Lakshmikumaran & Sridharan corporate

corporate

amicus

An e-newsletter from
Lakshmikumaran & Sridharan, New Delhi, India

March 2014 / Issue–32

March
2014

Contents

Article

Voting rights of holders of depository receipts abroad

By **Neha Yogi**

Depository Receipts (DR) are negotiable securities issued outside India by a depository bank against underlying rupee shares that are issued by a company incorporated in India. The DR can represent a fraction, single or multiple shares of an Indian issuer company ('the Company'). Issuance of DRs to non-resident investors is allowed under the prevailing FDI Policy of India read with the Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000, issued under the FEMA, 1999. The Company is required to comply with the provisions of the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 ("DR Scheme") and guidelines issued thereunder by the Central Government from time to time.

DRs are tradeable on overseas stock exchanges - those traded in the US are termed as 'American Depository Receipt' (ADR) and those traded in any other overseas country such as Singapore, Luxemburg and UK are called 'Global Depository Receipt' (GDR). As per the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004, *'American Depository Receipt' (ADR) means a security issued by a bank or a depository in United States of America (USA) against underlying rupee shares of a company incorporated in India;* whereas *'Global Depository Receipt' means a security issued by a bank or a depository outside India against underlying rupee shares of a company incorporated in India.*

Voting rights on ADRs and GDRs

Voting rights on equity shares to be issued under the DRs shall be primarily governed by the provisions of the Companies Act, 1956 (or the Companies Act, 2013 when notified), The Companies Act states that every member of a company whose name is entered in the register of members of the company, shall have a right to vote on every resolution placed before the company. In case of a company limited by shares, the member shall be a person holding the equity share capital of a company and whose name is entered as beneficial owner in the records of the depository.

For issuance of the DRs, the Company has to appoint a Domestic Custodian Bank (DCB) and an Overseas Depositary Bank (ODB). The Indian Company issues the underlying shares with the ODB, whose name is entered in the register of members of the Company, and deposited with the DCB. The DCB holds it on behalf of the ODB who is instructed to issue the DRs to the non-resident investors against the underlying shares held with the DCB, in terms of a tripartite agreement entered into between the ODB, the DR holders and the Company. The record of the DR holders is to be maintained by the ODB. There is no lock-in requirement for the DR and the same may be exchanged for the underlying shares at any time as requested

by the DR holders, in which case, the ODB shall request the DCB for the release of the underlying shares in favour of the DR holders. As such, the ultimate beneficial holders of the shares underlying the DRs are identified by the Company when the DRs are redeemed, i.e. when the DR holders exchange such DRs for the underlying shares. Consequently, their names are entered as the beneficial owners of the shares in the register of members of the Company at this juncture and not at the time when the DR's are issued. The Ministry of Corporate Affairs has clarified vide Circular No. 1/2009 dated 16 June 2009 (similar provision in the draft rules re: Companies Act, 2013) that the ODB is to be entered in the register of members since the underlying shares are allotted to it by the company.

Further, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations") provides that when 'an acquirer' by himself or by persons acting in concert with him acquires shares or voting rights which entitles them to exercise 25% or more of the voting rights in the company, he shall make a public announcement of an open offer for acquiring such shares. Clause (q) of Regulation 2 of the Takeover Regulations defines 'persons acting in concert' to mean persons who with a common objective of acquiring control over the target company, through agreement or understanding, whether formal or informal, who directly or indirectly co-operate for acquisition of shares or voting rights in the target company Associated companies are deemed to be persons acting in concert unless the contrary is proved.

It is important to note that the definition of 'shares' under the Takeover Regulations includes depository receipts carrying an entitlement to exercise voting rights in the target company. This means, if two or more DR holders agree in writing or otherwise to act as persons acting in concert with each other and with an intention to acquire control over the target company, convert their respective ADRs/GDRs into underlying shares together, which shall entitle them to hold 25% or more of the voting rights in the company; in such a case, they shall as a group make a public announcement for open offer in accordance with the Takeover Regulations. But, on the other hand, if an individual DR holder acquires 25% or more of the voting rights in the target company, then he shall comply with the obligation of making a public announcement for open offer.

It can be deduced from the above that the entitlement of the DR holders to exercise the voting rights shall be subject to the conversion of ADRs/GDRs into underlying shares up to the limit prescribed under the Takeover Regulations and adhere to the compliance required therein. However, if on conversion, the ADR and GDR holders acquire shares which entitle them to less than 25% of the voting rights in the target company, they need not comply with the Takeover Regulations. The underlying shares to which the DRs shall be converted whether will or will not carry voting rights, will be pre-decided by the issuer company and should be in the knowledge of the DR holders.

[The author is an Associate, Corporate Practice, Lakshmikumaran & Sridharan, New Delhi]

Notifications & Circulars

CSR provisions to come into force from 1st April 2014: Section 135 of Companies Act, 2013 (Act) and Schedule VII demarcating Corporate Social Responsibilities (CSR) of companies in India shall come into force from 1-4-2014. Along with notification relating to effective date for Section 135, Ministry of Corporate Affairs (MCA) has also issued, on 27-2-2014, notification relating to amendment to Schedule VII of the Act. Further, Companies (Corporate Social Responsibility Policy) Rules, 2014 has also been notified and shall come into force with Section 135 of the Act. After the amendment, scope of CSR activities which a company can undertake as per Schedule VII has been widened. As per Section 135, every company having net worth of Rs. 500 crore or more or turnover of Rs. 1000 crore or more or net profit of Rs. 5 crore or more during any financial year shall be required to spend, every financial year, at least 2% of the average net profits made by the company in the preceding three financial years as per its CSR Policy.

FDI Policy for SSIs / MSMEs: To align the Foreign Direct Investment policy with the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 it has been decided that: (i) a Micro and Small Enterprises (MSE) (earlier Small Scale Industries) as per MSMED Act, 2006 engaged in any activity/sector for which automatic route of foreign investment is available, may issue shares or convertible debentures to a person resident outside India, subject to the limits prescribed, in accordance with the entry routes specified and the provision of FDI Policy. Reserve Bank of India (RBI) A.P. (DIR Series) Circular No.107, dated 20-2-2014 issued in this regard also states that any industrial undertaking, with or without FDI, which is not an MSE, having an industrial license under the provisions of the Industries (Development & Regulation) Act, 1951 for manufacturing items reserved for manufacture in the MSE sector may issue shares in excess of 24% of its paid up capital with prior approval of the Foreign Investment Promotion Board.

Money Transfer Service Scheme (MTSS) - 'Direct to Account' facility introduced: Foreign inward remittances received under MTSS shall now be allowed to be transferred to the KYC compliant beneficiary bank account through electronic mode, such as NEFT, IMPS etc. Reserve Bank of India A.P. (DIR Series) Circular No.110, dated 4-3-2014 issued for the purpose also prescribes conditions and procedure to be followed in this regard.

Ratio Decidendi

Arbitration – Separate application under Section 8 not required: The Delhi High Court has held that separate application under Section 8 of the Arbitration and Conciliation Act, 1996 is not necessary. Rejecting the contention that a matter is not required to be referred to arbitration in case neither party files an application for reference of dispute to an arbitrator under said Section 8, the court held that there is no requirement of a request for

reference to arbitration as long as the arbitration agreement has been furnished. It was held that as long as a party invokes arbitration not later than when submitting his first statement on the substance of the dispute, the same is enough to bring the bar of Section 8 into play and the judicial authority/court then ceases to have jurisdiction. The defendant in the present case had neither made any prayer, nor in its preliminary objections in the written statement, sought reference to arbitration. Decision in the case of *Arti Jethani* was held as contrary to the mandate of Section 8 requiring the party before the court to only bring to its notice that the suit is subject to arbitration agreement.

The High Court also observed that civil disputes which are otherwise subject matter of arbitration agreement do not become non-arbitrable merely because the actions of the party also constituted offence and FIR of the said offence was lodged. Reliance on Supreme Court Judgement in the case of *Booz Allen and Hamilton Inc.* [(2011) 5 SCC 532] was rejected by the High Court here while it observed that the Apex Court had only held that arbitral tribunal cannot decide criminality and that same does not affect arbitrability. [*Sharad P. Jagtiani* v. *Edelweiss Securities Limited* – Delhi High Court decision dated 3-3-2014 in CS(OS) 461/2011]

No cartelization by asbestos cement sheet manufacturers: Competition Commission of India has held that there is no evidence to suggest cartelization by asbestos cement sheet (ACS) manufacturers and the provisions of Section 3(3) read with Section 3(1) of the Competition Act, 2003 have not been contravened. Discussing the findings of the Director General (DG), the Commission held that there was no evidence of any specific pattern indicative of sharing of market amongst the top players in a concerted manner. Taking note of oligopolistic form of market structure for asbestos cement sheets and seasonal nature of demand for the product, the Commission was of the view that the ACS industry was amendable to price parallelism and that the quarterly movement of price was not due to concerted action among the industry players. Price sensitivity of the rural market which formed major segment of the market for said products was also considered by the Commission in this regard.

On the allegation of dissimilarity in the price movements between the raw materials and prices of ACS, relying on findings of DG, the Commission was of the view that cost and price figures were not indicative of any concerted action as during peak demand (demand being seasonal) price was high despite fall in cost, while during periods of low demand, manufacturers were not able to pass the high cost to the buyers. No concerted action in shutting down their plants (to curtail production and supply) was noticed by the Commission, as all the top players had shut-down their plants during part of the period under consideration due to different reasons, and the production usually showed downward trend during periods of low demand. It was noted that production of the product increased from 2008-09 to 2011-12, there was increase in production capacity by major players, capacity utilization was around 90% and DG had given a finding of valid economic operational reasons

for steeper reduction in production at occasions. Further, analysis on profitability was found to be not relevant.

Communication between major manufacturers was found to be in respect of investment in raw material mine and minutes of meeting of the Asbestos Cement Products Manufacturers Association was also found to be not indicative of cartelization activities. [*Manufacturers of Asbestos Cement Products* – CCI Order dated 11-2-2014 in Suo-Motu Case No. 1 of 2012]

Suit permissible when challenge to arbitral award pending: Bombay High Court has held that a party invoking arbitration clause is entitled to also file a suit for the same reliefs. It was noted that the same could be, for instance to save the claim from being barred by limitation in the event if it is later held that there was no arbitration agreement. It was however held that such suit would remain stayed during pendency of arbitration proceedings and enforcement of the award and would proceed if the award is set aside. Relying upon Supreme Court ruling in the case of *National Agricultural Cooperative Marketing Federation* [1989 Supp (1) SCC 308], it was held that if the arbitral award in under challenge on issue of jurisdiction, then the suit would not be barred or be an abuse of process of court. The court, on the question of two decrees for same claim, held that there is no possibility of second decree as the suit would be withdrawn (as per the undertaking) in case the challenge to award on ground of jurisdiction was rejected.

Contention, that Section 43(4) of Arbitration and Conciliation Act, 1996 would come to rescue if the award is set aside, was rejected by the Court holding that the matter was not free from doubt and that it is arguable that Section 43 would not save limitation where the Arbitral Tribunal lacks inherent jurisdiction in case of absence of arbitration agreement. Further, the case was also found to be fit for exercise of powers under Section 151 of the Code of Civil Procedure, 1908 for grant of stay of the suit proceedings. In this regard it was noted that suit was entirely unconnected with the arbitration proceedings. [*Curzon Maritime Ltd.* v. *PEC Ltd.* – Bombay High Court Judgment dated 18-2-2014 in Appeal (L) No. 935 of 2005]