Lakshmi Kumaran & Sridharan
corporate

corporate amicus

An e-newsletter from Lakshmikumaran & Sridharan, New Delhi, India

September 2012 / Issue-14

September
2012

In Focus

- SEBI's jurisdiction interpreted
- Shaping the future of competition
- ECBs - Maximum permissible limit enhanced
- Agriculture Ministry & Insecticides Board not covered under Competition law
- International Commercial Arbitration - Constitution Bench overrules *Bhatia International*

SEP 2012

Contents

Articles

SEBI's jurisdiction interpreted

By **Sonali Kapoor**

The Hon'ble Supreme Court delivered a landmark judgment in the case of *Sahara India Real Estate Corporation Limited* v. *Securities and Exchange Board of India* resolving the long pending debate regarding the jurisdiction of the SEBI; and the applicability of the SEBI Act, 1992 to unlisted companies. The Court held that when an unlisted company offers or invites more than forty-nine persons to subscribe to its shares or debentures, mandatory listing on a stock exchange is triggered and SEBI validly assumes jurisdiction over such company.

Two unlisted public companies, namely, Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited (SHICL) (collectively, the "Sahara Entities") issued Optionally Fully Convertible Debentures (OFCDs), a hybrid security, authorized by special resolutions passed under the Companies Act, 1956. The Sahara Entities filed a Red Herring Prospectus (RHPs) with the Registrar of Companies (RoC) and issued Information Memorandums (IMs) to their *'friends, associates and group companies'*. The IMs of both companies stated that the issue was a private placement since (a) OFCDs would not be listed on any stock exchange and (b) subscriptions were invited only from the people to whom the IMs had been addressed. The Sahara Entities raised INR 25,781.37 crores from 3 million investors by issuance of OFCDs.

Pursuant to an investigation, SEBI directed the Sahara Entities to refund the money collected under the RHPs along with interest, to all the investors who had subscribed to the OFCDs. SEBI's reasoning was that the Sahara Entities failed to comply with various sections of the Companies Act ('the Act'), including in particular Section 67(3) for listing the OFCDs on a stock exchange.

The pronouncements on key issues framed by the Court are discussed in the following paragraphs.

Applicability of Section 67(3) of the Companies Act to OFCDs

The first proviso to Section 67(3) of the Companies Act provides that *in case an offer or invitation to subscribe to shares and debentures is made to fifty persons or more, the same will be treated as a public issue.* While the Sahara Entities claimed that only those people to whom the IM had been addressed were eligible to subscribe and hence the same amounted to private placement; the Court held that the issue of OFCDs was a public issue. The Sahara Entities had paid up share capital of only INR 10 lakhs, virtually no assets and the companies had collected about INR 26,000 crores from about 3 million subscribers, The IMs of the Sahara Entities were issued through 10 lakh agents and more than 2900 branch offices. Moreover, the Sahara Entities could not provide details of the relation or type of association with these 3 million investors. Also, the Court observed that the IM had a provision for introduction of investors, which was unnecessary in the event of IM being circulated to all associated persons of the Sahara Entities. Thus the Sahara Entities disguised a public issue to millions of persons as a private placement.

The Court held that generally an issue is not regarded as an offer of securities made to public in the following cases:-

a) to less than fifty persons;
b) only to the existing shareholders of the company (right issue);
c) to particular addressees and accepted by the persons to whom it is addressed;
d) it is the domestic concern of those making and receiving such offer or invitation.

Applicability of Unlisted Public Companies (Preferential Allotment) Rules, 2003

The Sahara Entities raised a contention that the Unlisted Public Companies (Preferential Allotment) Rules, 2003 (as amended in 2011) were applicable to the issue and a preferential allotment through private placement pursuant to a special resolution under Section 81(1A) of the Act was permissible. However, the Court held that the 2003 Rules are not applicable to any offer of shares or debentures to more than forty-nine persons. It held that the 2003 Rules were framed by the Government exercising powers conferred under Section 81(1A) of the Act which deals with issue of further securities and only gives pre-emptive rights to existing shareholders. It held that Section 81(1A) cannot override the provisions relating to public issue as the 2003 Rules are subordinate regulations and are to be read with the proviso to Section 67(3) and Section 73(1) of the Act.

SEBI's jurisdiction over unlisted companies

The Sahara Entities contended that they were not listed companies nor had any intention of listing on a stock exchange, hence under Section 55A of the Act, the Central Government had jurisdiction in such a situation and not SEBI. Rejecting this argument, the Court held that the main part of Section 55A confers jurisdiction on SEBI with regard to three matters, that is, issue of securities, transfer of securities and non-payment of dividend. The expression "all other matters" mentioned in the explanation would refer to all other matters excluding the aforementioned categories. This explanation does not take away powers from SEBI conferred under different sections of the Companies Act. Thus, SEBI has the power to administer listed public companies and companies intending to get listed on a stock exchange in respect of the three categories enumerated above.

OFCDs under the Securities Contracts (Regulation) Act, 1956

The contention of the Sahara Entities that OFCDs were hybrid securities and thus excluded from the purview of Section 67(3) of the Companies Act, which applies only to shares and debentures was also rejected by the court. *'Hybrids'* are distinct instruments that have attributes of both debt and equity securities and hence outside the scope of the SCR Act. The Court held that the definition in Section 2(h) of the SCR Act is wide and includes "other marketable securities of a like nature", which gives an expansive meaning to *the word 'securities'* to include "hybrids". Any security which is capable of being freely transferable is marketable. In the present case, OFCDs continue to remain *debentures,* and will become equity only when and if converted. Therefore, irrespective of the categorization of OFCDs as *'hybrids'* or debentures, they fall within the ambit of Section 2(h) of the SCR Act.

The Sahara Entities also argued that *OFCDs are* convertible bonds issued on the basis of the price agreed upon at the time of issue, under Section 28(1)(b) of the SCR Act, and thus provisions of the SCR Act are not applicable. The Court observed that Section 28 of the *SCR* Act exempts convertible bonds by foreign financial institutions that had the option to obtain shares at a later date. The preamble of the SCR Act also provides for "prohibition on options in securities" as a mode "to prevent the undesirable transactions in securities". The inapplicability of the SCR Act is not to the convertible bonds but to the entitlement of a person to whom such share, warrant or convertible bond has been issued, to have shares at his option. Consequently, OFCDs cannot be excluded from the purview of the SCR Act.

Listing of securities and the intention of the company

The Sahara Entities took the defence that they did not intend to get listed on any stock exchange and the same was also mentioned in the IMs. The Court held that Section 73 of the Companies Act casts an obligation on every company intending to offer shares or debentures to the public to apply on a stock exchange for listing the securities. Such companies have no other alternative but to list their securities on a stock exchange once they invite subscriptions from over forty-nine investors from the public. When an unlisted company expresses its intention, by conduct or otherwise, to offer its securities to the public by the issue of prospectus, it has a legal obligation to apply for listing. A Company's option, choice, election, interest or design does not matter, it is the conduct that matters and that is what the law demands.

Prospectus and IM

The Court observed that there is no obligation on a public company to circulate an IM prior to issue of securities, which is circulated to assess the demand and price which the public would be willing to offer. In this situation, as contended by the Sahara Entities, if they were making a private placement, there was no reason or justification for them to elicit these details through an IM, since Section 60B(1) deals with issue of IM to public alone. Thus, in this case the Court lifted the veil to examine the conduct and method adopted by the Sahara Entities to circumvent the provisions of the Companies Act read with provisions of the SEBI Act.

SEBI (Disclosure Investor Protection) Guidelines, 2000, DIP Guidelines and ICDR 2009:

It was argued by Sahara Entities that the OFCDs were issued in 2008 and no action was taken under the DIP Guidelines and hence ICDR 2009 (which came into force on August 2012) would not apply and have no retrospective operation. The Court examined the repeals and savings clause of ICDR 2009 and held that violation under DIP Guidelines was a continuing one. Regulation 111(1) of ICDR 2009 is of wide import and would cover anything omitted by a company which ought to have been done legally. In the instant case, the Sahara Entities did not inform SEBI of the issuance of securities while DIP Guidelines were in force and the Sahara Entities continued to mobilize funds from the public which was nothing but continued violation of DIP Guidelines which started when DIP Guidelines were in force and also when they were replaced by ICDR 2009.

On the basis of the above findings, the Court held that the Sahara Entities were liable to refund the amount collected from the subscribers in pursuance of the RHPs along with interest as per Section 73(2) of the Companies Act. With this judgment, the position is now clear for all companies in India that any issue of shares or debentures, including hybrid instruments, to more than forty-nine persons would be treated as a public issue triggering the relevant provisions of the SEBI Act, regulations framed thereunder and the Companies Act.

[The author is an Associate, Corporate Practice, Lakshmikumaran & Sridharan, New Delhi]

Shaping the future of competition

By **Sundar Ramanathan**

In a short span of time, the Competition Commission of India (CCI) has been credited with being a key player in ensuring free play of market forces in our economy[1]. The orders passed by the CCI have made the industry sit up and take notice (e.g. cement cartel case, DLF case). It appears that the CCI will play a decisive role in promoting competition and fair market practices. The recent ruling of CCI discussed below may have seminal implications on the jurisprudence of competition law in India as well as impact government intervention on commercial decisions of government companies.

The CCI in *Royal Energy Ltd v IOCL and others,* [MRTP Case No. 1/28], held that the decision by the Oil Marketing Companies (OMC) viz. Indian Oil Corporation Ltd, Bharat Petroleum Limited and Hindustan Petroleum Limited, to purchase bio-diesel at prices determined by themselves at prices less than the manufacturing cost was not in contravention of Section 3 (anti-competitive agreements) or Section 4 (abuse of dominant position) of the Competition Act, 2002 ('the Act').

The Ministry of Petroleum and Natural Gas issued the Bio-Diesel Purchase Policy to encourage use of alternate sources of energy, which envisaged supply of bio-diesel to the OMCs, for blending with the high speed diesel for use as vehicle fuel. Under this policy, the OMCs were to purchase the bio-diesel that met the BIS specifications *at a uniform price determined* by the OMCs. As the price of high speed diesel was fixed and regulated, the OMCs determined the purchase price of bio-diesel by backward integration. This price was considered less than adequate and below the manufacturing cost by the suppliers of bio-diesel. This was alleged to be an anti-competitive agreement by the OMCs. The CCI held that the OMCs could not be mandated to purchase the bio-diesel at a price higher than the price of the end product and make it commercially unviable for the OMCs to operate.

This raises an issue of the introduction of the commercial viability test as a defence in an investigation relating to breach of Section 3 of the Act. For example, if three non-dominant enterprises mutually agree to act in one of the ways determined under Section 3(3)(a) (by indirectly facilitating collusive bidding to get the contract to the disadvantage of the dominant enterprise) resulting in better competition and commercial viability of the colluding companies, whether such conduct will be regarded as having an appreciable adverse effect on competition for the purposes of Section 3(1). Such an action need not *necessarily* result in any of the benefits identified under Section 19(3) or may not have the effect of driving the dominant enterprise, and may be merely directed at meeting the competition posed by the dominant enterprise. Unlike the proviso to Section4(2)(a), Section 3 does not statutorily have the explicit 'meeting competition defence'. The action may merely result in promoting competition in the market in which the enterprises are operating - an action promoting the object of the Competition Act, 2002 and one of the duties of the CCI under Section 18. At least as held in the *Royal Energy* case, there seems to

[1] Views of the Minister of Corporate Affairs Mr. Veerappa Moilly, available at : <http://pib.nic.in/newsite/erelease.aspx?relid=84220>

be a possibility for using the commercial viability test because the subject investigation pertained to fixation of prices by direct competitors under Section 3(3)(a).

Another question that arises is whether commercial viability / protection of commercial interests are adequate defences in a Section 4 contravention (apart from Section 4(2)(a) cases). In the past, in Europe, it has been held that even dominant undertakings can take counter action to protect their commercial interests, however, such counter action should be proportionate to the threat taking into account the economic strength of the parties. [Case 27/76, *United Brands* v. *Commission*, judgment delivered by European Court of Justice, Para 189-190].

An important observation of the CCI is that *"even if an anti-competitive conduct flows from **any policy of the Government,** the Commission will still have jurisdiction to examine the conduct and in case of any violation suitable orders can be passed"*. The activity of policy determination by the government may be viewed as sovereign in nature (being an inalienable function of the government) and therefore, in light of Section 2(h) of the Competition Act, 2002 may be viewed as outside the purview of the CCI. Even if such government actions are not sovereign in nature, it needs to be seen whether the CCI would consider intervention or maintain a policy of deference on such matters to Parliament and therefore outside CCI's purview. This case gives some indication that the CCI may be more inclined to opine on such mandated policy decisions of the government if it has an impact on competition.

This may lead to the CCI scrutinizing the actions of several PSUs that function under the operative directions of a particular Ministry, pursuant to policy decisions. In addition, actions taken pursuant to policy decisions of other sectoral regulators may also fall within the purview of the CCI. This only heightens the current debate on the overlap between the CCI and sector regulator, one relating to a pending proposal to oust the jurisdiction of CCI in matters pertaining to acquisition and mergers of banks[2], other sectors are also not too far behind in seeking for an exemption from the rigours competition law[3]. However, the power to exempt any enterprise from the purview of the Act is available with the Central Government (Section 52) only if it is necessary in public interest or in the security of the state or to comply with any of India's obligations under an international treaty or for enterprises performing activities that are relatable to the sovereign functions of the state.

Furthermore, at a jurisprudential level, the CCI has also held in the case under discussion that the concept of collective dominance is not envisaged under Section 4 of the Competition Act. Collective dominance as accepted in Europe occurs where a group of unrelated entities that are united by economic links collectively hold a dominant position in a market[4]. No reasons are set out for the same, but one reason may be that Section 4 provides that no 'enterprise or *group*' should abuse its dominant position, the word "group" was specifically added in 2007 but the definition of group is restricted to

[2] Please see in this regard a news report in The Economic Times issue dated June 11, 2012 However, it will pertinent to note that recently in a policy u-turn, it appears that the Finance Ministry has decided to bring bank mergers within the purview of CCI. Please see in this regard a news report in the Hindu Business Line dated August 22, 2012

[3] Please see in this regard a news report in the Hindu Business Line issue dated May 29, 2012

[4] Case T-68, 77 and 78/89, Societa Italiana Vetra SpA v. Commission [1992] 5 CMLR 302, Para 358

entities under the same management or control. Therefore, the legislature may not have intended unrelated groups to be considered as one for the purpose of the Act. Further, should a concept that has its genesis in Europe be accepted in India? On the other hand ordinarily it is a statutory rule that a singular word would also include a plural.[5] Therefore, by that logic enterprise would also include enterprises and a group of enterprises can abuse their dominant position. However, these issues have not been effectively raised or decided by the CCI in the said case and therefore it will still remain to be seen whether the collective dominance concept is envisaged under Section 4.

Furthermore, this decision (and the principles enshrined therein) is still to be tested by the higher judicial echelons. It will be interesting to see, if and when, this decision (or the issues) reaches the Competition Appellate Tribunal or the Supreme Court, which way would the tide of competition sway.

[The author is a Principal Associate, Corporate Practice, Lakshmikumaran & Sridharan, New Delhi]

CIRCULARS

Minimum public shareholding requirements – Additional methods specified: Rights or bonus issues to public shareholders, with promoters/promoter group shareholders foregoing their respective rights entitlement have been notified as additional methods to facilitate listed entities to comply with the minimum public shareholding requirements within the time specified in Securities Contracts (Regulation) Rules, 1957. Listed entities desirous of achieving the said requirement through other means or seeking any relaxation from the available methods can also approach SEBI with appropriate details. As per SEBI Circular CIR/CFD/DIL/11/2012, dated 29-8-2012, such requests would be considered by SEBI based on merit and decision would be communicated within 30 days from the date of receipt of such requests.

Overseas Direct investment – Annual Performance Report to be submitted by 30th of June every year: An Indian party, which has set up/acquired a Joint Venture (JV) or Wholly Owned Subsidiary (WOS) overseas, is required to submit an annual performance report (APR) to the designated Authorised Dealer every year in Form ODI Part III. This report in respect of each JV or WOS outside India and other reports or documents as specified are required to be submitted on or before 30th of June every year. RBI A.P. (DIR Series) Circular No. 29, dated 12-9-2012 issued for the purpose also states that this APR has to be based on the latest audited annual accounts of the JV/WOS, unless specifically exempted.

External Commercial Borrowings - Maximum permissible limit enhanced: The maximum permissible limit of ECB has been enhanced to 75% (from 50%) of the average foreign exchange earnings realized during the past three financial years or 50% of the highest foreign exchange earnings realized in any of the immediate past three financial years, whichever is higher. In case of Special Purpose Vehicles (SPVs), which have completed at least one year of existence and do not have past performance for three financial years, the maximum permissible ECB will be 50% of the annual export earnings realized during the past financial year. As per RBI A.P. (DIR Series) Circular No. 26, dated 11-9-2012, the maximum ECB that can be availed by an individual company or group, as a whole, under this scheme will be restricted to USD 3 billion.

[5] Section 13 of the General Clauses Act, 1897

Agriculture Ministry & Insecticides Board not covered under Competition law

The Competition Commission of India in its recent order has held that the Ministry of Agriculture and Central Insecticides Board are not engaged in any activity to be termed as enterprise in terms of Section 2(h) of the Competition Act, 2002. Grievance of the informant was that the conditions prescribed for grant of registration certificate by the said authorities were onerous which created monopoly in respect of the existing entrants making it difficult for new entrants to get themselves registered. It was argued that the conditions under the Insecticides Act were difficult to achieve because of financial impracticability and high entry cost while the entry of second entrant (who is entitled to import the same insecticides with reduced field trial parameters) has been suspended under the new rules and regulations of 2010. The Commission however held that the opposite parties could not be considered as enterprise and also, they were not participants in the market under consideration. It was noted that the opposite parties were primarily responsible for the administration of Insecticides Act, 1968 and the rules framed thereunder and hence would not be covered under the Competition Act. It was also observed that no information to show charging of exorbitant price by importers and manufacturers, was provided by the informant. [*Saurabh Bhargava* v. *Secretary, Ministry of Agriculture and Cooperation* – Order dated 27-8-2012 in Case No. 70/2011].

State Electricity Commission not having jurisdiction to decide dispute involving Central Govt. controlled generating company

The Appellate Tribunal for Electricity has held that whenever there is a dispute involving the generating company owned or controlled by the Central Government, such a dispute shall be resolved under Section 79(1 (f) of the Electricity Act and not under Section 86(1)(f) ibid. It was held that the State Commission has no jurisdiction in the matter relating to NTPC which has to be dealt with only by the Central Commission. The appellant had argued that the jurisdiction of the Central Commission under Section 79(1)(a) is restricted only to regulation of tariff and that commercial terms and arrangements such as supply by NTPC to the distribution licensees which is governed by the terms of the agreement between the parties, and the adjudication of dispute pertaining to commercial terms and conditions of supply would attract the jurisdiction of the Delhi Commission. The Tribunal however held that Tariff Regulations 2009 and the Regulation of Power Supply Regulations, 2010 providing for the terms and conditions of tariff and regulation of supply are matters involving a generating company covered under Section 79(1)(a) and, therefore, would fall within the scope of Section 79(1)(f) of the Electricity Act, 2003. It was noted that power of State Commission to scrutinize the power purchase agreement cannot be taken to mean that the State Commission has got the powers to suggest modifications to the terms and conditions or even reserving to deal with the implications of the terms and conditions at a later stage. [*BSES Rajdhani Power Limited* v. *Delhi Electricity Regulatory Commission* – Order dated 4-9-2012 in Appeal No. 94 of 2012].

Tenders – Pre-qualification conditions when not arbitrary

The Supreme Court of India has upheld the decision of a State Road Transport Corporation where the latter had incorporated a pre-qualification criterion in the tender, restricting the participation in the bidding process only by the OEM suppliers. The Court was satisfied with the decision of Corporation that to acquire equipments of superior quality, it was necessary to incorporate such condition. The appellant had challenged the criteria as being unreasonable, arbitrary, discriminatory and opposed to public interest in general and had contended that the said criteria was incorporated with the ulterior motive to exclude appellant from the bidding process. The Supreme Court laid down the following five principles on this subject matter:

(1) The basic requirement of Article 14 of the Constitution is fairness in action by the State. Non-arbitrariness in essence and substance is the heartbeat of fair play;

(2) Fixation of a value of the tender is within the purview of the executive and courts hardly have any role to play in this process except for striking down an action which is arbitrary or unreasonable;

(3) In the matter of formulating conditions of a tender document and awarding a contract, greater latitude is required to be conceded to the State authorities unless the action of tendering authority is found to be malicious;

(4) Certain preconditions or qualifications for tenders have to be laid down to ensure that the contractor has the capacity and the resources to successfully execute the work; and

(5) If the State or its instrumentalities act reasonably, fairly and in public interest in awarding contract, interference by Court is very restrictive.

The Court held that the appellant-company failed to establish that the impugned conditions were mala fide or contrary to public interest and were discriminatory or unreasonable or arbitrary. [*Michigan Rubber (India) Ltd.* v. *State of Karnataka* - 2012 (7) SCALE 414].

NEWS NUGGETS

Constitution Bench overrules Bhatia International

The Constitution Bench of the Supreme Court has in its recent judgment dated 6-9-2012 in the case of *BALCO* v. *Kaiser Aluminium Ltd.*, prospectively overruled the decisions given by it in the case of *Bhatia International Ltd.* v. *Bulk Trading S.A.* [(2002) 4 SCC 105] and *Venture Global Engineering* v. *Satyam Computer Services Ltd* [(2008) 1 SCALE 214]. In an unanimous decision, the Constitution Bench of the Supreme Court has, inter-alia, held that Part I of the Arbitration and Conciliation Act, 1996 will not apply to International Commercial Arbitrations seated outside India.

The Constitution Bench has held that Part I and Part II are mutually exclusive and that the Parliament while enacting the statute had unequivocally adopted the principle of territoriality over subject matter of arbitration. In other words, the Constitution Bench has inter-alia, held that the centre of gravity for international commercial arbitrations having a foreign seat was the juridical seat of arbitration and not where the contract had to be performed.

The decision has been welcomed by litigants (domestic and foreign investors alike), as it has synchronised the Indian position on international commercial arbitration with the long accepted position across the world. But, uncertainty may continue for the past period as the Bench has declared the judgment as applicable prospectively to arbitration agreements, executed after 6-9-2012.

The decision is seen as a step towards making India an arbitration friendly jurisdiction. But the prospective overruling of *Bhatia International and Venture Global Engineering,* may have to be clarified in due course to understand the extent and scope of its application.