FINSEC Law Advisors

SECURITIES AND INVESTMENT REGULATIONS

June 2014 Newsletter

Has E-Voting Rendered General Body Meetings Redundant?

The new Companies Act, 2013, the revised listing agreement and the Companies (Management and Administration) Rules, 2014, have made it compulsory for all listed companies and companies having over 1000 shareholders to pass their shareholders' resolutions by way of electronic voting. For shareholders who cannot cast their vote electronically, voting is required to be conducted by way of postal ballot system. Further, Rule 20(vi) of the Companies (Management and Administration) Rules, 2014 requires that all voting by electronic means should be concluded 3 days prior to the date of the general meeting. These provisions seem to imply that general meetings of shareholders like AGMs and EGMs have now become a mere procedural drill as no voting exercise needs to be conducted during such meetings.

This issue has also been debated before the Bombay High Court in relation to a scheme of amalgamation involving Godrej Industries. The High Court while recognizing the anomaly of law, emphasized the need for voting during physical meetings of shareholders in AGMs and EGMs. It was of the view that every shareholder has an inalienable right to ask questions, seek clarifications and receive responses before deciding his vote. A physical gathering of shareholders provides such a forum for deliberation, confrontation and face-to-face accountability. While undecided shareholders may make up their minds during a meeting, those shareholders who have strong views may attempt to persuade others. Merely receiving countless pages of information is not sufficient for a shareholder to exercise his right to participate and cast an informed vote.

Taking the view that the elimination of all shareholder participation at an actual meeting is anathema to some of the most vital shareholders' rights, the High Court directed the Central Government and SEBI to file their replies before it for full consideration of the issues.

Continual Disclosure Obligations of Listed Companies

SEBI issued an approach paper on Draft SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2014 on 5 May, 2014. These regulations will be applicable to companies whose securities are listed on any recognized stock exchange in India. The purpose behind the draft regulations is to have a single and all-encompassing framework providing listing conditions and disclosure requirements for listed issuers and issuers desirous of listing various categories of securities. The draft regulations consists of existing provisions of the listing agreements and relevant provisions of Companies Act, 2013 in relation to listing conditions and disclosure requirements.

SEBI by way of the proposed regulations seeks to address the issue of rampant non-compliance of the listing agreement by issuers whose securities are listed on various stock exchanges. The draft regulations are aimed towards enhancing the enforceability of existing provisions of the listing agreement by substituting *contractual obligations* of issuers under listing agreement with *statutory obligations* under the draft regulations. SEBI, in a way proposes to consolidate its powers to regulate listed issuers to the extent such powers were delegated to stock exchanges under the listing agreements.

While globally there is a move towards regulating and enforcing securities law through market intermediaries, SROs and stock exchanges, the draft regulations may be a step back in regulating listed entities. The objective of SEBI to ensure strict compliance with listing conditions may be laudable, however it should not come at the cost of efficiency of the market.

FMC Revised Norms

The Forward Markets Commission released a notification dated 6 May, 2014 regarding Ownership, Net worth, Fit and Proper Criteria etc. of the Nationwide Multi Commodity Exchanges (NMCEs), to be made applicable with immediate effect. The revised norms are aimed at diversifying the ownership of commodity derivative exchanges and enhancing the presence of institutional investors in them. The FMC has directed all NMCEs to bring their rules in accordance with the revised norms within 45 days from the date of receipt of the directions and to report compliance of the same to the FMC by 23 June, 2014. The revised norms appear to have been made in light of the Rs. 5600 crore payment crisis at National Spot Exchange Limited.

As per the revised norms, a commodity exchange shall have a minimum net worth of Rs. 100 crore at all times and at least 51% of the paid up equity share capital shall be held by the public. Governance norms have been made stricter, for instance, trading and clearing members of the exchange cannot be appointed on the governing board of a recognized commodities exchange. Further, an individual promoter cannot hold more than 5% in any commodity exchange, as against the earlier permissible limit of 26%. Moreover, to encourage domestic exchanges and banks to hold stakes in domestic commodity exchanges, the combined holding of non-residents has been limited to 49%. The notification states that any person who ceases to be a 'fit and proper person' will have to divest his shareholding and shall not have any voting rights till his shares are sold.

The revised norms which seek to enhance public trust and participation in exchanges, will significantly impact the impending sale of FTIL's 24% stake in MCX. FMC had declaredon 17 December, 2013 that FTIL was unfit to run the exchangeand therefore FTIL has to divest its stake within the time allotted. The new norms may result in fewer eligible suitors for FTIL's stake in MCX and thereby impact the price at which the deal would be concluded. Further, since a person resident outside India cannot acquire or hold more than 5% of the paid-up equity share capital in a recognized stock exchange, potential foreign bidders may not be able to buy over 5% in MCX.

The revised norms also provide that certain categories of investors such as stock exchange, depositories, banks, insurance companies and PFIs may individually or together with PAC hold upto 15% in commodity exchanges. Such limits of 5% or 15% as prescribed by the revised norms will restrict ownership of exchanges and act as entry barriers for entities which have the capital and expertise to set up new exchanges.

Another Step Towards An Efficient Delisting Mechanism

On 9 May, 2014, SEBI released a discussion paper to review the existing delisting regulations in India. The discussion paper is in light of various concerns raised by market participants about the prevalent delisting process, such as those relating to the reverse book building process, insufficient demand and time taken. Further, investors apprehend that acquirers first park their shares though offer for sale or informal arrangements with a group of investors, and later acquire such shares at a predetermined price in the delisting offer. In this manner, promoters or acquirers affect true price discovery and transgress the delisting regulations.

SEBI has proposed various alternatives to the existing model of price discovery and measures to increase participation in the reverse book building process. Further, to shorten the delisting process, an indicative timeline has been proposed which could shorten the delisting process from 137 days as it stands today, to 64 days. Currently a delisting process happens in 4-6 months. SEBI has proposed to discontinue with the requirements of prior shareholders' approval by special resolution which typically takes 30 days, and in-principle approval by the stock exchange which is done within 30 days. Further, SEBI proposes to bring the minimum shareholding threshold for a successful delisting in line with international best practices, that is, of 90% of the shareholding. Currently the shareholding of the promoter or acquirer post the offer has to be either 90% of the total issued share capital or the aggregate percentage of pre offer promoter shareholding and 50% of the non-promoter shareholding, whichever is higher.

At present, only public shareholders are allowed to participate in the delisting process but the discussion paper moots the possibility of involving depository receipt holders in the delisting offer to enhance participation. It has also been suggested that allowing investors to tender their shares through a stock exchange platform may help in increasing retail participation as it would be more tax efficient.

The proposed review of the delisting regulations by SEBI has been overdue since past experience has raised practical problems in the working of the regulations and has highlighted the shortcomings of the existing scheme of delisting.

Jet-Etihad Deal

On 8 May, 2014, a Whole Time Member of SEBI passed an order holding that Etihad Airways' investment of 24% of the total equity share capital of Jet Airways and the various commercial contracts, such as the Investment Agreement, Shareholders' Agreement and the Corporate Governance Code executed between Jet, Etihad and existing promoters of Jet, did not amount to acquisition of “control” by Etihad Airways in Jet Airways. The WTM, in his order, acknowledged the fact that the meaning of “control” under the Competition Act, 2002 varied from that in the SEBI takeover regulations of 2011 and a finding by the Competition Commission of India under the Competition Act did not automatically mean that the acquirer has acquired “control” for the purposes of SEBI regulations. The Competition Commission had passed an order on 12 November, 2013, wherein it had made observations to the effect that agreements entered into between Jet and Etihad indicated joint control of Etihad over Jet. Accordingly, SEBI had alleged possible acquisition of joint control over Jet by Etihad and the promoters of Jet acting in concert as per regulation 2(1)(e) of the SEBI takeover regulations. The promoters contended that the reliance placed by SEBI on the order of the Competition Commission was not germane to the provisions of SEBI takeover regulations. Based on the transaction documents, the WTM concluded that Etihad was not a 'person acting in concert' with the promoters of Jet for acquiring joint control over Jet.

Further, the WTM held that the mere right to appoint two of twelve directors did not result in control of Jet by Etihad. The WTM's decision was also motivated by the fact that FIPB had cleared Etihad's investment under the FDI policy where the definition of control is similar to that under the SEBI takeover regulations. The FIPB had concluded that 'effective control' in Jet remained with Indian nationals, that is, existing promoters of Jet following the deal between them, as envisaged in the transaction documents. The WTM observed that given that the promoters of Jet continued holding 51% of the total equity share capital of Jet and retained the right to appoint the chairman of the board who would have a casting vote at all meetings, the lack of any quorum rights of Etihad at board meetings of Jet, and the lack of affirmative, veto or blocking rights at board or shareholder meetings and the lack of pre-emptive, tag along rights regarding transfer of shares, were sufficient proof that Etihad had not acquired “control” of Jet, under the SEBI takeover regulations. This order provides much needed clarity on the issue of what amounts to “acquisition of control,” given that the definition of “control” is subjective and does not set any precise and independent criteria.

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