
(2010) 08 BOM CK 0130

In the Bombay High Court

Case No : Company Petition No. 181 of 2010

Kotak Mahindra Bank Limited

APPELLANT

Vs

J.B. Diamonds Limited

RESPONDENT

Date of Decision : 11-08-2010

Acts Referred:

Contract Act, 1872 — Section 23
Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations,
2000 — Regulation 4
Foreign Exchange Management Act, 1999 — Section 10(1), 2
Reserve Bank of India Act, 1934 — Section 45U, 45V

Citation : (2011) 1 BomCR 156 : (2010) 112 BOMLR 3954 : (2011) 163
CompCas 152 : (2011) 1 CompLJ 225 : (2010) 104 SCL 154

Hon'ble Judges : S.J. Vazifdar, J

Bench : Single Bench

Advocate : Virag V. Tulzapurkar, Birendra Saraf, Sachin Chadarana and Jaisry Mani, instructed by Manilal Kher and Ambalal, for the Appellant; D.D. Madon, Chetan Kapadia, instructed by Sabeena Mahadik, for the Respondent

Judgement

S.J. Vazifdar, J.—This is a petition for winding up of the Respondent-company on the ground that it is unable to pay its debts.

2. The Petitioner had granted various facilities to the Respondent even prior to 14th September 2007. By a letter dated 14th September 2007 addressed to the Respondent the Petitioner conveyed its intention to continue and to amend the facilities sanctioned earlier subject to the terms and conditions stated therein. The Respondent endorsed its consent to the same. The letter sanctioned various facilities. The present petition is concerned with "Facility 3" mentioned therein. It was a revolving facility to enable the Respondent to hedge foreign currency exposure to the extent of Rs. 7,50,00,000. In view of the defense taken on the ground that the facility is illegal and contrary to public policy it is necessary to note only a few aspects thereof.

3. One of the covenants/conditions is that the derivatives/forward contract would

be booked only against a request letter from the Respondent detailing the amount and currency in which the derivatives/forward contract has to be booked. The Respondent is required to settle the negative Mark to Market within 15 days by deposits of cash margin. The letter required certain documents to be executed by the parties.

3(A). The Respondent executed two identical risk disclosure statements dated 12th March 2008 and 9th July 2008. The statement is prefaced with a declaration that it does not purport to disclose all the risks and other relevant considerations of entering into derivative transactions; that the Petitioner does not act as a financial adviser in relation to any derivative transactions; that the Respondent intends entering into such transaction and that it has obtained independent confirmation that the deal price is according to market levels. The declaration then sets out details regarding certain risks including market risk, basic risk, operational risk, legal, regulatory and tax risks. It states that the Respondent has considered the appropriateness of derivative transactions in the light of its own experience and objectives and that the Respondent has independently assessed the suitability of the derivative transactions that it proposes to enter into the transaction and by entering into the transaction confirms that it has assessed independently the financial and legal risks of the transaction and is prepared to assume the economic consequences of the same.

(B). The Respondent's Board of Directors at a meeting held on 9th July 2008 resolved that the Respondent is authorized to enter into foreign currency contracts for hedging its underlying export, import and other outstanding foreign currency liabilities and Indian rupee and foreign currency swap transactions or any other form of derivative products thereof with the Petitioner.

(C). The Respondent executed two forward contract declarations in favour of the Petitioner. The Respondent agreed and declared inter-alia that in entering into contracts it would rely solely on its own judgment and that while the Petitioner may provide information to it from time to time it will not provide advice upon the merits of a proposed currency transaction or otherwise. The Respondent agreed that the Petitioner would not be liable for any loss arising from its actions made as a result inter-alia of incorrect instructions where the bank acting reasonably, believed the instructions to be genuine. The Respondent also made various representations to the Petitioner which are significant in view of the defense now taken to the legality of the transaction. The Respondent represented that it was acting for its own account and has full power and authority and has taken all necessary steps to enable it lawfully to enter into and perform every forward contract stated therein. The Respondent agreed that wherever extension of forward contracts is sought from the Petitioner or are rolled over they shall be cancelled and rebooked at the current rate of exchange. The difference between the contract rate and the rate at which the contract is cancelled shall be recovered from/paid to the Respondent at the time of extension. Such a request for extension should be made on or before the maturity date of the contract.

Annexed to each of the declarations is a schedule containing the particulars of the facility.

4. Pursuant to the above facilities and in accordance therewith the Respondent entered into two forward contract transactions with the Petitioner dated 20th February 2008 and 17th March 2008. The Respondent executed the forward contract booking confirmation notes. It is not necessary to furnish details of the quantum of each transaction in view of the admissions by the Respondent as to its liability which I will refer to shortly. Suffice it to state that the Respondent has not denied the execution of the documents I have referred to thus far. Nor has it denied having been granted and having availed of the said facilities.

5. By a letter dated the 9th February 2009 (wrongly mentioned as 6th February 2009) addressed to the Petitioner the Respondent confirmed having entered into the said transaction dated 20th February 2008; that the same had been cancelled by it on 6th February 2009 and that as a result thereof it was liable to pay the Petitioner a sum of Rs. 1,68,55,000. It further stated that after certain adjustments, the balance payable by the Respondent to the Petitioner was Rs. 1,40,57,265. The letter stated that the Respondents Board of Directors had been kept apprised of the said liability and that their concurrence had been obtained to honour the same. The Respondent requested 90 days to repay the dues with interest at 8% and as per the installments stated therein.

6. By a letter dated 6th March 2009 the Respondent confirmed having entered into the said forward contract dated 17th March 2008 and that it had cancelled the same on 6th February 2009. The Respondent admitted its liability on account thereof in the sum of Rs. 1,03,50,000. In other respects the letter was similar to the one dated 9th February, 2009 (wrongly mentioned as 6th February 2009).

7 (A). The Petitioner by its letter dated 17th March 2009 inter-alia stated that the request for charging interest at 8% and was not acceptable and that interest at 13% and would be charged on the overdue amount.

(B). The Petitioner by a letter dated the 28th April 2009 demanded payment of the said amounts.

8 (A). The Respondent by its reply dated 14th May 2009 admitted its liability in the sum of Rs. 2,74,00,000. It stated that the cancellation of the said contracts was primarily on account of the delay in realization of its dues. It further stated that to address the liquidity crisis the consortium of certain lenders had formed a core committee to discuss the future course of action. The Respondent stated that it would soon come out of its temporary financial difficulties and that it was making an all-out effort to honour the Petitioner's dues.

(B) By a further letter dated 6th July 2009 the Respondent set out the various difficulties faced by it, the reasons for the same, the amounts due by it to various other lenders and the steps contemplated by it to overcome the crisis. The Respondent requested the Petitioner for a speedy appraisal of the proposed

restructuring scheme and the subsequent approval and implementation thereof.

9. The Petitioner by its advocates a letter dated 5th April 2010 addressed a statutory notice. According to the Petitioner of sum of Rs. 2,24,07,265 with interest thereon at 13% and from 9th February, 2009 was due and payable by the Respondent to it.

10. Mr. Madon, the learned senior counsel appearing on behalf of the Respondent, submitted that the transactions are illegal, contrary to public policy and therefore void. He however made no attempt to elaborate this contention except to state that the transactions constituted a wager and were therefore contrary to Section 23 of the Indian Contract Act. He stated that there were similar matters pending before various courts all over the country and that therefore this company petition ought to be dismissed and the Petitioner ought to be relegated to a civil suit where this aspect of the matter could be more appropriately decided.

11. Mr. Madon, however, did not furnish any details as to these proceedings which he stated were pending all over the country. Mr. Chadarana, the learned senior counsel appearing on behalf of the Petitioner, submitted that the proceedings referred to by Mr. Madon were not on the same issue.

12. As the details of these proceedings were not furnished I find it unnecessary to consider this aspect. Moreover even assuming that there are proceedings pending before various other courts it makes no difference. I am bound to decide the issue in the present matter. The submission based merely on the fact that similar issues are pending all over India does not constitute a bona-fide defence. The company court is not prevented from deciding the question of law.

13. In fact the only decision to which my attention has been invited is the judgment of a learned single judge of the Madras High Court in Rajshree Sugars and Chemicals Limited Vs. AXIS Bank Limited, formerly known UTI Bank Limited, . The learned judge has dealt with similar transactions in considerable detail including the nature of such transactions. The learned judge rejected the contentions that the transactions are illegal and cannot be enforced.

14. I am, however, content to rest my judgment on the statutory provisions and circulars relied upon by Mr. Chadarana, which expressly permit such transactions.

Section 45U(a) and 45V of The Reserve Bank of India Act, 1934 which fall under chapter IIID titled: "REGULATION OF TRANSACTIONS DERIVATIVES, MONEY MARKET INSTRUMENTS OR SECURITIES, ETC." reads as under:

45U. Definitions.- For the purpose of this Chapter:-

(a) "derivative" means an instrument, to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities (also called underlying"), or a combination of more than one of them and includes interest rate swaps, forward rate

agreements, foreign currency swaps, foreign currency-rupee swaps, foreign currency options, foreign currency-rupee options or such other instruments as may be specified by the Bank from time to time;

45-V. Transactions in derivatives.-(1) Notwithstanding anything contained in the Securities Contracts (Regulation) Act, 1956 (42 of 1956) or any other law for the time being in force, transactions in such derivatives, as may be specified by the Bank from time to time, shall be valid, if at least one of the parties to the transaction is the Bank, a scheduled bank, or such other agency falling under the regulatory purview of the Bank under the Act, the Banking Regulation Act, 1949 (10 of 1949), the Foreign Exchange Management Act, 1999 (42 of 1999), or any other Act or instrument having the force of law, as may be specified by the Bank from time to time.

(2) Transactions in such derivatives, as had been specified by the Bank from time to time, shall be deemed always to have been valid, as if the provisions of Sub-section (1) were in force at all material times.

15. There is no dispute that the Petitioner falls within the ambit of Section 45V. The question then is whether the transactions between the parties were in such derivatives as were specified by the Reserve Bank of India. If they were then in view of one of the parties thereto, namely the Petitioner, falling within the purview of Section 45V the transaction would be valid.

16. The Master Circular on Risk Management and Inter-Banking Dealings consolidates the existing instructions on the subject at one place. The same lists the circulars/notifications. It is issued with a sunset clause of one-year but is apparently renewed from year to year. One of the circulars pertains to: "Facilities for Persons Resident in India and other Authorized Dealers Category-I". The first item in this category pertains to "Forward Contracts". It provides that a person resident in India may enter into forward contracts with an Authorized Dealer Category I bank (Authorized Dealer Category-I bank) in India to hedge an exposure to exchange risk in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Foreign Exchange Management Act, 1999 or rules or regulations or directions or order is made or issued thereunder subject to the terms and conditions mentioned therein.

17. It was not disputed that the Petitioner is an authorized dealer within the meaning of Sections 2(c) and 10(1) of the FEMA which read as under:

2. Definitions

In this Act, unless the context otherwise requires,-

(c) ""Authorized person"" means an authorized dealer, money changer, off-shore banking unit or any other person for the time being authorized under Sub-section (1) of Section 10 to deal in foreign exchange or foreign securities;

10. Authorized person.--(1) The Reserve Bank may, on an application made to it

in this behalf, authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or off-shore banking unit or in any other manner as it deems fit.

18. The following provisions of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 are relevant:

Definitions.

2. In these Regulations, unless the context requires otherwise,-

(i) "Act" means the Foreign Exchange Management Act, 1999 (42 of 1999);

(ii) "authorized dealer" means a person authorized as authorized dealer under Sub-section (1) of Section 10 of the Act;

Permission to a person resident in India to enter into a Foreign Exchange Derivative contract.

4. A person resident in India may enter into a foreign exchange derivative contract in accordance with provisions contained in Schedule I, to hedge an exposure to risk in respect of a transaction permissible under the Act, or rules or regulations or directions or orders made or issued thereunder.

SCHEDULE I (See regulation 4) Foreign exchange derivative contract permissible for a person resident in India A. Forward Contract

1. A person resident in India may enter into a forward contract with an authorized dealer in India to hedge an exposure to exchange risk in respect of a transaction for which sale and/or purchase of foreign exchange is permitted under the Act, or rules or regulations or directions or orders made or issued thereunder, subject to following terms and conditions-

....

19. There is no dispute that the transactions entered into by the Respondent are those for which the sale and/or purchase of foreign exchange is permitted under the Foreign Exchange Management Act, 1999. In the statement of disclosure the Respondent stated that it had the legal capacity to enter into derivative transactions by the regulations and laws applicable to this country. The Respondent agreed to undertake only such derivative transactions as are permitted by the laws of India by which it is governed including the RBI guidelines. The company agreed before undertaking the transactions that it had considered the regulatory approval that may be needed.

The Respondent has not stated anywhere that it has made any misrepresentations to the Petitioner regarding its entitlement to enter into the said transactions. Nor has it contended that it has violated any law by entering into the said transactions. The Respondent has not contended that the above statutes, regulations and circulars do not apply to the said transactions or that the same are in violation thereof or at least not in conformity therewith.

20. It is clear, therefore, that the transactions entered into between the Petitioner and the Respondent were permissible in law.

21. There is no challenge to the above provisions of law on any ground. The said transactions were, therefore legal, valid and binding on the parties.

22. Mr. Madon submitted that in any event this is not a fit case for winding up the Respondent or even admitting the petition. I have for more than one reason, come to the conclusion that this is not a fit case to even admit the petition without first giving the Respondent an opportunity of making payment in a phased manner.

23. The Respondent employs about 2500 people. While this cannot be the only ground for not winding up a company it is certainly an important consideration especially where it is found that the company is going through a temporary financial crisis and there is a possibility of it overcoming the same.

24. Mr. Madon relied upon an Assessment Note dated 26th September, 2009, prepared by the State Bank of India. He stated that a consortium of 13 banks led by the State Bank of India has sanctioned a financial arrangement in respect of the Respondent. In this regard he relied upon the assessment note. The note states that it is subject to sanction by the higher sanctioning authority. Mr. Madon stated that the same has been sanctioned.

Although the assessment note has not been relied upon in the pleadings, considering the nature of these proceedings and the consequences of any order for either party, I permitted him to rely upon the same. I must in fairness to the Petitioner state that I proceeded with the matter by accepting what the Respondent has stated/represented in the assessment note without affording the Petitioner an opportunity of meeting the case based thereon. I adopted this otherwise impermissible approach as the order I intend passing will cause the Petitioner no prejudice.

25. The assessment note refers to the other 12 banks/financial institutions. The amounts due by the Respondent to the consortium exceed Rs. 800 crores. The assessment note deals with various aspects of the Respondent in considerable detail. It states that the Respondent is a reputable company in the diamond industry; that it was able to grow consistently over a period of about 30 years; that it had various advantages such as a captive market as it had been routing about 50% of its exports to units controlled by the family members of the promoters of the Respondent as a result of which it did not have to separately market its products and that as a result of all the exports being routed through these units the Respondent's business track record was highly satisfactory and the amounts due by the respondents in the past were not alarming. The note also recognises that during the financial year 2008-09 due to the appreciation in the South-East Asian currencies vis-a-vis the USD and the fall in demand due to global recession, the overseas trading offices were unable to recover their dues from the buyers resulting in a near halt of realisation for the Respondent. The

note further states that this has been the trend in the diamond industry. It is for these reasons that the amounts due by the Respondent to the various banks and financial institutions had increased only in the past about two years.

26. Both the learned Counsel placed considerable reliance upon the following observations in the note:

As substantial funds of the company are blocked in receivables, realisation therefore is expected to be delayed beyond a period of one year, the company has requested for restructuring its consortium working capital advances. We have weighed out company's request taking into consideration the following facts (based on the audited Balance sheet for the year ending 31/03/09):

- i) The company reported a net loss of Rs. 90.62 crores.
- ii) Resultantly, the company's net worth is eroded by Rs. 40.62 crores.
- iii) The company has incurred cash losses to the tune of Rs. 130.17 crores, thereby putting a strain on its liquidity position.
- iv) As on 31.03.09, Rs. 521.21 crores of debtors were outstanding for more than 6 months.
- v) Out of the total debtors of Rs. 1122.98 crores, around 52% are due from subsidiary companies/firms and related parties.
- vi) The holding level of receivables and creditors has stretched to 10.03 months and 4.58 months respectively.
- vii) As on 31.03.09, the outstanding bank finance was Rs. 825.09 crores as against the sanctioned limit of Rs. 780.00 crores. In addition to this, debit balance to the tune of Rs. 24.48 crores representing amount due on crystallisation of overdue bills and losses on cancellation of forward contracts was outstanding in the current a/c.
- viii) Drawing power of EPC a/c fell sharply primarily on account of increase in level of sundry creditors.
- ix) The consortium in the meantime implemented holding on operations in the ratio of 90:10 to enable the unit continue with its operations until any concrete restructuring proposal could be implemented.

Clause (x) sets out the position of the respondents account at the consortium level as on 31st March 2009. The outstanding as on 31st March 2009 was Rs. 825.09 crores and the irregularity was to the extent of Rs. 271.86 crores. The note goes on to state as under:

The company's operations are also considered technically feasible and economically viable as the unit was already engaged in manufacturing activity for over three decades reporting satisfactory profits. Further, it has the necessary capacity and expertise to achieve its estimated/projected levels. Despite erosion

in its NWC, the company has estimated to generate profits at PBIT level right from FY 2009-10. The loss at PBT level is only because of the higher interest costs on account of increase finance as against cheaper dollar finance earlier availed by the company. The company's operations are expected to generate profits from the FY 2010-11.

Considering the magnitude of the loss (Rs. 90.62 crores during FY 2008-09) and the overdue short-term obligations of the company, we propose to carve out a Working Capital Term Loan (WCT L) Rs. 200.00 crores repayable over a period of 30 months from the irregular portion.

The company has offered collateral security of Rs. 101.00 crores (50.50%) for the proposed WCT L of Rs. 200.00 crores.

The promoters have already infused funds to the tune of Rs. 74.46 crores by way of increase in share capital and a share premium to stem the erosion in NWC during the current year and agreed to bring in another Rs. 110.00 crores in the current and next fiscal in a phased manner.

To enable the company to run its business operations smoothly and tide over the present financial crisis, the regular FBWC limit of Rs. 625.00 crores (outstanding credit limits less proposed WCT L) is being proposed for the company for the current year.

Primary Assumptions underlying the present proposal are listed on Page No. 25.

Analysis of receivables outstanding as on 31.03.09:

As on 31.03.09, the receivables outstanding was approx. 84% of the total sales, of which the receivables to the tune of Rs. 59.48 crores were outstanding for more than 9 months. The major party wise receivables outstanding as on 31.03.09 and subsequent realisations from there till date are listed here under:

....

There follows a tabular statement of the amount outstanding as on 31st March 2009 from various entities most of which admittedly are family companies/sister concerns of the Respondent. The amount outstanding as on 31st March 2009 from these entities is Rs. 871.58 crores. The amount realised during the period 1.4.09 to 17.9.09 was only Rs. 206.44 crores. After the table the statement continues as follows:

As evident from the above, the company is realising the outstanding receivables but at a slow pace. The company has advised us that there are no bad debts and all the receivables would be realised within the stipulated period of 365 days.

It may be noted that some of the above mentioned units are controlled by family members of directors of JBDL, though they are not associates/subsidiaries of JBDL.

27. Mr. Chadarana relied upon the note to support his contention that the net

worth of the company is eroded and that the company is now not capable of being revived. He submitted that the company is and will be unable to pay the Petitioner's dues and it is therefore necessary to wind it up. I do not agree.

28. The assessment note certainly establishes that the company is going through a severe financial crisis. It however also indicates that there is a possibility of it overcoming the same. The fact that a consortium of 13 prominent banks/ financial institutions have come to this conclusion and have sanctioned a package prima-facie supports Mr. Madon's contention in this regard. The assessment note merely indicates that though the company is at present unable to pay all its dues it will be able to do so shortly. If there is a possibility of the company overcoming the financial difficulties public interest demands that it ought to be afforded an opportunity of doing so. There is everything to be gained by the same. There is nothing to be lost especially at the instance of the Petitioner who is unsecured creditor.

29. I will presume in the respondents favour that what is stated in the assessment note is correct. Mr. Madon did not indicate that the contents of the assessment note are either inaccurate or outdated. The Respondent's case itself is that even the enormous outstandings of the consortium of banks and financial institutions of over Rs. 800 crores will be repaid commencing only a short time hereafter. This is clear for instance from the respondents advice to the consortium that it has no bad debts and that all the receivables would be realised within the stipulated period of 365 days. This period of 365 days gets over next month. The amounts shown as outstanding are from the Respondent's family/ associate concerns themselves. Presumably therefore the representations of the Respondent contained in the assessment note are accurate.

30. I appreciate that it may be difficult for the Respondent to start repaying its dues whether of the Petitioner or of the members of the consortium, immediately thereafter. If what is stated in the assessment note is correct, and the respondents indeed maintain that it is, there can be no objection on the Respondent's part to commence payment after a few months and to continue paying the Petitioner's debts in reasonable installments thereafter. At the cost of repetition, it is the Respondent's case that it is and in any event will shortly be, in a position to do so. I proceed therefore on the justifiable assumption at least so far as the Respondent is concerned that no prejudice can be caused to the Respondent by an order to this effect.

31. I would therefore consider a moratorium on the repayment of the Petitioner's dues for a reasonable time and also grant the Petitioner installments liberally for repaying the Petitioner's dues. Having made the representation that about 52% of the respondents dues are from subsidiary companies/firms and related parties; that there are no debts and all the receivables would be realised within September this year and that the Respondent operations are expected to generate profits from the financial year 2010 -- 11 the Respondent can hardly have any grievance in respect of such an order.

32. The installments naturally would have to be paid with interest on the reducing balance. In that event the Petitioner would not be prejudiced and the Respondent would be benefited. Public purpose would thereby be served and the interests of all the creditors as well as the Respondent's workers would be protected.

33. In the circumstances the following order is passed:

(i) In the event of the Respondent paying the Petitioner an amount of Rs. 58,24,000 on or before 10th February 2011 and a further sum of Rs. 2,24,00,000 in 18 equal monthly installments payable on or before the 10th day of each month commencing from 10th February 2011 together with interest on the reducing balance at 13% per annum the company petition shall stand dismissed.

(ii) In the event of the company making default in payment of any three installments or the last two installments the company petition shall stand admitted without further orders and in that event to be advertised in Free Press Journal, Maharashtra Times and Maharashtra Government Gazette. The Petitioner to deposit an amount of Rs. 10,000/- with the Prothonotary and Senior Master of this Court within four weeks from the date of default.