

Regulatory Alert: NCLAT upholds NCLT order rejecting scheme of arrangement involving companies carrying NBFC activities where RBI approval not taken

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Summary

The National Company Law Appellate Tribunal (NCLAT) has upheld¹ order of the National Company Law Tribunal (NCLT) where it had rejected an application of amalgamation of 8 companies into the 9th company by holding that necessary approval of the Reserve Bank of India (RBI) on the scheme of arrangement was not sought.

On perusal of the report of the Regional Director (RD), the NCLT had observed that certain companies involved in the scheme of arrangement were carrying on with the NBFC activities as the financial assets of those companies was more than the non-financial assets and income from operations was zero without its break up between financial income and non-financial income, and hence were necessarily required to seek approval of the RBI on the scheme.

Facts

- The appellant companies (8 companies proposed to be merged into the 9th company) filed an application of amalgamation before NCLT.
- As per the report of the RD, some of the companies involved in the scheme were carrying on NBFC activities and approval of the RBI was not taken.
- The appellants claimed that the RD relied on the circular of RBI dated 19-10-2006². However, appellants claimed that income of certain companies was zero, and therefore, they cannot be treated as NBFCs due to non-fulfilment of the 2nd condition of the 50-50 test.
- The RD contented that there are huge investments as assets in the books of the companies and the intrinsic value of these investments (assets) is not known. Accordingly, reasonableness of the proposed exchange ratio was not ascertainable.
- With regards to fulfilment of the second condition, the RD observed that financial assets are more than non-financial assets, and income from operation is zero without its break up between financial income and non-financial income. Thus, the RD concluded that the required criteria to determine the principal business of the company being a finance company is met.
- The NCLT agreed with the contentions of the RD and accordingly rejected the scheme of arrangement.

Held by the NCLAT

- The NCLAT upheld the decision of the NCLT and the contentions of the RD and held that the accounts showing zero income and showing huge investments as assets must be said to be not inspiring confidence.
- It further observed that if there are huge investments as assets and it shows that financial assets are more than non-financial

¹ Bank Street Securities (P.) Ltd. v. Regional Director

² defining NBFC as compliance with more than 50% asset invested in financial activity and more than 50 % income from financial activity: 50-50 test

assets, and income from operation is zero without its break up between financial income and non-financial income, the required criteria to determine the principal business of the company being finance company is met. Accordingly, the rejection of the scheme of arrangement by the NCLT was upheld.

Our comments

Various companies wherein the quantum of financial assets exceeds the non-financial assets do not get registration as an NBFC, since the quantum of financial income does not exceed the non-financial income.

However, the NCLAT judgment in the present case would mean that companies qualifying the 1st condition of the 50-50 test and having NIL income would also be required to be classified as an NBFC.

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