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Highlights from SEBI's Latest Board Meeting

SEBI has issued a press release discussing the regulatory decisions it has taken during its board meeting held on June 23, 2015. Apart from approving changes proposed in recent discussion papers relating to fast track issuances and offers for sale through stock exchanges, the following are the major decisions of SEBI.

The all new - Institutional Trading Platform

SEBI has introduced a simplified framework for several large young companies to list in what is essentially a reform of the previously rather unworkable ITP segment. If one were to condense the new ITP (NITP), it allows companies, particularly technology oriented companies to raise capital for general corporate purpose from sophisticated investors. To be sure, this platform is for capital raising and it is for rather large companies (minimum investment of Rs. 10 lacs (Rs. 1 million) with minimum 200 investors means a total capital raise of Rs. 20 crores) of capitalisation of approximately Rs. 100 crores or upwards. The NITP is also a big change from the nit-picking ITP requirements which included the maximum age of the company, the maximum revenue of the company, the maximum size of the company etc. The NITP is a big step forward, not just from the ITP in existence but also from the draft proposal for the NITP which was full of silly requirements. It is a tribute to SEBI's openness that all the silliness has gone away (Finsec among many had commented on the draft paper).

It should be noted that except for the purpose of raising funds and some relaxations in reaching the valuations, there is no relaxations from either disclosure standards (with a minor exception relating to immaterial issues which can now be disclosed on the website of the company) or corporate governance standards. In other words, this is not a forum like the AIM market or other alternate segments. This is a big boys market where both the issuer and the investors are big boys (minimum issue size and trading lots are both Rs. 10 lacs (Rs. 1 million)). The main purpose of NITP is to bring a market which was travelling abroad - onshore. This is likely to be effective in achieving that purpose.

Over the medium term it would be good to see the NITP being transformed from a separate trading segment into the primary board itself, where the trading size remains large to protect less sophisticated investors from participating. This should achieve the purpose of segmenting sophisticated investors from the unsophisticated without fragmenting the market into different segments. This integration is straightforward from a disclosure perspective too as the companies are complying with almost identical standards of disclosures in quality and frequency. Finally, it would be great to see SEBI relax the rather archaic rule restricting companies from using raised funds for general corporate purpose for all companies. SEBI's job is to remove ignorance and fraud from the market, not stupidity.

Promoters Re-classified

SEBI has decided to put in place a regulatory mechanism for the re-classification of promoters of listed companies as public shareholders. As per SEBI's ICDR Regulations, shareholders who are in control of a company, who are instrumental in planning a company's public offer of securities or those who are named as promoters in the offer document, along with those related to such persons, are considered to be part of the promoter/ promoter group. Till date, there was no clarity on how and when promoters would seize to be part of the promoter/ promoter group and become 'public shareholders'.

As per the press release, SEBI will allow the re-classification of promoters as public shareholders in two circumstances.

The first situation is when a new promoter replaces the existing promoter, for instance, by making an open offer. The existing promoter can be re-classified as a public shareholder provided their shareholding drops below 10% of the share capital of the company and subject to receiving approval from its shareholders. Both these conditions seem to be too onerous, especially since one can become a promoter without either holding over 10% of the share capital or obtaining shareholder approval.

The second situation applies to companies which are considered to be 'professionally managed', i.e., no person or group (along with persons acting in concert with them) hold more than 1% of the share capital of the company. In such circumstances, the existing promoters may be re-classified as public shareholders while the company becomes a company not having any identifiable promoter. However, Mutual Funds/Banks/Insurance Companies/Financial Institutions/FPIs may individually hold upto 10% of the share capital. With the threshold at 1%, it seems unlikely that many companies will achieve the status of being 'professionally managed' implying that SEBI is not comfortable with allowing a company to exist promoter-less.

On re-classification, the press release discusses further conditions that will be applicable, the most important of which are: (a) The existing promoter must not have any special rights through any formal or informal arrangements; (b) Subsequent to promoter re-classification, their shareholding cannot be counted towards satisfying the minimum public shareholding norms. As the press release does not provide clarity on what constitutes 'special rights', it would seem that the condition is too expansive. In regard to the second condition, SEBI has apparently created a third category of shareholders who neither fall within the promoter/ promoter group or under the public shareholder category.

Strategic Debt Restructuring Scheme

The RBI, in its recent circular titled *"Strategic Debt Restructuring Scheme"*, provided a framework whereby lender banks have been granted enhanced capabilities to initiate a change in ownership of a defaulting borrower by converting the loan dues into equity shares. As per the circular, the option to resort to SDR must be approved by the shareholders of the borrower company by way of a special resolution at the time of the initial restructuring. During the restructuring, if the lenders decide to undertake the SDR mechanism, a maximum period of 180 days is available for them to complete the conversion of the debt to equity either by the lenders themselves or through the CDR mechanism. Lenders must acquire atleast 51% of the share capital of the borrower. The circular seems to give lenders the discretion to determine the fair value, i.e., the price at which the debt is converted into equity, subject to upper and lower limits. As there is no clarity on how to arrive at the fair value or on whether the fair value also requires the approval of the borrower's shareholders, the provision seems to be lender centric.

Post conversion, the lenders must strive to divest control of the defaulting borrower to a 'new promoter' at the earliest, allowing them to recuperate their loan dues. The debt will be reclassified as a standard asset and the lenders may refinance the company if necessary. This benefit is not available if the lenders fail to divest. Additionally, the conversion under the SDR scheme shall benefit from an exempt from the requirements of making an open offer under the SEBI Takeover Regulations. However, this benefit does not extend to when the lenders divest their control to new promoters.

The SDR mechanism is a potent weapon in the hands of lenders as it ensures that the shareholders bear the first loss rather than the debt holders. While practical hardships might discourage lenders from resorting to SDR, it will certainly ensure that promoters take measures to please their lenders.

Appointment of Directors to the Board of Yes Bank

The Bombay High Court recently pronounced its judgment in *Madhu Ashok Kapur and Ors.* v. *Rana Kapoor and Ors.*, providing some relief in the two-year long battle between Yes Bank and Madhu Kapur, the widow of co-founder Ashok Kapur. Ashok Kapur and the other co-founder, Rana Kapoor, enjoyed certain privileges in the management of Yes Bank. The dispute arose when Madhu Kapur and the other Plaintiffs, following Ashok Kapur's demise, were denied these rights. The Court first considered whether the said rights were hereditary. It agreed with the Plaintiffs that, since shares include proprietary rights, the participatory rights given in the articles which the founders enjoyed are in the nature of moveable property. Moreover, the articles contained express provisions pursuant to which any rights that Ashok Kapur had would pass on to his heirs and legal representatives. Hence, the Court held that the rights were not personal but were heritable and assignable.

In relation to the right of appointment of directors to the board of Yes Bank, the Court construed the right to recommend directors, as given in the articles, to mean a right to nominate, not just a right to suggest. Had it been a mere right to suggest, it would not have been specifically provided for in the articles as all members of a company have the very same right under the Companies Act, 2013. Further, the Court observed that the articles indicated that Ashok Kapur and Rana Kapoor were to act together. Hence, neither the Plaintiffs nor Rana Kapoor's group had the right to make a unilateral nomination to the exclusion of the other. Based on these findings, the Court found the past appointment of seven individual directors to be invalid and also rejected the unilateral nomination of Ashok Kapur's daughter. Further, the court rejected the Plaintiffs' contention that Rana Kapoor's appointment as the Managing Director was a related party transaction by observing that it was made in the ordinary course of business and was an arms-length transaction.

This decision comes at a time when corporate governance is being given significant prominence and companies must stay clear of deviations from the provisions within their articles. If not, courts may go to the extent of invalidating the appointment of directors even if it may hamper the operations of the company.

FDI with Assured Returns?

The Bombay High Court's recent decision in the case of *IDBI Trusteeship Services Limited* v. *Hubtown Ltd.* could prove to be a game changer as far as laws related to foreign investment are concerned. Through a complex transaction, a foreign investor subscribed to compulsory convertible debentures and 10% of the equity shares of an Indian holding company, which on conversion would entitle it to 99% shareholding. Further, the Indian holding company invested in two of its wholly owned subsidiaries by subscribing to optionally fully convertible debentures which carried a fixed coupon rate of 14.5%. The present summary suit was filed when the subsidiaries defaulted.

Citing the Supreme Court's decision in the Vodafone case, the Court held that the transaction should be reviewed as a whole, by resorting to the substance over form approach. Having examined the facts, it held that the structure seemed to have been designed to circumvent restrictions imposed under the FDI policy. Based on the fact that the Indian holding company is to receive a fixed return of 14.5% from its subsidiaries and that the foreign investor would hold 99% of Indian holding company post conversion, the court held that the foreign investor would receive an assured return. This is not permitted under the FDI policy and FEMA Regulations. While this judgement has the potential to adversely affect a number of foreign investment transactions, this is only a prima facie view expressed by the court and final verdict is no doubt keenly awaited by all stakeholders.

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