscription Agreement dated 27th March, 2018. IFIN also entered into an Option Agreement on the same date with Aditya Khaitan, Amritanshu Khaitan and Williamson Magor (described in the agreement as "Option Counterparties") under which IFIN had a put option on the Option Counterparties in respect of the "Facility". The facility was thereafter secured by pledge of shares of Eveready Industries India Ltd. (EIIL) by Williamson Magor vide a Pledge Agreement dated 27th March, 2018 (the Exclusive Pledge Agreement) and a further pledge of shares of Mcleod Russel pledged by Williamson Magor, Bishnauth Investments and Williamson Financial Services Ltd. under a Pledge Agreement dated 27th March, 2018 (the "Pari Passu Pledge Agreement") in favour of IFIN. Under the terms of the Agreements, the Pledgor and the Option Counterparties ensured that IFIN stood secured for the subscription to the Compulsorily Convertible Preference Shares.

The petitioners failed in their obligations under the agreements which would be evident from a notice dated 10th May, 2019 issued by IFIN to the petitioners reiterating the occurrence of the factum of default. The defaults committed by the petitioners were specified in the notice of 10th May, 2019 and specified the defaults on the part of the petitioners including failure to pay over-dues, failure to maintain the requisite security cover and private cash top-up etc. The notice also mentions that IFIN had exercised its put option on 26th March, 2019 in terms of the Option Agreement and had asked the Option Counterparties to discharge their financial debt to IFIN. The notice further clarifies that in view of the ongoing default on the part of the petitioners, IFIN may take steps under the agreements and exercise its right in respect of the shares pledges in favour of IFIN. It was also made clear that IFIN is entitled to sell and dispose of the shares invoked in tranches or in full for realizing the amounts outstanding to IFIN.

A letter of 1st April, 2019 issued by Williamson Magor to IFIN, is relevant in the context of IFIN's right to invoke and sell the pledged shares. In this letter, Williamson Magor admits that it is facing a

cash crunch and has started selling its Tea Estates including its stake in a leading listed company of the group which would translate to a cash cushion of Rs. 1,000 cr. Significantly, Williamson Magor expressed its intention of buying out the shares subscribed by IFIN in McNally Bharat and requested 60 days time for purchasing the CCPS from IFIN in a phased manner. The letter also records that IFIN has already sold 1,77,100 shares of Eveready Industries. The admission of financial liability of Williamson Magor would also appear from an acknowledgement of its Chartered Accountant, which records the liability of Williamson Magor towards IFIN in its books of accounts in the first quarter of the financial year 2019-2020. Note-54 in the annual report of Williamson Magor for 2019-2020 also reiterates this position. The correspondence as stated aforesaid, shows that the petitioners, particularly Williamson Magor had defaulted in their payment obligations to IFIN under the agreements and were put on notice of the fact of default. By reason of the continuing default, IFIN was constrained to issue the letter dated 10th May, 2019 putting the petitioners on notice that IFIN would be at liberty to exercise its rights under the Pledge Agreements. The failure on the part of the Williamson and the petitioners to honour its financial obligations to IFIN culminated in the notice of invocation and sale of shares dated 2nd July, 2020 pledged to IFIN under the Pledge Agreements. The fact that IFIN was entitled to act under its rights secured vide the Pledge Agreements, would also appear from the suit filed by IFIN against Aditya Khaitan and Ors. in C.S No. 177 of 2019 for recovery of about Rs. 117 cr. from the defendants.

The sequence of events, therefore, goes to show that IFIN was entitled to exercise its rights under the Pledge Agreements, which is reinforced by the unequivocal admission on the part of Williamson Magor that it was in financial distress and needed time to purchase the CCPS from IFIN. The resistance of the petitioners to IFIN selling the pledged shares also finds a discordant note in an order dated 3rd September, 2019 passed in an interim application in the suit filed by IFIN. The said order records the stand taken by Mcleod Russel India Ltd. relying on the Option Agreement and asserting that the remedies of IFIN lie in realizing its dues under the Option Agreement by selling the shares which remain pledged with IFIN. It is further significant that the petitioners have not put up a credible defence to the financial debt owed to IFIN. Admittedly, the current dues are more that Rs. 100 cr. and there is no existing order of the Court including that of the Ld. Single Judge dated 3rd September, 2019 or the Division Bench dated 25th November, 2019 in the suit filed by IFIN, which gives any measure of protection to the petitioners. Whether the letter of IFIN dated 16th October, 2019 indicates that it was not in a position to buy back the CCPS/ Equity Shares of McNally Bharat.

By this letter, IFIN made it clear that McNally Bharat was already aware that IFIN had exercised its Put Option under the Option Agreement on 26th March, 2019. This position was reiterated by IFIN by a further letter dated 23rd December, 2019. IFIN's rights in relation to the Option Agreement would be clear from Clause 2 of the Option Agreement dated 27th March, 2018. Under this Clause - "Put Option", in return for the Subscription to the CCPS made by the Investor (IFIN), IFIN is granted the right, during the Put Option exercise period, to require the Option Counterparties to purchase all the option shares in accordance with Clause (2) of the Option Agreement. The term "Put Option exercise period" has been defined in Clause (1) of the Agreement as any period after the expiry of 12 months from the date of allotment of the CCPS till 18 months from the date of allotment of the CCPS or any time after the occurrence of an event of default (underlined for emphasis). The

term "Option Shares" has been defined in Clause (1) of the Agreement as the Subscription CCPS or the equity shares of McNally Bharat held by the Investor IFIN at the time of exercising the Put Option. The fact that a continuing event of default existed would be evident from IFIN's letter of 10th May, 2019 which referred to at least four prior notices specifying that an event of default had occurred under the Option Agreement.

Clause (2) of the Option Agreement hence makes it clear that on the occurrence of an event of default, IFIN had the right to exercise its Put Option and require the Option Counterparties to purchase the CCPS subscribed to by IFIN. Admittedly, the Option Counterparties, namely Williamson Magor, Aditya Khaitan and Amritanshu Khaitan failed to purchase the CCPS pursuant to IFIN exercising its option under Clause (2) of the Option Agreement. The onus therefore was not on IFIN to acquire the shares but on petitioner nos. 1, 2 and 4 to purchase the CCPS which had been subscribed to by IFIN. The arguments made on behalf of petitioners that IFIN had acquired the CCPS on the latter being converted to equity shares and was hence sufficiently protected, cannot be a ground to restrain IFIN from exercising its rights under the Option Agreement. It should also be stated that the conversion of CCPS to equity shares took place by reason of operation of law, more specifically under Regulation 162 of the SEBI (Issue of Capital and Disclosure Requirements) Regulation, 2018 and none of the parties had any role to play in the said conversion. It is also an admitted fact that more than Rs.100 crores presently remains outstanding to IFIN. The petitioners have not been able to establish a substantial defence on merits that a sum in excess of Rs.100 crores is not due and owing to IFIN. The contention of IFIN that the shares are presently of negligible value is not a fact which the Court can take into consideration at this point of time. The most relevant factor however is that IFIN has lawfully exercised its right under the Pledge Agreements and in the absence of a substantial defence to the same, cannot be restrained from doing so.

It should also be emphasized that agreements of the nature forming the subject-matter of the present dispute are essentially for facilitating sale and purchase of commodities including shares between contracting parties. Such transactions form, what is popularly described as the backbone of the "lifeblood of commerce" and unless parties are held to their contractual obligations, the smooth functioning of commercial transactions would be irrevocably hampered. After all, parties who voluntarily enter into a contract cannot be permitted to resile from terms which may become inconvenient at a subsequent date unless there are compelling reasons attributable to all the contracting parties for allowing the same.

The order dated 30th July, 2020 restraining IFIN from selling any further shares, described as the "balance shares" in the order, in terms of the notice dated 2nd July, 2020 was passed on the basis that the interest of the parties should be preserved till the disputed questions were fully heard out. The order was passed at a stage before IFIN disclosed its documents by way of an affidavit. The order was also passed on the premise that the petitioners were presumably caught unawares of IFIN proceeding to sell a tranche of shares under the Pledge Agreements did not have any particulars of such sale. This presumption would be belied by a letter of 1st April, 2019, subsequently disclosed by IFIN in its affidavit. This letter from Williamson Magor to IFIN contains an unambiguous acknowledgment that Williamson Magor was fully aware that IFIN would proceed to take steps in terms of the Agreements entered into between the parties. It was on this basis that Williamson

Magor expressed its intention to buy out the CCPS in a phased manner. Notably, the letter indicates that Williamson Magor, as on 1st April, 2019, was aware that IFIN had already sold 1,77,100 shares of Eveready Industries India Limited : in fact the phrase used is "As authorised by us you have already sold 1,77,100 shares of Eveready Industries India Limited ...". The stand taken by Williamson Magor is further reiterated by a disclosure of Williamson Magor to BSE Limited, the National Stock Exchange and the Calcutta Stock Exchange on 16th July, 2020 stating that 1,88,032 equity shares of Eveready Industries held by Williamson Magor was invoked by IFIN on 14th July, 2020 and that intimation of such was received by Williamson Magor on 15th July, 2020. Similar letters were issued by Williamson Magor on 17th July, 2020 and 20th July, 2020 involving other equity shares of Eveready Industries. As would be evident from these documents, the presumption on which the Court passed the injunction, was factually incorrect and is now required to be revisited.

One other issue needs to be addressed ; the interim order dated 30th July, 2020 took into consideration preservation of the subject matter till the matter was finally heard out, the concern being that the arbitration, when commenced, would have something to decide upon. Having held that the Pledge Agreements do not contain an arbitration clause, that consideration is no longer material. Shares being of ordinary monetary value, the petitioners can always pursue a claim for damages in an appropriate proceeding.

The decisions cited on behalf of the petitioners essentially deal with the question whether a statement contained in a balance sheet can constitute an unconditional acknowledgement of debt. V. Padmakumar vs. Stressed Assets Stabilisation Fund: 2020 SCC OnLine NCLAT 417, a decision of the National Company Law Appellate Tribunal was primarily concerned with the issue of limitation under section 18 of The Limitation Act, 1963. Notably, in the same decision however, it was held that balance sheet/annual returns of a corporate debtor can indeed amount to an acknowledgement of debt. G. Eswara Rao vs. Stressed Assets Stabilisation Fund : 2020 SCC OnLine NCLAT 416 was also concerned on whether the date of default can be forwarded to a future date under section 18 of The Limitation Act.

In the view of this Court, these cases cannot assist the petitioners for injuncting IFIN from proceeding in terms of enforcing its right under the Pledge Agreements. Even if this Court were to disregard the annual returns of Williamson Magor for 2019-2020, the question with regard to IFIN being lawfully entitled to enforce its right under the Pledge Agreements remains undisturbed.

For the above reasons, the order dated 30th July, 2020 restraining IFIN from exercising its rights under the relevant agreements and selling the balance shares, is vacated.

AP 206 of 2020 does not disclose any grounds for granting the reliefs prayed for and is accordingly dismissed without any order as to costs.

(MOUSHUMI BHATTACHARYA, J) sg/TO/kc/RS