Rajani, Singhania & Partners
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RSP
INDIA LEGAL UPDATE

INDIA LEGAL UPDATE is a journal of Rajani, Singhania & Partners which offers a legal perspective on the new business climate and opportunities in India in keeping with the existing laws, current happenings and events in Corporate India.

In this Issue

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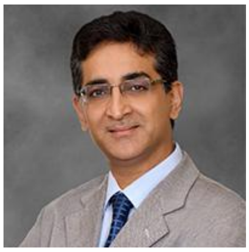

Prem Rajani

Dear Readers,

Welcome to the April 2015 issue of India Legal Update!

In the Legal Suite section, we have discussed the legal rules that exist for transfer of property with regards to the benefit of the unborn person and the rule against perpetuity.

The Companies Act 2013 introduced the concept of One Person Company (OPC). The concept of OPC, though well intentioned has not received much attention in the market. We have featured an article on the One Person Company in the Legal Insight section, that attempts to identify and study the pitfalls associated with OPC in India.

In another feature, we have enumerated the essentialities of a guarantee and covered the entire gamut of guarantee – Valid Contract, Types, Invocation, Revocation, Discharge, Rights of Surety, Letter of Comfort and other evolving concepts.

Hope you find this issue interesting and informative.

Look forward to your suggestions and feedback at info@rsplaw.in

Best Regards,

Prem Rajani
Managing Partner

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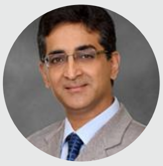

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Legal Suite

A Brief Write-Up On Transfer Of Property For The Benefit Of Unborn Person And Rule Against Perpetuity

INTRODUCTION

The rule as regards the transfer of property for the benefit of unborn person and the rule against perpetuity (collectively, the "Rules"), which are mainly governed by sections 13 and 14, respectively, of the Transfer of Property Act, 1882 ("TOPA"), have, since decades, troubled lawyers of all ages across the country. These Rules are often described as one of the most complicated legal rules ever.

Where property is desired to be transferred/ bequeathed by any person, to more generations than one, it is imperative that these Rules are conformed to.

ORIGIN

The origin of rule against perpetuity stems from the days of feudal England as far back as in 1682 from the case of Duke of Norfolk's, wherein, Henry (the 22nd Earl of Arundel), tried to create a shifting executory limitation in a way that one of his titles would pass to his eldest son (who was mentally deficient) and thereafter to his second son, and another title would pass to his second son and thereafter, to his fourth son. The estate plan also included provisions for shifting the titles many generations later, if certain conditions were to occur. It was held by the House of Lords that such a shifting condition could not exist indefinitely and that the tying up of property too long beyond the lives of people living at the time was wrong. The concept of trying to control the use and disposition of property beyond the grave was often referred to as control by the "dead hand". The rule against perpetuity, in England, was later

codified in the form of the Perpetuities and Accumulations Act, 1964.

ILLUSTRATIONS

- With a view to understand the Rules, let us first consider the following five illustrations:
    i. **A** transfers his property to **B** (his unborn child).
    ii. **A** transfers his property to **B** (his child) for life, thereafter to **C** (his unborn grandchild) for life and

finally, to **D** (his unborn great grandchild) absolutely.

iii. **A** transfers his property to **B** (his child) for life and thereafter to **C** (his unborn grandchild) absolutely which property is to vest in **C** when he attains the age of twenty one years.

iv. **A** transfers his property to **B** (his child) for life, thereafter to **C** (his unborn grandchild) absolutely which property is to vest in **C** upon birth. However, C is unborn till the time of death of B.

v. **A** transfers his property to **B** (his child) for life, thereafter to **C** (his unborn grandchild) absolutely which property is to vest in **C** upon birth. C is born before the death of B.

- From the aforesaid five (5) illustrations, only the transfer sought to be made in favour of the unborn person in illustration "v" will take effect. The transfers sought to be made in favour of the unborn person in the remaining illustrations will fail and not take effect. In order to understand the rationale behind the failure of such proposed transfer in favour of an unborn person, it is necessary to understand the relevant provisions with respect to the Rules.

RULE FOR TRANSFER OF PROPERTY FOR THE BENEFIT OF UNBORN PERSON

- Section 13 of TOPA provides that:

"Where, on a transfer of property, an interest therein is created for the benefit of a person not in existence at the date of the transfer, subject to a prior interest created by the same transfer, the interest created for the benefit of such person shall not take effect, unless it extends to the whole of the remaining interest of the transferor in the property."

RULE AGAINST PERPETUITY

- Section 14 of TOPA provides that:

"No transfer of property can operate to create an interest which is to take effect after the life time of one or more persons living at the date of such transfer, and the minority of some person who shall be in existence at the expiration of that period, and to whom, if he attains full age, the interest created is to belong."

ANALYSIS OF PROVISIONS

- Section 13 and 14 of the TOPA go hand in hand, in as much as, section 13 and 14 are to be read together in order to understand the provisions governing the Rules.
- The TOPA does not permit transfer of property directly **in favour of** an unborn person. Thus, in order to transfer a property for the benefit of a person unborn **on the date of the transfer**, it is imperative that the property must first be transferred in favour of some other person **living on the date of transfer**. In other words, the property must vest in some person between the date of the transfer and the coming into existence of the unborn person since property cannot be transferred directly in favour of an unborn person. In other words, the interest of the unborn person must, in every case, be preceded by a prior interest.
- Further, where an interest is created in favour of an unborn person on a transfer of property, such interest in favour of the unborn person shall take effect only if it extends to the whole of the remaining interest of the transferor in the property, thereby making it impossible to confer an estate for life on an unborn person. In other words, the interest in favour of the unborn person shall constitute the entire remaining interest. The underlying principle in section 13 is that a person disposing of property to another shall not fetter the free disposition of that property in the hands of more than one generation.
- Section 13 does **not** prohibit successive interests (limited by time or otherwise) being created in favour of several persons **living** at the time of the transfer. What is prohibited under section 13 is the grant of interest, limited by time or otherwise, to an unborn person.
- Further, Section 14 of TOPA provides that where an interest is created for the benefit of an unborn person (in accordance with the provisions of section 13), such interest shall not take effect if the interest is to vest in such unborn person **after** the life time of one or more persons living on the date of the transfer (i.e. the person in whose favour the prior interest is created as required under section 13) **and** the minority of such unborn person. In other words, the interest created for the benefit of an unborn person shall take effect only if the interest is to vest in such unborn person **before** he attains the age of eighteen years.
- Section 14 further provides that the unborn person, in whose favour the interest is created, must have come into existence **on or before** the expiry of the life or lives of the

person(s) in whose favour the prior interest is created as required under section 13.

OTHER RELEVANT PROVISIONS

- **Sections 113 and 114 of Indian Succession Act, 1925 ("ISA"):** Sections 113 and 114 of the ISA are almost identical to sections 13 and 14, respectively, of TOPA. The main difference between the provisions under the ISA and the provisions under TOPA is that the former deals with bequests which take effect only on the death of the testator while the latter relate to transfer of property inter vivos. Section 13 of TOPA controls Section 113 of ISA and both of them are to be read together, as opined by the Apex Court in **Raj Bajrang Bahadur Singh vs. Thakurain Bakhtraj Kuer** (AIR 1953 Supreme Court 7). It was further observed by the Court that:

"It is quite true that no interest could be created in favour of an unborn person but when the gift is made to a class or series of persons, some of whom are in existence and some are not, it does not fail in its entirety; it is valid with regard to the persons who are in existence at the time of the testator's death and is invalid as to the rest."

RULES SIMPLIFIED

- The effect of these Rules is that a transfer/ gift can be made to an unborn person subject to the following conditions: (i) that the transfer/ gift shall be of the whole of the remaining interest of the transferor/ testator in the thing transferred/ bequeathed and not of a limited interest; and (ii) that the vesting is not postponed beyond the life in being and the minority of the unborn person.
- In simple terms, while section 13 of TOPA lays down the mechanism for transfer of property for the benefit of unborn person and *"what property"* is required to be ultimately transferred in favour of an unborn person in order to validate such transfer, section 14 of TOPA provides the *"maximum period as to when"* such property can be vested upon such unborn person.
- Section 14 of TOPA supplements section 13 of TOPA and thus, it is pertinent to note that when an interest in any property is intended to be transferred in favour of an unborn person, sections 13 and 14 of TOPA are required to be read together and the provisions contained thereunder are required to be duly complied with, in order to give effect to the intended transfer in favour of such unborn person.

Legal Insight

One Person Company – Problems And Pitfalls

INTRODUCTION

The concept of One Person Company ("***OPC***") was introduced in the Companies Act, 2013 ("***Companies Act***") and was hailed as a marque feature providing a completely new form of limited liability company. However, the concept of OPC, though well intentioned has not received much traction in the market. A total of 913 OPCs have been incorporated in India from the period of April 2014 (when the incorporation of OPCs were first allowed) to October 2014. Though the number looks large, during the same period, a total of 32,401 limited liability companies were incorporated in India. Therefore, a mere **2.8%** of the total number of limited liability companies incorporated during that period were OPCs. This Article attempts to identify the pitfalls associated with OPC in India and analyse the reasons behind the same.

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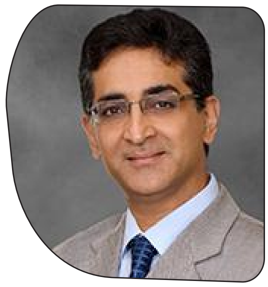

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THE BASICS

- An OPC is defined under Section 2(62) of the Companies Act as "a company which has only one person as its member". An OPC is a legal entity which functions on the same principles as that of a private company but has only one person as its shareholder.
- The Company (Incorporation) Rules, 2014 ("Rules") state that only a natural individual, who is an Indian citizen and an Indian resident in the current financial year, shall be eligible to incorporate an OPC ("Member"). The Member is further required to nominate another natural Indian citizen and resident (with their prior written consent) ("Nominee") who shall become the member in the event of the death or incapacity of the Member.
- The minimum paid up share capital of an OPC is Rs.1,00,000 (Rupees one lakh only). The Companies Act grants certain benefits to an OPC vis- à - visa private limited company, including, waiver of requirement of annual general meetings; waiver from creation of cash flow statement; waiver for having quorum of meetings and notice of meetings; exemption from circulation of members resolutions, etc.
- The Major pitfalls associated with OPCs are as follows:

ONLY NATURAL INDIVIDUAL

The main concern with the OPC is the restriction on membership to natural persons. Under the Companies Act, a "person" may incorporate an OPC. The definition of person includes a duly incorporated company. The Rules however have restricted this right only to an Indian citizen currently residing in India. As such, in the event a company desires to form an OPC as a wholly owned subsidiary, it simply cannot do so. If companies were to be allowed to set up wholly owned OPC, it would with its limited procedure allow for easier diversification and greater control over the management of such fledging ventures. One still does not know, nor can fathom, why this restriction on a company setting up an OPC has been imposed under the Act.

MANDATORY NOMINATION

The concept of OPC is centred on the ability of an individual to enter into a business with limited liability without a partner. This entire objective has been overshadowed due to the requirement of a Nominee, who in the event of death or incapacity of the Member shall become the sole member of the OPC. The prior permission of the Nominee is required for this appointment and the Nominee may resign from this position at any time, requiring the Member to identify a new nominee within fifteen days. Though, the concept of Nominee has a rationale objective (to ensure continual existence of the OPC), at a practical level it mars the entire objective of the concept through its procedural complications. The concept of Nominee further raises the question of inheritance, would the Nominee inherit the OPC? Or will the inheritance of the OPC follow the personal laws of the Member?

NUMBER OF OPCs

A Member is restricted from incorporating more than one OPC. A restriction which is unique to OPC, i.e. a person may incorporate an infinite number of sole proprietorship concerns, partnerships and companies but only one OPC. This unnecessary restriction imposes an additional burden on the state to track not only the Member of an OPC but also the Nominee, to ensure that a person may not incorporate more than one OPC. The Rules further, do not deal with the status of an OPC incorporated in contravention of this limit. Whether such OPC will have to be dissolved or lose its corporate personality or treated as a sole proprietorship has not been clarified. The question therefore arises as to why there exists a limit to the number of OPCs. There is therefore an additional restriction on the Member forcing him/her to incorporate additional private limited companies with majority shareholding to circumnavigate the problem.

INCOME TAX ON OPC

The concept of OPC is not yet recognized under Income Tax Act, 1961 ("IT Act") and may be put in the same tax slab as other private companies, making it liable for several additional taxes including the dividend distribution tax. As per the IT Act, private companies have been placed under the tax bracket of flat 30% taxation on the total income. On the other hand, sole proprietors are taxed at the rates applicable to individuals, which means that different tax rates are applicable for different income slabs. Sole proprietors also benefit from exemptions available to individuals under the IT Act. It is unclear if the IT Act would be amended to include such exemptions to OPC, as per the present date, the concept of OPC is in limbo under applicable taxation laws.

NO ECB

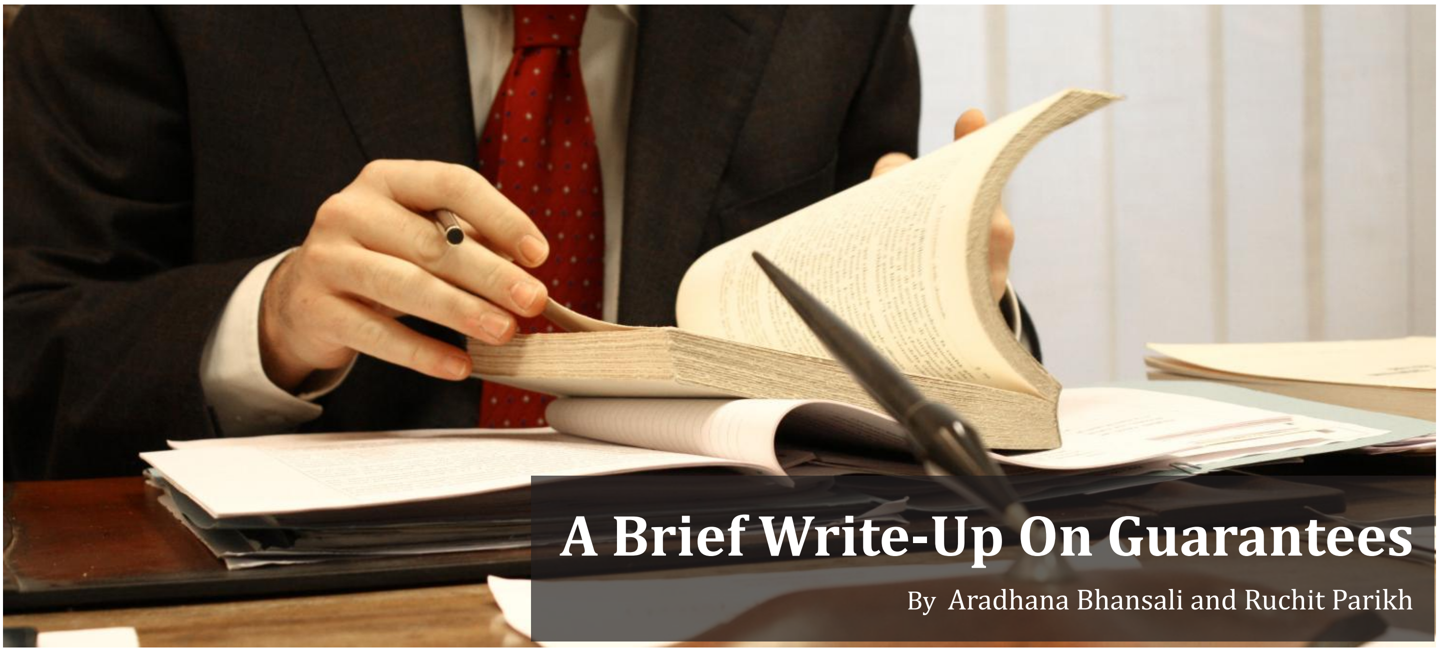
The OPC is not a recognised concept under the External Commercial Borrowing and Trade Credits dated July 1, 2014 ("ECB Policy"). An OPC therefore cannot obtain funding from foreign recognised lenders as per the extant ECB Policy.

RESTRICTIONS ON CONVERSION OF OPC

- An OPC must compulsorily convert into a private limited company within six months of either its paid up share capital exceeding Rs.50,00,000 (Rupees fifty lakhs) or its average annual turnover exceeding Rs 2,00,00,000 (Rupees two crores). These additional restrictions are also unique to OPC and the rationale behind the same eludes the authors. It also causes an absurd situation wherein an OPC set up with the very intention of avoiding the additional paperwork and bureaucracy of a private limited company is punished for its very success. The reasons for the imposition of the limit is unclear, it appears that it's a limit on the prosperity of the OPC.
- The Rules are characteristically ambiguous as to the event if an OPC fails to find a partner willing to sign on to a private limited company with the Member. The Rule is also silent on the implication of the failure of the OPC to complete such a conversion. There is also ambiguity as to the status of the OPC between the point it exceeds of the turnover restriction and its eventual conversion as per the Rules. Would the OPC be treated as a private limited company or continue as an OPC?

OUR VIEW

To conclude, it is evident that OPC is a promising concept, but it is still in it's of infancy and there still exist many unsolved questions pertaining to its existence and continuation. It further has more restrictions than a private limited company and must also ensure compliance with a set of new regulations. The various other acts of India also may or may not accept an OPC and require suitable amendments. The silver lining of OPC however is that the majority of restrictive clauses exist not in the Companies Act but the Rules, allowing for the possibility of quick amendments from the government. Though it seems that OPCs have started off on the wrong foot, with suitable modification to the Rules, the concept may still be capable of having several commercial applications.



A Brief Write-Up On Guarantees

By Aradhana Bhansali and Ruchit Parikh

INTRODUCTION

Guarantee is security in form of a right of action against a third party called the surety or the guarantor. The English law defines a 'guarantee' as a 'promise to answer for the debt, default or miscarriage of another'. In simple terms, a Guarantee means, the promise to pay another's debt or fulfill another's contractual obligations, if that party fails to pay its debt or perform its obligations. It can either be a promise for the execution, completion, or existence of something or a promise or an assurance attesting to the quality or durability of a product or service.

CONTRACT OF GUARANTEE

- A contract of guarantee pre-supposes a principal debt or an obligation that the principal debtor has to discharge in favour of the creditor. A contract of Guarantee is governed mainly by the provisions of the Indian Contract Act, 1872 ("Contract Act"). Section 126 of the Contract Act defines a contract of guarantee as a contract to perform the promise or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the "surety", the person in respect of whose default the guarantee is given is called the "principal debtor" and the person to whom the guarantee is given is called the "creditor". The Contract Act uses the word 'surety' which is same as a 'guarantor'.

- In India, a contract of guarantee may be oral or written. It may even be inferred from the course of conduct of the parties concerned.

- In a contract of guarantee, there are two contracts, the principal contract between the principal debtor and the creditor as well as the secondary contract between the creditor and the surety. The contract of the surety is not a contract collateral to the contract of the principal debtor but is an independent contract.

ESSENTIALS OF A VALID CONTRACT OF GUARANTEE

- Essentials of a valid contract: Since a contract of guarantee is a species of contracts, the general principles governing contracts are applicable here. Thus, all the essential requirements of a valid contract (such as free consent, valid consideration, etc.) are required to be fulfilled.

- A principal debt must pre-exist: A contact of guarantee seeks to secure payment of a principal debt. Thus, it is necessary that a recoverable principal debt must pre-exist. There cannot be a contract to guarantee a time barred debt. The House of Lords, as early as 1836, in the Scottish case of Swan vs. Bank of Scotland [(1836) 10 Bligh NS 627] held that if there is no principal debt, there can be no valid guarantee.

- Consideration: Consideration received by the principal debtor is sufficient for the surety. Anything done, or any promise made for the benefit of the principal debtor can be taken as sufficient consideration to the surety for giving guarantee.

TYPES OF GUARANTEE

The main types of guarantees are as follows:

- Personal/ Corporate Guarantee: A Personal/ Corporate Guarantee is a guarantee in which an individual/ corporation agrees to be responsible for the financial obligations of or the performance of contractual obligations by the principal debtor to the creditor, in the event the principal debtor fails to discharge his financial obligations or perform the contractual obligations. A personal/ corporate guarantee, almost by definition, is unsecured, which means it is not secured by or tied to any specific asset of the surety. However, in case of a corporate guarantee, it is essential to peruse the charter documents of the corporation in order to ensure that the corporation is authorised to issue the corporate guarantee and to verify the prescribed limit. Further, it is essential that the necessary resolutions are passed for the purpose.

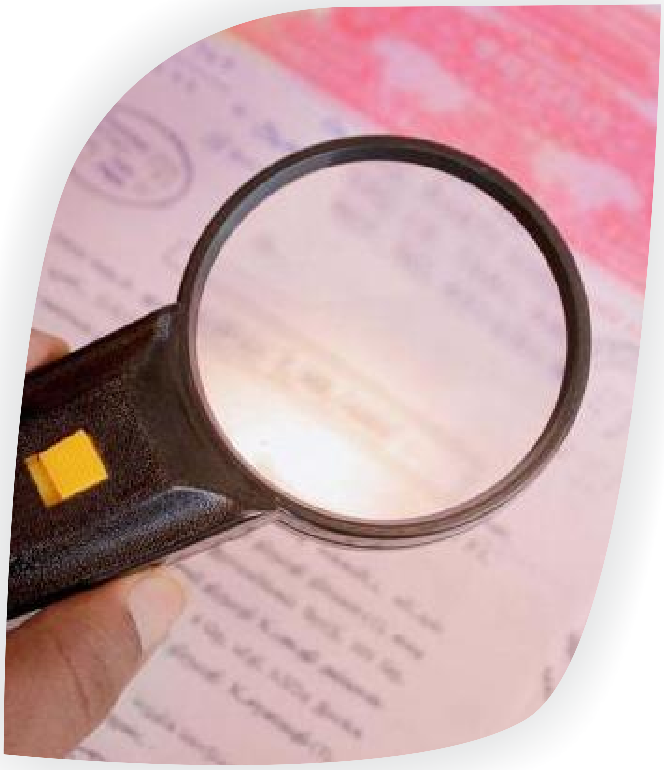
- Bank Guarantee: A Bank Guarantee is an innovative financial instrument whereby, the bank itself stands as a guarantor for a particular amount and whereby, if the beneficiary of the bank guarantee perceives that there has been a breach of contract by the other party, he can encash the bank guarantee and avail of the amount immediately, without having to undergo the hassles of litigation.

- Continuing Guarantee: A Continuing Guarantee is a guarantee in which a person agrees to be held responsible for a series of transactions for the financial obligations of or the performance of contractual obligations by the principal debtor to the creditor, in the event the principal debtor fails to discharge his financial obligations or perform the contractual obligations. In the case of continuing guarantee, so long as the account is a live account i.e. the account is not settled and there is no refusal on the part of the guarantor to carry out the obligation, the period of limitation does not at all start to run and that is the view taken by the Supreme Court in the case of M/s. Margaret Lalita Samuel vs. Indo-Commercial Bank Limited [(1979) 2 SCC 396], and the said proposition was also followed in the case of Union Bank of India, Ernakulam vs. T.J. Stephen & Others [AIR 1990 Kerala 180].

INVOCATION OF GUARANTEE

- A contract of guarantee is a contract of strictissimi juris. The surety receives no benefit and no consideration and therefore, is entitled to insist upon a rigid adherence to the terms of his obligations by the creditor.

- Under the Contract Act, the liability of a surety is co-extensive with that of the principal debtor (unless



otherwise provided by the contract of guarantee), the surety cannot, in the absence of a contract to the contrary, require the creditor to recover the debt from the principal debtor personally or from other securities furnished by the principal debtor for repayment of the loan either by way of hypothecation, pledge or mortgage.

- Section 13 (11) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, which governs the enforcement by the secured creditor of the security interest created in favour of the creditor without the intervention of court or tribunal, further impresses upon the aforesaid right of the secured creditor to recover the debt from the surety without first recovering the same from the principal debtor personally or from other securities.

REVOCATION OF GUARANTEE AND DISCHARGE OF SURETY

A contract of guarantee may be revoked and a surety may be discharged in any of the following ways:

- By mutual consent of the parties;
- By death of the surety;
- By variance in contract between the principal debtor and creditor without the consent of the surety;
- By release or discharge of the principal debtor;
- By compounding or granting of time by the creditor to the principal debtor without the consent of the surety;
- By impairment of surety's eventual remedy against the principal debtor on account of the creditor's act or omission; and
- Where the contract of guarantee is obtained by misrepresentation or concealment by the creditor or with his knowledge.

RIGHTS OF THE SURETY

- Where a debt has become due or default of the principal debtor to perform a duty has taken place, the surety, upon payment or performance of all that he is liable for, becomes invested with all the rights which the creditor had against the principal debtor.

- The general rule of equity expounded by Sir Samuel Romilly and accepted by the Court of Chancery in Crythorne v. Swinburne [(1807) 14 Ves. 160], that the surety will be entitled to every remedy which the creditor has against the principal debtor, including the enforcement of every security stands statutorily recognised and incorporated in section 141 of the Contract Act.

- A promise by the principal debtor to indemnify the surety is deemed to be implicit in a contract of guarantee and as such, the surety is entitled to recover, from the principal debtor, all such sums which he has rightfully paid under the guarantee.

LETTER OF COMFORT AND OTHER EVOLVING CONCEPTS:

Could your letter of comfort be a contract of guarantee?

- A letter of comfort is a document which is provided by a person (typically an affiliate such as the holding/parent company of the borrower) to the financial institution assuring the financial soundness of the borrower to repay the debt(s). Ordinarily, a letter of comfort does not create any payment/financial obligation on the person giving the letter of comfort. However, under certain circumstances, a letter of comfort may be regarded as a contract of guarantee depending upon the usage of the language in the letter of comfort.

Other evolving concepts:

- In today's commercial era new instruments such as letter of awareness, standby letter of credit, etc. are constantly emerging. The question whether such instruments would be construed as a contract of guarantee depends upon case to case basis as also upon the language used in such instruments. The legal status and enforceability of these letters have been the source of much debate in many jurisdictions.

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Rajani, Singhania & Partners acted as legal counsel to Shandong RuYi Science and Technology Group Co Ltd

Our firm acted as sole Indian Legal Counsel to Shandong RuYi Science and Technology Group Co Ltd for their participation in the ownership of the Textile Business ("Vimal" Brand Business) of Reliance Industries Limited ("RIL") on a joint venture basis where RIL will own a majority 51% stake, with the balance 49% to be owned by CSTT (RuYi).

Rajani, Singhania & Partners acted as legal counsel to GloboPlc UK

Our firm advised Globo Emea Holdings Limited and Globo PLC (the "Buyers") in relation to the acquisition of 100% shares of Sourcebits Technologies Private Limited ("Sourcebits India") and SourceBits Inc. USA held by SourcebitsPTE Limited, a Singapore based company (being the majority shareholder) and the promoters of seller group.

SYNAPSE

Rajani, Singhania & Partners acted as legal counsels to D.S. Kulkarni Developers Limited

Our firm acted as the Legal Counsel to the Issue for the Public Issue of Secured Redeemable Non Convertible Debentures (NCDs) aggregating to Rs.200 crores by D.S. Kulkarni Developers Limited. This was the first Debt Public Issue by a real estate company. The Company has come out with this Public Issue to fund partially for any/ all of the four (4) Projects under Development (more particularly specified in the Prospectus) and general corporate purposes.

Rajani, Singhania& Partners acted as legal counsel to Zee Media Corporation Limited

Our firm acted as the Legal Counsel for the fund raising exercise by Zee Media Corporation Limited ("Zee") by way of the proposed Rights Issue of Rs.2,000 million. Axis Capital Limited is the Sole Lead Manager to the Rights Issue. The equity funds raised through the proposed Rights Issue will be utilized for repayment of loans, Funding Subsidiaries for repayment of Loans, and other general corporate purposes.

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