DEVELOPMENTS IN SECURITIES LAW

IN NOVEMBER 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 incisive legal advice taking into consideration 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.

INTRODUCTION

This newsletter covers key updates about the developments in Indian securities law during the month of November 2018. We have summarized the key regulatory developments including informal guidance, regulatory changes brought about or proposed by the Indian capital market regulator in relation to listing obligations and disclosure requirements, disclosure by credit rating agencies, transfer of securities in physical mode and unified payment interface mechanism and certain important orders of the Securities Exchange Board of India ("**SEBI**") in relation to penalty for fraudulent trade practices due to self-trade, trade reversal, non-repayment of funds to investors, falsification of accounts and insider trading. Please see below the summary of the relevant developments and orders.

NO OPEN OFFER REQUIRED UNDER THE TAKEOVER CODE FOR OFF MARKET TRANSFER BETWEEN IMMEDIATE RELATIVES

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 laws. The informal guidance is not binding on SEBI.

SEBI on 14 November 2018 had issued informal guidance in the matter of Lactose (India) Ltd. ("**LIL**") relating to the requirement of making an open offer in case of off-market transfer of shares between immediate relatives, under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**").

The applicant ("**Applicant**"), a shareholder and promoter group entity of LIL, held 0.52% of the paid-up equity capital of LIL. Additionally, the Applicant held certain warrants which were convertible into equity shares by April 2019. Through certain proposed off-market transactions between Applicant's niece, Applicant's sister and the Applicant ("**Transactions**"), the promoter group's shareholding in LIL would increase by approximately 9%, from 34.28% to 43.51%. The Applicant sought guidance on whether the Applicant would be exempt from making an open offer under the Takeover Code, since after the Transactions, the promoter group shareholding of LIL would increase by more than 5%, which would ordinarily trigger open offer obligations under the Takeover Code.

SEBI held that the Transactions are exempted from the requirement of making an open offer, since they will take place between 'immediate relatives' as per the Takeover Code. Additionally, the conversion of the convertible warrants held by the Applicant may trigger the open offer requirements under the Takeover Code at a latter time, depending upon the shareholding pattern of the 'promoter and promoter group' prevailing at the time of such conversion.

1. SONI GROUP BARRED FROM STOCK MARKET FOR FRAUDULENT TRADE PRACTICES

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B. SEBI Orders

SEBI has barred Mr. Sanjay Jethalal Soni and 17 related entities ("**Entities**") (collectively, "**Soni Group**") from the securities market until further orders are passed, for engaging in self trade, first trade, match trade, price manipulation through last trade price ("**LTP**") contribution and new high price ("**NHP**") in violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 ("**PFUTP Regulations**"), *vide* its order dated 16 November 2018 in

the matter of trading by Soni Group in the scrip of M/s. Parichay Investments Ltd.

SEBI had conducted an investigation in the scrip of Parichay Investments Ltd. ("**PIL**") during the period of 21 July 2010 to 30 August 2011. SEBI issued show-cause notices dated 24 August 2017 and 24 October 2018, alleging that some of the Entities had conducted matched trades of more than 10,000 shares of PIL, by trading within the Soni Group repeatedly, which resulted in creation of artificial volumes in the scrip. The trades were matched in such a way that nearly 100% of the purchased shares were matched within the Soni Group. Further, some Entities had repeatedly engaged in self trades of more than 10,000 shares for more than 2 days, thereby creating artificial volumes without any real transfer of ownership of shares. Additionally, certain Entities were involved in manipulating the price of the scrip by increasing LTP through first trades, thus fraudulently causing an increase in the price of the scrip.

SEBI held that it is irrelevant that the trades met all legal obligations of delivery and payment, since these obligations were purposefully met in order to hide the *mala fide* intention behind the trades. Further, the high percentage of matched orders within the Soni Group could not have been possible unless there had been a prior understanding between the entities executing them. The Entities, while conducting self-trades and match trades, had contributed to gross positive LTP that contributed to 57.06 % of the total market positive LTP.

Based on the above findings SEBI held that even though no disproportionate gain was made by the Entities, the Entities were in violation of the relevant provisions of the SEBI Act 1992 and PFUTP Regulation. SEBI barred the Entities from trading in the securities market until further orders are passed and imposed penalties ranging from INR 500,000 to INR 2,500,000 on each of the individual Entities.

2. SEBI IMPOSES PENALTY OF INR 2,000,000 FOR EXECUTION OF REVERSAL OF TRADES IN STOCK OPTIONS

SEBI has ordered Pepson Steels Private Limited ("**PSPL**") to pay INR 2,000,000 as penalty for making disproportionate gains by carrying out non-genuine and reversal trades in illiquid stock options, thereby creating artificial volume in violation of the PFUTP Regulations, *vide* its order dated 05 November 2018 in the matter of Pepson Steels Private Limited.

SEBI had observed large scale reversal of trades in stock options segment of Bombay Stock Exchange ("**BSE**"), leading to creation of artificial volume. Accordingly, SEBI conducted an investigation into the trading activities of certain entities, including on PSPL, in illiquid stock options on the BSE, during the period of 01 April 2014 to 30 September 2015. SEBI found that the Noticee had executed 100 non-genuine trades in 42 unique contracts ("**Contracts**") on 30 trading days i.e., from 11 March 2015 to 08 September 2015.

SEBI noticed that PSPL had bought and sold option contracts with the same counter parties and reversed its trades in less than 1 minute from its earlier buy / sell trades, at substantial price difference, even though none of the parameters for pricing of the option, such as volatility, price of underlying stock, etc., had undergone any change during the currency of trades. Further, certain trades had artificially raised the volume of the stock by as much as 100%. These non-genuine trades executed by PSPL

had significant differential in buy rates and sell rates, considering that the trades were reversed on same day.

SEBI held that PSPL had violated the PFUTP Regulations by indulging in manipulative reversal trades, thereby creating artificial volumes and a false and misleading appearance of trading in the illiquid stock options at BSE. Further, the trades executed by PSPL had contributed significantly to the total number of trades in the market for the Contracts. SEBI concluded held that such trades are fraudulent in nature and imposed a penalty of INR 2,000,000 on PSPL.

3. SEBI ORDERS REFUND OF INR 141 BILLION TO INVESTORS; BARS SAHARA GROUP COMPANY, PROMOTER AND DIRECTORS FROM THE SECURITIES MARKET

SEBI has ordered Sahara India Commercial Corporation ("**SICCL**"), its promoter Mr. Subrata Roy and its former directors, to refund an amount of INR 141.06 billion received from the allotment of optionally fully convertible debentures ("**OFCDs**") to the relevant investors, *vide* its order dated 31 October 2018 in the matter of M/s Sahara India Commercial Corporation Limited.

During the course of investigation by SEBI into OFCDs issued by 2 group companies of the Sahara group of companies in 2008-2009, SEBI noticed that SICCL had made an offer of OFCDs which opened on 06 July 1998 and closed on 30 June 2008 ("**Offer**") and raised an amount of at least INR 141.060 billion from over 19 million investors ("**Allotment**"), without complying with the due legal process for public issue of securities. SEBI issued show cause notice to SICCL on 20 February 2015.

SEBI alleged that the Allotment amounted to public issue of securities under the Companies Act, 1956 ("**CA 1956**"), since the Offer had been made to more than 50 persons. Consequently, SICCL had failed to comply with the relevant requirements under CA 1956, SEBI (Disclosure and Investor Protection) Guidelines, 2000 and SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. Further, M/s Sahara India, a partnership firm belonging to the Sahara Group ("**Firm**"), had acted as 'arranger' to the issue and facilitated the issue as merchant banker, without being duly registered with SEBI.

SICCL contended that the proceedings initiated by SEBI are time-barred, since they have been initiated 15 years after the Allotment. Further, the Allotment was a private placement, since it was issued to a select group of people only ("**Private Group**"). Additionally, the *proviso* to section 67(3) of CA 1956 ("**Proviso**"), which deems all offers made to more than 50 persons to be 'public' offers, is not applicable since it came into effect on 13 December 2000 with prospective effect, that is, after the Offer was made. Similarly, the registrar of companies ("**ROC**"), and not SEBI, has jurisdiction over this matter, since section 55A of CA 1956, giving SEBI jurisdiction over matters relating public issue of securities, came into effect on 13 December 2000.

Further, SICCL produced a certificate of its chartered accountant ("**CA Certificate**") to show that it had already discharged all liabilities in relation to the OFCDs by 31 October 2017, by way of cash payment ("**Repayment**"), except a sum of INR 180,000,000 could not be refunded, since the relevant OFCD holders did not turn up to receive payment. Finally, SICCL stated that the government is bound by estoppel from raising any issue, since neither the ROC and Ministry of Corporate Affairs

("**MCA**") had raised any issue at the time that of approval.

SEBI held that there is no limitation for initiating action by SEBI, and the Offer was still open after the Proviso came into effect. Thus, the Proviso will be applicable in the present matter and the OFCDs issued after 13 December 2000, will be considered to be 'public' issue of securities. Additionally, SICCL had failed to produce any evidence to support its contention that the Offer had, in fact, only been made to the Private Group.

Further, SEBI has jurisdiction over the matter since section 55A of the CA 1956 gives SEBI retrospective jurisdiction over violations which occurred before this section came into effect. Additionally, to protect the interest of the investors, the Repayment would only be considered fulfilled when the same is done through a verifiable banking channel, individual subscriber-wise, through bank demand draft or pay order, all of which must be crossed as 'non-transferable' ("**Appropriate Methods**"). Since SICCL had not produced any documentary evidence to show that the Repayment had, in fact, been made through the Appropriate Methods, the CA Certificate and SICCL's mere statements, were not sufficient proof of Repayment. SEBI noted that there is no estoppel against violation of law, and ROC, MCA and SEBI cannot be barred from acting upon violations of law by SICCL due to any prior inaction. Finally, the Firm had performed the role of a merchant banker, without being duly authorized and registered with SEBI.

In light of the above, SEBI directed SICCL, Mr. Subrata Roy and the former directors of SICCL during the time of Offer and Allotment ("**Erstwhile Directors**"), to refund the entire amount of INR 141.06 billion to the relevant investors, through the Appropriate Methods, with interest of 15%. Further, SICCL, Mr. Subrata Roy and Erstwhile Directors have been barred from accessing the securities market for a period of 4 years from the date of completion of the refund to the investors.

4. SEBI BARS PROMOTERS, DIRECTORS AND RELATED ENTITIES OF SATYAM COMPUTERS FROM SECURITIES MARKET FOR 14 YEARS; ORDERS DISGORGEMENT OF ILLEGAL GAIN WORTH INR 8.134 BILLION

SEBI has barred Mr. Ramalinga Raju, Mr. Rama Raju, Mr. Suryanarayana Raju and SRSR Holdings Ltd. ("**Noticees**") from the securities market for a period of 14 years and ordered disgorgement of unlawful gains with interest, for falsifying the financial statements and insider trading in the scrip of Satyam Computers Services Ltd. ("**SCSL**") *vide* its order dated 02 November 2018 in the matter of SCSL with respect to Ramalinga Raju, Rama Raju, Suryanarayana Raju and SRSR Holdings.

SEBI had passed orders on 15 July 2014 ("**First SEBI Order**") and 10 September 2015 ("**Second SEBI Order**") (collectively, "**SEBI Orders**") against the Noticees, for falsification of SCSL's financial statements, insider trading in the scrip of SCSL and illegal gains through pledge of shares of SCSL by SRSR Holdings, a privately owned company by Mr. Ramalinga Raju and Mr. Rama Raju, the promoters / directors of SCSL ("**Promoters / Directors**"). The SEBI Orders were subsequently challenged at the Securities Appellate Tribunal ("**SAT**"), which upheld the SEBI Orders on merits but set aside the directions relating to the quantum of illegal gains to be disgorged, and the period of restraint from the securities market ("**SAT Orders**"). The SAT Orders found a contradiction between the SEBI Orders, since the First SEBI Order cast liability on the Promoters / Directors for disgorgement of illegal gains, and the Second

SEBI Order cast joint and several liability for disgorgement of the illegal gains on all the noticees in the Second SEBI Order (which included parties in addition to the Noticees in the present matter). Further, SAT held that the loan amounts raised by pledge of shares of SCSL could not be considered as 'gain' under securities law, since this was a loan transaction. Further, SEBI had not specified any reasons for imposing a uniform bar from the securities market of 14 years on all the Noticees. Therefore, SAT remanded the matter back to SEBI, for fresh decision on the issues of disgorgement and restraint.

On reconsidering the matter as directed by the SAT Order, SEBI directed the Noticees to disgorge a total amount of INR 8.134 billion received as illegal gains. SEBI held that an interest of 12% per annum on the amount of illegal gains to be disgorged by the Noticees, will be calculated from the 07 January 2009, that is, the date on which Mr. Ramalinga Raju had confessed to falsifying the accounts of SCSL. Further, SEBI clarified that it is irrelevant that the Promoters / Directors used the gains for philanthropic purposes, since the purpose or end use of illegal gains is not relevant.

Further, SEBI held that SRSR Holdings had pledged shares of SCSL and raised funds on the basis of unpublished price sensitive information regarding the inflation in share price, which cannot be treated as a pure loan transaction. Therefore, gains made by SRSR Holdings are liable to be disgorged. SEBI reduced the capital gains tax paid, from the gains to be disgorged by Mr. Suryanarayana Raju. Further, SEBI upheld its decision to bar the Noticees from the securities market for 14 years, since all Noticees had played an equal role in violation of securities law. However, the period of restraint already suffered by the Noticees *vide* the SEBI Orders would form a part of this 14 year-period.

The Hon'ble Supreme Court, *vide* its order dated 15 September 2917, had directed that any decision made by SEBI in its proceedings on remand in this matter would come into effect only upon the directors of the Hon'ble Supreme Court. Accordingly, the SEBI order will come into effect on such date as directed by the Hon'ble Supreme Court, in accordance with the instructions . Till such date, the SAT Orders will continue to be in force.

1. SEBI AMENDS THE LODR REGULATIONS

C. Circulars and Regulations

On 16 November 2018, SEBI notified certain amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR Regulations**") *vide* SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2018 ("**Amendment**"). The Amendment came into effect on 16 November 2018.

Some key points of the Amendment are:

1. 'Fugitive economic offenders' ("**FEO**") defined: The Amendment has introduced and defined the concept of FEO, that is, an individual who is declared a fugitive economic offender under section 12 of the Fugitive Economic Offenders Act, 2018.
2. Revised conditions for reclassification of promoters / public: The Amendment has provided a new process of reclassification of any person as promoter / public. The key aspects of such reclassification

are:

i. The listed entity must make an application for reclassification of such persons / entities within 30 days from the date of approval by shareholders in general meeting. Such application must be made after fulfilling certain requirements, such as:
   - The board of directors must place the request for
   - reclassification in front of the shareholders of the listed entity, along with the board of directors' comments, after 3 months but before 6 months of the date of such board meeting;
   - The shareholders of the listed entity must approve of the request for classification by an ordinary resolution in a general meeting. The promoter seeking reclassification or persons related to such promoter ("**Related Persons**"), will not be allowed to vote to approve the request for reclassification.
   - The promoter seeking reclassification, Related Persons and the listed entity must adhere to certain stipulated restrictions and conditions, both prior to and subsequent to the reclassification.

ii. A public shareholder seeking to reclassify himself as a promoter must make an open offer in accordance with the Takeover Code.

iii. The Amendment has provided for certain conditions in case of transmission, succession, inheritance and gift of shares held by a promoter or a person belonging to the promoter group.

iv. A listed entity will be considered as 'listed entity with no promoters' if as a consequence of such reclassification, the entity does not have any promoters.

v. The Amendment provides certain 'material events' which must be notified by the listed entity to the stock exchanges within 24 hours from their occurrence.

vi. Certain provisions of reclassification have been exempted from being applicable where reclassification is as per resolution plan approved under the Insolvency and Bankruptcy Code 2016, provided that the promoter seeking reclassification does not remain in control of the listed entity.

2. SEBI ISSUES GUIDELINES FOR ENHANCED DISCLOSURES BY CREDIT RATING AGENCIES

To enhance the quality of disclosures made by Credit Rating Agencies ("**CRAs**") in order to make it easier for investors to understand underlying rating drivers and make more informed investment decisions, SEBI on November 13, 2018 prescribed guidelines to be followed by CRAs while performing their credit rating functions *vide its* circular no. SEBI/HO/MIRSD/DOS3/CIR/P/2018/140 ("**Circular**").

Some key points of the Circular are:

1. Disclosures to be made in the press release by CRAs regarding rating actions: SEBI, *vide* its circular dated 01 November 2016, had provided a format for issuing the mandatory press release by CRAs after assigning a rating. In this press release, CRAs must disclose the relevant factors used by the rating committee to determine the creditworthiness of an issuer in the press release regarding the rating action. The Circular prescribes that the following information which must be included in the press release:
   i. When the CRA rating factors in expectation of support from a

parent company / group company / government by infusion of funds for timely debt servicing, then the rationale for such expectation may be provided.

ii. A specific section should highlight parameters like liquid investments or cash balances, access to unutilized credit lines, adequacy of cash flows for servicing maturing debt obligation, and so on.

2. Disclosure of Average Rating Transition Rates for long term instruments: CRAs must publish their average one-year rating transition rate over a 5-year period for each rating category, on their respective websites, in the format as provided in Annexure A of the Circular.
3. Disclosure of performance of CRAs on Stock Exchange and Depository website: CRA must furnish data on sharp rating actions in investment grade rating category, to stock exchanges and depositories for disclosure on their website on a half-yearly basis, within 15 days from the end of the half-year (that is, 01 March / 30 September), in the format provided in Annexure B of the Circular.

3. SEBI ISSUES CIRCULAR STANDARDIZING NORMS FOR TRANSFER OF SECURITIES IN PHYSICAL MODE

On 06 November 2018, SEBI modified the documentation and procedure for transfer of securities in physical mode, *vide* its circular SEBI/HO/MIRSD/DOS3/CIR/P/2018/139 dated 06 November 2018 ("**Transfer Circular**"), in order to standardize the norms for transfer of such securities in physical mode.

Some key changes brought about by the Transfer Circular are:

1. No mandatory requirement for PAN to register transfer deeds executed before 01 December 2015: The LODR Regulations require the transferor and transferee to mandatorily provide a copy of their Permanent Account Number ("**PAN**") card, for registration of transfer of securities. However in several cases, transferors in transfer deeds executed before the date of coming into effect of the LODR Regulations, that is, prior to 01 December 2015, did not have a PAN. The Transfer Circular clarifies that PAN will not be mandatory for registration of transfer deeds executed prior to the notification of LODR Regulations, and registration for such deeds may be done with or without PAN as per the requirement of quoting PAN under the applicable income tax rules.
2. Additional documents in case of mismatch of name in PAN card and the name in share certificate / transfer deed: In case of the name on the PAN card does not match the name of the transferor / transferee on the share certificate / transfer deed, the transferor / transferee must furnish a copy of either (a) passport, or (b) legally recognized marriage certificate, or (c) iii) gazette notification regarding change in name, or iv) Aadhar card, to register the transfer.

4. SEBI ISSUES CIRCULAR ON UNIFIED PAYMENTS INTERFACE MECHANISM

SEBI has notified the use of Unified Payments Interface ("**UPI**") mechanism for retail investment in public issues, in a phased manner, vide its circular SEBI/HO/CFD/DIL2/CIR/P/2018/138 dated 01 November 2018 ("**UPI Circular**"). The Circular will be effective for all red herring prospectuses filed for public issues opening on or after 01 January 2019. The Circular is aimed at streamlining the process of public issue of equity shares and convertible securities, and the process of raising of funds by public issue. It

is expected to help reduce the time between closing of an initial public offering ("**IPO**") and listing of security from 6 working days, to 3 working days.

UPI is an instant payment system, which enables merging several banking features, seamless fund routing and merchant payments, into a single forum. It allows instant transfer of funds between bank accounts, using a payment address which uniquely identifies the individual's bank account.

Some of the key provisions of the UPI Circular are:

1. Phases of implementation: The UPI Circular will be implemented in 3 phases. In the first phase, between 01 January 2019 to 31 March 2019, retail investors will get the option of UPI payments along with the existing options. The second phase will commence after 31 March 2019, for a period of 3 months or a floating of 5 main board public issues (whichever is later). Retail Investors in the second phase will only have the option to pay through UPI mechanism. In the third phase, the final reduced timeline will be made effective using the UPI mechanism. The listing timeline in the first 2 phases will remain 6 working days. After completion of 6 months or 10 IPOs, whichever is later, this timeline will reduce to 3 days. The listing timeline for the third phase will be notified by SEBI subsequently.
2. Use of UPI ID through designated bank account: While making payment through UPI, the retail investor making an application in public issues, shall only use his / her bank account or the bank account linked to the designated UPI ID. This will ensure parity across various channels for submitted applications. Where the investor does not have a UPI ID, he / she will have to create one with its bank.
3. Bidding process: The investor must submit his / her bid details along with his / her UPI ID in the prescribed application form, to the market intermediary. Once the bid has been entered into the bidding platform, the stock exchange will validate the investor's PAN and demat account details. After verification, the bid details shall be uploaded on the stock exchange platform and intimation *via* mobile SMS shall be sent to the investor. The bid details of the investor along with the UPI ID would also be shared by the escrow or sponsor bank. Thereafter, the sponsor bank shall request the investor to block the amount of funds required for the application amount and for the subsequent debit of funds in case of allotment. Upon confirmation of receipt of funds in the escrow account or sponsor bank, shares will be credited to the investor's account.