

# **SEBI's Jurisdiction – A Case Report**

By Sundar Ramanathan

The Securities Appellate Tribunal (SAT), on 18<sup>th</sup> October, 2011, passed an order which could have wide ramifications for the entire corporate sector. It has directed Sahara Group Companies, its promoter and directors as jointly and severally responsible to return amounts collected (mentioned as ₹ 19400,86,64,200/- in the order) from investors along with interest @ 15% per annum from the date of receipt of money till date of payment on the issuance of Optionally Fully Convertible Debentures ('OFCDs') by unlisted companies. The SAT was disposing appeals in the case of Sahara India Real Estate Corporation Ltd and Ors v. SEBI and Anr., Appeal No. 131 of 2011 along with Sahara Housing Investment Corporation Ltd and Ors v. SEBI and Anr., Appeal No. 132 of 2011. The issues are discussed herein below.

## **Facts**

Two unlisted companies of Sahara India Group raised funds through unsecured OFCDs without any intention of listing the proposed issue in any stock exchange for the purposes of financing acquisition of lands, development of townships etc. A Red Herring Prospectus was filed with the RoC wherein it was mentioned that the companies do not intend the proposed issue to be listed in any stock exchange. Subsequently an information memorandum was filed for private placement to the friends, associates, group companies, workers/employees and other individuals connected with the Sahara Group. SEBI found that by issuing the OFCDs, Sections 56, 73, 117A, 117B and 117C of the Companies Act had been contravened.<sup>1</sup>

## **Key Issues**

### **(1) OFCDs are 'Securities'**

It was argued that the OFCDs are not securities for the purposes of the SEBI Act and hence, SEBI does not have the jurisdiction to regulate them. SAT conclusively ruled that the SEBI Act is a complete code in itself pertaining to securities and securities market and the reference to the definition of securities under the Companies Act cannot be used to determine the scope of securities under SEBI Act. It was held that OFCDs are commonly understood as debentures in the securities market or by those connected therewith and are 'securities' for the purposes of the SEBI Act. Furthermore, SAT held that OFCDs being a combination of debt instrument and equity instrument and, therefore, a hybrid security would also qualify as 'securities' under SEBI Act.

### **(2) OFCDs are 'Marketable Securities'**

It was contended that OFCDs was not 'a marketable security' and hence not securities under SEBI Act as the transfer of OFCDs was made subject to the approval of the company. Rejecting this contention the SAT held in the first instance that such a restriction is not permissible in the light of Sections 111A (2) read with Sections 9 and 82 of the Companies Act ('CA').<sup>2</sup> In addition, it was also held that 'marketable' would only imply that a product is

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<sup>1</sup> The litigation history before the Hon'ble Allahabad HC and the Hon'ble SC has been avoided in this write up for the sake of brevity

<sup>2</sup> It would be interesting to note that this gains prominence in the light of the on-going matters on the issues of ROFR, ROFO etc in the case of public companies.

capable of being bought and sold and there is no need for an actual sale. The OFCDs in the case was found to be eligible to be transferred to third parties and hence was held as a marketable security.

### **(3) Power of SEBI to regulate unlisted companies / unlisted securities**

It was held by SAT that SEBI has been empowered under Sections 11, 11A and 11B of the SEBI Act to take necessary steps to safeguard the interest of the investors in securities and regulate the securities market and widest interpretation needs to be given. Therefore, it was held that the SEBI has the power to regulate listed and unlisted companies and securities and that the SEBI Act does not distinguish between the two. Furthermore, it held that **as the company has issued OFCDs it was a 'person associated with the securities market' and therefore amenable to the regulatory jurisdiction of SEBI.**

### **(4) Mandatory public listing of OFCDs (or other 'securities') by unlisted company**

It was contended that the OFCDs were only issued to friends, associates, group companies, workers / employees and other individuals associated with Sahara India Group and was, therefore, a private placement and not a public issue. Rejecting this contention, the SAT held that the companies always knew that they were going to offer it to more than 50 persons. **The SAT held interpreting the Proviso to Section 67 (3) of CA, that offering securities to more than 50 persons would automatically make it a public issue.** In the instant case it was found that more than 2 crore investors had subscribed to the OFCDs.

In addition SAT held that the fact that the Company had issued an information memorandum is indicative of the fact that the securities were offered for public as it was trying to assess the demand for the securities.

After holding that the issue of OFCDs was a public issue, the SAT by interpreting Section 73 of CA held that a plain reading of Section 73 required every company intending to offer shares or debentures to the public to do so by issuing a prospectus and in turn applying to a recognised stock exchange for permission for listing of the securities. Furthermore, it was reiterated that when shares are offered to the public, the requirements of Section 73 are to be complied.

### **(5) Regulating unlisted companies**

It was contended that by virtue of Section 55A(c) of the Companies Act,<sup>3</sup> SEBI could not regulate an unlisted company. Rejecting this contention, it was held that the powers under Sections 11, 11A, 11B of SEBI Act cannot be whittled down or in any way affected by Section 55A of CA and that the powers under Section 55A was exclusive of the provisions of SEBI Act. Furthermore, SAT held that the powers under Section 55A have been exercised by SEBI even before the introduction of the said provision. Therefore, **under the SEBI Act, SEBI can deal with both listed and unlisted companies.**

In addition, it was also held that having gone to the public by circulating an information memorandum by virtue of Section 73 the law mandates the securities to be listed and

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<sup>3</sup> Section 55A of CA provides that in respect of various provisions of the CA in so far as they relate to issue and transfer of securities and non-payment of dividend in the case of listed public companies and public companies intending to get their securities listed would be administered by SEBI and in all other cases by the Central Government.

therefore in law it will be assumed that the company intended the securities to be listed and would fall under Section 55A(b) of CA and amenable to the jurisdiction of SEBI.

The SAT went even further and elaborated that although the explanation to Section 55A declared that all other matters for the purposes of Section 55A (c) including prospectus etc would be exercised by the Central Government or RoC, it was found that on a harmonious construction, the matters relating to issue and transfer of security and non-payment of dividend in a prospectus etc would still be regulated by SEBI.

#### **(6) Convertible bonds and OFCDs**

It was sought to be argued that by virtue of Section 28 (1) (b)<sup>4</sup> the provisions of Securities Contract (Regulation) Act ('SCRA') the provisions relating to listing etc under the SCRA Act will not apply. It was held that convertible bond is not the same as convertible debenture and the exemption under Section 28 is only applicable to convertible bonds and not convertible debenture as in the instant case.

#### **(7) ICDR Regulations and unlisted companies**

It was argued that the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 is inapplicable to unlisted companies. It was held that **the ICDR regulations was applicable for all public issues and as no distinction was made between listed and unlisted public issues & listed and unlisted companies** in the regulation, it could regulate all public issues.

The decision of SAT is seminal as it has sought to lay down several legal propositions relating to restrictions on transfer of securities by a public company, power of SEBI to regulate unlisted companies and unlisted securities and the implications arising out of a public issue. It needs to be seen whether these propositions would be upheld when the matter is taken up on appeal before the Hon'ble Supreme Court.

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<sup>4</sup> Under Section 28 (1) (b) the provisions of the SCRA will not apply to any convertible bond which is issued at a price agreed upon at the time of issue.