IN THE NATIONAL COMPANY LAW TRIBUNAL
ALLAHABAD BENCH, PRAYAGRAJ

CP (IB) No. 392/ALD/2019

In the matter of:
An application for initiating Corporate Insolvency Resolution Process under Section 7 of Insolvency and Bankruptcy Code, 2016 r/w Rule 4 of the Insolvency & Bankruptcy (Application to Adjudicating Authority) Rules, 2016.

In the matter of:
Mahesh Sharma
Son of Mr. Mohari Sharma
128, Shrinagar Extension, Near Kalindi Park,
Indore-452018

... *Financial Creditor*

Versus

Onspon Services Pvt Ltd.
Having its registered office at:
38/1, Moti Kunj,
Agra, (Uttar Pradesh)-282002

... *Corporate Debtor*

Coram:
Shri Praveen Gupta. : Member (Judicial)

Shri Ashish Verma : Member (Technical)

Appearances (through physical hearing):

For Financial Creditor : Ms. Babita Jain, Adv.

For Corporate Debtor : Sh. Aishwarya Pratap Singh, Adv.

Order pronounced on: 31.03.2023

-Sd- -Sd-

ORDER

1. This Application has been filed by the Applicant, Mr. Mahesh Sharma under Section 7 of the Insolvency & Bankruptcy Code, 2016 (hereinafter referred as I&B Code, 2016) read with Rule 4 of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules 2016 in Form 1 containing all the information as required in Part I, II, III, IV and V of the Form, against the Respondent, M/s Onspon Services Pvt. Ltd., which is a company engaged in the business of event management and sponsorship. Applicant, Mr. Mahesh Sharma is treated as Financial Creditor and the Respondents, M/s Onspon Services Pvt. Ltd. is treated as Corporate Debtor in terms of the provisions of Section 7 of the I&B Code, 2016. This application has been filed by the Financial Creditor for initiating corporate insolvency resolution process (hereinafter referred as CIRP) against the Corporate Debtor providing details of default occurred due to non-payment of a financial debt amounting to Rs. 17,70,000/- as computed in Part IV of the Application in Form 1.

2. The facts leading to filing of this Application as discussed in the Form 1 are as below:

2.1 The Corporate Debtor, namely, Onspon Services Private Limited allotted 1486 Optionally Convertible Preference Share (hereinafter referred as OCPS) of Rs. 1000/- each bearing certificate number 01 to Mr Mahesh Sharma on 15th June 2016.The Share Subscription Cum Shareholders Agreement (hereinafter referred to as the Shareholders Agreement) in its Article 8.2(b) stated that if the OCPS is not converted within the first two years, that shall be redeemed by the company to investors along with the simple interest of 6% per annum. Also, Article 8.5 (d) mentioned that if the investors choose not to exercise the option to convert, it shall be deemed that they have waived off their option to convert and the OCPS would automatically be redeemed at the end of 3 years from the date of issue and allotment. In the present case, the Financial Creditor did not exercise his option of converting the OCPS within the first two years of allotment, thus, the period of 3 years expired on 14 June 2019. Therefore, as

per article 8.5 (d), the Applicant became eligible to exercise his PUT option of redeeming his shares. As per the Applicant, the OCPS automatically got converted into debt of the Corporate Debtor when the Corporate Debtor failed to redeem the OCPS.

2.2 The Financial Creditor sent reminder letters dated 9thand 29thJuly, 2019 to the Corporate Debtor to exercise PUT option of redemption as the period of 3 years had already expired and also instructed the Corporate Debtor to redeem and remit the redemption amount in the Bank Account for which details were provided by the Applicant. Since the Corporate Debtor failed to redeem OCPS along with interest @ 6% per annum, the Applicant is of the view that the OCPS automatically got converted into debt after the expiry of 3 years i.e., 14thJune 2019. The Applicant demanded the principal amount of Rs. 14,86,000/- along with 6% interest of Rs.2,70,000/-. Thus, the total default amount was Rs. 17,70,000/- due as on 31stJuly 2019.

2.3 The Applicant sent a notice dated 01.08.2019 to the Corporate Debtor giving it an opportunity to pay the default amount within 7 days of the receipt of this notice. The Corporate Debtor neither replied nor repaid the money to the Applicant. Since the Corporate Debtor did not pay the amount within the prescribed period of 7 days, the Applicant filed an application for initiation of CIRP against the Respondent/Corporate Debtor before this Adjudicating Authority.

3. Countering the above details and disputing the claim of the Financial Creditor as discussed in the Application concluding that the Corporate Debtor defaulted on repayment of the Financial Debt, a detailed reply has been filed by the Respondent/Corporate Debtor submitting as below,

3.1 The Respondent averred that this Application is liable to be dismissed since the Applicant herein is not a Financial Creditor of the Corporate Debtor, he is rather a shareholder of the Company. Hence, he does not have the required locus to file an application for initiation of CIRP against the Corporate Debtor under section 7 of I & B Code, 2016.

3.2 The Respondent further submitted that a conjoint reading of Article 2.1 with Schedule D to the Shareholders Agreement makes it clear that the Applicant was allotted a total of 1486 OCPS of Rs.1000/- each and one equity share of Rs.14000/- in the Respondent Company/Corporate Debtor. Therefore, it is contended by the Respondent Company/Corporate Debtor that this amount received from Applicant was an investment in the share capital of the Corporate Debtor and it wasn't done with the intention of earning interest over a period of time. It is also stated that the Hon'ble NCLAT in various cases, has made it clear that shareholders of a company cannot be deemed to be its creditors.

3.3 The Respondent further stated that an OCPS with the rights attached to it under the Shareholders Agreement cannot be considered to fall under the definition of "financial debt" since it is neither money borrowed against payment of interest nor it is an amount raised pursuant to any note purchase facility, issue of bonds, notes, debentures, loan stock etc., and it does not have the effect of a borrowing.

3.4 While the Applicant relied on Article 8.5 (d) of the Shareholders Agreement, which stipulated that at the end of three years, the OCPS would become redeemable, however, as pointed out by the Respondent, the Applicant has intentionally failed to mention Article 8.6 of the Shareholders Agreement, which states that no individual investor will be entitled to exercise any of its rights in the Company arising from his shareholding in the company individually and contrary to the collective decision taken by all the investors in terms of the Shareholders Agreement entered into and executed by them.

3.5 It is further submitted by the Respondent that under Article 11.8 which states that all investors agreed that they shall exercise their right to seek redemption or conversion of the OCPS held by them collectively and not individually. Thus, the right of the Applicant under the Shareholders Agreement to claim redemption of the OCPS can only be materialized when all other investors under the Shareholders Agreement agree to seek redemption of their OCPS. The redemption in this case by the Applicant is not made collectively and

hence, the Respondent pointed out that this individual right of redemption does not vest in the Applicant.

3.6 It is further mentioned by the Respondent that under Article 6 of the Shareholders Agreement, an authorized representative of the Investors, (Mr. Abhishek Sanghvi) represents their interests as well as liaises with the Corporate Debtor as and when required via a facilitator (Swan Investments Management Service LLP.) This arrangement was done to ensure a seamless communication channel between the investors and the Corporate Debtor. The Respondent also argued that the Applicant herein, has attempted to completely circumvent the terms of the Shareholders Agreement and not to adhere to the aforementioned mechanism. The Respondent is of the view that the liability of the Corporate Debtor would only arise, if there was a collective request made by all the investors, but in this case, no debt has arisen in favour of the applicant as no such collective request has been made for redemption.

3.7 The Respondent further pointed out that the Applicant very conveniently hasn't mentioned the response of the Corporate Debtor in reply to the letters sent by the Applicant. The Respondent/Corporate Debtor had sent letters dated3rdand 7thAugust 2019 to the Applicant. But the Applicant did not respond to the same and proceeded with the filing of this Application.

3.8 The Respondent further goes on to state that even if it is assumed that the Applicant is a Financial Creditor and the debt is owed by the Corporate Debtor to the Applicant, this Application is still not maintainable because no event of default has been established. In the present case, no amount has become payable by the Corporate Debtor given the provisions of the contract and the legal constraints as provided in the Shareholder Agreement.

3.9 The Respondent also pointed out that though Article 8.5(d) of the Shareholders Agreement provides for automatic redemption of OCPS at the end of three years but the Applicant has failed to undertake the provisions of Section 55 of the Companies Act, 2013, which deal with the redemption of preference shares. It is stated that in terms of Section 55 of the Companies Act, preference shares

can be redeemed only out of the profits of the company. In the instant case, the Corporate Debtor is not a profit-making enterprise hence, the Corporate Debtor cannot redeem the OCPS held by the Applicant in violation of the applicable laws. The Shareholders Agreement cannot override the express provisions of law and hence, there is no default on the part of the Corporate Debtor.

3.10 It is also mentioned by the Respondent that the Applicant has taken the articles of the Shareholders Agreement in isolation for his own convenience. A holistic reading of the entire Shareholders Agreement shall make it clear that it is incumbent upon the Corporate Debtor to redeem the OCPS in three years in terms of the provisions of the contract where the option of conversion has been adopted by all the shareholders collectively. Here, the Applicant is the only one investor trying to exercise this right and hence, the liability of the Corporate Debtor does not arise.

3.11 The Respondent in its reply also drew the attention of this Adjudicating Authority on the terms of the Shareholders Agreement, which state that the remedy for non-redemption available to the Applicant who is an investor under the Shareholders Agreement, is not against the Respondent Company/Corporate Debtor but against the promoter shareholders and the facilitator (Both defined under the shareholders agreement).

3.12 It is further submitted by the Respondent Company/Corporate Debtor that as per Article 8.3 of the Shareholders Agreement, where the Corporate Debtor is not capable of redeeming the OCPS, the promoter shareholders shall make suitable arrangement to buy the OCPS along with the accumulated interest thereon to enable the exit of the investors from the company, failing which, the facilitator shall identify a third party to buy the OCPS at a price not less than that offered by the promoter shareholders.

3.13 In this reply, the Respondent emphasised that in the instant case, if the Corporate Debtor is incapable of redeeming the OCPS given the express provision of the Companies Act, the investors are entitled to call upon promoter shareholders first and then the facilitator as defined under the Shareholders

Agreement. Here also the Applicant is trying to circumvent the terms of the Shareholders Agreement.

3.14 The Respondent also emphasised that there is no particular provision of the Shareholders Agreement under which the Corporate Debtor is liable to redeem the OCPS on the demand of an individual investor, despite the constraints of the Companies Act. Hence, there exists no event of default. The Respondent in the end has prayed to this Adjudicating Authority for dismissing the instant application as the Applicant is not a Financial Creditor and there is no debt or event of default.

4. The Applicant by filing a rejoinder countered the above reply submitted by the Corporate Debtor and put forth further arguments to disprove the contention raised by the Corporate Debtor and strengthening his claim of the amount due on redemption of OCPS as being financial debt and occurrence of default due to non-payment. It is discussed as below,

4.1 In response to the Respondent's claim that the Applicant is not a Financial Creditor, the Applicant has stated that the Shareholders Agreement clearly mentioned about the term "Simple Interest". This term is self-explanatory as the word interest implies a financial debt. Applicant is of the view that OCPS is nothing but another word for debt which is owed in this case by the Corporate Debtor to the Applicant.

4.2 The Applicant also rebutted the objection of the Respondent when he says that the investment of the investor was in the share capital of the Corporate Debtor and not with the intention of earning interest over a period of time, stating that this statement made by the Corporate Debtor is false as investment made by the Applicant was solely with the intention of investment in the company for a limited period of time i.e., 2 years failing which it is converted into that of the Corporate Debtor. At the end of 3 years, i.e. 14.06.2019 due amount of debt on conversion from OCPS became payable by the Corporate Debtor along with simple interest of 6% per annum.

4.3 Article 8.4 of the Shareholder Agreement states that all investors would be entitled to receive individual notices along with the Agenda for all the General Body Meeting of the company and shall be further entitled to attend and vote at the general body meeting of the company either in person or through proxy as the case may be. The Applicant pointed out that Corporate Debtor failed to send individual AGM notices to the OCPS holders. He therefore, violated the Companies Act and rules there under along with Article 8.4 of the Shareholders Agreement, thus, suppressing the rights of the Applicant as Financial Creditor of the Company.

4.4 The Applicant pointed out that the reference made by the Respondent about the ruling of the NCLAT in certain cases is also erroneous as those cases talk about preference shares not OCPS and OCPS is debt becoming payable by the Corporate Debtor if PUT option available to Financial Creditor is not exercised for conversion.

4.5 As per the Applicant, the OCPS are converted into equity shares only during the first 2 years from date of issue, if PUT option is exercised by OCPS holder. If not exercised, the OCPS shall convert into debt after 3 years. Thus, this clearly illustrates that the OCPS is in the nature of a borrowing and hence, it is a "financial debt" having existence of "time value of money". The Applicant relies on the case of ***Bombay Cotton Mfrg. Co. Re, (1909) 11 BOM LR 1302*** to illustrate the fact that a creditor remains a creditor irrespective of him claiming the debt immediately or deferring it to a future time.

4.6 The Applicant further submitted that though the Shareholder Agreement talks about a facilitator/ authorized representative to coordinate between investors and company and that the investors would exercise their rights collectively, it cannot bar the Applicant from exercising his rights as an individual investor.

4.7 The Applicant also stated that the reply letters dated 03.08.2019 and 07.08.2019 sent by the Corporate Debtor are merely business communication and no response from the Corporate Debtor regarding repayment of debt has been received, that led to the filing of this application.

4.8 The Applicant further emphasised that the Shareholders Agreement in its Article 8.2(b) stated that if the OCPS is not converted within first two years, that shall be redeemed by the company to investors along with the simple interest of 6% per annum. Also, Article 8.5 (d) mentioned that if the investors choose not to exercise the option to convert, it shall be deemed that they have waived off their option to convert and the OCPS would automatically be redeemed at the end of 3 years from the date of issue and allotment. Thus, the "event of default" arose on 14.06.2019 when the 3 years elapsed and the debt became payable and thus, as per the Applicant, the view of the Respondent that "event of default" did not arise, is unfounded.

4.9 The Applicant further stated that though the Respondent mentions Sec 55 of Companies Act, 2013, he very conveniently ignored Rule 9 (6) of the Companies (Share Capital and Debentures) Rules, 2014which states:

> *"...(6) A company* ***may redeem its preference shares only on the terms on which they were issued*** *or as varied after due approval of preference shareholders under section 48 of the Act and the preference shares may be redeemed:— (a) at a fixed time or on the happening of a particular event; (b) any time at the company's option; or (c) any time at the shareholder's option."*

As per the Applicant, the terms for redemption in this case will depend upon the Shareholder Agreement and this agreement provides for automatic redemption after 3 years. Thus, in view of the Applicant, the debt is liable to be paid.

5. We have considered all the pleadings put before us by the Applicant and Respondent and also heard the arguments of their Ld. Counsels. Before deciding the admission of petition u/s 7 of Code, we have first deliberated upon the provisions under the company law relating to issuance, conversion and redemption of OCPS and other provisions connected with admission of petition u/s 7 of I & B Code, 2016.

6. OCPS is nothing but a preference share that carries an option of to be converted into equity shares. The option of conversion may be given either with the

company or with the shareholders or it may be a combination. Generally, terms and conditions for exercising such option are governed by a Shareholder Agreement. Issuance and redemption of preference shares is governed by the provisions of section 55 of the Companies Act, 2013 read with Rule 9 of the Companies (Share Capital and Debentures) Rule, 2014. These provisions as under:-

Issue and redemption of preference shares.

Section 55. (1) No company limited by shares shall, after the commencement of this Act, issue any preference shares which are irredeemable.

(2) A company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed.

***Provided** that a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares may be prescribed on an annual basis at the option of such preferential shareholders:*

***Provided further** that--*

(a) no such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

(b) no such shares shall be redeemed unless they are fully paid;

(c) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account, and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the Capital Redemption Reserve Account were paid-up share capital of the company; and

(d) (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed:

***Provided also** that premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by*

any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

(3) Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed:

***Provided** that the Tribunal shall, while giving approval under this sub-section, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.*

Explanation.-- For the removal of doubts, it is hereby declared that the issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

(4) The capital redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Explanation.-- For the purposes of sub-section (2), the term infrastructure projects means the infrastructure projects specified in Schedule VI.

Rule 9. Issue and redemption of preference shares.

(1) A company having a share capital may, if so authorized by its articles, issue preference shares subject to the following conditions, namely:-

(a) the issue of such shares has been authorized by passing a special resolution in the general meeting of the company.

(b) the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued either before or after the commencement of this Act or in payment of dividend due on any preference shares.

(2) A company issuing preference shares shall set out in the resolution, particulars in respect of the following matters relating to such shares, namely:-

(a) the priority with respect to payment of dividend or repayment of capital vis-à-vis equity shares;

(b) the participation in surplus fund;

(c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;

(d) the payment of dividend on cumulative or non-cumulative basis;

(e) the conversion of preference shares into equity shares;

(f) the voting rights;

(g) the redemption of preference shares.

7. Now, the question before us is whether "the OCPS due for redemption" can be taken as a "debt". As defined in Section 3(11), of the I & B Code, 2016, "*Debt" means a liability or obligation in respect of a claim which is due from any person and includes a financial debt and operational debt as dealt with under Section 7 and 9 of I&B Code, 2016 respectively*. In the I & B Code, 2016, *"Creditor"* has also been defined in Section 3(10) as *"any person to whom a debt is owed and includes a Financial Creditor, an Operational Creditor, a secured creditor, an unsecured creditor and a decree holder.*

8. In the case under consideration, we are dealing with an Applicant who is claiming to be a Financial Creditor to whom a debt has become due on OCPS becoming due for redemption. The Applicant has claimed that the Respondent Corporate Debtor has not made the payment of amount that has become due on redemption, hence, in his view, the Respondent Corporate Debtor has defaulted in terms of Section 7 of the I & B Code, 2016. Therefore, an application u/s 7 read with Rule 4(1) of the Insolvency and Bankruptcy (Application to Adjudicating Authority) Rules, 2016 in prescribed Form 1 has been filed providing relevant information about the Corporate Debtor and the debt claimed to be due from it in Part I, II, III, IV and V of the said Form 1.

9.1 The terms "Financial Creditor" and "Financial Debt" are also defined in the I & B Code 2016 and the same is reproduced as under:-

5(7) "Financial Creditor" means any person to whom a financial debt is owed and includes a person to whom such debt has been legally assigned or transferred to;

5(8) "Financial debt" means a debt alongwith interest, if any, which is disbursed against the consideration for the time value of money and includes-

(a) money borrowed against the payment of interest;

(b) any amount raised by acceptance under any acceptance credit facility or its de-materialized equivalent;

(c) any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock, or any similar instrument;

(d) the amount of any liability in respect of any lease or hire purchase contract, which is deemed as a finance or capital lease under the Indian Accounting Standards or such other accounting standards as may be prescribed;

(e) receivables sold or discounted other than any receivables sold on non-recourse basis;

(f) any amount raised under any other transaction, including any forward sale or purchase agreement, having the commercial effect of a borrowing;

[Explanation.- For the purposes of this sub-clause –

(i) any amount raised from an allottee under a real estate project shall be deemed to be an amount having the commercial effect of a borrowing; and

(ii) the expressions, "allottee" and "real estate project" shall have the meanings respectively assigned to them in section 2(d) and 2(zn) of the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);]

(g) any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price. For calculating the value of any derivative transaction, only the market value of such transaction shall be taken into account;

(h) any counter-indemnity obligation in respect of a guarantee, indemnity, bond, documentary letter of credit, or any other instrument issued by a bank or financial institution;

(i) the amount of any liability in respect of any of the guarantee or indemnity for any of the items referred to in above sub clauses (a) to (h) of this clause;

9.2 The term "default" as defined in I & B Code 2016 u/s 3(12) is as under:

9(12) "default" means non-payment of debt when whole or any part or instalment of the amount of debt has become due and payable and is not paid by the debtor or the corporate debtor, as the case may be;

10. In order to determine whether amount paid by a person to a company is in the nature of "share capital" or "debt", we are of the opinion that this issue in present case can be decided only after examination of the Shareholders Agreement in the light of relevant provisions of the Companies Act, 2013 as discussed in previous para no.6 of this order. Under the Companies Act, 2013, there is a fundamental difference between the Capital made available to a company by issue of a share and money obtained by a company under a loan or debenture. The nature of money available with a company in its Capital Account through convertible preference share shall depend upon respective incidences and consequences connected with the issuing of a convertible preference share by a Company as per an agreement underlying the relevant terms and condition for its conversion to equity share or redeeming its value at subsequent date. Therefore, first we examined the Shareholders Agreement and our findings are discussed in succeeding paras.

11. On 12th May, 2016, the Respondent Company/Corporate Debtor, M/S Onspon Services Private Ltd. and its four promoter shareholders i.e. Mr. Bharat Bhushan Gossain, Ms. Teena Gossain, Mr. Hitesh Gossain and Mr. Sharad Seth entered into Share Subscription Cum Share Holders Agreement (Shareholders Agreement) with 14 persons collectively referred to as the "Investors" and a "Facilitator" named M/S Swan Investments Management Serves LLP for making of investment of a sum of Rs.1,05,00,000/- (Rupees One Crore and Five Lacs only) in the Company by these Investors collectively in the Equity Shares and in the Optionally Convertible Preference Shares (OCPS) of the Company. Applicant, Mr. Mahesh Sharma is one of these 14 Investors. As per the facts brought before us by the Applicant who is one of 14 investors in the above Shareholders Agreement, he subscribed to 1486 OCPS valuing Rs. 1000/- each and 1 Equity Share of Rs. 14000/- of the Respondent Company as

per the details given in Para 1 of the Schedule D of the said Shareholders Agreement. For making this investment, the Applicant, Mr. Mahesh Sharma paid a consideration of Rs.15,00,000/- (Rupees Fifteen Lacs) on 13.06.2016 and in lieu of this payment, he was allotted 1486 OCPS of Rs.1000/- each and 1 Equity Share of Rs. 14000/- on 15.06.2016 for a total amount of Rs. 15,00,000/- paid by him.

12. Terms and conditions relating to allotment, conversion, redemption, dispute resolution etc. are provided in this Shareholders Agreement under various articles totalling to XVII Articles. We have considered the relevant Articles of this Shareholders Agreement in order to decide about the dispute that has arisen between Applicant and the Respondent Company/Corporate Debtor on the amount claimed by the Applicant to have become due for payment by the Corporate Debtor on redemption of the OCPS allotted to him, but so far not redeemed by the Corporate Debtor and also, to decide whether failure of the Corporate Debtor to redeem OCPS and pay the requisite amount to the Applicant, would amount to "default" in payment of a "financial debt" in terms of provisions of section 7 for which, whether CIRP can be initiated against the Respondent Corporate Debtor or not as per the application filed u/s 7 of the Code before us by the Applicant.

The relevant articles of this share agreement are reproduced as under:

ARTICLE-VI

INVESTOR AGREEMENT

*6.1 The Investors hereby state that they have entered into the Investors Agreement incorporating therein their terms of investment to be made in the Company. They further state that they have authorised Mr. Abhishek Sanghvi S/o Mr. Mahendra Sanghvi aged about 38 years and residing at AG-158, Scheme No. 54, Vijay Nagar, Indore and is the Managing Partner at Swan Investments Management Services LLP (hereinafter referred to as **"the Authorised Representative"**) to act on their behalf including to be nominated as a Director/Nominee Director on the Board of the Company. All acts, deeds and actions taken by the Authorised Representative shall be binding on all the Investors and no Investor shall be entitled to question the Company, the Promoter Shareholders or the*

Facilitator for any action taken based on the Authorised Representative's acts/deeds. However, in case where the OCPS are not converted into Equity Shares and the Investors have opted for redemption and have received the same along with the interest applicable, then the Nominee Director shall cease to hold his position from the date the Investors cease to hold the OCPS in the Company.

6.2 The Authorised Representative is duly authorized by all the Investors to represent their interests on the Board of the Company vis a vis their Committed Investment and also liaison between the Company and the Investors through the Facilitator as and whenever required.

6.3 Subject to the terms of Clause 10.3 of this Agreement, obligations of the Company towards the Investors shall be deemed to be complied with if the Company complies with the obligations with reference to the Authorised Representative and not with reference to each of the Investors.

6.4 The Investors should inform and shall keep the Promoter Shareholders and the Company informed at all times of any amendment, modifications or representations carried out to the Investor Agreement.

6.5 The Investors Facilitator and Shareholders agree and accept that the Company maintains and works on proprietary algorithms and processes proprietary databases. Such intellectual properties and proprietary information are property of the Company protected either as intellectual property and/or as trade secrets. The Investors, Promoter Shareholders and the Facilitator undertake and agree not to share such property information without consent of the Company.

ARTICLE-VIII

RIGHTS AND OBLIGATIONS OF OPTIONALLY CONVERTIBLE PREFERENCE SHARES (OCPS)

8.1 The OCPS issued and allotted to the Investors shall carry voting rights on an as if converted basis on par with Equity Shares of the Company and the Charter Documents especially the Articles of Association of the Company shall be suitably amended to provide for and reserve voting rights on the OCPS.

8.2 The OCPS shall carry a rate of interest payable as dividend which shall be cumulative and payable within one year from:

i. the date of investors opting for redemption of the OCPS, or

ii. the date of completion of two years from the date of allotment of OCPS

Whichever is later.

For the purpose of calculation of interest, the value of the OCPS shall be face value plus premium value per Article 1.15 of this agreement.

a. *If prior to the closing of the second year the OCPS are converted into Equity Shares by the Investors, all accumulated and cumulative interest will be paid by the Company at the rate of 0.01% p.a. till the date of conversion.*
b. *If the OCPS is not converted within the first two years, that shall be redeemed by the Company to Investors along-with a simple interest of 6% p.a.*

8.3 *In the event of the Company not being capable of redeeming the OCPS on request received from the Investors, the Promoter Shareholders shall make suitable arrangement to buy the Investor Shares along with accumulated interest thereon to enable the exit of the Investors from the Company, failing which, the Facilitator shall identify a third party to buy the Investor Shares at a price not less than that offered by the Promoter Shareholders.*

8.4 *At all General Body Meetings of the Company the Investors shall be entitled to vote on all the OCPS held by them on an as if converted basis along with their voting rights exercised on the Equity Shares held by each Investor in the Company. All the Investors would be entitled to receive individual notices along with Agenda for all the General Body Meetings of the Company and shall be further entitled to attend and vote at such General Body Meetings of the Company either in person or through proxy as the case may be. The Company shall recognise and acknowledge all proxies deposited with it. All Investors proposing to appoint proxies shall do so 48 hours prior to the date of meeting and ensure that the proxy forms are duly filled and deposited with the Company.*

8.5 *In the event the Investors propose to convert their OCPS into Equity Shares, they can do so only during the first two years from the date of issue and allotment of OCPS to them and the same shall be converted by them in the manner detailed below:*

a. *If there is subsequent round of funding which is considered a Qualified Round (that is, the Funding amount is either greater than or equal to Rs.5,00,00,000/- (Rupees Five Crores only) then the Investors may convert at valuation as given in the Article 9.1(a) below. If they choose not to convert at this juncture, they will have an option to convert at a valuation as given in Article 9.1(b).*

b. *If there is subsequent round of funding which is not a Qualified Round (where the funding is less than Rs.5,00,00,000/- (Rupees Five Crores Only) then the investors shall not exercise their right to convert their OCPS.*

If they do not convert at this juncture, they still remain their right to convert in future after the matter is duly discussed at a meeting of the Board of the Company as agreed thereat.

c. *If there is no funding received within 2 years from the Effective Date, the Investors will have an option to convert at a valuation as given in the Article 9.1(b) at the end of the second year.*

d. *If the Investors choose not to exercise their option to convert under any of the three categories above, it shall be deemed that they have waived off their option to convert and the OCPS would automatically be redeemed at the end of 3 years from the date of issue and allotment as provided in Article 9.1*

8.6 *It is understood by the Investors that they shall exercise all their rights except voting rights vis a vis the Investor Shares collectively. In other words, no individual Investor will be entitled to exercise any of his rights in the Company arising from his shareholding in the Company individually and contrary to the collective decision taken by all the Investors in terms of the Investor Agreement entered into and executed by them.*

8.7 *The maximum voting rights equivalent to shareholding, for all the investors, cannot exceed 10% of the total voting rights with the members of the Company.*

ARTICLE-XIII

DRAG ALONG AND EXIT RIGHTS

13.1 The Promoter Shareholders shall facilitate the exit of the Investors collectively after four years from the date of issue and allotment of Investors Shares to them in the following manner:

a. *The Investors can sell Investor Shares to a third party entity.*

b. *In the event the Company decides to raise subsequent round of funding the Investors can collectively at their sole discretion sell their Investor Shares to the new investor at a mutually agreed price.*

c. *In the event the Promoter Shareholders are unable to facilitate the exit of the Investors after a period of 4 years from the date of issue and allotment of the Investor Shares, the Investors can, through written notice, cause the Company and/or the Promoter Shareholders to provide them an exit by buying back the Investor Shares at a fair value, determined by a mutually agreed independent valuator in consultation with the Facilitator.*

d. *Without prejudice to any other rights that Investors may have under Law or this Agreement, if any of the Investors receive an offer from a third party to purchase all the Investors Shares anything after*

May 2020, the Investors shall have the right ("Drag Along Right") to issue notice (the "Drag-Along Notice") to the Promoter Shareholders stating the intention of the Investors to sell all the Investors Shares to such third party purchaser. For such a transfer the Investors may require the Promoter Shareholders to transfer such proportion of their shareholding in the Company, on same terms as those offered to the investor, to such a bona fide purchaser as may be sought by the Investor. The Promoter Shareholders undertake to provide such number of shares as may be sought by the Investors for the enforcement of this Clause.

e. The Promoter Shareholders of the Company shall have the right of first offer to buyback these Investor Shares at the same value as offered by another purchaser. However, the Investors agree to provide up to 12 months of time to arrange for the fund required as long as the Promoter Shareholders deposits 10% of the agreed value and complete the remaining payment along with a quarterly interest of 4%.

f. The Investors shall be entitled to drag along the Promoter Shareholders in any sale prior to the said period of four years if the Company is valued more than US$ 15 Million for the purposes of such a transaction.

13.2 In the event of any breach committed by the Promoter Shareholders and/or the Company either in terms of this Agreement or with reference to any statutory requirements/compliances under the provisions of the Act, other statues impacting the Business of the Company and the operations of the Company, the Investors reserve the right to exit in favour of any other third party and exercise their drag along rights at such event of default.

ARTICLE-XV

EVENTS OF DEFAULT

15.1 Over and above the drag along rights reserved above in the event of default, the Investors further reserve the right to exercise their right to acquire the Promoter Shareholders' shareholding in the Company at par value regardless of the valuation of the Company at that point of time.

15.2 The events of default are:'

a. misrepresentation or breach by any of the Promoter Shareholders and/or the Company of any of the Representations and Warranties set out in this Agreement, that are not remedied within 10 (ten) Business Days from the date of the same having been brought to the notice of the Promoter Shareholders/Company;

b. breach by any of the Promoter Shareholders and/or the Company of any of the covenants and/or other terms and conditions set out in this Agreement, that are not remedied within 10 (ten) Business Days from the date of the same having been brought to the notice of the Promoter Shareholders/Company;

c. failure to obtain consent of the Investors or acting contrary to any consent provided by the Investor with regard to any of the matter requiring positive consenting vote of the Investors or any other provision under this Agreement which requires the consent/approval of the Investors;

d. declaration of Insolvency against any of the Parties (other than the Investor);

e. if, any of Promoter Shareholders commits any act which, as determined by an order of a court of competent jurisdiction, detrimentally affects the Company, including but not limited to an act of dishonesty, fraud, wilful disobedience, misconduct or material breach of duty in relation business of the Company;

f. if any of the Promoter Shareholders is convicted of a criminal offence and is convicted with an offence involving moral turpitude, other than minor traffic violations.

15.3 Each of the Promoter Shareholders and the Company covenant that they shall, immediately upon and in any event within 2 (two) days of any of them becoming aware of the occurrence of or the existence of circumstances that may lead to the occurrence of any Event of Default, notify the Investors in writing of such occurrence. The Investors shall promptly after becoming aware or being notified of the occurrence of an Event of Default send a written notice (Default Notice) to the Promoter Shareholders and the Company in writing requesting them to cure the Event of Default to the satisfaction of the Investor within a period of 10 days from the date of Default Notice (Cure Period). The failure of the Investors to timely issue a Default Notice shall not relieve the Company or the Promoter Shareholders from any liability associated with the underlying default. The Default Notice shall state the details of the event(s) which constitutes an Event of Default.

15.4 On the occurrence of Event of Default and after the expiry of Cure Period of such Event of Default, the Investors shall exercise their right to acquire all Promoter Shareholders' share at par value in proportion to their Investor's Share held in the Company. The decision of the Investors shall be final and binding on the Promoter Shareholders and the Company. The Facilitator shall ensure that transfers as may be required are the given effect to as and when the Investors requests for the same.

ARTICLE-XVI

DISPUTE RESOLUTION

16.1 In the event of any dispute or different between the Investors, Promoter Shareholders and the Company arising out of this Agreement, they shall endeavour to resolve the same using the good offices of the Facilitator. If the dispute is not resolved within 15 days from the date of the dispute being referred to the Facilitator, the Promoter Shareholders and the Facilitator shall together identify and appoint a sole arbitrator to resolve the dispute and the Parties shall refer the dispute to the sole Arbitrator so appointed.

16.2 It is clarified that any dispute arising out of the present agreement shall be referred to arbitration. The arbitration proceedings shall be in accordance with the Indian Arbitration and Conciliation Act, 1996 or any enactments in substitution thereof. The venue of the arbitration proceedings shall be at Indore. The award of the arbitrator shall be final and binding upon the Parties and non-appealable and the Parties agree to be bound by the same and the successful Party may seek to enforce the same in a Court having jurisdiction.

13. The above Shareholders Agreement has also been listed at S1. No.5 in part V of the Application filed by the Applicant, Mr. Mahesh Sharma in Form 1 for the purpose of furnishing details of "Financial Debt Documents, Records and Evidence of Default" for initiation of CIRP against the Respondent Corporate Debtor. Relying on this agreement and referring to Article 8.2(b) and 8.5(d) of this agreement providing terms and conditions for redemption of OCPS as reproduced in previous para no.12, it is contended by the Applicant that he did not exercise option to convert the OCPS in equity share within 2 years of allotment and the said period of 3 years expired on 14.06.2019 and hence, OCPS was automatically redeemed at the end of 3 years as provided in Article 8.5(d) and for this purpose, he also gave notice to the Corporate Debtor vide his letter dated 09th July, 2019 and then letter dated 29.07.2019 to exercise PUT option for redemption of 1486 OCPS along with interest of 6%. However, as per the Applicant, as the Company failed to redeem OCPS along with interest at the rate of 6% simple interest p.a., this OCPS was automatically converted into "debt" on failure of redemption of OCPS after expiry of 3 years on 14.06.2019. Therefore, the Applicant demanded the principal amount of

Rs.14,86,000/- along with 6% simple interest p.a. of Rs.2,70,000/-, totalling to Rs.17,70,000/- that became due on 31.07.2019 from the Company, treating this amount as "financial debt", himself as "lender" and the Company as "Corporate Debtor", as the Company failed to pay the redemption amount to the Applicant, Mr. Mahesh Sharma. Being aggrieved due to non-payment of the above amount of Rs.17,70,000/-, the Applicant sent a notice dated 01st Aug, 2019 to the Company treating it as Corporate Debtor and himself as Financial Creditor for initiation of CIRP due to default on non-payment of this amount, and gave an opportunity to the Company/Corporate Debtor to pay the requisite amount within seven days of receipt of the Notice but no payment was made and hence, treating the Company as defaulter Corporate Debtor, this application u/s 7 has been filed before us by the Applicant as Financial Creditor for our consideration.

14. We have carefully considered the above fact brought before us by the Applicant canvassing his view that the OCPS automatically got converted into debt of the Company on failure of redemption of OCPS by the Company. It is undisputed fact that the Applicant is an investor in the Company as per the Shareholders Agreement, investing in its 1486 OCPS of Rs.1000/- each and 1 equity share of Rs.14000/-. The Applicant is never shown as creditor in the Financial Statement of the Company produced before us and always treated as shareholder of the Company in the documents produced before us. Now, the question as raised before us is whether the OCPS which is nothing but "preference share" would automatically get converted into "debt" of the company in case of default on part of the Company, to redeem such OCPS to a particular investor on exercising of PUT option of redemption by him, in case if any such default has occurred in terms of the Shareholders Agreement.

15. In this regard, we have considered a similar case decided by the Hon'ble Supreme Court in case of ***"Indus Biotech Private Ltd. Vs. Kotak India Venture (Offshore) Fund &Ors in Arbitration petition (Civil) No.48/2019 with Civil Appeal No.1070/2021 @ SLP(C) No.8120 of 2020 dated***

26.03.2021" in which also, dispute arose between parties on the issue whether default on payment of amount becoming due on redemption of OCPS would be in the nature of default in payment of debt. In this case, decision was taken in a board meeting of the issuer company to redeem OCPS on the date as mentioned in the agreement but dispute arose on computation of redemption value and hence, delay occurred in payment and therefore, holder of OCPS i.e. Kotak India Venture moved petition u/s 7 for initiating CIRP but the Corporate Debtor, Indus Biotech Pvt. Ltd. moved petition for arbitration u/s 8 of the Arbitration Act, 1996. The Adjudicating Authority did not admit the petition u/s 7 holding that they are not satisfied that default has occurred because there was dispute on valuation of shares, calculation and conversion formula and fixing of QIPO date and all these disputes are arbitral. Therefore, it was held by the Adjudicating Authority that an attempt must be made to reconcile the difference between the parties and their respective perceptions. Due to dispute on the question of determination of redeemable value, it is also held by the Adjudicating Authority that no meaningful purpose will be served by pushing the Corporate Debtor into CIRP at this stage.

16. This order of Adjudicating Authority on appeal, has been found to be reasonable by the Hon'ble Supreme Court holding that it is the satisfaction of the Adjudicating Authority on the occurrence of default before admitting the petition u/s 7 and in the facts and circumstances of the case, the Hon'ble Supreme Court was in agreement with the satisfaction drawn by the Adjudicating Authority that default has not occurred due to redemption value being not determinable in view of dispute on computation of its value being pending at that stage. In this decision, the Hon'ble Supreme Court categorically held that "*it would not have been appropriate to hold that there is default and admit the petition merely because a claim was made by Kotak Venture (Financial Creditor in that case as claimed by it) as per the originally agreed date and a petition was filed*". It is also held by the Hon'ble Supreme Court in this decision that "*it would be premature at this point to arrive at a conclusion*

that there was default in payment of any debt until the said issue is resolved and the amount repayable by Indus Biotech Private Ltd. (Corporate Debtor as claimed by petitioner) to Kotak India Venture with reference to shares being issued is determined. In the process, if such determined amount is not paid, it will amount to default at that stage".

As it is clear from the provision of the Companies Act, 2013 that the holder of OCPS are basically shareholder and as held in the above decision of the Hon'ble Supreme Court, they cannot become creditor of loan/ debt automatically just by making claim for redemption on the agreed date unless and until the amount to be paid on redemption of OCPS is determined. After determination, if it is not paid, it will amount to default at that stage. The relevant para of the decision of Hon'ble Supreme Court wherein the above referred decisions have been taken are reproduced as under:-

> *20. Therefore, in a fact situation of the present nature when the process of conversion had commenced and certain steps were taken in that direction, even if the redemption date is kept in view and the clause in Schedule J indicating that redemption value shall constitute a debt outstanding is taken note; when certain transactions were discussed between the parties and had not concluded since he point as to whether it was 30 per cent of the equity shares in the company or 10 per cent by applying proper formula had not reached a conclusion and thereafter agreed or disagreed,* ***it would not have been appropriate to hold that there is default and admit the petition merely because a claim was made by Kotak Venture as per the originally agreed date and a petition was filed.*** *In the process of consideration to be made by the Adjudicating Authority the facts in the particular case is to be taken into consideration before arriving at a conclusion as to whether a default has occurred even if there is a debt in strict sense of the term, which exercise in the present case has been done by the Adjudicating Authority.*
>
> *32. In such situation, in our opinion,* ***it would be premature at this point to arrive at a conclusion that there was default in payment of any debt until the said issue is resolved and the amount repayable***

> ***by Indus Biotech Private Limited to Kotak India Venture with reference to equity shares being issued is determined. In the process, if such determined amount is not paid it will amount to default at that stage.*** *Therefore, if the matter is viewed from any angle, not only the conclusion reached by the Adjudicating Authority, NCLT insofar as the order on the petition under Section 7 of the IB Code at this juncture based on the factual background is justified but also the prayer made by Indus Biotech Private Limited for constitution of the Arbitral Tribunal as made in the petition filed by them underSection11oftheAct,1996beforethisCourtisjustified.*
>
> *(Emphasis supplied)*

17. In the present case under consideration, though matter of determining the redemption value is not taken to arbitration panel as there is initial dispute on the act of redemption becoming due itself in terms of the Shareholders Agreement and Section 55 of the Companies Act, 2013, the arising of debt cannot be said to have happened on the agreed date in the Shareholders Agreement. While disputing the claim of the Applicant on OCPS becoming due for redemption, the Respondent Company contended that the Applicant relies on Article 8.5(d) of the Shareholders Agreement which stipulates that at the end of three years, the OCPS would become redeemable but on referring to Article 8.6 and Article 11.8 of the Shareholder Agreement, it can be seen that Applicant's right under the Shareholders Agreement to claim redemption of the OCPS is crystallized only when all other investors under the Shareholder Agreement collectively agree to seek redemption of their OCPS as well and it is shown by the Respondent Company clearly that at present, this condition has not been fulfilled. Respondent Company has also pointed out that the Applicant has not adhered to the set out mechanism prescribed for communication for sorting out the dispute with the Company as provided in Article 6, through the Authorized Representative (i.e. Mr. Abhishek Sanghvi) and Facilitator (i.e. Swan Investment Management Services, LLP) to represent their interests as well as liaise with the Company. It is also pointed out that notice for redemption given by the Applicant vide letter dated 9th July and 29th

July, 2019, was duly replied by the Company for discussion on redemption of OCPS. The same is reproduced as under:-

"*Mahesh Sharma*

128, Shrinagar Extension,

Outside Kalindi Park,

Indore 452018

Subject: Your letter seeking redemption of your individual preference shares

Dear Mahesh Ji,

Thank you for reaching out to us through your letters dated 09 July and 29 July 2019.

I hope you have had a chance to look at regular updates shared by us with your Authorized Representative regularly on company financials and company updates. We have also given live access to the company accounts (through Quickbooks software) since the SHA execution date. In addition to that, our last business summary communication was sent out by email on 10 July 2019.

Given the current financial situation of the company, please do suggest how we can address your concerns. As also mentioned in our business summary note shared earlier, we would be happy to discuss this with you and take your guidance.

Thank you

On behalf of Onspon Services Private Limited."

18. In response to the above letter of the company, no steps were taken by the Applicant to settle the dispute with the company in respect to redemption of OCPS as per the various Articles of the Shareholders Agreement, which are reproduced in para 12 of this order for a ready reference.

19. On point of "default", it is contended by the Respondent Company/Corporate Debtor referring to definition given in Section 3(12) of the I & B Code, 2016 that default occurs only when debt is not paid either as whole or any part or instalment of the amount of debt that has become due and payable and is not paid by the Corporate Debtor. Therefore, it is essential for the Applicant to show that the debt against the Corporate Debtor has become due and payable, for it to constitute an event of default. In the present case, the Applicant is

undoubtedly an "investor" as per the Shareholders Agreement and his conversion to a "creditor" will happen only after his investment in OCPS is redeemed as per the terms of the Shareholder Agreement read with the provision of the Companies Act, 2013. The Respondent Company/Corporate Debtor in its reply has already explained that OCPS are not redeemed as all the investors under the Shareholder Agreement have collectively not exercised their right to seek redemption as per Article 8.6 and 11.8. In case of their being any dispute in this regard, the Applicant being an investor, could have attempted to find out solution through Authorised Representative and Facilitator as per Article 6, which he failed to adhere to as per the set out mechanism in the Shareholder Agreement and therefore, the claim of the Applicant about any "debt" arising to him and becoming due for payment is premature and hence, question of any "default" on non-payment of such debt which is still not "determined", does not arise as redemption of the OCPS has itself not taken place.

20. The Respondent Company/Corporate Debtor, apart from showing to us that no redemption of OCPS is done due to non-fulfilment of the terms and conditions of Shareholders Agreement, he also drew our attention to the provisions of Section 55 of the Companies Act, 2013 applicable for redemption of preference shares. These provisions have already been reproduced in para 6 of this order for a ready reference along with relevant Rule 9. As per these provisions, preference shares shall be redeemed out of the profits of the company or out of the proceeds of a fresh issue of shares made for the purpose of such redemption. It has been explained by the Respondent Company/Corporate Debtor that it is not a profit making enterprise and hence, as per the statutory provision, it cannot redeem the OCPS held by the Applicant otherwise if any redemption is done on the claim notice sent by the Applicant, it will be in violation of the applicable law. In support of its claim of not doing redemption of OCPS due to non-availability of the required profit, annual returns of the Company has been produced. Thus, even as per the relevant statutory provision

under the Companies Act, 2013, which will override any express provision of an agreement/contract, the liability of the Respondent Company/Corporate Debtor to redeem the OCPS, has not yet arisen in the instant case.

21. It is also shown to us by the Respondent Company/Corporate Debtor from the Shareholder Agreement that remedy for non-redemption of OCPS is available to the Applicant being an "Investor" under the Shareholders Agreement itself from the "Promoter Shareholders" and the "Facilitator" and not from the Corporate Debtor. As per Article 8.3 of the Shareholder Agreement, where the Corporate Debtor is not capable of redeeming the OCPS, the "Promoter Shareholder" shall make suitable arrangement to buy such OCPS along with the accumulated interest thereon to enable the exit of the Investors from the Company, failing which, the "Facilitator" shall identify a third party to buy the OCPS at a price not less than that offered by the "Promoter Shareholder". In view of this Article in the Shareholders Agreement providing remedy for non-redemption of OCPS, we find that the resorting to provision of Section 7 of the I & B Code, 2016 for initiating CIRP is premature exercise when redemption of OCPS has not yet taken place converting preference share into debt and remedy provided in the Shareholder Agreement for non-redemption is also not exhausted.

22. Against the facts and circumstances brought before us by the Respondent Company/Corporate Debtor explaining the non-redemption of OCPS, the Applicant through his Ld. Counsel filed rejoinder disputing the interpretation made by the Respondent Company/Corporate Debtor from the Articles of the Shareholders Agreement and provisions of the Companies Act, 2013 for not redeeming the OCPS and it was contended that OCPS automatically got converted into debt on redemption becoming due after three years and no payment of redemption value is made resulting into default and therefore, justified initiation of CIRP against the Respondent Company/Corporate Debtor. The Applicant in its rejoinder emphasised the word "Simple Interest" mentioned in 8.2(b) to be paid on redemption of OCPS, and stated that it is self

explanatory and implies "Financial Debt" or liability (by whatever name called) and he being the Financial Creditor was allotted OCPS on 15.06.2016, disregarding the fact of him being an Investor as mentioned in the Shareholders Agreement. He even went to the extent of stating that the nomenclature "OCPS" is nothing but the "debt" to be paid by the Corporate Debtor as creditor. Such submission made by the Applicant even disregards the provisions of the Companies Act by equating a "preference share" with "debt" just because one Article of Shareholder Agreement says that OCPS shall be redeemed with simple interest ignoring the fact that such redemption has not taken place.

In case of ***Aditya Prakash Entertainment Pvt. Ltd. Vs. Magikwand Media Pvt. Ltd. in Company Petition No.404 of 2016 decided by the Bombay High Court vide order dated 05.03.2018,*** the Petitioner approached the Court as creditor seeking winding up of the Respondent Company despite being preference shareholder but claiming to be a creditor as redemption of preference share has become due but redemption not done due to non-availability of profit with the Respondent Company. On these facts, Bombay High Court held as under:-

"9. In this case, there is no dispute to the fact that petitioner was a shareholder holding preferential redeemable preference shares. The only question that requires to be considered is whether petitioner would be a creditor of the company. Sub-section 1 of Section 80 says, subject to the provisions of this section, a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed. Proviso, however, states that no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. ***This aspect, in my view, shows that where redeemable preference shares are issued but not honoured when they are ripe for redemption, the holder of those shares does not automatically assume the character of a "creditor". The reason is that his shares can be redeemed only out of the profits of the company which would otherwise be available for dividend, or by afresh issue of shares. This is a limitation which is not applicable to any other creditor of the company. The shareholders of redeemable preference shares of the company do***

not become creditors of the company in case their shares are not redeemed by the company at the appropriate time. They continue to be shareholders, no doubt subject to certain preferential rights mentioned in Section 85 of the Companies Act, 1956. If they do not become the creditors of the company, they cannot apply for winding up of the company under Section 433(e) of the Companies Act, 1956.

[Emphasis supplied]

9. A Division Bench of our Court while considering SBI Bank of India (supra) whose facts were different, has opined that preference shareholders cannot be called 'creditors' to attend the meeting of the creditors of the company to be held under Section 391 of the Companies Act, 1956. Paragraph 25 of the said judgment reads as under:-

> *"25 The right given under clause (b) of Sub-section (2) is "to vote on every resolutions placed before the company at any meeting." In our opinion, the words "before the company at any meeting" refer to a meeting of the company i.e. a meeting of the members of the company. A meeting of outsiders like the creditors of the company is not a meeting of the company. It is a special type of meeting of outsiders for a special purpose under Section 391 of the Act. Section 165 to 197 of the Act grouped under the heading "Meetings and proceedings" in Chapter I of part VI of the Act contain certain provisions relating to the meetings. They also regard only the meetings of the members of the company (as opposed to the meetings of outsiders like creditors) as the meetings of the company. Another clue to this interpretation can be found by reference to clause (c) of subsection (2) of Section 87 which lays down that the voting right of a holder of preference share who has a right to vote under Sub-section (2) shall be in the same proportion as the capital paid up in respect of the preference share bears to the total paid up equity share capital of the company. For the purpose of determining the value of the vote cast by a preference shareholder, one has to find its proportion to the total paid up equity capital of the company and not to the total debts of the company. In the meeting of the creditors of the company to be held under Section 391 of the Act, the value of creditors vote for ascertaining requisite majority of 3/4th in value has a reference to the total debt of the company and not to the total paid up capital. A preference share is not a debt instrument. Preference share amount is a capital and not a debt. Thus, in the meeting of the creditors, it would not be possible to assign a value to the vote of a holder of preference share. If we were to hold that the preference shareholders who are not paid dividend for more than two years are also entitled to attend the meeting of the creditors under Section 391 of the Act and to vote thereat, then it would be impossible to determine what would be the value to their votes vis-*

a-vis the value of votes of creditors. It would be wrong to contend that preference shareholders have a right to vote but, valuation of their vote is unascertainable. We are therefore of the view that preference shareholders are not entitled to attend and vote at the meeting of the creditors convened under Section 391 of the Act even though dividend on the preference shares have remained unpaid for more than 2 years.

10. The Division Bench of Calcutta High Court in Hindustan Gas and Industries Ltd.(supra) has also held that a debenture-holder, as a creditor, has a right to sue the company, whereas a shareholder has no such right and preference shareholder is a shareholder of the company. Paragraphs 10, 11, 12 and 13 of the said judgement read as under:-

10 Mr. Sengupta also submitted that the holder of a redeemable preference share did not stand on the same footing as a creditor and could not sue the company for redemption of the shares as an ordinary creditor. In support of his contentions Mr. Sengupta cited the following passages from the "Company Law" by Robert R. Pennington, 2nd edn. at pages 127-128 and at page 164:

> *"A shareholder is not a creditor of the company for his share capital, although he undoubtedly has a contractual right to share in the company's assets in a winding up after its creditors have been paid, and if the company has traded successfully, his share may amount to very much more than the money he originally subscribed. The reason why share capital is shown on the liabilities side of the company's balance sheet is that a balance sheet shows what payments would fall to be made out of the company's assets if it were wound up immediately, and one of these payments, is, of course, share capital. It does not follow that all such payments are debts of the company; share capital is one of the payments which is not.*

11 Share capital, then, is the amount contributed by the shareholders to the company's resources. The money with which the contribution is made becomes the company's property forthwith, but the company does not become the shareholder's debtor for its repayment. The shareholder has a number of contractual and statutory rights against the company, among which are a right to share in its assets when it is wound up, and a right to receive dividends out of its profits when duly declared in accordance with the articles and it is primarily these two rights which give his shares a value, and make them saleable." (Pages 127-128).

> *"Unlike 'capital' or 'share capital', the expression 'loan capital' is not a legal term of art, but a commercial expression used to indicate the total amount borrowed by a company otherwise than by short and medium term borrowing. Loan capital will be represented by mortgages, debentures and loan stock, and the law*

relating to these securities, which is vastly different from that relating to share capital, will be dealt with in Chapter 12. Loan capital appears on the liabilities side of the company's balance sheet beneath share capital and reserves, but unlike share capital, it does represent indebtedness by the company, and holders of loan capital have the remedies of creditors to recover what the company owes them." (Page 164.) 12 Consequently, when the date for the redemption of redeemable preference shares has passed, their holders cannot sue the company for the repayment of their capital as creditors though they may petition for the winding up of the company as shareholders."

13 On a consideration of the provisions of the Companies Act, 1956, as also similar provisions in the English company law we cannot persuade ourselves to accept the contentions of the assesse and hold that when a company issues redeemable preference shares it is in fact obtaining a loan as it could by issuing debentures. There is a fundamental difference between the capital made available to a company by issue of a share and money obtained by a company under a loan or a debenture. Respective incidences and consequences of issuing a share and borrowing money on loan or on a debenture are different and distinctive. A debenture-holder as a creditor has a right to sue the company, whereas a shareholder has no such right. Apart from that the scheme of the Companies Act and in particular the forms and contents of its balance-sheets are extremely rigid and, in our view, by reason of the specific compartments in such accounts it is not possible to convert an item of capital into an item of loan as has been suggested on behalf of the assesse."

[Emphasis supplied]

11. The Division Bench of Delhi High Court in National Co-operative Development Corporation (supra), while considering appeal filed under Section 260(A) of the Income Tax of Delhi, 1981, approved finding of the Gujarat High Court. If a company defaults in redeeming the preference shares by the date fixed for redemption, the holder thereof cannot compel it to do so by suing in debt for the return of his capital or by filing for a mandatory injunction. Paragraph 10 reads as under:-

"10 We may also refer to a judgment of the Gujarat High Court in Anarkali Sarabhai v. CIT Gujarat [1982] 138 ITR

437. That case arose under the Income Tax Act and the question was whether the assesse was liable to pay capital gains tax on receipt of an amount equal to the face value of the preference shares when the company redeem them. The assesse received from the company an amount which exceeded the amount which he had paid for these shares. In deciding this question the Gujarat High Court had to examine the nature of redeemable preference shares issued by a company. The Court referred to Palmer's

Company Law (page 356, paragraph 1, 22nd Edition) wherein it was observed that "from the financial point of view, redeemable preference shares are a hybrid form of shares and debentures, incorporating features of both, and ITA Nos.512/2011, 513/2011, 810/2011, being closer to the latter than other preference shares, but from the legal point of view they are shares and are treated as such". The Court further noted the view of the learned author in Pennington's Company Law, 4th Edition, page 195 that if redemption of the petitioner's shares would make a company insolvent, it may not be allowed to redeem those shares because repayment of preference capital would be a fraud upon the company's creditors. According to the Gujarat High Court this view of the author clearly indicated that the holder of preference shares is not in the same position as that of a creditor. The learned author had also expressed the view in the aforesaid treatise, as noticed by the Gujarat High Court, that if a company defaults in redeeming the preference shares by the date fixed for redemption, the holder thereof cannot compel it to do so by suing in debt for the return of his capital or by filing for a mandatory injunction. This view of the author, according to the Gujarat High Court also negatives the contention that once the company decides to redeem its preference shares, the holder thereof would be in the position of a creditor."

12. *So far as the judgment in Anarkali Sarabhai (supra) relied upon by Shri Arsiwala, in my view, the judgment actually aids petitioner****. The Apex Court has noted that under Section 80 of the Companies Act, 1956, preference shares must not be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. When a preference share is redeemed by a company, what a shareholder does in effect is to sell the share to the company. Such a transaction is nothing but sale of the preference shares by the shareholders to the company. The Apex Court also held that if redemption of preference shares did not amount to sale, it would not have been necessary to specifically provide that the restriction imposed upon a company in respect of buying its own shares will not apply to redemption of shares issued under Section 80.***

[Emphasis supplied]

13. ***Petitioner has approached this Court on the basis that the company is not doing any business and the net-worth of the company is going down year after year. Petitioner has approached this Court as creditor of the company as could be seen from paragraph 31 of the petition where it says'..... The Petitioner states that the present Petition seeking winding up of the Respondent Company is being filed by it in the capacity of a creditor and not as a shareholder...". <u>As already held that petitioner cannot be a creditor and it is rather clear that redemption cannot be made except out of profits of the company which would</u>***

otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption, in my view, the petition is not maintainable.

14. Petition stands dismissed. *No order as to costs."*

(Emphasis supplied)

23. From the above decision, it is clear that a preference shareholder cannot become creditor just on redemption becoming due and such redemption can be made only out of the profit of issuer company and in absence of profit, if redemption is not made, preference shareholder will not become creditor. Therefore, this contention of the applicant that OCPS is nothing but debt due to "Simple Interest" of 6% being mentioned in the Article of Shareholder Agreement relating to redemption is rejected.

Another argument of the Applicant that decisions pertaining to preference shares shall not apply to OCPS, and OCPS is nothing but the Debt is also fallacious. Optionally Convertible Preference Shares i.e. OCPS are those preference shares which carry an option to be converted into equity shares. Such OCPS can be redeemed if not converted to equity shares, for which the company must create a Capital Redemption Reserve or CRR out of the profits of the company which are available for dividend distribution. CRR is required only to the extent of the face value of preference shares to be redeemed. CRR is not required if the redemption is made out of proceeds of fresh issue of shares. The fresh issue could be of equity or preference shares. CRR is also not required in respect of the premium on redemption of preference shares. The premium component can be redeemed out of the shares premium account standing in the account of Company's book. With these details of OCPS, it is very clear that it is a preference share and not debt, though can be redeemed but only out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares and unless and until OCPS is redeemed, it cannot be regarded as debt, as held by Courts as discussed by us in forgoing paras.

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It is also contended by the Applicant that OCPS in this case are automatically converted into debt and is payable with the simple interest of 6% p.a. at the end of 3 years and clearly indicates the existence of "Time Value of Money" and hence, a financial debt is due on Corporate Debtor. This contention of the applicant is also not tenable as because of non-redemption of OCPS due to profit not being available with the company, it is not converted into debt. Therefore, question of existence of "Time Value of Money" does not arise and hence, we do not find any financial debt as being due on the Respondent Company/Corporate Debtor towards the Applicant.

24. Decision of Bombay High Court in case of *Bombay Cotton Mfrg Co. Re (1909) 11 BomLR1302* cited by the Applicant for making any claim of debt by creditor to future time is not found relevant as it does not pertain to any such matter of arising of debt on redemption of OCPS becoming due and hence, not relevant to present case. In his rejoinder, the Applicant repeatedly kept on discussing about his right of redemption disregarding the fact that such redemption has not taken place in absence of profit and also, all terms and conditions of Shareholders Agreement are not fulfilled and unless such redemption takes place, no debt can be said to have become due on account of the Respondent Company/Corporate Debtor payable to him. He even countered the provision of Section 55 of the Companies Act; 2013 placing reliance on Rule 9 of the Companies (Share Capital and Debentures), Rules, 2019 ignoring the well settled principle of interpretation of a statute that Rules are subservient to the substantive provisions of the Act and therefore, cannot be read in derogation of the substantive law. The Rules are subordinate legislation and cannot go beyond the ambit and scope of the main enactment. Rules only provides a procedural law in respect of a substantive provision in the Act. Therefore, Rule 9 cited by the Applicant only provides a procedure to be followed for redemption of preference shares but it cannot overrides the substantive provision of Section 55 that redemption can be only made out of profit. In judicial pronouncements as discussed by me in paras 15, 16 & 22 also, it is

held that redemption of preference share can be made out of profit of the issuer company.

25. Even otherwise also, while going through the contents of the Shareholders Agreement, we find that the tenor of the language used in the said agreement is that the redemption is possible on the happening of incidents when the investors have not exercised their rights to convert prior to the stipulated period and collectively decide for conversion or redemption. As the relevant provisions of the aforesaid shareholder agreement have been reproduced above, we observe that this Tribunal as an Adjudicating Authority would enter jurisdiction only when there is already a clear debt established and then would examine that whether the debt has become due or not. This Adjudicating Authority however, would not be inclined to decide about the creation of the debt itself on happening of some events and the provisions of Section 7 of the Code can be actuated when there is already a debt established/determined and then this Adjudicating Authority would deal with the matter in accordance with the provisions of the I & B Code, 2016. Once, there is no determination or establishment of the debt, this Adjudicating Authority would not enter into a question of arising of the debt or otherwise. This Adjudicating Authority therefore, would also not be inclined to interfere on question of default of such debt in view of the mandate U/s 7 of I & B Code, 2016 as elaborately discussed hereinabove.

26. After considering all our findings discussed in foregoing paras, we are satisfied that no debt has become due from the Respondent Company/Corporate Debtor to be paid to the Applicant due to non-redemption of OCPS in view of the profit not being available with the Respondent Company in terms of provision of Section 55 of the Act and non-fulfilment of all terms and conditions of Shareholder Agreement. We do not feel it to be appropriate to hold that there is default and admit the petition u/s 7 merely because a claim for redemption of OCPS was made by the Applicant as per the originally agreed date in the Shareholder Agreement and a petition in this respect is filed. We feel that it

would be premature at this point to arrive at a conclusion that there was default in payment of any debt until issue of redemption of OCPS is resolved between the Applicant and Respondent Company as per all the Articles of the Shareholders Agreement and extant provisions of the Companies Act and amount payable by the Respondent Company to the Applicant is determined taking into consideration the profit earned by the Company later. In the process, if such determined amount is not paid, it will amount to default at that stage. Therefore, the twin condition of admitting a petition u/s 7 for a financial debt becoming due and default taking place in not paying the due debt, as laid down by the Hon'ble Supreme Court in case of ***Innovative Industries Ltd. Vs. ICICI Bank and Another (2018) 1 SCC 407***, has not been found to be in existence at present, as no financial debt has become due, is established, hence, question of its default within the meaning of Section 7 of the I & B Code, 2016 would not arise.

27. Accordingly, application for initiation of CIRP against the Corporate Debtor M/S Onspon Services Private Ltd. is rejected and CP (IB) No. 392/ALD/2019 is hereby dismissed.

-Sd-

(Ashish Verma)
Member (Technical)

-Sd-

(Praveen Gupta)
Member (Judicial)

31st March, 2023

Priya Agarwal
(Stenographer)