DEVELOPMENTS IN SECURITIES LAW

IN AUGUST 2018

ACUITY LAW

ABOUT ACUITY LAW

Acuity Law was founded in November 2011. Acuity Law comprises of a team of young and energetic lawyers led by Souvik Ganguly and Gautam Narayan, who have deep and diverse experiences in their chosen areas of practice. We have advised Indian and multinational companies, funds, banks and financial institutions, founders of companies, management teams, international law firms, domestic and international investment banks, financial advisors and government agencies in various transactions in and outside India.

Acuity Law takes pride in rendering astute legal advice informed by commercial realities. Our areas of practice are divided into two departments.

The Corporate practice is led by Souvik Ganguly and the Disputes practice is led by Gautam Narayan.

As part of the Corporate practice, Acuity Law advises on:

- Mergers and acquisitions;
- Distressed mergers and acquisitions;
- Insolvency Law;
- Private Equity and Venture Funding;
- Employment and labour laws
- Commercial and trading arrangements; and
- Corporate Advisory

As part of the Disputes practice, Acuity Law under the leadership of Gautam Narayan advises and represents clients on domestic and cross - border:

- Civil disputes;
- Criminal law matters; and
- Arbitration matters

Acuity Law actively follows legislative and policy developments in its chosen areas of practice and shares such developments with clients and friends on a regular basis.

If you want to know more about Acuity Law, please visit our website www.acuitylaw.co.in or write to us at al@acuitylaw.co.in.

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INTRODUCTION

This newsletter covers the updates about the developments in Indian securities law during the month of August 2018. We have summarized the key regulatory developments including informal guidance and regulatory proposals of the Indian capital market regulator and certain important judgements of the Securities Exchange Board of India ("**SEBI**"), Securities Appellate Tribunal ("**SAT**"), Hon'ble Supreme Court of India and the Bombay High Court dealing with insider trading, fraudulent and unfair trade practices, securities transaction tax, minimum public shareholding, compliance requirements for foreign investors and the SEBI settlement mechanism. Please see below the summary of the relevant developments, proposals and judgements.

A. Informal Guidance issued by SEBI

In 2003, SEBI introduced the Informal Guidance Scheme ("**Scheme**") in the interest of better regulation and development of the Indian securities market. Under the Scheme, parties may seek guidance from SEBI in case of any queries, in relation to any proposed action / inaction or interpretation of Indian securities norms. The informal guidance is not binding on SEBI.

UNDERTAKING BY INDEPENDENT DIRECTOR PRIOR TO SHARE SALE

SEBI on 19 July 2018 through informal guidance in the matter of Hawkins Cookers Ltd. ("**HCL**") took a view that under the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**"), even an independent director is required to give an undertaking to the compliance officer of the company along with his trading plan, stating that he was not in possession of any unpublished price sensitive information ("**UPSI**"), since, by virtue of his position in the company, he would otherwise be presumed to always be in possession of UPSI.

B. SEBI, SAT and Court Orders

1. SEBI IMPOSES FINE FOR SYNCHRONIZED AND CIRCULAR TRADING

SEBI has imposed a penalty of INR 350,000 on Mr. Sunil Purohit ("**Noticee**") for synchronized and circular trading in violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 ("**PFUTP Regulations**") in the matter of SKS Logistics Ltd ("**SKS**") on 31 July 2018.

The Noticee had allegedly collaborated with certain other individuals and entities ("**Group**") to create artificial volume in the scrip of SKS through synchronized and circular trading. The Noticee contended that his identity had been used fraudulently for the trades. He argued that he did not have an active bank account for the past 10 years, while simultaneously stating that he had recently sold shares from his dematerialized account. Further, SEBI procured the signed Know Your Customer ("**KYC**") form filled by the Noticee for opening a trading account, whereas the Noticee had stated that he had not signed any such KYC form.

SEBI held the Noticee liable for violation of the PFUTP Regulations, since the Noticee had engaged in fraudulent and unfair trading with an intent to drive up the value of the scrip without change in ownership, and had further taken contradictory stands throughout his pleadings. SEBI also held that the test of 'preponderance of possibilities' is relevant to establish liability under the PFUTP Regulations, for establishing connection between a noticee and the suspected associates. Irrefutable evidence is not required for the purpose of establishing such a connection.

2. SEBI IMPOSES FINE ON MERCHANT BANKER FOR NON-DISCLOSURE OF LOAN ADVANCEMENT IN IPO DOCUMENTS

SEBI has imposed a fine of INR 500,000 on merchant bankers Anand Rathi Advisors Ltd. (“**ARAL**”), for their failure to disclose details of loans advanced to Dr. Datsons Labs Ltd. (“**Datson**”), in the matter of Dr. Datsons Labs Ltd on 31 July 2018.

Datson came out with an Initial Public Offer (“**IPO**”), for which ARAL was one of the book running lead managers. Datson had raised Inter Corporate Deposits (“**ICDs**”) worth INR 358,500,000, out of which ICDs worth INR 20,000,000 were advanced by a group company of ARAL. Datson repaid the ICDs through the IPO proceeds. However, the IPO prospectus (“**Prospectus**”) had failed to make appropriate disclosures about the ICDs and the repayment of the same from the IPO proceeds.

SEBI held the merchant banker ARAL liable for failure to disclose material information that the IPO proceeds would be used to repay loans, in the Prospectus, in violation of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and the Code of Conduct for Merchant Bankers. Further, SEBI held that ARAL had failed to conduct proper due diligence, since ARAL did not independently examine the board resolutions of Datson and only depended on Datson’s correspondence that it had ‘nil’ indebtedness prior to the IPO.

3. BAR FROM SECURITIES MARKET WILL NOT PREVENT LIQUIDATION OF SHARES IN DEMAT ACCOUNT

The Hon’ble Supreme Court of India vide order dated 03 August 2018 in the matter of SEBI v. Rajesh Pavithran, confirmed SAT’s order dated 30 October 2017 holding that a person barred from dealing in securities market is not automatically prohibited from liquidating the shares in his demat account (“**Shares**”).

SEBI had restrained Mr. Pavithran (“**Appellant**”) from accessing the capital market and dealing in securities or instruments for a period of 10 years from 05 September 2017. Upon appeal by Appellant, SAT observed that SEBI had not passed any order to recover any amount or attach the Shares. Therefore, the mere fact that the Appellant was barred from dealing in the securities market will not bar him from selling the Shares.

4. 0.10% STT PAYABLE ON PHYSICAL SETTLEMENT OF STOCK DERIVATIVES

The Bombay High Court vide its order dated 28 August 2018 has upheld the circular issued by the National Stock Exchange (“**NSE**”) dated 17 July 2018 (“**Circular**”), directing members in the equity derivative segment to collect Securities Transaction Tax (“**STT**”) at 0.10% on futures contract which are settled by way of physical delivery (“Concerned Transactions”), with effect from 26 July 2018.

NSE sought clarification from the Central Board of Direct Tax (“**CBDT**”) regarding the applicability of STT to the Concerned Transactions. As an interim measure till CBDT’s response, NSE issued the Circular imposing the same STT at 0.10% on the settlement price to be paid by the purchaser of the Concerned Transactions. The Association of National Exchanges Members of India (“**ANMI**”) had approached the Bombay High Court against the Circular, contending that NSE as no legal basis to impose STT on the Concerned Transactions in this manner.

The CBDT clarified that a transaction involving a derivative contract settled by physical delivery of shares, is not different from a transaction in equity shares where the contract is settled by actual delivery or transfer of shares. Therefore, the 0.10% STT applicable to such delivery-based equity transactions will also be applicable to the Concerned Transactions.

C. Circulars, Rules and Regulations

1. AMENDMENT OF MINIMUM PUBLIC SHAREHOLDING REQUIREMENT

The Central Government has amended rule 19A of the Securities Contract (Regulation) Rules 1957, which requires every listed company to ensure that at least 25% of its shareholding is held by the public, vide notification no. G.S.R. 675(E) dated 24 July 2018 ("**Amendment**"). According to the Amendment, a listed entity whose public shareholding falls below 25% due to implementation of a resolution plan under the Insolvency and Bankruptcy Code 2016, must bring its public shareholding back to 25% within 3 years of the fall. In case the public shareholding falls below 10%, the listed entity must bring it back to 10% within 18 months of such fall, and to 25% within the next 18 months.

2. TIME FOR LISTING OF DEBT AND NON-CONVERTIBLE SECURITIES REDUCED TO 6 DAYS

SEBI has reduced the time for listing of debt securities, non-convertible redeemable preference shares ("**NCRPS**") and securitized debt instruments ("**SDI**") to T+6 working days, where T is the date of issue closure, vide its circular no. CIR/DDHS/P/ 121/2018 dated 16 August 2018 ("**August Circular**"). Prior to the August Circular, the debt securities, NCRPS and SDI were required to be listed within T+12 days. The August Circular is applicable to public issues of debt securities, NCRPS and SDI opening on or after 01 October 2018.

3. CLARIFICATIONS ON ELECTRONIC BOOK MECHANISM FOR PRIVATE PLACEMENT OF SECURITIES

SEBI has issued certain clarifications regarding the use of Electronic Book Provider ("**EBP**") platform for private placement of securities vide its circular no. SEBI/HO/DDHS/CIR/P/2018/122 dated 16 August 2018 ("**EBP Circular**"). The EBP Circular will come into effect from 01 October 2018.

The key points of the EBP Circular are:

1. Closed bidding permitted on EBP platform: Closed bidding will now be permitted on the EBP platform, along with open bidding. However, the issuer must disclose the mode of bidding in the private placement memorandum ("**PPM**") / information memorandum ("**IM**").
2. Allotment on yield-time priority basis: The securities will be allotted on a "yield priority" basis. If 2 or more bids are at the same yield, then the securities will be allotted on a "time -priority" basis. If the bids have the same yield and time, then allotment shall be done on a "pro-rata" basis.
3. Pay-in of funds through escrow bank account of issuer: Issuers may now opt for pay-in of funds through their escrow bank account, provided that this is specified in the PPM or IM. The process of pay-in of funds by investors and pay-out to issuer can be done on either T+1 or T+2 day, where T day is the issue day.

4. SEBI EXTENDS TIMELINE FOR COMPLIANCE WITH KYC REQUIREMENTS REGARDING BENEFICIAL OWNERS BY FPI

SEBI had prescribed certain KYC requirements for Foreign Portfolio Investors ("**FPI**") *vide* its circular No. CIR/IMD/FPIC/CIR/P/2018/64 dated 10 April 2018 ("**April Circular**"). Existing FPIs were required to comply with the following KYC Requirements, mainly relating to beneficial owners, in the April Circular by 10 October 2018:

1. Provide the list of beneficial owners ("**BO**") in the prescribed format;
2. Change their structure / close operations in India if their BO are non-resident Indians / overseas citizens of India / resident Indians;

3. Provide an undertaking that the FPI will provide certain KYC documents that they are otherwise exempted from submitting, if demanded by legal authorities;
4. Comply with the provisions of Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, with respect to clubbing of investment in equity shares of a company.

SEBI has extended this timeline for compliance with the KYC Requirements of the April Circular to 31 December 2018, vide its circular dated 21 August 2018.

D. Reports

1. REPORT OF COMMITTEE ON FAIR MARKET CONDUCT

The Committee on Fair Market Conduct submitted its report ("**FMC Report**") to SEBI on 08 August 2018, suggesting amendments to SEBI Act 1992, PIT Regulation and PFUTP Regulations. All stakeholders have been invited to provide their comments on the FMC Report by 27 August 2018. The recommendations of the FMC Report are divided into 4 separate parts dealing with market manipulation and fraud, insider trading, code of conduct related to insider trading and recommendations related to surveillance, investigation and enforcement process.

Some key recommendations are:

1. <u>Non-promoters not liable for inter-se off-market trading</u>: Under the current law, a promoter will not be liable under the PIT Regulations, if he engaged in an off-market inter-se transfer between with another promoter, who was in possession of the same UPSI. The FMC Report proposes to extend this protection to non- promoters also, provided that the UPSI was not obtained through the modes specified in Regulation 3 (3) of the PIT Regulations, relating to transactions that either entail open offer obligations, or are otherwise declared by the directors to be in the best interests of the company.
2. <u>Different Codes of Conduct under PIT Regulations</u>: PIT Regulations currently specify a common Code of Conduct applicable to listed companies, market intermediaries and other persons who are required to handle UPSI during their business operations. The FMC Report recommends that there should be 2 separate codes of conduct, prescribing minimum standards for (1) Listed companies and (2) Market Intermediaries and other persons who are required to handle UPSI.
3. <u>Power to intercept calls</u>: The FMC Report recommends that SEBI should seek power to intercept telephone calls and electronic communication, to collect strong evidence against repetitive offenders in cases including those of insider trading, front running or market manipulation.
4. <u>Employees and agents of intermediaries also liable</u>: Due to lack of explicit provisions, often intermediaries alone are held responsible for any fraud under PFUTP Regulations, while equally guilty employees / agents escape. The Report recommends that the PFUTP Regulations should also cover market participants, including employees and agents of intermediaries.

2. DAVE COMMITTEE REPORT ON SETTLEMENT MECHANISM

The High-Level Committee chaired by Justice A. R Dave ("**Dave Committee**"), constituted on 14 December 2017, on 10 August 2018, submitted its report ("**Settlement Report**") on 10 August 2018 to SEBI, suggesting changes to the existing framework for settlement for securities law violations. All stakeholders have been invited to provide their comments on the Settlement Report by 01 September 2018.

The Dave Committee has recommended that the existing SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 ("**2014 Regulations**") be repealed and replaced with Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018 drafted by the Dave Committee.

The key recommendations of the Settlement Report are:

1. Power to settle matters under Companies Act, 2013: SEBI should be given the power to settle securities laws violations under laws such as Companies Act 2013, provided that the violation is administered by SEBI.
2. Filing of settlement application and cooling off period: Under the 2014 Regulations, an applicant could not file a settlement application within 24 months from the last date of settlement order issued to the applicant ("**Cooling Off Period**"). Further, the applicant could re-apply for settlement after rejection of first settlement application, in certain situations. The Dave Committee recommended that the Cooling Off Period should be removed, if the second application is for a different cause of action. However, an applicant should not be allowed to re-apply for settlement for same cause of action, if the first application has been rejected. Additionally, no settlement should be allowed if an investigation, audit, inquiry or inspection is pending, unless it will help SEBI to complete the investigation, audit, inquiry or inspection.
3. Settlement of serious violations: Under the 2014 Regulations, serious offences such as fraud, insider trading and front-running cannot be settled. The Dave Committee has recommended that proceedings relating to fraud, including insider trading, front-running and misstatements in offer documents, may be settled depending on the facts and circumstances of each case.
4. Settlement with confidentiality: The Dave Committee has recommended that the confidentiality of applicants who provide certain information regarding serious securities law violations should be protected by SEBI. The identity of the applicant will not be disclosed when such settlement orders are published on the SEBI website.
5. Effect of settlement order: The Dave Committee has clarified that a settlement order should not be admissible as evidence in any other proceedings relating to an alleged default not covered under the settlement order.
6. Settlement application in pending proceedings: Where proceedings are pending or to be initiated against a group, such proceedings will only be stayed against those persons who file a settlement application, and not against the entire group.