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## DSK Legal Knowledge Center

### Updates on

- Corporate
- Banking and Finance

## CORPORATE

### A. Hedging of Freight Risk by domestic oil-refining, shipping companies and other companies

The Reserve Bank of India (“RBI”), vide its circular dated February 4, 2009<sup>1</sup>, has delegated powers to AD Category - I banks to approve commodity hedging, to allow hedging of freight risk by domestic oil-refining companies and shipping companies on the terms and conditions as outlined in the said circular. Prior to approving any commodity hedging as contemplated in this circular, the AD Category – I banks are required to ensure the following:

- that the entities hedging their freight exposures have Board approved Risk Management policies which define the overall framework within which derivative transactions should be undertaken and the risks contained;
- that that the sanction of the company's Board has been obtained for the specific activity and also for dealing in overseas exchanges / markets;
- that the Board approval includes explicitly the authority/ies permitted to undertake the transactions, the mark-to-market policy, the counterparties permitted for OTC derivatives, etc. and a list of transactions undertaken should be put up to the Board on a half-yearly basis.

<sup>1</sup> RBI/2008-09/373 A. P. (DIR Series) Circular No. 50

The AD Category - I bank is required to obtain a copy of Risk Management Policy from the company, incorporating the above details, at the time of permitting the transaction itself and as and when changes are made therein.

In the case of other companies which are exposed to freight risk, AD Category - I banks may approach the RBI for permission on behalf of their customers.

The directions contained in the circular are without prejudice to permissions / approvals, if any, required under any other law.

For more information please refer to

<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/AP%20DIR-50-Hedging%20of%20freight0.pdf>

B. Buyback / Prepayment of Foreign Currency Convertible Bonds (“FCCBs”)

The RBI has, vide its circular dated March 13, 2009<sup>2</sup>, extended the date for completion of premature buyback of FCCBs from March 31, 2009 to December 31, 2009. Accordingly, the entire

procedure of buyback should be completed by December 31, 2009.

For more information please refer to

<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/IAPDIR581303.pdf>

and

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<http://www.dsklegal.com/html/news.htm>

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## BANKING AND FINANCE

### A. Ratings of Non-Banking Financial Companies (“NBFC”)

The RBI, vide its notification dated February 4, 2009<sup>3</sup>, has mandated that all NBFCs (both deposit taking and non-deposit taking) with asset size of Rs 100 crore and above excluding Residuary Non-Banking Companies shall furnish the information about downgrading / upgrading of assigned rating of any financial product issued by them, within 15 days of such a

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<sup>2</sup> RBI/2008-09/411 A. P. (DIR Series) Circular No. 58

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<sup>3</sup> RBI /2008-09 /372 DNBS (PD) CC. No.134/03.10.001 / 2008 -2009

change in rating, to the Regional Office of the Bank under whose jurisdiction their registered office is functioning.

For more information please refer to

<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/CC%20of%20nBFCs.pdf>

#### B. Introduction of Advanced Approaches of Basel II Framework in India –Draft Time Schedule

Pursuant to the circular issued by the RBI dated April 27, 2007<sup>4</sup> in respect to the New Capital Adequacy Framework, foreign banks operating in India and the Indian banks having operational presence outside India migrated to the simpler approaches available under the Basel II Framework since March 31, 2008. Other commercial banks are required to migrate to these approaches from March 31, 2009. Thus, the Standardised Approach for credit risk, Basic Indicator Approach for operational risk and the Standardised Duration Approach for market risk (as slightly amended under Basel II framework) have been implemented for the banks in India. Having regard to the necessary up-gradation of risk management framework as also capital efficiency likely to accrue to the banks by adoption of the

advanced approaches envisaged under the Basel II Framework and the emerging international trend in this regard, the RBI, vide its circular dated February 5, 2009<sup>5</sup>, has laid down the proposed time schedule for implementation of the advanced approaches for the regulatory capital measurement in the said circular. Further, banks have been advised to undertake an internal assessment of their preparedness for migration to advanced approaches, in the light of the criteria envisaged in the Basel II document, as per the aforesaid time schedule. The banks, at their discretion, have the option of adopting the advanced approaches for one or more of the risk categories, as per their preparedness, while continuing with the simpler approaches for other risk categories, and it would not be necessary to adopt the advanced approaches for all the risk categories simultaneously. However, the banks are required to obtain prior approval of the RBI for adopting any of the advanced approaches.

Comments in respect to the proposed time schedule were to be sent to the RBI before February 27, 2009.

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<sup>4</sup> DBOD.No.BP.BC.90/20.06.001/2006-07

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<sup>5</sup> RBI/2008-09/376 DBOD.BP.BC.No.109/21.06.001/2008 -09

For more information please refer to

[http://rbidocs.rbi.org.in/rdocs/notification/PDFs/Draft\\_T.pdf](http://rbidocs.rbi.org.in/rdocs/notification/PDFs/Draft_T.pdf)

C. Lending under Consortium Arrangement / Multiple Banking Arrangements

The RBI, vide its circular dated September 19, 2008<sup>6</sup>, required the banks to strengthen their information back-up about the borrowers enjoying credit facilities from multiple banks by, among others, obtaining regular certification by a professional, preferably a Company Secretary. The RBI, vide its circular dated February 10, 2009<sup>7</sup>, has clarified that in addition to a Company Secretary, banks can also accept the certification by a Chartered Accountants and Cost Accountants. Further Annex III - Part I (Diligence Report) and Part II (Certifications of Borrowal Companies by Chartered Accountants / Company Secretaries/ Cost Accountants) has been modified and a copy of the same has been enclosed in the said circular.

For more information please refer to

<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/DOC%20379%20Circular%20DBOD.pdf>

D. Monitoring Framework for non-deposit taking NBFC

The RBI, vide its circular dated March 02, 2009<sup>8</sup>, requires all NBFCs (non-deposit taking NBFCs with asset size of Rs 50 crore and above but less than Rs 100 crore) shall submit a quarterly return on important financial parameters as hard copy and soft copy (via e-mail in Excel format) to the Regional Office of the Department of Non-Banking Supervision in whose jurisdiction their company is registered, within a period of one month from the close of the quarter, till the online procedure in this regard is advised. All other instructions in the circular dated September 24, 2008<sup>9</sup> in respect to monitoring framework for non-deposit taking NBFCs is to be complied with.

For more information please refer to

<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/CCMFW.pdf>

<sup>6</sup> RBI/2008-2009/183 DBOD No. BP. BC.46/ 08.12.001/2008 -09  
[<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/287063.pdf>]

<sup>7</sup> RBI/2008-2009/379 DBOD.No. BP.BC.110/08.12.001/2008 -09

<sup>8</sup> RBI/2008-09/397 DNBS.PD/ CC.No. 137 / 03.05.002 /2008 -09

<sup>9</sup> RBI/2008-09/194 DNBS.PD/ CC.No.130 / 03.05.002 /2008 -09  
<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/87121.pdf>

E. Central Bank of India v. State of Kerala and Others<sup>10</sup>

Issues raised before the Hon'ble Supreme Court-

1. Whether Section 38C of the Bombay Sales Tax Act, 1959 ("the Bombay Act") and Section 26B of the Kerala Revenue Recovery Act, 1968 ("Kerala Act") and similar provision contained in other State legislations by which first charge has been created on the property of the dealer or such other person, who is liable to pay sales tax etc., are inconsistent with the provisions contained in the Debts Due to Banks and Financial Institutions Act, 1993 ("DRT Act") for recovery of 'debt' and the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 ("SARFAESI Act") for enforcement of 'security interest'.
2. Whether by virtue of non obstante clauses contained in Section 34(1) of the DRT Act and Section 35 of the SARFAESI Act, two Central legislations will have primacy over state legislations.

Facts-

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<sup>10</sup> Civil Appeal Nos. 95 of 2005, 2811, 3549, 3973, 4174, 4909 of 2006, 1288/2007 and C.A. No. 1318 of 2009 (Arising out of S.L.P. (C) No. 24767 of 2005)

The Central Bank of India ("Appellant") gave cash/ credit facility to the tune of Rs. 1,200,000 to Kerala Refineries (P) Ltd ("Borrower"). The Borrower executed mortgage of movable and immovable properties by creating the first charge for securing repayment. As the Borrower failed to repay the dues, the Appellant obtained a decree from Debts Recovery Tribunal ("the Tribunal") for an amount of Rs. 5,500,000 with future interest. As a result, the recovery officer issued notice for sale of the movable and immovable properties of the Borrower. At this stage, the Tehsildar also issued notice to the Borrower for recovery of Rs. 4,038,481 as arrears of sales tax stating therein that moveable and immovable properties of the Borrower had been attached and that steps are being taken to sell the attached property by public auction. The Tehsildar claimed that by virtue of Section 26B of the Kerala Act, the State Government had got first charge over the attached properties. Section 26 B of Kerala Act states as under:

"Section 26 - Tax payable to be first charge on the property - Notwithstanding anything to the contrary contained in any other law for the time being in force, any amount of tax, penalty, interest and any other amount, if any, payable by a

dealer or any another person under this Act, shall be the first charge on the property of the dealer, or such person."

The bank challenged the notice of the Tehsildar by filing a writ petition in High Court under Article 226 of the Constitution of India. The Appellant argued that the Recovery of DRT Act, being a Central legislation, would prevail over the Kerala Act by which first charge was created in favour of the State.

The single judge of Kerala High Court rejected the Appellants claim on the ground that under Kerala Act, within 14 days any person other than the defaulter can file an objection to the attachment of the whole or any portion of defaulter's property by state.

The appeal to the Division Bench of the High Court against the orders of single judge was also dismissed on the ground that the Appellant can avail remedy by filing objection to the said attachment under the Kerala Act.

The matter was referred to the Hon'ble Supreme Court for consideration. The Hon'ble Supreme Court tagged various appeals involving interpretation of the non-obstante clause

under Section 35 of the SARFAESI Act and Section 34 (1) of DRT Act.

Held-

The Hon'ble Supreme Court held that the DRT Act and SARFAESI Act have been enacted by Central Government under Entry 45 in List I in the Seventh Schedule whereas Bombay Act and Kerala Act have been enacted by the concerned State Government under Entry 54 in List II in the Seventh Schedule, implying that the two sets of legislations have been enacted with reference to entries in different lists in the Seventh Schedule. The Hon'ble Supreme Court held that, there is no conflict in the operation of the DRT Act and SARFAESI Act vis-à-vis against the provisions of Bombay Act and Kerala Act and there is no ostensible overlapping between two sets of legislations. Therefore, Article 254 of the Constitution of India cannot be invoked per se for striking the said State Government legislation, as the same are not in conflict with the mentioned two Central Government legislations.

The Hon'ble Supreme Court further held that, it could have given effect to the non-obstante clauses contained in Section 34(1) of the DRT Act and Section 35 of the SARFAESI Act vis-à-

vis Section 38C of the Bombay Act and Section 26B of the Kerala Act and similar other State legislations, only if there was a specific provision in the two Central Government legislations creating first charge in favour of the banks, financial institutions and other secured creditors. In the absence of any specific provision to that effect, it is not possible to read any conflict or inconsistency or overlapping between the provisions of the DRT Act and SARFAESI Act on the one hand and Section 38C of the Bombay Act and Section 26B of the Kerala Act on the other and the non obstante clauses contained in Section 34(1) of the DRT Act and Section 35 of the SARFAESI Act cannot be invoked for declaring that the first charge created under the State legislation will not operate qua or affect the proceedings initiated by banks, financial institutions and other secured creditors for recovery of their dues or enforcement of security interest, as the case may be.

The non obstante clauses contained in Section 34(1) of the DRT Act and Section 35 of the SARFAESI Act give overriding effect to the provisions of those Acts only if there is anything inconsistent contained in any other law or instrument having effect by virtue of any other law. Section 38C of the Bombay Act and Section 26B of the Kerala Act also contain non obstante clauses and give

statutory recognition to the priority of State's charge over other debts, which was recognized by Indian High Courts.

Hence, Hon'ble Supreme Court held that the DRT Act and SARFAESI Act do not create first charge in favour of banks, financial institutions and other secured creditors and the provisions contained in Section 38C of the Bombay Act and Section 26B of the Kerala Act are not inconsistent with the provisions of the DRT Act and SARFAESI Act so as to attract non obstante clauses contained in Section 34(1) of the DRT Act or Section 35 of the SARFAESI Act.

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