



**DEVELOPMENTS IN
SECURITIES LAW**

IN MARCH

2019

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 incisive legal advice taking into consideration commercial realities. Our areas of practice are divided not 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.

INTRODUCTION

This newsletter covers key updates about the developments in Indian securities law during the month of March 2019.

We have covered key regulatory developments including a case with respect to the discretion that Securities and Exchange Board of India (“SEBI”) has while imposing penalty under the SEBI Act, 1992 (“SEBI Act”); informal guidance relating to lock-in period of warrants issued to promoters; SEBI’s press release on extension of deadline for applicability of amendment to section 23(1)(a) SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, and on transfer of securities held in physical mode; and SEBI’s circular withdrawing the 20% limit for investment by foreign portfolio investors in corporate bonds.

We have also covered SEBI’s consultation paper on issuance of differential voting rights.

Please see below summaries of the relevant developments.

1. SEBI HAS THE DISCRETION TO IMPOSE PENALTIES UNDER THE SEBI ACT

Matter: Adjudicating Officer, Securities and Exchange Board Of India Vs. Bhavesh Pabar

Date: 28 February 2019

Summary:

The Supreme Court in this matter discussed whether, SEBI’s adjudicating officer has the discretion to determine the quantum of penalty with reference to sections 15A to 15HB and section 15J of the SEBI Act. Sections 15 A to 15HB specify penalties for breaches of the SEBI Act. Under Section 15I, the adjudicating officer has the power to initiate proceedings and levy penalties under Sections 15A to 15HB. Section 15J states the factors which can be considered by the adjudicating officer while determining the quantum of penalty.

The Supreme Court finally settled this issue which was previously discussed in the Roofit and Siddharth Chaturvedi cases. In the Roofit judgment, the Supreme Court dealt with the issue of whether section 15J was applicable in respect of section 15A between 2002 and 2014 on account of amendments. The Court observed that prior to 2002 and post 2014, the adjudicating officer had discretion to decide the penalty amount as the provision provided the maximum penalty. However, post the 2002 amendment until the 2014 amendment, the adjudicating officer did not have the discretion to determine the penalty amount as the section provided the minimum penalty. This judgment led to SEBI being constrained to levy higher penalties for even minor violations as it could not exercise its discretion under Section 15J of the SEBI Act. Consequently, in 2017, Section 15J was amended to clarify that the adjudicating officer had the discretion to exercise its powers under Section 15J while determining the penalty amount.

In order to harmonize and reasonably interpret sections 15A to 15HA with section 15J of the SEBI Act, the Supreme Court has held that:

- Sections 15A to 15HA have to be read along with section 15J. The imposition of penalty depends upon satisfaction of the substantive provisions as contained in Sections 15A to 15HA of the SEBI Act.
- Conditions stipulated under Section 15J are not exhaustive and are merely illustrative. There can be circumstances beyond those enumerated under Section 15J which can be taken note of by the adjudicating officer while determining the penalty amount.

2. SEBI RESTRICTS TRANSFER OF SECURITIES IN PHYSICAL FORM

On 28 March 2018, SEBI had decided that transfer of securities would be permitted only if the securities were dematerialized (i.e., in electronic form) other than in case of transmission or transposition. The implementation of this restriction was extended to 1 April 2019 keeping in mind practical challenges faced by investors holding shares in physical form. In this regard, SEBI has issued the following clarifications vide press release PR No.: 12/2019 dated 27 March 2019 available [here](#).

- SEBI's decision does not prohibit investors from holding shares in physical form. However, shares can only be transferred by an shareholder if the shares are dematerialized.
- To facilitate a smooth transition, SEBI has further clarified that transfer deeds which are lodged prior to 1 April 2019 but returned due to deficiency in documentation can be re-lodged for transfer after 1 April 2019.

3. EXTENSION OF DEADLINE FOR APPLICABILITY OF AMENDMENT TO SECTION 23(1)(A) SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

Pursuant to section 23(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR"), a listed company is required to formulate a policy on materiality of related party transactions. Regulation 23(1)(A) of LODR, provided that payment made to related parties towards brand usage or royalty would be considered material if the transactions exceed 2% of the annual consolidated turnover of the listed entity during the financial year. This provision was required to come into effect from 1 April 2019. However, after receiving representations from various stakeholders, SEBI has extended the timeline to 30 June 2019.

The relevant SEBI press note is available [here](#).

4. WITHDRAWAL OF 20% LIMIT FOR INVESTMENT BY FOREIGN PORTFOLIO INVESTORS IN CORPORATE BONDS

In order to encourage foreign investment in India, the Reserve Bank of India ("RBI"), on 15 February 2019, withdrew the limitation which required a foreign portfolio investor ("FPI") to limit its exposure to 20% of its bond portfolio to a single corporate. To give effect to this provision, SEBI vide SEBI Circular No.: IMD/FPIC/CIR/P/2019/37 dated 12 March 2019 (available [here](#)) has withdrawn its corresponding circular concerning exposure limits of FPIs in corporate bonds.

SEBI has further clarified that all the circulars and directions issued by RBI on investment conditions for FPI Investment in corporate debt securities shall be complied with as per the timelines specified in the RBI circulars. No separate circulars will be issued by SEBI.

5. SEBI INFORMAL GUIDANCE ON LOCK-IN PERIOD OF WARRANTS ISSUED TO PROMOTERS

Jindal Steel & Power Ltd. had approached SEBI for informal guidance with respect to the lock-in period applicable to unlisted warrants issued by it to Opelina Finance Investment Ltd., the promoter, on a preferential basis.

Regulation 78(6) of SEBI (Issue of Capital and Disclosure Requirements) Regulation, 2009 requires that the entire pre-preferential allotment shareholding of the promoters be locked-in from the relevant date up to 6 months from the date of trading approval (where holder intends to list the securities within 18 months of date of allotment). Further, in case where trading approval is inapplicable to warrants, the lock-in period is from the relevant date till expiry of 6 months from the date of allotment of warrants.

Based on the facts, SEBI held that the warrants will be locked in from the relevant date up to 6 months from the date of the allotment.

The informal guidance is available [here](#).

6. SEBI RELEASES CONSULTATION PAPER OF DIFFERENTIAL VOTING RIGHTS

Currently, the Indian regulatory regime does not permit companies to issue shares with differential voting rights ("DVRs") which have higher or superior voting rights (that is one share has more than one vote). However, a company can issue shares with DVRs which provide for a lower voting right. As the conditions attached to issuance of DVRs are cumbersome only five listed companies in India have issued DVRs as of date. SEBI has released a consultation paper on issuance of DVRs after receiving report on DVRs by the DVR group constituted by the primary market committee of SEBI.

The consultation paper appreciates the role, the DVRs have played in various jurisdictions and the advantages of permitting DVRs in the Indian context. In India, where most companies are promoter led, shares with DVRs could help promoters retain control/decision making power even when their shareholding is diluted. Some of the key recommendations under the consultation paper are summarized below:

- A company should be entitled to issue DVRs subject to:
 - (i) authorization in the articles of association of the company; and
 - (ii) special resolution passed by shareholders' in a general meeting.

- The proposed DVRs issuance structure is provided below:
 - (i) Listed companies may issue fractional voting rights shares initially by rights issue, bonus issue and follow on public offer. Follow on public offer can be made to third parties in addition to existing shareholders.
 - (ii) Listed companies may make subsequent issuances of fractional shares where fractional voting rights shares have been previously issued.
 - (iii) Unlisted companies may issue superior voting rights shares only to its promoters. The unlisted company will be permitted to do an initial public offer of its ordinary equity shares provided that (A) the superior voting rights shares, if issued, have been held by the promoters for at least one year prior to filing the draft offer documents with SEBI; (B) the superior voting rights shares will be subject to locked-in post the initial public offer. Post-listing, the total voting rights of the promoters including through superior voting rights shares should not exceed 75% of the total voting rights. Further, the shares with superior voting rights will be mandatorily converted to ordinary shares five years from the date of listing subject to provision for extension of another five years, if approved by shareholders through a special resolution.
 - (iv) A company cannot issue superior voting rights shares once it is listed.
- The ratio of fractional voting rights shares should not exceed 1:10, i.e., one vote applicable to ordinary equity shares would be voting entitlement on ten fractional voting rights shares. The company can have only one class of fractional voting rights shares at a time.
- The ratio of superior voting rights shares should not exceed 10:1, i.e., ten votes for every one superior voting rights share. The company can have only one class of fractional voting rights shares at a time. A superior voting rights share will have only one voting right on matters as may be specified by the regulator such as voluntary winding up of the company, appointment or removal of independent director and auditors, change in control of the company initiation of voluntary resolution plan, extension of date of mandatory conversion of shares with superior voting rights post listing etc.

The consultation is a welcome step as shares with DVRs are much need in the context of India being a growing economy. Further, DVRs would provide a mechanism for promoters to structure the shareholding in an optimal manner.

The consultation paper is available [here](#).