WTM/KMA/CFD/392/06/2011

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

DIRECTIONS UNDER SECTIONS 11, 11(4), 11A AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 AND REGULATION 107 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009 IN THE MATTER OF ISSUANCE OF OPTIONALLY FULLY CONVERTIBLE DEBENTURES BY SAHARA INDIA REAL ESTATE CORPORATION LIMITED (NOW KNOWN AS SAHARA COMMODITY SERVICES CORPORATION LIMITED) AND SAHARA HOUSING INVESTMENT CORPORATION LIMITED

1. This Order is passed in compliance with the Order and directions of the Honourable Supreme Court of India dated May 12, 2011 in Petition for Special Leave to Appeal (Civil) No.11023/2011, which is as follows:

> "In this matter the questions as to what is OFCD and the manner in which investments are called for are very important questions. SEBI, being the custodian of the Investor's interest and as an expert body, should examine these questions apart from other issues. Before we pass further orders, we want SEBI to decide the application(s) pending before it so that we could obtain the requisite input for deciding these petitions. We request SEBI to expeditiously hear and decide this case so that this Court can pass suitable orders on re-opening. However, effect to the order of SEBI will not be given. We are taking this route as we want to protect the interest of the Investor. In the meantime, the High Court may proceed, if it so chooses, to dispose of the case at the earliest.
>
> The special leave petitions shall stand over to July, 2011."

2. A brief background to the matter is outlined in next few sections. In the course of processing the Draft Red Herring Prospectus (hereinafter referred to as the

DRHP) of Sahara Prime City Limited, in respect of its proposed initial public offer, the Securities and Exchange Board of India (hereinafter referred to as SEBI) had noticed that two other companies forming part of the Sahara Group, namely, Sahara India Real Estate Corporation Limited, now known as Sahara Commodity Services Corporation Limited (hereinafter referred to as SIRECL) and Sahara Housing Investment Corporation Limited (hereinafter referred to as SHICL) had issued Optionally Fully Convertible Debentures (hereinafter referred to as OFCDs) allegedly in contravention of the provisions of the Companies Act, 1956(hereinafter referred to as the Companies Act), the Securities and Exchange Board of India Act, 1992(hereinafter referred to as the SEBI Act), the erstwhile Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 (hereinafter referred to as the DIP Guidelines) and the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (hereinafter referred to as the ICDR Regulations). It was observed that SIRECL and SHICL (hereinafter collectively referred to as the two Companies) were raising sizable amounts of money from the public without conforming to the prudent disclosure and other investor protection norms which govern public issues. Moreover the details of such mobilization were also not made available in the public domain. To protect the interest of investors, SEBI, in order to prevent the two Companies from raising further resources from the public, passed an Order dated November 24, 2010 and *inter alia* restrained SIRECL and SHICL from mobilizing funds under the Red Herring Prospectus (hereinafter referred to as the RHP) dated March 13, 2008 and October 6, 2009, respectively, filed with the concerned Registrar of Companies, till further directions. The two Companies were directed not to offer their equity shares/OFCDs or any other securities, to the public or invite subscriptions, in any manner whatsoever, either directly or indirectly, till further directions.

3. The aforesaid Order was challenged before the Lucknow Bench of the Honourable High Court of Judicature at Allahabad. The Honourable High Court, vide Order dated December 13, 2010 admitted the writ petition for hearing and passed the following direction: “As an interim measure, the operation of the impugned order contained in Annexure No. 1 to the writ petition is stayed with liberty to SEBI to proceed with the inquiry but no final decision shall be taken”. This order of Honourable High Court was challenged by SEBI by way of a Special Leave Petition (in petition for special leave to appeal civil no. 36445/2010) before the Honourable Supreme Court of India and the Honourable Court, vide Order dated January 4, 2011 had *inter alia* observed as follows:

> "Since the impugned order is an ad-interim order and as the matter is listed for peremptory hearing on 12th January, 2011, we see no reason to interfere at this stage. However, in view of the stakes involved (including protection of the investors), we are directing the High Court to proceed with the hearing of the case on day-to-day basis from 12th January, 2011, without adjourning the case. We are directing SEBI and ROC to file its counter affidavit by 7th January, 2011, and copy be furnished immediately to Respondent No.1 herein."
>
> ……..
>
> ……..
>
> From the said paragraph, we find that the High Court has given liberty to SEBI to proceed with the inquiry. At the same time, the High Court has directed Respondent No.1 to give the names of the investors to ROC in terms of the notice dated 21st September, 2010 and 14th October, 2010. We make it clear that SEBI would also be entitled to call for any information which it deems fit, including the names of the investors who have invested in OFCD in the course of the inquiry. Mr. Sorabjee, learned senior counsel appearing for Respondent No.1, very fairly states that they agree to give information that SEBI will call upon them to furnish in the inquiry. However, it shall be given without prejudice to the rights and contentions in the pending matter.
>
> Before concluding, we make it clear that we express no opinion on the merits of the case. We request the High Court to expeditiously hear and decide the case.
>
> The special leave petition is disposed of accordingly."

4. Thereafter, the matter was heard by the Honourable High Court of Judicature at Allahabad, Lucknow Bench and subsequently, while vacating the interim order (passed on dated December 13, 2010), vide Order dated April 7, 2011, the Honourable Court *inter alia* observed the following:

> "The petitioners were supposed to cooperate in the inquiry and their interest was protected by restraining the SEBI from passing any final orders. The matter was being heard finally under the expectation that the assurances given by the Learned Counsel for the petitioners would be honoured by the petitioners and the matter would be finished at the earliest. But the petitioners appear to have thought otherwise. The Court's order cannot be allowed to be violated or circumvented by any means.
>
> We, therefore, do not find any ground to continue with the interim order, which is hereby vacated for the own conduct of the petitioners and for which they have to thank their own stars."

5. The said Order of the Honourable High Court was challenged by SIRECL before the Honourable Supreme Court of India in Petition for Special Leave to Appeal (Civil) No.11023/2011. In the meanwhile, SIRECL filed another application before the Honourable High Court of Judicature at Allahabad, Lucknow Bench to restore the stay order passed by it, vide order dated December 13, 2010. The Honourable High Court of Judicature at Allahabad, Lucknow Bench, vide order dated April 29, 2011 while dismissing the said application, made the following observation:

> "A person, who comes to the Court, is supposed to come with clean hands and bona fide intentions, and has to abide by the orders passed by the Court, more so in a case where the parties' counsel agree for certain actions to be undertaken. If some assurance is given by any person to the Court, as has been done in the present case, and the said assurance/understanding is not honoured, the Court would not come to his rescue.
> The application is therefore, rejected."

Subsequently, the Honourable Supreme Court of India, vide order dated May 12, 2011 (reproduced in Paragraph 1 above) directed SEBI, being the custodian of the Investor's Interest and as an expert body, to examine the issues including the nature of OFCDs and the manner in which the investments are called for.

6. In order to conclude the proceedings, in compliance with the directions of the Honourable Supreme Court of India, SEBI issued a notice dated May 20, 2011 to the two Companies, and persons named as Promoters and Directors of the two Companies in their respective RHPs, viz. Mr. Subrata Roy Sahara, Ms. Vandana Bhargava, Mr. Ravi Shankar Dubey and Mr. Ashok Roy Choudhary, asking them to show cause as to why appropriate directions including directions mentioned in the Order dated November 24, 2010 should not be issued against them. Further, an opportunity of hearing was also provided to them by SEBI on June 6, 2011. The two Companies, vide letters dated May 30, 2011, filed detailed replies to the show cause notice, which are discussed in the latter part of this Order. SIRECL, in the said letter filed a copy of a fresh Certificate of Incorporation consequent upon change of name to Sahara Commodity Services Corporation Limited. Mr. Subrata Roy Sahara, Ms Vandana Bhargava, Mr. Ravi Shankar Dubey and Mr. Ashok Roy Choudhary, vide separate letters dated May 31, 2011 requested SEBI to consider the replies of SIRECL and SHICL as if the same were incorporated in their respective letters. On June 6, 2011, Mr. Sudeep Seth, advocate appeared on behalf of the aforesaid entities/persons. After detailed arguments on the lines of the aforesaid replies of the two Companies, the Learned Counsel requested that the matter may be continued to be heard on the next day. It was mutually agreed, that the matter would be heard on June 8, 2011. Accordingly, the Learned Counsel concluded his submissions on the said date. Mr. B.M. Tripathy and Mr. Anupam Prakash of Sahara India Parivar were also present during the hearings held on June 6, 2011 and June 8, 2011. The primary submissions of the Learned Counsel, briefly, are the following;

A. The two Companies have made 'private placements' of Optionally Fully Convertible Debentures (OFCDs) to persons related or associated with the Sahara India Group, and therefore these issuances are not 'public' issues.

B. OFCDs are neither shares nor debentures in its strict sense and are in the nature of 'hybrid' as defined in the Companies Act, 1956 (hereinafter referred to as the Companies Act).

C. SEBI does not have any jurisdiction on such hybrid issues as the term 'hybrid' is not included in the definition of 'securities', under the SEBI

Act, or in the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as the SCR Act).

D. Such hybrid securities were issued by the two Companies (both unlisted), in terms of Section 60B of the Companies Act and therefore, the jurisdiction in respect of such issues lies with the Central Government in terms of Section 55A(c) thereof and not with SEBI.
E. Sections 67 and 73 of the Companies Act are not applicable to such hybrid securities issued by the two Companies.
F. The DIP Guidelines and the ICDR Regulations would not be applicable to the hybrid securities as neither the SEBI Act nor SCRA confer jurisdiction on SEBI in respect of such securities.

7. I have considered the prima facie findings and observations made by SEBI in its Order dated November 24, 2010, the show cause notice dated May 20, 2011, the replies filed by the parties and the submissions made by the Learned Counsel during the hearing. In compliance with the Order of the Honourable Supreme Court of India dated May 12, 2011, my findings and observations in respect of various issues in the matter are given in the subsequent paragraphs. I have set out this Order in three parts. In Part A, I have addressed various issues raised by the two Companies challenging the jurisdiction of SEBI on the matters in this Order, under the broad head of ‘Question of Jurisdiction’. In Part B, I have discussed the relevant provisions of law in the Companies Act and the SEBI Act, the DIP Guidelines and the ICDR Regulations and their applicability to the two Companies and the OFCDs issued by them under the general head of ‘Discussion of Applicable Legal Provisions’. In Part C, I set out my observations and record my findings, on the basis of the appreciation of the issues in Part A and B. The Learned Counsel for the two Companies had referred to a very diverse range of issues in finance as well as in law. Each of these raises questions of great importance; hence for ease of reference, I have discussed them in separate sections within the three Parts in this Order.

PART A

QUESTION OF JURISDICTION

8. In this Part, I proceed to discuss two fundamental issues, vital to these proceedings before me. The first relates to the nature of OFCDs themselves. The second is on whether SEBI has the jurisdiction to regulate OFCDs. Before I do so, it would be instructive to briefly describe the salient features of the OFCDs issued by the two Companies.

9. Description of OFCDs issued by the two Companies

9.1. From the written statement and documents furnished by the two Companies, it is observed that the financial instruments issued are unsecured OFCDs. Brief descriptions of these OFCDs issued by the two Companies are given below. I am however, informed by the Investigating Authority that some variations in details across Application Forms issued in the same type of bond has been observed. I should in passing mention that the two Companies have used the term 'Bonds' for their OFCDs. However, the term 'bonds' and 'debentures' are used interchangeably in finance, though in the stricter sense, bonds imply a more explicit covenant or contract between the investor (buyer) and the issuer (seller) of the bond.

9.2. **SIRECL**, has issued **three types of bonds**, as given below:

a. **Abode Bond** – The bond had a face value of ₹5,000/- (for 5 bonds) with a tenure of 120 months, with a redemption value of ₹15,530/-. The minimum application size was ₹5000/-. The said bond can be redeemed prematurely after 60 months. The holders may also exercise option for conversion of bonds against the face value of each bond into one fully paid equity share of ₹10/- each at a premium of ₹990/- each, provided such option is exercised on completion of 119 months. The bond holder can transfer the bonds to any other person, subject to the terms and conditions and approval of the company.

b. **Real Estate Bond** – Applicant may apply for a minimum of two bonds of ₹6000/- each by paying ₹200/- per month and additional bonds may be subscribed by paying additional ₹100/- per month for 60 months. Weekly, Monthly, Quarterly, Half-yearly and Yearly payments were also accepted in the same proportion. The bond has a face value of ₹12,000/- (for two bonds) and can be redeemed after 60 months for a value of ₹15,254/- (redemption value).Holders of the bonds may exercise option for conversion against the face value of each bond into ten fully paid equity shares of ₹10/- each at a premium of ₹590/- each, provided such option is exercised on completion of 59 months. The bond holder can transfer the bonds to any other person, subject to the terms and conditions and approval of the company.

c. **Nirmaan Bond** – Applicants can apply for a minimum of five bonds of ₹1000/- each and in multiples of ₹1000/- thereafter. The bond has a face value of ₹5,000/- (for five bonds) with a tenure of 48 months. On completion of the term, the bonds can be redeemed for ₹7,728/-. The bonds can also be redeemed earlier on completion of 18 months. Holders of the bonds also have the option of conversion. The face value of each bond can be converted into two fully paid equity shares of ₹10/- each at a premium of ₹190/- each, provided such option is exercised on completion of 47 months. The bond holder can also transfer the bonds to any other person, subject to the terms and conditions and approval of the company.

9.3. **SHICL**, also has, as seen from its written reply, issued **three types of bonds**, as given below:

a. **Multiple Bond** – Applicants may apply for a minimum of two bonds of ₹12000/- each by paying ₹200/- per month for 120 months and each additional bond may be subscribed by paying additional ₹100/- per month for 120 months. Payments can be made on weekly, monthly, quarterly, half-yearly and yearly basis. The tenure of the bond is 180 months. The holders may exercise option for conversion of fully paid up bonds against the face value of each bond into twelve (12) fully paid equity share of ₹10/- each at a premium of ₹990/- each, provided such option is exercised on completion of 179 months. The bonds can also be redeemed after 180 months. The bond holder also has an option of pre-mature redemption after completion of 120 months by giving 30 days notice. If the bond holder has not completed payment of instalments regularly for 120 months, it shall be termed 'partly paid' and in such case, the partly paid bond holder shall be paid interest in proportion of the principal amount standing to his credit till the time of redemption. The bond holder can transfer the bonds to any other person, subject to the terms and conditions and approval of the company.

b. **Income Bond** – Applicant may apply for a minimum of six bonds of ₹1000/- each and in multiples of ₹1000/- thereafter. The tenure of such bonds is 120 months. The bond holders shall be paid monthly interest on the bond amount as below:

Tenure in months	120
Face value of 6 bonds (in ₹)	6000
Monthly interest withdrawal amount for 120 months (in ₹)	52.50
Redemption on completion of tenure (in ₹)	6000

The holders of such bonds may exercise option for conversion of fully paid up bonds against the face value of each bond into one fully paid equity share of ₹10/- each at a premium of `990/- each, provided such option is exercised on completion of 119 months. The bond holder can transfer the bonds to any other person, subject to the terms and conditions and approval of the company.

c. **Housing Bond** – Applicants may apply for a minimum of five bonds of ₹1000/- each and in multiples of ₹1000/- thereafter. The tenure of the bond is 180 months. Holders of the bonds may exercise option for conversion of fully paid up bond against the face value of each bond into one fully paid equity share of ₹10/- each at a premium of ₹990/- each, provided such option is exercised on completion of a period of 179 months. The bond can also be redeemed on the request of the bond holder on completion of 180 months for ₹31,500/- when conversion option is not exercised and opt for partial withdrawal or monthly withdrawals, as provided therein. Pre-mature redemption of the bonds is also allowed on completion of 10 years (120 months), by giving 30 days notice. The bond holder can also transfer the bonds to any other person, subject to the terms and conditions and approval of the company.

10. The entire thrust of the Learned Counsel both in his submissions and in the written replies filed by the two Companies, is the following:- OFCDs are 'hybrid' securities. Hybrid Securities are covered under the definition of term 'securities' in the Companies Act, while they do not come under the definition of the term 'securities' under the SCR Act and therefore under the SEBI Act. When the definition of "securities" was amended to accommodate 'hybrids" in the Companies Act in 2000, the SEBI Act or the SCR Act were not correspondingly amended. Therefore, the two Companies contend that SEBI has no jurisdiction and no regulatory remit over hybrid securities. Hybrid Securities fall under the regulatory jurisdiction of the Government of India in the Ministry of Corporate Affairs. In fact, all other arguments that the two Companies have advanced seem to hinge on this one single hypothesis – that SEBI has no regulatory jurisdiction on "hybrid" securities and hence over the "OFCDs" issued by them.

11. The Honourable Supreme Court of India has in its order, directed SEBI, as an expert body, *inter alia*, to examine the nature of OFCD. As much of this exercise would involve analysis that might also be of a technical nature, I shall first endeavour to bring together the views expressed by various authorities on the pertinent issues beginning first with the definition and classification of this instrument class that goes under the nomenclature 'OFCD' and thereafter a more detailed exposition of the true nature of such instruments. I shall then proceed to arrive at certain inferences, relevant to the disposal of these proceedings before me.

12. Definition of OFCD

12.1. The acronym 'OFCD' as stated above, stands for <u>"Optionally Fully Convertible Debentures"</u>. Palmer's Company Law (XXIV Ed. 1987, 672-673) explains the meaning of "debenture" in the following manner:

"The term debenture is not a technical term. Lindley J observed in one case

"….what the correct meaning of 'debenture' is I do not know. I do not find anywhere any precise definition of it. We know that there are various kinds of instruments commonly called debentures……You may have debentures which are bonds;…. You may have a debenture which is nothing more than an acknowledgement of indebtedness."

Chitty J. expressed a similar view: "I cannot find any precise legal definition of the term, it is not either in law or commerce a strictly technical term, or what is called a term of art."

In another case the same learned judge described the meaning of the term "debenture" as follows: "The term itself imports a debt – an acknowledgement of a debt – and speaking of the numerous and various forms of instruments which have been called debentures without anyone being able to say the term is incorrectly used, I find that generally, if not always, the instrument imports an obligation or covenant to pay. This obligation or covenant is in most cases at the present day accompanied by some charge or security."

In modern commercial usage a debenture denotes an instrument issued by the company, normally – but not necessarily – called on the face of it a debenture and providing for the payment of, or acknowledging the indebtedness in, a specified sum….at a fixed date, with interest thereon. It usually – but not necessarily – gives a charge by way of security – though not invariably – expressed to be one of a series of like debentures."

12.2. At a basic level, debentures are of two categories viz. <u>Convertible</u> Debentures and <u>Non-Convertible</u> Debentures. <u>Convertible</u> Debentures are a type of debt security where either a part or whole value of the debenture is convertible into equity shares as predetermined, when the debenture is issued. Thus convertible debentures are issued with provisions that allow the holder to exchange the debenture for company stock or equity, and upon such exchange when the debt obligations inherent in such debentures are discharged by the entity by issuing stock or equity. Palmer's Company Law defines Convertible debentures in the following manner:

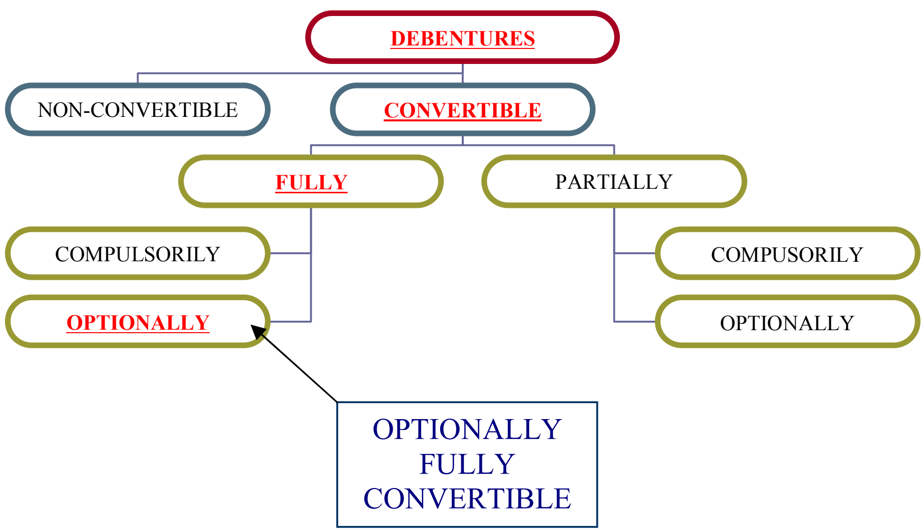
> "The company may further issue so-called convertible debentures which are a hybrid form between debentures proper and shares. A convertible debenture which may be issued <u>secured</u> or <u>unsecured</u> contains an option entitling the holder to convert his debt, at times stated in the debenture, into ordinary or preference shares of the company at stated rates of exchange."

Conversely, <u>Non-Convertible</u> Debentures are those where no such conversion is permitted on the discharge of the debt obligation inherent in the debenture. In other words, in the case of Non-Convertible Debentures, the purchaser of such debentures, by virtue of having purchased such debentures, does not get to become a holder of equity or stock in the entity issuing such debentures, at the termination of the debentures on discharge of the debt liability inherent in the same.

12.3. Convertible Debentures are further subdivided into two categories viz. <u>Fully Convertible</u> Debentures and <u>Partially Convertible</u> Debentures. Fully Convertible Debentures, as the name indicates, are those where the **<u>whole</u>** value of the debenture is convertible into equity of the issuer, as predetermined, at the time of issue. Conversely, Partially Convertible Debentures would be where only a **<u>portion</u>** of the debt would be eligible for conversion into equity of the issuer, as pre-determined at the time of issue.

12.4. In general, in the case of all convertible debentures, the conversion of the debt obligation into equity of the issuer can be either at the option of the debenture holder or such conversion has to necessarily happen at the time of discharge of the debt obligations. In the former class of convertible debentures, the purchaser or holder of such debentures will exercise her right or option, to choose whether or not to convert the debt that is owed to her, at the appointed time. Hence such convertible debentures are referred to as Optionally Convertible Debentures. In the latter class of convertible debentures, the debt obligations inherent in the debentures necessarily or compulsorily are repaid in the form of equity of the entity. Hence such convertible debentures are referred to as Compulsorily Convertible Debentures.

12.5. While there are characteristics of such instruments that can be used to mutate these Debentures into more complex legal and financial forms, a discussion of those would not be relevant to the issues considered in this proceedings. As mentioned earlier, every class of debentures can be either <u>secured</u> or <u>unsecured</u>. A taxonomy of debentures, restricted in this context to the issues involved herein, is presented below. Each of the classes of debentures pictorially depicted below can be of the above two varieties – viz. secured and unsecured.



12.6. OFCDs are indicated in the diagram above. The OFCDs issued by the two Companies are admittedly unsecured in nature. Thus, defined simply, OFCDs are Optionally Fully Convertible Debentures where the OFCD holder (purchaser), [generally on the discharge of the debt by the issuer entity at the specified time] gets an option to obtain equity shares of the entity issuing (selling) such OFCDs, in lieu of cash, based on the terms determined at the time of issue/sale of these instruments.

13. Are OFCDs issued by the two Companies 'Hybrid Securities'?

13.1. To resolve this question, it is first necessary to understand the nature of hybrid securities themselves. Section 2(19A) of the Companies Act defines **'hybrid'** as to mean "any security which has the character of more than one type of security, including their derivatives". (Introduced through the Amendment Act No.53 of 2000). Section 2(45AA) of the Companies Act defines **'securities'** as defined in clause (h) of section 2 of the SCR Act and includes hybrids".

13.2. In the replies filed by the two Companies as well as during the arguments of the Learned Counsel, the point that convertible debentures are hybrid securities was very strongly emphasised. The replies of the two Companies quoted extensively from the judgement of the Honourable Supreme Court in **Narendra Kumar Maheshwari vs. Union of India** as reported in 1990 (Suppl.) SCC 440 where the Honourable Supreme Court notes that "Even a debenture, which is only convertible at option has been regarded as a 'hybrid' debenture by Palmer's Company Law (paragraph 44.07 at page 676)." The replies filed by the two Companies also cite several judicial pronouncements and argue that a pure debenture is quite distinct and separate from a convertible debenture which is a hybrid security. It was also urged that even the Reserve Bank of India has taken the position that optionally convertible/partially convertible debenture are hybrid instruments. Black's Law Dictionary (VIII Ed.) defines hybrid security as follows:

> "A security with features of a debt instrument (such as a bond) and an equity interest (such as share or stock). An example of a hybrid security is a convertible bond, which can be exchanged for shares in the issuing corporation and is subject to stock-price fluctuations."

13.3. The following discussion in **A Ramayia (XVII Ed. 2010 - Guide to the Companies Act)** sheds light on hybrid securities, and the features that distinguish them from other securities.

> "This clause is a new provision inserted by the Amendment Act, 2000 to define "hybrid". Throughout the world, corporate growth has been accompanied by the introduction of various

forms of securities like debt-equity hybrids, derivatives, options and shares with differential rights.

The term "hybrid" is an omnibus term meaning an instrument having embedded features that are economically and substantively different from the features of the host contract. Depending on the context, the word 'hybrid' means a financial instrument having an embedded derivative, or a hybrid between debt and equity. For instance, a subordinated bond is a hybrid between debt and equity. It is legally in the form of a debt, but economically, being subordinated to the claims of general creditors, has the features of equity. A convertible bond is also said to be a hybrid having an embedded derivative in it. The right to convert the bond into a share inherently includes a call option on the shares of the issuing company, which is a derivative. Accounting standards for financial instruments such as IAS 39 and AS 30 require splitting of a derivative embedded into a financial instrument under certain circumstances." (Page 59)

"Hybrid Securities means securities which have some of the attributes of both debt securities and equity securities. A type of security which, in the form of a debenture, contains elements of indebtedness and elements of equity stock also is an example of a hybrid." (Page 100)

13.4. It is an admitted fact that the financial instruments issued by the two Companies, are OFCDs. A mere perusal of the description of the instruments issued by the two Companies set out in Paragraph 9 above would show, that these instruments have the essential characteristic of an OFCD namely that the investor has the right to convert her debentures into shares at the appointed time and on the basis of predetermined terms. Clearly, as observed by the Honourable Supreme Court in **Narendra Kumar Maheshwari vs. Union of India** (quoted supra) long before the term 'hybrid' was introduced in the Companies Act, and from the foregoing discussions, there is no ambiguity that OFCDs issued by the two Companies are in the nature of hybrid securities. Having concluded so, I now proceed to look into the meaning of the term 'securities' as defined in the SCR Act and thereafter to compare the scope of the term 'securities' as defined therein and the Companies Act.

14. Scope of the term "Securities" defined in the SCR Act

14.1. Section 2(h) of the SCR Act defines the term "securities" to include

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act,2002;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests in securities;

14.2. In the matter of **Sudhir Shantilal Mehta vs. Central Bureau of Investigation [2009 (8) SCC 1]**, commenting on the scope of securities encompassed by the definition of the term in Section 2(h) of the SCR Act, the Honourable Supreme Court of India, observed as follows:

> "The definition of 'securities' is an inclusive one. It is not exhaustive. It takes within its purview not only the matters specified therein **but also all other types of securities as commonly understood**. The term 'securities', thus, should be given an expansive meaning.
>
> In State of Bombay and others v. The Hospital Mazoor Sabha and others, AIR 1960 SC 610 this Court while interpreting the definition of "industry" as contained in Section 2(j) of the Industrial Disputes Act, 1947 held as under:-

"It is obvious that the words used is an inclusive definition denote extension and cannot be treated as restricted in any sense. (Vide : Stroud's Judicial Dictionary", Vol. , p. 1415). Where we are dealing with an inclusive definition it would be inappropriate to put a restrictive interpretation upon terms of wider denotation"" (Emphasis supplied)

14.3. I also note that the Honourable Supreme Court of India in **Naresh K. Aggarwala and Co. vs. Canbank Financial Services Limited and another [2010 (6) SCC 178]**, while referring to the definition of the term "securities" defined under the SCR Act and the applicability of a circular issued by the Delhi Stock Exchange Limited, observed the following:

"20. The contention that the circular did not apply to unlisted securities was duly considered and rejected by the Special Court. The Special Court thoroughly considered the term `securities' as defined in Section 2(h) of the Act. It reads as under:-

"2(h) Securities include –

….

…."

Perusal of the above quoted definition shows that it does not make any distinction between listed securities and unlisted securities and therefore it is clear that the Circular will apply to the securities which are not listed on the Stock Exchange." [Emphasis supplied]

14.4. The Division Bench of the Honourable Bombay High Court, while interpreting the above definition of 'Securities' in **Dahiben Umedbhai Patel v. Norman James Hamilton And Others [1985 57 CompCas 700 Bom]** held as follows:

"Now it is difficult for us to accept the argument of the appellants that the definition of "securities" must be so read that the words "other marketable securities of a like nature" were not intended to indicate an element of marketability in so far as the preceding categories were concerned. A reading of the inclusive part of the definition shows that the Legislature has enumerated different kinds of securities and

> by way of a residuary clause used the words "or other marketable securities of a like nature". The use of these words was clearly intended to mean that the earlier categories of securities had to be marketable and any other securities of "like nature", that is to say, like those which were categorized or enumerated earlier were also to be marketable before they could be held to fall within the definition of "securities".”

The Learned Counsel for the two Companies argued that while the OFCDs are transferable, they are not ‘tradable’ or ‘marketable’. Therefore, it is necessary to get some insight into the meaning of the two terms, particularly in the context of the definition of the term ‘securities’ in the SCR Act.

14.5. Marketability vs. Transferability:

14.5.1. The Learned Counsel pointed my attention to the fact that in the Red Herring Prospectus filed by them, it has been clearly indicated that an investor would have the right to transfer the bonds to any other person, subject to the terms and conditions and approval of the company. This has been done to ensure that the OFCDs are transferable. But, according to the Learned Counsel, that does not make these instruments ‘marketable’. The fact that ‘marketability’ of a security is a defining characteristic of the term security has been well established under law. The Honourable High Court of Calcutta [**B.K. Holdings (P) Ltd. v. Prem Chand Jute Mills (1983) 53 Comp Cas 367 (Cal)]**, while interpreting the expression “marketable securities” held as follows: **“I see no warrant whatsoever for limiting the expression “marketable securities” only to those securities which are quoted in the stock exchange.”**

14.5.2. If marketability of a security is so vital in determining the applicability of the Section 2(h)(i) of the SCR Act itself to a wide class of instruments, then the question arises as to what the term itself means. The Honourable High Court of Judicature at Bombay in its judgment dated July 28, 2004 in the matter of **Mysore Fruit Products Limited and others vs. The Custodian and others [(2005), 107 BOMLR 955]**, while quoting certain portions of the judgment rendered in the matter of **Dahiben Umedbhai Patel v. Norman James Hamilton and Others,**had observed the following:

> "The Division Bench has also, *inter alia*, held that in the case of shares of a public limited company, the transfer is complete and even if the transfer is not registered the transferor holds the shares for the benefit of the transferee. The Division Bench held that it was clear that the definition of the word "securities" would include shares of a public limited company. The Division Bench has also held that the term "securities" would, therefore, mean securities which were capable of being listed on a stock exchange. The use of the term "capable", in my view, would clearly include securities which are not just listed but also securities of public companies which are **capable of being listed on a recognised stock exchange**." (Emphasis supplied)

The Honourable Court further observed as follows:

> "If one goes through the provisions of the Act, the scheme of the Act makes it clear that no restrictive interpretation can be placed on the terms used in the Act. If the provisions of the Act are looked at, it is clear that it relates not merely to securities which are listed but it also relates to securities which may not be listed in any stock exchange. All that is required is that there must be "marketability". In my view, it cannot be said that any security which is not listed on any recognised stock exchange is not "marketable". As laid down by the Single Judge and the Division Bench (in the judgments set out above) "marketability" implies ease of selling and includes any security which is capable of being sold in the market. This does not mean that it must be sold in the market. All bonds of Government companies are freely and easily transferable. Normally, shares of public limited companies are also freely transferable. **Any security which is capable of being freely transferable is marketable.**As is seen, the definition of the word "security" under Section 2(h) is an inclusive definition. It is very wide. Thus all securities

which are marketable and which have an ease or facility of selling and/or which have a high degree of liquidity and/ or are capable of being sold in a market i.e. stock exchange, are included. ….” (Emphasis supplied)

14.5.3. Thus, marketability denotes the ease with which a security is capable of being sold. The easiness of doing any thing is seldom precisely measurable. It has to be defined in the context in which the idea of easiness is entertained. In the domain of finance and accounting, marketable securities are those that are easily convertible to cash because there is sufficient demand for these securities and they can be sold quickly. Marketability and liquidity are closely inter-related, even though the terms are not synonyms. Marketability, as I would see it, it is measure of the ability of a security to be bought and sold. A greater degree of exactness is seen in alternate definition of the term that it denotes the relative ease with which an asset can be sold quickly at a price near the price at which similar assets are selling. The Learned Counsel for the two Companies stated that the investors in the OFCDs are allowed to transfer the securities and this is permitted to ensure the transferability of these instruments. However he mentioned that transferability and marketability are different, though he did not stress the point further or go into the subtler aspects of this difference. In the context of securities markets, it is not uncommon to see the two terms ‘marketability’ and ‘transferability’ used broadly with similar connotations. I am not persuaded that for the purpose of this Order, I should probe the semantic differences between the two terms.

14.5.4. In **Dahiben Umedbhai Patel v. Norman James Hamilton And Others (quoted supra)**, the Honourable Bombay High Court observed: “The securities referred to in the definition were clearly intended to have character of marketability. It is no doubt true that **what is saleable can also be marketable**.” (Emphasis supplied). Admittedly, the two Companies have issued OFCDs to 6.6 million investors. These instruments are also transferable, subject to the terms and conditions of the Companies. During the course of the hearing before me, I raised a specific query as to the provision of law, which governs this transferability. The Learned Counsel responded that the conditions that apply to this transfer are under Section 108 of the Companies Act. A perusal of Section 108 shows that it addresses the transfer of shares and debentures only. Would it mean that there are no sections anywhere in the Companies Act that govern the transfer of other securities including those issued by the two Companies? But that is a question that I shall deal with elsewhere in this Order.

14.5.5. Section 108 of the Companies Act is a generic clause that stipulates that every transfer of shares and debentures shall be done only on production of the instrument of transfer. The two Companies have not produced any document that sheds light on whether there is any specific restriction that comes in the way of free sale of the OFCD, by the original investor to any another person, who does not fall under the category of " friends, employees, associates…….". Since a purchaser of an OFCD issued by the two Companies can sell it to any other person, **without any prior reference** to the Company issuing the OFCD itself, I have to presume that there are in fact no restrictions imposed by the Company on the marketability of the security. When 6.6 million subscribers (though not all necessarily different investors) are allowed to freely transact in the OFCDs, and transfer them to any person, clearly that provides a wide and diversified base of investors and would undoubtedly constitute a market in these securities. The case of the two Companies is that they have issued OFCDs only to members associated with the Sahara group. Even, if one were to accept this argument, I doubt whether one would have any difficulty whatsoever in acknowledging the fact that 6.6 million is colossal wide base of investors, and could independently constitute a market for these debentures. Even the listed company with the biggest market capitalisation and the largest investor base in India has only under 4 million investors. In fact, the total investor base in India currently (reckoned on the basis of unique depository accounts in the two Depositories taken together) is only of the order of 15 million! But that apart, Section 108 of the Companies Act clearly is not intended to cast any restrictions on the transfer, on the other hand it is primarily intended to protect the rights of the buyer. In other words, it is not a Section in the Companies Act, intended to introduce any covenant that impedes the free transferability of the security.

14.5.6. Based on the guidance of the Honourable High Courts outlined above, I find that firstly, marketability of a security denotes the ease with which it can be sold, secondly what is freely transferable is marketable and thirdly what is saleable is also marketable. Clearly, OFCDs issued by the two Companies to such a wide base of investors who can sell these securities among themselves, if not to others are evidently 'marketable'. **I have to therefore regard the OFCDs issued by the two Companies as marketable securities.**

14.6. Are 'Optionally Fully Convertible Debentures' a class of 'Debentures'?

14.6.1. From the nomenclature itself, 'Optionally Fully Convertible Debentures' are 'Debentures', as they indeed are named so. A 'red rose' is as much a 'rose' as any other rose flower. Debentures are securities under the SCR Act, and therefore OFCDs are securities as well, under the same Act. While there would be palpably nothing wrong in such reasoning, I suspect that a tinge of facetiousness might be perceived in such reasoning, inappropriate in any serious consideration of the issues involved. A succinct elucidation of what the test for a "security" under securities laws may be found in A Ramayia (XVII Ed. 2010 - Guide to the Companies Act – Page 100). The acid test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others so that whenever an investor relinquishes control over her funds and submits their control to another for the purpose and hopeful expectation of deriving profits thereof, she is in fact investing her funds in a security. The test derived from the jurisprudence on securities laws in the United States of America is "whether the investment is made in a common enterprise which is premised upon the reasonable expectation of profits solely from the managerial or entrepreneurial efforts of others. Such test contains three elements: the investment of money; a common enterprise; and profits or returns solely derived from the efforts of others." As this test has its origin in the securities laws applicable to the United States of America, it would be appropriate to use such a test only if the definitions of the term 'securities' in the two jurisdictions themselves are reasonably similar in scope, in so far as it relates to debentures and hybrids – the two securities relevant to these proceedings before me. The definition of 'security' in the Securities Act of 1933 (United States of America) is reproduced below:

> "SEC. 2. (a) DEFINITIONS.—When used in this title, unless the context otherwise requires— (1) The term ''security'' means any note, stock, treasury stock, security future, security-

based swap, bond, **debenture**, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a ''security'', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." (Emphasis supplied)

14.6.2. What are pertinent to the circumstances that are under consideration in this Order is that both the definitions under securities laws in India and the United States of America, do not distinguish further sub classes of 'debentures', and that there is very high degree of congruence between the two sets of definitions. This more than reasonably, justifies employing the test referred to above, to identify a security, and to determine whether OFCDs issued by the two Companies, would come under the ambit of Section 2(h) of the SCR Act, and I, therefore proceed to do so. In this case, the investor purchasing the OFCD makes an <u>investment.</u> Both the two Companies issuing the OFCDs are <u>common enterprises,</u> being public limited companies. The investor herself has absolutely no part in generating profits on her investment – and therefore, as such, the <u>profits or returns are solely derived from the efforts of others</u>. Therefore, on the basis of this test, it is amply evident that OFCDs come well within the scope of securities as defined in Section 2(h) of the SCR Act.

14.6.3. In **Essar Steel Ltd. Vs. Gramercy Emerging Market Fund (2003 116 CompCas 248 Guj)**, the Honourable High Court addressed the issue as to what constitutes a 'security' and observed the following:

> "In order to determine whether a transaction involves a 'security;, the transaction has to be examined to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a 'security'."

It does not need any further elaboration to see that the OFCDs issued by the two Companies satisfy the ingredients of this test. This test too reaffirms that the OFCDs in question come well within the scope of securities as defined in Section 2(h) of the SCR Act.

14.6.4. In Paragraph 12 above, I had set out the definition of 'debentures' and cited from relevant authorities that the term 'debentures' is not defined with any degree of precision, and what the term has come to mean in modern day usage, in financial and legal interpretation. Section 2(12) defines the term 'debentures' in the Companies Act and is pertinent:

> "(12) "debenture" includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not;"

Thus even the Companies Act contemplates the inclusion of a wide range of securities within the term 'debentures', and refrains from attempting to restrict this into an exclusive list of specific securities within the meaning of the term. The term debenture has its origin in the latin word "*debentur*" which translates into "there are owed". Debenture is "A debt secured only by the debtor's earning power, not by a lien on any specific asset." Perhaps the best insight into the very wide scope and amplitude of the term 'debentures' is the following: (quoted in Stroud's Judicial Dictionary of Words and Phrases – Vol. II, V Ed. 1986)

> "The word "debenture" has, apart from any definition, no precise meaning. It is the name of **<u>a genus and not of a species</u>**." (Emphasis supplied)

14.6.5. For greater completeness to the discussion, I refer to the scope of the expression 'securities' in the securities law pertaining to another jurisdiction, where

OFCDs and similar securities are issued and listed freely. Instruments creating or acknowledging indebtedness that fall under 'securities' defined in Clause 3(1) of the Financial Services and Market Act, 2000 (United Kingdom) include (a) debentures; (b) debenture stock (c) loan stock (d) bonds (e) certificates of deposit and (f) any other instrument creating or acknowledging indebtedness. I observe that this definition applicable in the said jurisdiction too does not specify any special class of securities that is designed to accommodate a hybrid like OFCD.

14.6.6. There is no information available to me on any jurisdiction where the expression 'securities' explicitly and separately provides for the definition of various types of debentures (like OFCDs) or 'hybrids' to enable its regulation in that jurisdiction. In fact, OFCDs themselves in the financial world can have in turn, different nuances in the form of embedded put and call derivatives. In my opinion, it would be superfluous and simply impracticable to keep on widening and fine tuning the scope of the term 'securities' to keep pace with the explosive growth of new genres of products and asset classes – each with its own complexity in their design, valuation, risk characteristics, accounting considerations and tax implications. Some jurisdictions, like the United Kingdom, have even adopted a rather elegant solution to this issue by extending their list of securities through a <u>notification</u>, as and when it is required. Others jurisdictions like the United States of America tackle this problem by simply defining "securities" to include "in general, any interest or instrument <u>commonly known</u> as a 'security'."

14.6.7. Debentures, in line with its definition in the Companies Act itself, therefore, as mentioned supra, have to be considered as a **'genus'**, capable of accommodating a large variety of financial instruments with essentially similar core characteristics that may differ in other peripheral and even important features. OFCDs can be considered only as a 'species', within this 'genus' of debentures. In this case, the core similarity between Debentures and OFCDs are that, both are interest paying debt instruments, where the principal has to be repaid. The essential unifying thread between plain 'Debentures' and 'OFCDs' is that the issuer 'owes' something distinct to the investor, which has to paid back with due consideration (viz. the interest). Such debt that is owed would have to be redeemed by the issuer at the appointed time on the pre-determined terms. The peripheral, nevertheless important difference between a Debenture (straight i.e. Non-Convertible) and an Optionally Fully Convertible Debentures – simply is that at the time of such redemption of the debt, the investor can opt for redemption in kind (in the form of equity shares) instead of redemption in cash. However, by no stretch of imagination, can one conclude that Optionally Fully Convertible Debentures would therefore fall outside the 'genus' of Debentures themselves.

14.6.8. In **Narendra Kumar Maheshwari vs. Union of India** (quoted supra), the Honourable Supreme Court, observed that in the various guidelines applicable to such instruments, compulsorily convertible debentures are regarded as 'equity' and not as a loan or debt." One of the critical considerations adopted by the Honourable Supreme Court of India in concluding so, is that **"A compulsorily convertible debenture does not postulate any repayment of the principal."** The thinking of the Honourable Supreme Court revealed in this judgement, not only clarifies the issue, but also provides me with a touchstone to determine whether the OFCDs issued by the two Companies are more in the nature of shares or debentures. SIRECL has issued three bonds viz. Abode Bond, Real Estate Bond and Nirmaan Bond. SHICL has also issued three bonds viz. Multiple Bond, Income Bond and Housing Bond. From a plain reading of the summary of their descriptions at Paragraph 9.2 and 9.3 above, it is evident that **<u>all these six bonds postulate a repayment of the principal</u>**. The repayment of the principal will be at the option of the investor. The investor holds the option, which gives her a right to determine whether she would like to get her principal back in cash or as equity shares. Hence, Optionally Fully Convertible Debentures unlike their counterpart category of Compulsorily Convertible Debentures do not share the characteristic pointed out by the Honourable Supreme Court in arriving at the conclusion that Compulsorily Convertible Debentures are more of equity than of debentures. Thus, all the six financial instruments issued by the two Companies share the defining feature of debentures in that a payment of interest to the investor and a repayment of the principal, albeit at the option of the investor, is postulated.

14.6.9. In the written replies as well as in the submissions by the Learned Counsel, it was pointed out that Section 81(3) of the Companies Act exempts the increase of the subscribed capital of a public company caused by the exercise of an “option attached to” the debentures issued. While this argument of the two Companies is being addressed separately, what is crucial here is that this again drives home the fact that the Companies Act in Section 81(3) recognizes a ‘convertible debenture with an option attached to it’ as belonging to the broad family of ‘debentures’. As observed above, the OFCD issued by the two Companies, is nothing but a ‘convertible debenture with an option attached to it. In other words, even the Companies Act, where it makes a reference to such products or instruments where an option gets attached to a debenture – acknowledges that the primary genus is that of the ‘debenture’. This relation between the option and the debenture, to which it is attached, is never perceived to be reflexive viz. an OFCD is never visualized in the science of finance or in law, as a ‘debenture’ that gets attached to an ‘option’.

14.7. Design and Valuation considerations for OFCDs

14.7.1. To conclude this discussion, it becomes also relevant to examine the financial characteristics of OFCDs themselves. Clearly, OFCDs (as issued by the two Companies) are a combination of two securities - Debentures into which the ‘option’ to fully convert the same, at the appointed time, into equity shares of the respective Company has been embedded. I have referred to a widely recognized authority on the subject viz. The Handbook of Fixed Income Securities, VII Ed., Frank J. Fabozzi (Editor) – Chapters 59 and 60. This discussion provides useful insights into why companies issue convertible securities (like OFCDs) and why investors purchase them. Some of the discussion therein is extracted and reproduced below.

> “The value of a convertible security is related to many variables, including changes in the price of the underlying stock and changes in interest rates, credit quality and the volatility of both the stock and the interest rates. The ideal convertible bond renders a bondlike return if the return on the underlying issuer’s stock is minimal or negative and an equity-like return if the underlying stock’s return is quite positive. Naturally, a bond like return, if held to maturity is determined by the coupon payments, the earnings on the reinvested coupons, and the return of principal. Thus the

convertible provides the investor with the "better of" return profile."

"Convertible issues offer two basic potential advantages to the issuer. The issuance of convertible bonds offers the advantage of lower interest cost and less restrictive covenants relative to a nonconvertible bond issue. In other words, the investor pays for the right to participate in future favourable price changes in the underlying common stock by accepting a lower yield and a less restrictive debt agreement."

"An investor purchasing a convertible security receives the advantages of a more senior security: the safety of principal (prior claim to assets over equity securities holders) and relative income stability at a known interest rate. Furthermore, if the common stock of the issuer rises in price, the convertible instrument usually also will rise to reflect the increased value of the underlying common stock."

14.7.2. The same authority in Exhibit 59.2 (Page 1373) titled **"Convertible Securities: The Best of Two Worlds"**, provides an elegant depiction of the basic convertible structure as follows:

STRAIGHT BOND + **OPTION** = **CONVERTIBLE**

where the term 'straight bond' is used as a synonym for a straight 'Debenture'.

"An investor in a convertible security effectively owns a nonconvertible fixed income security and a call option on the issuer's common stock. The value of a convertible security is therefore the sum of these two values…." (from Fabozzi cited supra)

14.7.3. Thus, in line with the discussion above, any convertible debenture (including OFCDs) is a combination of a **debenture** and an **option.** As mentioned above, Section 81(3) of the Companies Act also refers to exactly such a combination. The combined value of the debenture and the option determines the actual value of the convertible debenture. Simple Debentures are valued on the basis of evaluation of present value of all cash flows (in the form of payments) accruing from it. Options are valued on the basis of the applicable mathematical model, appropriate to the specific terms of the option itself. The whole value of the combined product then would be sum of the two part values of its components. While therefore, a convertible debenture like an OFCD, is a combination of two distinct products viz. the debenture and an option, they are never considered or classified as a type of **option.** To quote from the same authority cited supra, "The most frequently cited reason to invest in convertibles is that convertibles provide upside participation with downside protection." This simply means that an investor is assured of a definite return (hence the term 'downside protection') as in the case of a plain debenture, but should the company grow and its stock price increase, then the investor gets to participate in this growth and even gets to be an owner in the company as an equity holder after the conversion (hence the term 'upside participation'). In other words, Convertible Debentures (including OFCDs) are a dual combination of two products, they are never classified as options, because the 'option' simply sits elegantly on the 'debenture' as a sweetener (as referred to in some text books) to attract investors to invest in the same. A scrumptious cake enticingly decorated with icing on top of it is known by the cake and not by the icing that sits atop it. Analogously, OFCDs belong to the primary family of Debentures and not Options.

14.8. Palmer's Company Law (XXIV Ed. Page 676) notes that "Convertible debentures may be issued as debentures or debenture stock". [Here the expression debenture stock is distinguished from debentures, primarily in the divisibility of the stock itself. Debenture stock can be transferred in fractional amounts, but essentially are debentures.] Thus, even from this consideration of how such financial instruments are issued, Convertible Debentures like OFCDs are issued in the nature of debentures alone.

14.9. During the course of the argument, the Learned Counsel submitted that the SCR Act is not applicable to convertible bonds under Section 28(1)(b) of the same. However, it is not difficult to see that the Learned Counsel has interpreted this

Section erroneously. What is contemplated in this Section 28(1)(b) is that the said Act shall not apply to the 'entitlement' of the buyer, inherent in the convertible bond. In other words, the entitlement that may be severable by itself does not qualify as a security that can be administered by the SCR Act, unless issued in a detachable format.

14.10. The following summarises the discussions above:

1. As laid down in the judgement in the matter of **Sudhir Shantilal Mehta vs. C.B.I** (quoted supra), the definition of 'securities' in Section 2(h) of the SCR Act is an inclusive one and not exhaustive, with adequate latitude to accommodate OFCDs.

2. OFCDs issued by the two Companies are marketable securities.

3. These instruments satisfy all the characteristic features that identify a security based on clear tests used to identify what a security under Section 2(h) of the SCR Act is.

4. Debenture is a genus and not a species of financial instruments. This genus includes OFCDs.

5. OFCDs contemplate the repayment of principal, and hence using the yardstick adopted by the **Honourable Supreme Court of Indiain Narendra Kumar Maheshwari vs. Union of India** (quoted supra), these instruments indeed are debentures.

6. The Companies Act recognizes OFCDs as a composite financial instrument where an option is attached to a debenture.

7. Design and valuation characteristics of OFCDs, show that it is the sum of the valuation of the two parts viz. debenture and option, where the option is valued as a 'sweetener' to improve the pricing and risk characteristics of the debenture.

8. OFCDs are issued as debentures (Palmer's Company Law - XXIV Ed. Page 676).

14.11. From the foregoing discussions, it therefore becomes abundantly clear that OFCDs belong to the family of Debentures covered by the definition of the term 'securities' in Section 2(h) of the SCR Act. That an OFCD is a hybrid therefore does not detract from the fact that an OFCD is by definition, design and its characteristics, intrinsically and essentially a '**<u>debenture'</u>**.

15. Comparison of the definition of the term securities under the Companies Act and the SCR Act and Powers of SEBI

15.1. To reiterate, Section 2(19A) of the Companies Act defines **'hybrid'** to mean "any security which has the character of more than one type of security, including their derivatives". **Black's Law Dictionary** (VIII Ed.) defines hybrid security as: "A security with features of a debt instrument (such as a bond) and an equity interest (such as share or stock)." While the Companies Act contemplates that a hybrid can be **<u>any</u>** combination of securities – and makes it an omnibus definition, the more precise definition in Black's Law Dictionary is that it is a combination of a <u>debt instrument</u> and an <u>equity interest</u>. In fact in the real world of finance, it is this definition that actually holds. I have not come across any wide reference to an hybrid in the financial markets in India that is not a combination of a debt and equity security – perhaps with a derivative embedded into it. But the basic equation viz. hybrid = debt + equity, is almost universally true, with debt and equity being mixed in different strengths, to suit the financial requirements of the issuer. This is where one needs to revisit Section 2(h)(i) of the SCR Act, which specifies that "securities" includes "shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate". In this list of instruments, the last three viz. bonds, debentures and debenture stock are <u>debt instruments</u>, and the first three viz. viz. shares, scrips and stocks are <u>equity instruments</u>. Under the definition, any marketable security of 'a like nature' automatically falls under Section 2h(i) of the SCR Act. A hybrid, as long as it is marketable, regardless of the strength or proportion in which the debt and equity components are assembled together, bears an unmistakable likeness to one or more of these six instruments. So clearly, any marketable hybrid, in the way we understand hybrids in India today, is a marketable security of a 'like' nature. In other words, when debt and equity are mixed together to form a 'hybrid', what happens is that - to use an analogy from the science of Chemistry - a 'mixture' is created where the unmistakable characteristics of the elements (debt and equity) are both preserved. The resulting synthesis of the hybrid does not create a new 'compound', where the original characteristics of the components are totally lost or altered beyond recognition.

15.2. This is not to say that all hybrids invariably have to combine debt and equity. Many issuers have sold debt instruments where the amount of principal payable at maturity is tied to the performance of a stock or bond index, or a commodity or foreign currency or even the rate of inflation. Whether in the future, financial engineering will create newer hybrids as combinations of other securities that become popular in India is hard to predict – but today, it is unequivocally true that all marketable hybrids available in the market neatly fall into the categories "marketable securities of a like nature".

15.3. From Section 2(19A) of the Companies Act, it is evident that a "hybrid" is a form of security. There seems to be no ambiguity regarding this. However, the Learned Counsel for the two Companies has strenuously argued that the definition of securities introduced into the Companies Act has widened the scope of securities beyond the scope of the same expression as defined in the SCR Act. The Learned Counsel seems to base his averment on the supposition that the scope of definition of the term 'securities' in the Companies Act has been widened by the terms "<u>and includes hybrids</u>".

15.4. I shall, at some length, go into the legal interpretation of the term "<u>and includes</u>", as it appears in Section 2(45AA) of the Companies Act, to appreciate the status of 'hybrids' in the scope of securities. In **Godfrey Phillips India Ltd. and Another vs. State of U.P and Others (WP(C) Nos. 567 and 568-569/94 dated January 20, 2005)**, the Honourable Supreme Court, while interpreting the meaning of the word "including" contained in Entry 62 in List II (State List) in the sentence "Taxes on luxuries, **including** taxes on entertainments, amusements, betting and gambling", observed as follows:

> "We are aware that the maxim of *noscitur a sociis* may be a treacherous one unless the 'societas' to which the 'socii'

belong, are known. The risk may be present when there is no other factor except contiguity to suggest the '*societas*'. But where there is, as here, a term of wide denotation which is not free from ambiguity, the addition of the words such as 'including' is sufficiently indicative of the societas. **As we have said the word 'includes' in the present context indicates a commonality or shared features or attributes of the including word with the included.**" (Emphasis supplied)

15.5. To cite an example from the jurisprudence around this subject, in the **United States of America [Montello Salt Co. V. Utah, 221 U. S. 452 (1911)]**, the Court while interpreting words "and including all saline lands in the state", found that the words "and including" following a description do not necessarily mean "in addition to," but may **refer to a part of the thing described**, observed as follows:

"We have seen that the state urges that the word "and" is always employed to express the relation of addition, and it is said, with words of emphasis, that Congress cannot be supposed to have been ignorant of its meaning. The supreme court of the state also gave special significance to the use of "and," as adding something to that which preceded. The court also considered that the word "including" was used as a word of enlargement, the learned court being of opinion that such was its ordinary sense. **With this we cannot concur. It is its exceptional sense, as the dictionaries and cases indicate**." (Emphasis supplied)

15.6. In the matter of **The South Gujarat Roofing Tiles Manufacturers Association and another vs. The State of Gujarat and another [1977] 1SCR878**, the Honourable Supreme Court of India observed "It is true that 'includes' is generally used a word of extension, but the meaning of a word or phrase is extended when it is said to include things that would not fall within its ordinary connotation." A 'hybrid' being nothing but a combination of securities, as discussed above, it would be difficult to argue that it would not fall within its ordinary connotation. Blacks Law Dictionary (VIII Ed. 2004) defines the term "includes" as "to contain as part of something". In short, applying the obvious and the natural meaning of the phrase "and includes" as used in Section 2(45AA) of the Companies Act, clearly means that "hybrid" are contained in the expression "securities as defined in" Section 2(h) of SCR Act. There are no exceptional circumstances that emerge here, that would persuade one to attribute any other meaning to the expression "<u>and includes</u>" as used in Section 2(45AA) of the Companies Act. Therefore, it would follow that securities defined in the Companies Act have the same meaning as defined in the SCR Act, which would also cover the species of "hybrid" defined in Section 2(19A) of the same Act. Thus, the expression "<u>and includes</u>" merely is explanatory in nature. It simply clarifies and elaborates what is already known, and reaffirms that the newly defined class of securities is also part of the existing set of financial instruments already covered under the SCR Act.

15.7. Section 2(45B) (introduced by the Depositories Act, 1996) in the Companies Act recognises the Securities Exchange Board of India established under Section 3 of the SEBI Act. Section 55A (inserted by the Companies (Amendment) Act, 2000) defines the powers of SEBI under the Companies Act. It sets aside a working demarcation of the areas that are given to SEBI and those set aside for being administered by the Central Government.

Section 55A reads as follows:

> <u>Powers of Securities and Exchange Board of India.—</u>
>
> 55A. The provisions contained in sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207, so far as they relate to issue and transfer of <u>**securities**</u> and non-payment of dividend shall,—
>
> (a) in case of listed public companies;
>
> (b) in case of those public companies which intend to get their securities listed on any recognized stock exchange in India, be administered by the Securities and Exchange Board of India; and
>
> (c) in any other case, be administered by the Central Government. (Emphasis supplied)

15.8. The statement of objects and reasons for Companies (Amendment) Act, 2000 provides for measures, *inter alia,* as follows:

> "to provide that the Securities and Exchange Board of India be entrusted with powers with regard to all matters relating to public issues and transfers including power to prosecute defaulting companies and their directors."

Therefore, in reading and interpreting Section 55A, the paramount consideration that should be that SEBI has been entrusted with all powers to regulate public issues as is appropriate.

15.9. Section 55A embodies the powers transferred under the Companies Act to the body 'SEBI' established under Section 3 the SEBI Act. The word 'securities' in Section 55A of the Companies Act refers to the expression 'securities' defined in the Companies Act itself. It goes without saying that it does not refer to the expression 'securities' in the SEBI Act or SCR Act. Each of the two Acts is self contained in their definitions, and unless it is explicitly provided that a definition from another Act is imported for the purpose of any specific Section in either. Therefore, for the sake of argument, even were we to assume that the scope of the term 'securities' is wider as defined under the Companies Act as compared to its definition under the SCR Act, SEBI would exercise all the powers that Parliament has conferred on it, under Section 55A of the Companies Act. Therefore, as far as SEBI's powers under the Companies Act go, they extend to all 'securities' falling under the Companies Act, circumscribed of course, by what Parliament has provided under Section 55A therein. The powers of SEBI to regulate 'securities' under each of these Acts are separately based on the respective definition of the term 'securities' therein. These powers flow parallel and are not intertwined or mutually dependent. I would hold that it is immaterial therefore, whether there is congruence between the two definitions of the expression 'securities' under the Companies Act and the SCR Act, for the exercise of the powers of SEBI under Section 55A of the Companies Act.

15.10. But any assumed divergence between the two definitions even for the sake of argument, leads to a fairly preposterous situation in the regulatory framework for securities. The Companies Act confers powers on SEBI under Section 55A for very specific purposes. SEBI has been *inter alia*, assigned powers through very specific Sections in Part III (relating to Prospectus and Allotment and Other Matters relating to issue of shares or debentures) and Part IV (relating to Share Capital and Debentures). In short, the regulatory remit of SEBI lies under the broad head of issue and transfer of securities and non-payment of dividends. On the other hand, the SCR Act has been enacted to prevent undesirable transactions in securities by regulating the business of dealing therein. The SEBI Act in turn provides for the establishment of a Board to *inter alia* regulate, the 'securities' market, where the expression 'securities' has the meaning assigned to it in Section 2(h) of the SCR Act. Thus, the Companies Act provides for the **creation, issue and transfer** of securities and the SCR Act provides for the regulation of the **transactions of these securities** in the market itself. If, say, 'hybrids' referred to in the definition of 'securities' under the Companies Act are outside the scope of the same expression under the SCR Act, it would mean that SEBI regulates the creation, issue and transfer of such securities, as allowed under Section 55A of the Companies Act, but does not regulate transactions of such 'hybrids' in the securities market. In fact, as a corollary, then it would follow that there are no laws of our land that provide for the regulation of transactions of 'hybrids' at all, because save the SCR Act – no other Act defines securities for this purpose. It would then follow that, transactions in 'hybrids' are in a regulatory limbo in India. That could not have been the intention of Parliament, and such an interpretation would simply be a deep affront to the wisdom of our lawmakers. Hence, *reductio ad absurdum*, for this reason too, hybrids cannot exist outside the definition of "securities" in the SCR Act.

15.11. Even from a clinical appreciation of this definition, using the tools that the science of Logic provides us, it is not hard to see that the argument of the Learned Counsel would lead to a fallacy. If 'hybrids' are defined as a combination of '**securities' (under Companies Act)**, which comprises of **'securities' (under SCR Act)** and **'itself'**, then obviously the definition itself is a circular one. An object cannot be defined in terms of the same object that is to be defined. In the science of logic, this would be a classic case of circular definition – or more stylised by the general class of fallacies that are referred to as '*circulus in probando*' or '*petitio principi*'. It would tantamount to a definition failing to provide any elucidation on the object that it purportedly defines.

15.12. Five definite conclusions emerge from the above discussion.

1. OFCD as a hybrid is a 'debenture' under Section 2(h)(i) of the SCR Act and is also a marketable security.

2. The import of the expression "<u>and includes</u>" as used in Section 2(45AA) of the Companies Act has to be appreciated against the maxim of *noscitur a sociis*. The term '<u>securities</u>' itself has a very extensive scope. There are no exceptional circumstances that suggest the need for any deviation from a normal and common interpretation of such expression. Therefore, the definition of the term 'securities' in Section 2(h) of SCR Act encompasses "hybrid" also and is therefore equivalent to the definition in Section 2(45AA) in the Companies Act.

3. The powers conferred on SEBI under Section 55A of the Companies Act, relate to 'securities' defined under that Act, and not under the SCR Act. So even if one were to assume that there are differences between the two definitions (even though there are none), SEBI can regulate all securities (whether hybrid or not) under Section 55A of the Companies Act.

4. Any assumption, even for argument's sake, that hybrids are not covered under the SCR Act, would lead to an untenable position, with a regulatory vacuum in so far as regulation of transactions in such hybrids are concerned, once they are issued.

5. Finally, were "hybrid", as defined in the Companies Act, to be treated as distinct from, and falling outside "securities" under the SCR Act, then this would give rise to an incurable defect in the very definition of the term "hybrid" itself.

15.13. While I have in the next Section, examined why the term 'hybrid' was introduced in the Companies Act at all, I am of the view that the inclusion of the word "hybrid" in the definition of the expression 'securities' in the Companies Act, does not have any significant legal or financial implications. In fact, the term 'hybrid' is not used anywhere in the Companies Act, other than in the definitions themselves. I am further strengthened in this conviction, as I find that in the proposed Companies Bill, 2009, the Ministry of Corporate Affairs has in fact not found it necessary to maintain such a separate classification of 'hybrids'. It has adopted the same definition in the SCR Act. Section 2(zzzc) of the Companies Bill, now under process, reads as follows:

"(zzzc) "securities" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956;"

15.14. I am therefore of the considered opinion that there are no differences, whatsoever, in the actual scope of what is covered under the expression 'securities' in their definitions in the Companies Act and the SCR Act. The Companies Act merely clarifies that "hybrid" are securities too. Its presence in the definition of the term 'securities' in the Companies Act does not enlarge the scope of the term securities beyond what is contemplated in the SCR Act but merely elucidates it further. Furthermore, the SEBI Act in Section 11A therein independently too empowers SEBI to regulate all matters relating to the issue of securities, without prejudice to the Companies Act.

16. The introduction of "hybrid" in the definition of securities under the Companies Act

16.1. Even in 1990, when the Honourable Supreme Court of India pronounced its judgement in **Narendra Kumar Maheshwari vs. Union of India (quoted supra)**, evidently companies were issuing hybrids in the form of Compulsory Convertible Debentures to raise capital. Other hybrids like optionally or compulsorily convertible preference shares were also in the battery of instruments available for firms to raise capital. All this predates the introduction of the term 'hybrid' in the Companies Act in 2000. There is no case that hybrids in India were issued only after the introduction of the definition in Section 2(19A) and Section 2(45AA) of the Companies Act.

16.2. According to information available with the Registrar of Companies, Kolkata, Sahara India Commercial Corporation Limited (a company belonging to Sahara India Group), had itself issued OFCDs in 1998. This issue, which was closed after ten years in 2008 was for ₹17,250 cr. over five schemes. Clearly, companies in the Sahara India group –to which the two Companies themselves belong, were issuing OFCDs even prior to the introduction of the definition of 'hybrid' in the Companies Act.

16.3. Therefore evidently, at least in the matter of convertibles like OFCDs, it is not the case that these hybrids were all new innovations that required the strength of Section 2(19A) and 2(45AA) of the Companies Act, for their introduction into Indian financial markets. That being so, it is legitimate to ask this question as to what was the purpose served by including the definition of 'hybrid' in the Companies Act. Was this new definition superfluous and redundant? Was it merely to restate what was already permitted in the securities market, in a more compact and stylised fashion? To find an answer to this, one has to look outside the Companies Act itself.

16.4. The Working Group on Companies Act (1997), on whose recommendations the Amendments were made to insert the said provisions in the Companies Act, explained the term 'hybrid' as "an omnibus term that allows the combination of securities including their derivatives and options." (Footnote to Para 3.6 of their report). Relevant extracts of this Report are given below.

> "3.6 Throughout the world, corporate growth has been accompanied by the introduction of various forms of securities: debt-equity hybrids, derivatives, options, and shares with differential rights. No capital market of the size of India's remains anchored to the old, three-fold classification of securities: pure debt instruments, ordinary shares and preference shares."

16.5. So it seems somewhat obvious to me, that what was intended by introducing a new definition of 'hybrid" was to break the gridlock of companies being confined to shares, preference shares and debentures for their needs for capital. It has to be inferred that Parliament introduced the new definition primarily to give a new direction, thrust and fillip to formation of capital in the country, through more innovative channels. I can see at least three purposes that may have been intended by the new definition. The first, as mentioned above, the term 'hybrid' in the definition helps highlight the idea that in India securities can be combined to design innovative financial instruments, to suit the needs of the issuer and satisfy the risk appetite of the investor. Secondly, it provides a wider space in the future for any type of combination of securities to create hybrids, than what is available in the market now – viz. without restricting hybrids to pure combinations of debt and equity (with or without derivatives). Thirdly, for valuation and taxation purposes it is easier to classify these innovative instruments under this class viz. hybrid, particularly where the valuations of the component parts may have to be disassembled and disclosed.

16.6. Beyond the reasons discussed above for introducing the term ‘hybrid’ in the Companies Act, I am of the considered view that the presence of the term ‘hybrid’ in the definition of the term ‘securities’ does not introduce anything fundamentally radical into our understanding of the term ‘securities’ itself.

PART B

DISCUSSION OF APPLICABLE LEGAL PROVISIONS

17. Manner of calling for investments by the two Companies for their OFCD schemes – Are these public or private placements?

17.1. The Honourable Supreme Court of India has in its Order, has directed SEBI to examine *inter alia* the manner in which investments are called for by the company. The two Companies have submitted that the OFCDs issued by them have been made by circulation of information memorandum by way of private placement and without any advertisement to the public, by adopting the route provided under Section 60B of the Companies Act.

17.2. I rely on the Order (dated July 19, 2004) of the Honourable Securities Appellate Tribunal in the matter of **Toubro Infotech and Industries Limited and Another v Securities and Exchange Board of India,** wherein the Honourable Tribunal raised the issue, as to whether the debentures were offered to the public or whether it was a private placement. The Honourable Tribunal had observed the following:

> “12. Section 67 of the Companies Act gives an indication of the difference between private placement and public issue.

Section 67(3) is clear and categorical. Section 67(3) reads as follows:

"No offer or invitation shall be treated as made to the public by virtue of sub-section (1) or sub-section (2), as the case may be, if the offer or invitation can properly be regarded, in all the circumstances-

(a) as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation; or

(b) otherwise as being a domestic concern of the persons making and receiving the offer or invitation :"

The first proviso to section 67(3) inserted by the Companies (Amendment) Act, 2000 with effect from 13.12.2000 sets at rest the question by stating that if an invitation to subscription is made to 50 or more persons, it ceases to be a private placement. The first proviso reads as follows:

"Provided that nothing contained in this sub-section shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more:"

This proviso was not in force when the two debenture issues were made by the company. The first issue was on 1st of September 1999 and the second issue was on June 1, 2000. The allotments were completed by July 2000. **Therefore, the proviso, which came into force on 13.12.2000 holding that any issue made to 50 or more persons will be deemed to be public issue**, was not in force. [Emphasis supplied]

17.3. The position is therefore clear as to what constitutes a 'public' issue. After December 13, 2000, any offer of securities by a public company to more than 50 persons will be treated as a public issue under the Companies Act. In this case admittedly, the issue has been made after December 2000 and the number of investors run into several millions. Hence, there is no ambiguity as to whether the two Companies have issued OFCDs to the public.

17.4. The Learned Counsel also referred to two judgments, where he pointed out that these referred to two instances where SEBI has not claimed jurisdiction even though the issue was made to more than 50 persons. The first judgement is of the

Honourable High Court of Judicature at Bombay in the matter of **Kalpana Bhandari vs. SEBI**, cited in support of his contention that SEBI can exercise powers under Section 55A only in the case of listed public companies and those public companies which intend to list and not over unlisted companies. In this judgement, I find that the company therein, Sesa Industries Limited had made a preferential allotment of equity shares during the year 1993 to around 31,000 investors, being shareholders of a domestic concern. This allotment had happened in 1993 much before the insertion of the proviso to Section 67(3) of the Companies Act. The proviso to Section 67(3) states that nothing contained in Section 67(3) shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more. Therefore, the case law does not appear to be relevant to the present facts and circumstances.

17.5. In the judgment of the Honourable High Court of Delhi in the matter of **Society for Consumer and Investor Protection vs. Union of India and Others**, to which the Learned Counsel had also referred, the issue related to investor complaints arising from a rights issue of an unlisted company. In this judgement, the Honourable Court referred it back to SEBI for further examination. SEBI after examination forwarded the same to the Ministry of Corporate Affairs for doing the needful as the complaints referred to the rights issue of an unlisted company. A rights issue by a Company leading to allotment of shares to its own shareholders is certainly not comparable to the instant case, where the two Companies are collecting subscriptions from millions of subscribers in the country allegedly under the guise of private placement. The concerns of SEBI as a regulator charged with the protection of investors would be radically different in the case of rights issue by an unlisted company where the securities are primarily issued only within the fold of existing shareholders.

17.6. Let me now, for a moment ignore the stipulation that any issue of securities to 50 or more persons, is a public issue – and merely analyse the actual manner of issue of the OFCDs by the two Companies and see whether there is anything that is of a nature that makes the offer of OFCDs by the two Companies a <u>private issue</u>. Is there in fact, a ‘private’ nature to the issue as claimed by the two Companies? The argument of the two Companies is that these OFCDs have been issued to persons related or associated with the companies themselves. During the course of his submissions, the Learned Counsel explained the rationale as to why the addresses of investors in the Compact Disc (CD) furnished by them were misunderstood to be incomplete, when in fact they were not. He took great pains to explain that for rural areas in India, investors can be identified by simple 'names' and that is the reason why names alone have been furnished along with their village of residence. In semi-urban areas you might need a few more of details like street name etc., to identify the investor and hence partial addresses were provided. It is only in urban areas, that full and complete addresses are required to identify the investor. On behalf of the two Companies, the Learned Counsel offered the assistance of their staff, if SEBI wished to identify any investor in the list. I was quite intrigued both by this argument as well as the offer to assist SEBI in tracing investors. On the face of it, I would certainly think that anyone would be appalled by such a casual manner of maintaining a list of investors. In this age, when regulators across the globe are exerting themselves to refine the 'Know Your Client' (KYC) forms and design and maintain more robust databases of investors, containing data on their identities, such a lackadaisical and cavalier attitude to investor identification, euphemistically speaking, is simply shocking.

17.7. In the Information Memorandum of SIRECL under Part II thereof, the said company had referred to Section 68A(1) of the Companies Act. This provision prescribes the penalty that falls on any person who makes an application to a company for acquiring or subscribing to any shares in a fictitious name. For a private placement done by a company to selected and specified investors associated with them, I wonder how and why the two Companies considered it necessary to include a reference to that Section, if indeed they were making their offer only to persons associated with it. Therefore, I can only infer that the two Companies did not have any particular target group of persons for placement of its debentures and had intended to offer the same to others also, from the general public, to whomsoever their agents were able to successfully market it. In other words, the company had designed the OFCD issues to invite subscriptions from the public at large.

17.8. In the present case, subscriptions into the OFCDs have been mobilized from millions of investors through thousands of service centres, through an information memorandum. Further, the two Companies have not brought on record, in these proceedings, any document to show that the OFCDs were specifically offered to a targeted set. No offer letters from the two companies to the identified set of persons or documents showing acceptance of the offer only by such identified persons were produced before me. Furthermore, the resolutions of the two companies authorizing the said issuances did not contain any list of persons to whom the offer was intended.

17.9. I note that the Investigating Authority had, as directed by me, made enquiries with two of the subscribers (who are residing in Mumbai) to such OFCDs made by the companies. These investors had stated that their investments in such instruments were made on the basis of the representations made by the local agents (employed by the companies) and that they had no connection, whatsoever, with the two Companies themselves or to the Sahara India Parivar.

17.10. Adopting the guidance of the Honourable Tribunal in the matter of **Toubro Infotech & Industries Limited and another vs. SEBI**, referred to above, this would be conclusive grounds to hold that the issuance of OFCDs made by the two companies were actually not private placements as claimed to be but **public issues which were disguised as private issues.**

17.11. In the bonds of both the companies, SIRECL and SHICL, under the head "Declaration", the following is *inter alia* mentioned:

> "….I confirm that I am/applicant associated with Sahara India Group. I have been explained everything in the language known to me and I have given my full consent on terms and conditions mentioned above".

The relation or association with the Sahara India Group seems to have been left curiously vague in the above standard vanilla declaration. In fact, the two Companies have not put forward any oral argument or written documents to even explain as to what such an association or relationship implies, or as to what are the qualifications set for a person to be defined as an associate or for being related to the Group.

17.12. Further, towards the end of the page containing the terms and a condition of a bond, the following is also mentioned:

"I have explained everything in the language known to the applicant/Representative of applicant and he/she has given his/her full consent on terms and conditions mentioned above. I, hereby further declare that all declaration made by the Bond Holder/Representative of Bond Holder and all the information/personal particular given above by the Bond holder/Representative of Bond Holder are correct and true to the best of my knowledge and belief.

Signature of the Introducer _________________________"

17.13. All these are indeed suggestive of the fact that the bond issued by the two Companies is simply a general one designed to solicit subscription from the public at large. If the OFCD issues were privately placed to persons known to the two Companies, as claimed, then there would be neither any need of an "introduction" nor any need for an "introducer". No entity would need to introduce an associated or related person to itself. The Learned Counsel, rather unconvincingly suggested that the idea of introducer was kept for 'Know Your Customer (KYC)' purposes. If the offer has been made to persons who are known, related or associated with the issuer, then I fail to appreciate how the KYC will get enhanced, if an introducer vouchsafes for the personal details of the investor.

17.14. The information memorandum of SIRECL, in Part II thereof, under the head "Objects of the Issue and Authority therefor" declares the following:

"The present issue of the OFCD's has been authorized by the equity holders of the company in the Extra Ordinary General Meeting held on 3rd March, 2008. However, if the number of interested parties to this issue exceeds 50 the company shall approach the Registrar of Companies to file a Red Herring Prospectus as per Section 67(3) of the Companies Act, 1956" (Underline supplied)

Clearly the two Companies proceeded with the issue of OFCDs, perfectly in the knowledge that once they exceed the threshold of fifty investors, they come under the purview of Section 67(3) of the Companies Act, and that their issues would be public.

17.15. I have also examined copies of the letters written by SIRECL in January 2011, to a few professional accounting firms, submitted among the documents filed by SIRECL before me. The letter to these firms notes that "The Company has from time to time issued Optionally Fully Convertible Debentures (OFCD) which have been subscribed **by various people all over the country**". The letter seeking professional services "by way of deputation of professional staff to collate data and to the necessary **compilation** by putting the data together in a consistent format and doing the necessary **authentication** of the same, given the fact that the data is voluminous and is **spread across thousands of service centres**." (Emphasis supplied) Clearly, the OFCDs are issued, admittedly to various people all over the country. The compilation of the data is not available with the firm. The data is unauthenticated and the fund mobilisation is spread across thousands of service centres. I hardly think there is any great deal of analysis required to see that these are not exactly the defining features of a 'private' placement to known or related or associated individuals.

17.16. These facts drive home one rather straightforward inference viz. the issue was marketed to and subscribed by the general public and it was not a private placement by any stretch of imagination. Therefore the OFCD issues by the two Companies cannot be held, even for a moment, to be of a "domestic concern" or "that it was not subscribed to by others to whom such offer was not made" (as referred to in Section 67(3) of the Companies Act). Further, it is the case of SIRECL that they have 6.6 million subscribers. Given the above circumstances, I do not hesitate in being a tad dismissive of the argument advanced by the Learned Counsel, when I say that 6.6 million subscribers is too colossal a pool of persons associated to the Companies, to be labelled 'private', particularly in the absence of any definition of what such an association or relationship is. What seems to be very obvious is that the two Companies are obtaining subscriptions into its OFCD schemes through mass subscription solicitation through service centres sprawled across the country. I have no hesitation in concluding that placements of OFCDs made by the two Companies were indeed made to the public. In fact, unless there is a database of investors already available with an issuer, the offer letters under a 'private placement' simply cannot be mailed out. The very absence of a 'database' readily available with the two Companies itself is the best indicator that these not by any means 'private placements'.

17.17. In this context, Circular F.No.2/10/2010-GL-V dated 22nd November 2010 by the Ministry of Corporate Affairs is pertinent. Paragraph 2 of this Circular is very pertinent in this regard and reads as follows:

> "It has come to the notice of the Ministry that unlisted public companies have been resorting to offering shares or debentures (convertible as well as non convertible) to friends, associates and other persons in violation of the spirit of section 67(3) as amended in the year 2000 as mentioned above."

17.18. As observed by the Honourable Securities Appellate Tribunal in the matter of **Toubro Infotech and Industries Limited and Another vs. SEBI** (quoted supra), an invitation to subscription made to 50 or more persons ceases to be a private placement. But it is instructive to examine, whether the Companies Act provides any exemption from this rule. The second proviso to Section 67(3), immediately following the first proviso quoted above, is the following:

> "Provided further that nothing contained in the first proviso shall apply to the non-banking financial companies or public financial institutions specified in section 4A of the Companies Act, 1956 (1 of 1956)"

Clearly, what this implies is that other than non banking financial companies or public financial institutions under Section 4A of the Companies Act, no other entity is exempt from the 'Rule of 50', which defines what an offer to the public means. **This is the one and only one exemption contemplated in the Companies Act.** It is not the case of the two Companies that they fall in this exempted category of companies.

17.19. The Learned Counsel had also drawn my attention to the correspondence of SEBI with the Ministry of Finance, wherein it had been stated that "*Privately placed debentures are issued as per the Companies Act, 1956 and come under the purview of Ministry of Corporate Affairs (MCA).*" It is true that privately placed debentures would be under the regulatory purview of the MCA. However, for this, the issue of debentures need to first qualify as "privately placed" to be solely under the regulatory ambit of the MCA and this certainly will not be met by merely naming what clearly is an issue to the public as 'private placement'.

17.20. The above findings are summarised below:

1. The OFCDs in question here constitute an offer to the public as they have been made to over fifty persons.
2. The manner and the features of fund raising under the bond issues by the two Companies discussed above, suggest these issues are by no means 'private'. What seems evident is that the two Companies have been running a mass subscription solicitation from the public.
3. The two Companies do not fall under the entities specified in the second proviso to Section 67(3) which is the only exemption granted to the 'Rule of 50', that defines offer to the public, under the Companies Act.

I would therefore conclude that the OFCDs issued by the two Companies are **public issues**, without any ambiguity.

18. Applicability of Section 73 of the Companies Act

18.1. Section 73 of the Companies Act reads as follows:

> "73. Allotment of shares and debentures to be dealt in on stock exchange.—
>
> (1) Every company intending to offer shares or debentures to the public for subscription by the issue of a prospectus **shall**, before such issue, make an application to one or more recognised stock exchange for permission for the shares or debentures intending to be so offered to be dealt with in the stock exchange or each such stock exchange." (Emphasis supplied)

Therefore, based on the inferences summarised above, the OFCDs issued are **debentures** offered to the **public** through a **prospectus**. From a plain reading of Section 73(1) of the Companies Act quoted above, it follows that the two Companies as issuers, are bound to necessarily abide by this section and apply to one of the stock exchanges for permission to list such securities even before they make their issues. In passing I might mention that the use of the word “shall” used in Section 73(1) in contrast to the word “may” used in Section 60B(1), only serves to emphasise the finality and conclusiveness with which the Law expects an issuer making a public offer, to abide by the requirement in Section 73(1).

18.2. In the counter affidavit dated January 7, 2011 filed on behalf of the Registrar of Companies, Uttar Pradesh and Uttarakhand, before the Honourable High Court of Judicature at Allahabad, Lucknow Bench, it was submitted that SIRECL had mentioned the following in its letter dated January 1, 2011 addressed to the said Registrar:

> “as regards to number of allottees exceeding 50, please take reference of our Form No.23 filed dated 08.03.2008 vide SRN No. A33406802 and Form No. 62 (Red Herring Prospectus) filed dated 13.03.2008 vide SRN No. A33724675 approved by your office vide acknowledgment dated 18.03.2008, **wherein it is clearly stated that number of allottees will be more than 50, as a result of which, the company has filed Red Herring Prospectus with your office in compliance of Section 55A, 60B, 67, 69 and 73** inter-alia and acknowledgment card issued by your office dated 18.03.2008.”

18.3. The two Companies had stated in their information memorandum that the number of persons (to whom the offer is made) may exceed fifty. Thus, the company, SIRECL had itself stated that the number of allottees would be more than 50 and that it had filed RHP with the Registrar in compliance of Sections 55A, 60B, 67, 69 and 73 of the Companies Act. I, therefore observe that the Company would be even ‘estopped’ in now taking a plea that its issue would not attract Sections 55A, 60B, 67 and 73 of the Companies Act.

18.4. The Learned Counsel had submitted during his submissions the opinion of Mr. Mohan Parasaran, Additional Solicitor General of India attached to the reply of the two Companies, wherein it has been mentioned “However in this matter divergent opinions have been expressed. My learned and distinguished colleague Mr. Parag Tripathi has disagreed with the views taken by the Law Ministry and agreed with SEBI’s action and has sought to place heavy reliance upon the provisions of Section 73(1) of the Companies Act, 1956 read with Section 67 of the said Act and in particular the proviso to Section 67(3)….". I observe that the opinion expressed by Mr. Parag Tripathi is not in the records made available to me by the two Companies, and hence I do not have the benefit of reading it. Therefore, in all humility, it is submitted that the learned Additional Solicitor General has expressed his view that is contrary to another view of Mr. Parag Tripathi which is also available in the files of Government of India. In any case, the Learned Additional Solicitor General has relied on the order of the Honourable Securities Appellate Tribunal in **Toubro Infotech and Industries Limited vs. SEBI,** where the Honourable Tribunal (quoted above) has observed as follows:

> "**The first proviso to section 67(3) inserted by the Companies (Amendment) Act, 2000 with effect from 13.12.2000 sets at rest the question by stating that if an invitation to subscription is made to 50 or more persons, it ceases to be a private placement.**"

18.5. As mentioned in the preceding discussion, the two Companies have stated that in case the subscribers exceed 50 in number, they would file red herring prospectus under Section 67(3) of the Companies Act. Admittedly, in the OFCD issues of both of the two Companies, the subscribers had exceeded 50 in number and in fact admittedly are several millions. The company's statement and the number of actual subscribers are more than sufficient to conclude that the OFCD issuances made by the two Companies were to the public and the said issues were actually "public issues" and not "private placements".

18.6. Schedule II of the Companies Act prescribes the matters to be specified in the prospectus. Paragraph 22 of this Schedule prescribes the final Declaration to be signed by the Directors of the Company and reads as follows:

> "**Declaration:** That all the relevant provisions of the Companies Act, 1956, and the guidelines issued by the Government or the guidelines issued by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992, as the case may be, have been complied with and no statement made in prospectus to the provisions of the Companies Act, 1956 or the Securities Exchange Board of India Act, 1992 or rules made thereunder or guidelines issued as the case may be.

Signatures of directors”

Curiously, in the declarations in the RHPs filed by the issuers, the Directors have signed a version of the Declaration that has carefully excluded all mention of SEBI. The issuer has fashioned a new version of the Declaration for its directors, to suit its own imagination. During the course of the submissions, the Learned Counsel mentioned that these references to SEBI were discarded because they were not deemed applicable. I wonder how statutory declarations prescribed under an Act of Parliament can be mutilated to one's liking or to suit one's preferences. Typically in such declarations, when the law gives a choice to the person filing the declaration to score off the inapplicable part if any, then there will be specific instructions to that effect. Thus, it appears that the RHPs themselves have been distorted to conceal facts about the actual legal provisions that applied to the issue of OFCDs by the two Companies.

18.7. To sum up, for a public issue, whose parameters are set by the first proviso to Section 67(3) of the Companies Act, the issuer is bound to proceed to Section 73, and comply with the requirements stipulated there. In fact, there does not seem to have been any doubts in the minds of the two Companies that they were bound to comply with Sections 67 and 73 of the Companies Act, as seen from their statement to the Registrar itself. I also suspect that there has been a reprehensible attempt to conceal this applicability of the provisions of laws and the jurisdiction of SEBI on the issue itself, by making changes in the form and structure of the statutory declaration filed by the Directors of the two Companies.

19. The expression "intend to list" in the Companies Act.

19.1. In all the prospectuses to the six bonds issued by the two Companies, the issuer has categorically declared that it <u>does not intend</u> to list the issue. So this brings me to a very important question. What is the meaning of the expression "intend to list" used *mutatis mutandis*, in the various sections of the Companies Act? As has been brought out in the discussion above, this consideration, in fact becomes central to this Order. Therefore, firstly, I propose to examine this from the context of what the expression itself logically would imply under the Companies Act. Secondly, I shall explore the connotation that the English Language itself attaches to this expression.

19.2. Section 73(1) of the Companies Act,(quoted *supra*)mandates that any company that invites subscription from public should apply to a Stock Exchange for listing before inviting subscription. Subsection (2) of Section 73 further states that if listing is not applied for or is not granted the money collected should be refunded. Section 73(4) of the Companies Act reads as follows:

> "(4) Any condition purporting to require or bind any applicant for shares or debentures to waive compliance with any of the requirements of this section **shall be void**." (Emphasis supplied)

The consequence of this obligation under Section 73(4) is that a declaration for a public issue by any issuer to the effect that it has no intention to list its securities in either the application form or prospectus - where the law enjoins on it such a duty that flows from Section 67(3) and Section 73(1) - **is itself patently illegal and void** *abinitio*. This amply brings home the cardinal principle that the issuer has no choice whatsoever on whether to seek listing or not, once it has invited subscription from over fifty investors from the public. Hence the mere circulation of prospectus or memorandum inviting subscription from the public is virtually synonymous with an 'intention to list'. One cannot be divorced from the other. Listing is a legal responsibility or duty that flows from the act of inviting subscriptions from the public. The former is a consequence that emanates, *suo motu* and naturally, out of the latter. It does not arise as an act of volition on the part of the issuer. In the context of a public issue of securities to more than 50 investors, 'listing' comes as a duty inseparably attached to the act of inviting subscriptions from the public.

19.3. The choice of the words 'intend to list' also seems to have been made for a very specific reason. Listing itself is not automatic. The mere application for listing does not entitle the issuer's securities for listing. The duty of 'listing' that follows the act of 'issuing' securities to the public does not always have to culminate in the securities actually being listed. Listing is granted after careful examination and subject to the satisfaction of many requirements spelt out in listing rules. These listing rules are themselves based on provisions in the SCR Act, the Companies Act and applicable legal framework. That these conditions have to be met is a prerequisite for being allowed listing. To reiterate, the intention to list (read as the 'duty' to list) of an issuer, does not always have to fructify in an approval being granted to list the securities on a stock exchange. In all humility, I have to interpret, that this could have been the reason why Parliament, in its wisdom, preferred to adopt the specific words "intend to" in the matter of listing the securities of companies that have issued them to the public, in preference to any other possible alternate choice of words.

19.4. Black's Law Dictionary (VIII Ed.) gives the meaning of the term "intend' as follows:

> **Intend, 1.** To have in mind a fixed purpose to reach a desired objective, to have as one's purpose…. **2.** To contemplate that the usual consequences of one's act will probably or necessarily follow from the fact, whether or not those consequences are desired for their own sake…. **3.** To signify or mean.

19.5. Whether the desired objective itself is something where the person who 'intends' has a choice in the matter of that objective is immaterial. In other words, the desired objective can be something that the person who 'intends' is legally obliged to carry out. It does not have to necessarily be, that the objective itself might always have to be palatable to the person who "intends". The word 'intention', within its meaning in the English language, can therefore denote a situation where the desired objective might be statutory in nature or an 'obligation' cast on the person who 'intends'. At least in this context, I would think that it is in fact necessary to adopt this interpretation. A counterfactual view will help appreciate this point. What would happen if a public company issuing its shares to the public, for some perverse reason, were to decide, that it does not 'intend' to list? Do all the consequences and obligations arising from the Companies Act and the entire framework for investor protection prescribed by Government and SEBI, melt and fade away? It would be no different from the situation where an intractable school child declares belligerently that he does not 'intend' to do his assigned homework. That would make him no less amenable to the discipline of his school.

19.6. In the judgement in the matter of **Raymond Synthetics Ltd. and Ors vs Union of India and Ors on 4 February, 1992, (1992 AIR 847),** the Honourable

Supreme Court of India, has interpreted the principles that underlie listing of securities in the following words.

> "Listing means the admission of the securities of a company to trading privileges on a Stock Exchange. The principal objectives of listing are to provide ready marketability and impart liquidity and free negotiability to stocks and shares; ensure proper supervision and control of dealings therein; and protect the interests of shareholders and of the general investing public."
>
> "A public limited company has no obligation to have its shares listed on a recognised stock exchange. **But if the company intends to offer its shares or debentures to the <u>public</u> for subscription by the issue of a prospectus, it must, before issuing such prospectus, apply to one or more recognised stock exchanges for permission to have the shares or debentures intended to be so offered to the public to be dealt with in each such stock exchange in terms of section 73.**" (Emphasis supplied)

19.7. Therefore the intention to list, contemplated in the Companies Act does not originate from the benevolence and large-heartedness of the issuer or from a voluntary desire to subject itself to greater regulatory discipline. It arises because Parliament, in its wisdom, as explained in the aforesaid observations of the Honourable Apex Court, had decided that listing the shares or debentures of a public company that issues shares or debentures to the public, on a stock exchange should be an integral part of the measures for investor protection in our country. In other words, where the expression "intend to" is used in the Companies Act, in the matter of listing, the law does not offer a choice to the issuer, but mandates the same.

20. Applicability of Section 60B of the Companies Act

20.1. One of the arguments put forward by the two Companies and forcefully argued by the Learned Counsel for them, is that Section 60B in the Companies Act is the <u>only</u> route available to them for raising capital through issue of hybrid securities and that other sections like Section 67 and 73 of the Companies Act refer to shares and debentures, and do not address the issue of hybrid securities. That being so, Section 60B(9) of the Companies Act clearly provides that for all entities other than listed public companies, the final prospectus shall be filed with the Registrar of Companies only. The argument is that the extant issues of OFCDs by the two Companies therefore do not lie under the regulatory jurisdiction of SEBI.

20.2. I have already addressed the issue of the real nature of OFCDs and have, on the basis of the detailed discussions above, concluded that OFCDs are Debentures - very much as the name itself indicates. As far as shares and debentures go, there is a well defined and much travelled route available in Part III of the Companies Act, for companies to raise capital through either of these instruments. On the one hand, the Learned Counsel has argued that Section 81(3) of the Companies Act exempts the issue of these OFCDs from Section 81 totally, because securities and hybrids are not mentioned therein. On the other hand, the two Companies in their General Body Meetings had resolved under Section 81(1A) of the Companies Act to take recourse to the issue of OFCDs – when in fact, ironically, this subsection too addresses the further issue of <u>shares</u> alone and does not mention 'securities'. This argument, on the face of it, seems to lack consistency, and appears convoluted and knotty. But nevertheless, notwithstanding that there is a well laid out process envisaged in the Companies Act, for issue of capital through debentures including OFCDs, I shall disregard the same for the moment, to examine the merit of the contention of the two Companies, in greater detail.

20.3. As stated herein above, the two Companies have argued that they have circulated information memorandum by way of private placement and without any advertisement to the public, by adopting the route provided under Section 60B of the Companies Act. I have discussed above the reasons why the issue of OFCDs by the two Companies are offers to the public and are not private placements. Section 60B(1) of the Companies Act reads as follows:

> "(1) A public company making an issue of securities may circulate information memorandum **<u>to the public</u>** prior to filing of a prospectus." (Emphasis supplied)

A plain reading of the Section 60B(1) would show that, if as claimed by the two Companies, theirs is a private issue, then the two Companies simply cannot issue an information memorandum, as this subsection contemplates **ONLY** an issue to the public. *Ab initio* therefore, if one were to accept the argument of the two Companies that they have made a private placement, then they have erred in using the Section 60B route for raising capital as this route is not at all intended for private placements. On the one hand, the two Companies cannot claim that their OFCD issuances are "private placements" and on the other hand, use a mode meant for "public" offers.

20.4. Section 60B(9) of the Companies Act, 1956 reads as follows:

> "(9) Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised, whether by way of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of a listed public company with the Securities and Exchange Board and Registrar, <u>and in any other case with the Registrar only</u>."
> (underline supplied)

What the above section does indeed say is that the final prospectus in all other cases other than a 'listed public company' shall be filed with the Registrar. The two Companies have constructively worked backward from the words "<u>and in any other case with the Registrar only"</u> that appears in Section 60B(9) to reach the inference that consequently, issue of securities under Section 60B – 'the Information Memorandum' route, falls and solely falls under the regulatory powers of the Government (Registrar) and not SEBI.

20.5. Before I explore the scope of Section 60B and its various subsections, I need to turn to the scope of the expression "<u>and in any other case with the Registrar only"</u> in Section 60B(9) of the Companies Act. Section 60B(9) recognises two categories of companies – <u>listed public companies</u> being the first category with the rest of the companies falling under a second category <u>'any other case'</u>. From the discussion in the preceding sections in this Order, it is amply clear that a public company making an offer of securities to the public necessarily **<u>has</u>** to apply to the Stock Exchange to list their securities for trading on the Stock Exchange. The law leaves no choice to a Company in this. This means, that the moment a Company decides to issue securities to the public, immediately, *pari passu,* a duty is cast on the issuer to seek listing of these securities on a Stock Exchange. Thus, when any Company decides to issue an Information Memorandum under Section 60B(1), it must and would already have applied to the Stock Exchange for listing. Otherwise, it would be in violation of Section 67(3) and Section 73 of the Companies Act. This means that at the stage of public company making a public issue, the process of listing on a Stock Exchange has actually begun and is in motion. In fact, an issuer at the stage of his crossing into the threshold of Section 60B(1), will be a **"public company that has applied for listing."** Now the question that one then needs to ask is - into which group do we assign such a category within the two groups specified in Section 60B(9) – listed public companies and any other case? One could argue *ad nauseam*, that a public company that has applied for listing should be in the category 'any other case', because **literally**, it still is not a 'listed public company'. But in the context of the Companies Act, and the well thought out approach of Parliament on why, in the interest of investors viz. securities issued to the public should be listed, this argument would be somewhat perverse. Arguing to the contrary, would imply that we would simply be missing the trees for the woods. Possibly, the expression 'any other case' may have been meant to cover those companies exempt from the first proviso under Section 67(3) – viz. companies covered by Section 4A of the Companies Act itself.

20.6. Therefore, in the spirit of the Companies Act, an issuer that has made an offer of securities to the public, and therefore has applied for listing as legally required, undoubtedly has to sit in the category of 'listed public companies' and not 'others' in Section 60B(9) of the Companies Act – and would indeed therefore be under the regulatory umbrella of SEBI, as provided in this subsection itself. In other words, had the two Companies abided by the requirements set by law, under Section 67(3) and Section 73, and applied for listing, they legitimately should have been dealt with, for the purposes of Section 60B(9), on par with any listed public company. So, even the argument of the two Companies, that they belong to the category of 'others' under Section 60B(9)is *ultra vires* of the law, because it is premised on a violation of two important provisions of the Companies Act – viz. Section 67(3) and 73.

20.7. As the title to the Section itself conveys, Section 60B of the Companies Act refers to the "Information Memorandum". Section 2(19B) of the Companies Act, that came into force on April 1, 2003 inserted by the Companies (Second Amendment) Act, 2002 defines 'Information Memorandum' as follows:

"(19B) "information memorandum" means a **process** undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed, by means of a notice, circular, advertisement or document" (emphasis supplied)

20.8. Clearly therefore, the information memorandum, under the Companies Act, is envisaged as a 'process'. The process itself is laid down in Section 60B. What is pertinent, in this case for our understanding of the same, is that the process itself certainly does not originate in Section 60B(9). In fact, Section 60B(9) is the last subsection in Section 60B, which lays down this process and refers to the 'final prospectus' alone. For any issuer, the entire process of 'information memorandum' is a journey through a terrain of well-specified regulatory compliance. The issuer embarks on the journey with the issue of an information memorandum in Section 60B(1) which provides that a public company making an issue of securities to public may circulate an information memorandum prior to filing of a prospectus. Section 60B(2) provides that:

"(2) A company inviting subscription by an information memorandum shall be bound to file a **prospectus** prior to the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer." (Emphasis supplied)

Section 60B(3) is on the legal obligations attached to the information memorandum and red-herring prospectus, and clearly stipulates that both these documents shall carry the 'same obligations' as are applicable in the case of a prospectus.

20.9. Thus there are three distinct 'gates' that have to be crossed in the process of raising capital through the 'information memorandum' route – firstly, the issue of the information memorandum itself [Section 60B(1)], secondly the filing of the red-herring prospectus [Section 60B(2)] and lastly the filing of the final prospectus [Section 60B(9)]. Evidently, the 'final prospectus' is the last post to be reached. A careful reading of Sections 60B(1), (2) and (3) clearly shows that at the stage, when the information memorandum and prospectus (red-herring) are filed, the Companies Acts directs the process in the regulatory sense to Section 55 (on the dating of prospectus) and Section 56 (where the matters to be stated and set out in the prospectus are defined.

20.10. Section 60B of the Companies Act, from a plain reading of the Act itself, and as also argued by Learned Counsel, applies to all securities, and therefore it would apply to 'shares' and 'debentures' as well. It offers a route to 'listed public companies' and 'public companies which intend to get their securities listed' as well. Any issuer company has to cross the first two gates in the process – circulation of an Information Memorandum and a RHP under Section 60B(1) and 60B(2). Section 60B(3) places all these documents on par with a prospectus. Evidently therefore these provisions in the Companies Act imply that Section 55 and 56 of the same apply in *toto*. Parliament, it its wisdom, under Section 55A, has decided that SEBI should administer Sections 55 and 56, insofar as it relates to 'listed public companies' and 'public companies which intend to get their securities listed'. Therefore, it goes without saying, that as far as 'listed public companies' and 'public companies which intend to get their securities listed' are concerned, SEBI is the regulatory gatekeeper, posted at Sections 60B(1) and 60B(2) of the Companies Act. In fact this indeed is precisely what happens now, when 'listed public companies' and 'public companies which intend to get their securities listed' file their DRHP and RHP before SEBI.

20.11. To reiterate, Parliament has conferred on SEBI, under Section 55A, the powers to administer Section 55 and 56 wherever they relate to issue and transfer of 'securities' listed public companies and those public companies that intend to get their securities listed. So as long as the issuer falls into either of these two categories – viz. a listed public company or a public company that intends to list, SEBI is the guardian, that should be vigilant in its duty at its post at Section 60B(1) and 60B(2) of the Companies Act, for overseeing the issue and filing of any prospectus to raise capital by such companies.

20.12. But, curiously, in advancing their arguments, the two Companies proceed first to the last step of the regulatory ground to be traversed in the process of raising capital in Section 60B viz. the filing of the final prospectus in Section 60B(9) and then argue backward in the reverse direction. The whole effort seems to be to somehow align the entire process of raising capital itself with the clause "<u>and in any other case with the Registrar only</u>" that is seen in the last sub-section of this section viz. Section

60B(9). But in the process, the entire rationale for prudent regulation of capital mobilisation would stand compromised. I certainly do not see any coherent reason why the natural progression in the regulatory sequence from subsection (1) to (9) in Section 60B should be reversed and be made to stand on its head, other than just to make the argument that OFCDs other than that of listed public companies do not fall under the powers of SEBI.

20.13. It is also necessary to appreciate the context in which Section 60B was inserted in the Companies Act by the Companies (Amendment) Act, 2000. This was done on the recommendation of the Working Group while redrafting the Companies Act, in order to facilitate such book building process for a company to obtain the best price for the securities so offered. The mechanism for making public issues through such book building process is found elaborated in the ICDR Regulations. Section 60B was thus inserted with an objective of exploring the demand for securities and price at which securities may be offered to the public, by a public company. The scope of this section can be further understood from the following: (as extracted from A Guide to the Companies Act – A Ramaiya – 17th Edition 2010 at Part I page 957)

> "Notes on Clause 52 of the 1997 Bill stated thus: This Section provides for the concepts of 'book building' and 'information memorandum'. This is an international practice and refers to collecting orders from investment bankers and large investors based on an indicative price range. **This is essentially a pre-issue exercise which will facilitate the issuers to get better idea of demand and the final offer price.** The directors of the Company, however, will not be permitted to resort to underwriting on book building". (Emphasis supplied)

Clearly therefore, Section 60B in the Companies Act was introduced to facilitate a 'pre issue exercise' to get better idea of demand and the final offer price. Section 60B was neither intended nor designed to be a separate code unto itself, to regulate the issue of hybrid securities or securities other than shares and debentures.

20.14. Section 60B(2) of the Companies Act, as stated above, refers to the stage at which the 'Red Herring Prospectus' has to be filed by the issuer. In the context of securities market, this expression has a specific connotation. It is one in which the price and quantum of securities or the total amount to be raised, described in the same are left blank to be filled up later. However, in the six bonds issued by the two Companies, the face value of such bonds and the conversion price were all explicitly mentioned. So if Section 60B contemplates a process of price discovery - evidently there was nothing that has been discovered here by the two Companies - because the bonds were issued with the face value and conversion price was also indicated. Clearly therefore, at least in the case of the six bonds issued by the two Companies, the use of Section 60B is patently inappropriate as the elicitation of neither the price nor the quantum of securities or the total amount to be raised was actually involved.

20.15. It is evident from the foregoing discussion that the two Companies, had they conformed to the provisions of Section 67(3) and 73 of the Companies Act, would be in the category of public companies that have to be treated on par with listed public companies for the purpose of Section 60B. The two Companies have not made a case to explain the purpose of carefully excluding <u>'public companies that intend to list'</u> (as contemplated in Section 55A, - the root section that confers powers on SEBI under the Companies Act, as regards issue and transfer of securities) from the regulatory reach of SEBI under Section 60B(9) - by introducing the expression "<u>and in any other case with the Registrar only".</u> There is ostensibly, no purpose of making such a fine exclusion with surgical precision in Section 60B(9), of public companies that intend to list, from the purview of SEBI. Clearly no arguments have been adduced anywhere as to what was the reason for disturbing a fine demarcation of regulatory powers that was cemented in Section 55A. Apparently the notes to the introduction of the Companies (Second Amendment), 2002 too do not shed any light on this. That Parliament could not have in its wisdom intended a restriction on the powers of SEBI is evident, if one were to visualize the unintended consequences that could follow from the argument that the two Companies have put forward. In any well-regulated jurisdiction in the world, the issue of capital by unlisted companies to the public at large, goes through a regimen with the necessary discipline and rigor needed to protect the investors who contribute to this capital. The minimum qualifications that are required for a company to raise capital, the quality and specifications required in the disclosures, the careful scrutiny process attached to the documents filed by an issuer, the elaborate listing requirements approved by SEBI and monitored by the Stock Exchanges are all part of a carefully built edifice which has its firm foundations on the avowed objectives of enhancing investor protection and building strong capital markets in India. Even the maximum time duration permissible between the approvals of the offer document, the opening and closing of an issue and the listing of the security on the stock exchange are all specified in the framework. All these are captured in the ICDR Regulations and in the Listing Agreement entered into between the Issuers and the Stock Exchanges. If the arguments of the two Companies were to be accepted, then it would be tantamount to making the ICDR provisions on Initial Public Offers, totally irrelevant.

20.16. SHICL, one of the two Companies opened the issue in 2008 and admittedly has not closed the issue. SIRECL, the second of the two Companies opened the issue in 2009 and it too admittedly has not closed the issue. As mentioned elsewhere, Sahara India Commercial Corporation Limited, a company related to SHICL and SIRECL too had kept an issue for an overall size of ₹17250 cr. open for ten years. Can an issuer can file an Information Memorandum, open the issue and keep the same open for indefinitely? In fact, does it mean that an issuer need not even close the issue and can keep it open perpetually? As mentioned above, I note that one of the group companies itself, had in fact kept their issue open for ten years.

20.17. If 'public companies which intend to get their securities listed', have the route of filing Information Memorandum and Red Herring Prospectus with the Registrar of Companies, as the case may be, then why should such companies adopt the rather irksome regulatory route prescribed for making Initial Public Offers under the Companies Act and the ICDR Regulations, with its strict timeline prescribed for various activities? Why should any such public company 'which intend to get their securities listed', enter through the narrower gate and traverse the thornier path to raise capital, when obviously the route which was adopted by the two Companies is available to them also? However, if unfortunately, there are companies that deliberately choose to escape the regulatory rigor associated with the issue of capital, then the much less rigorous route adopted under the guise of Section 60B of the Companies Act could come in handy for this. Such an alternative conduit of capital mobilisation bypassing much of the regulatory framework applicable to issue of capital, could potentially subject our country's financial market and its investors to inordinate risks. Needless to say, the risk that such softer paths could be misused for massive money laundering is also dangerously real. Any dilution of the regulatory regime for the issue of capital by companies in India clearly is antithetical to our own objectives of investor protection. As brought out above, Section 60B was introduced for a definite and specific purpose. It was never intended to provide conduits for raising capital, with easier regulatory standards attached to them.

20.18. I am of the view that, when the principles of interpretation are carefully applied to Section 60B and its subsections, it is easy to see that the whole Section gets correctly aligned with the rest of the Companies Act itself. An expression in one of its subsections - Section 60B(9) - “and in any other case with the Registrar only”, cannot be the fulcrum of Section 60B itself. Travelling backward from Section 60B(9) to reach Section 60B(1), where the first step to issue the information memorandum to the public is laid down, would be logically regressive – and that would not be the normal way in which statutes are interpreted. Section 60Bshould not be aligned solely with its last subsection viz. Section 60B(9) to make an argument that the Section itself would then constitute a neat self-contained mechanism for companies to raise capital. The expression “in all other cases with the Registrar” that occurs in Section 60B(9) cannot be the tail that wags the dog. It would run counter to the objectives of the various provisions that relate to mobilisation of capital by a corporate, and would most certainly be a blatant misuse of Section 60B itself – which was designed and enacted for an entirely different purpose.

20.19. To sum up the discussion in this section, the following conclusions emerge:

- If the offer of OFCDs are ‘private’ in nature, as claimed by the two Companies, then Section 60B is not the correct route to traverse for issuing OFCDs, given that Section 60B deals with issue of information memorandum to the **public** alone. The two Companies cannot, in one breath, claim that their issues are private placements and at the same time proceed to use a route, exclusively designed for public issues.

- At the stage of taking recourse to Section 60B under the Companies Act, a public company that proposes to issue securities to the public should already have applied, as is required under law, for listing on a stock exchange, and as such can only be treated on par with a "listed public company" and not in the category of the other group "and in any other case with the Registrar only" under Section 60B(9) of the Companies Act.

- The argument that they are in the latter category is built on the presumption that the two Companies need not have complied with Section 67(3) and Section 73. The two Companies are required under law to conform to these applicable legal provisions. Therefore, the framework for issue of capital under the Companies Act, the SEBI Act and its Regulations would apply *in toto* to the OFCD issues of the two Companies.

- Section 60B should not be aligned solely with the expression "and in any other case with the Registrar only", but has to be read progressively, in its context, going from Section 60B(1) all the way to Section 60B(9).

- Section 60B - whether for listed public companies or other companies – was introduced in the Companies Act, for a specific purpose under the Companies (Second Amendment) Act, 2002. It was never designed to create an island of regulatory standards that are distinct from and contrary to the spirit of various other provisions in the Companies Act itself, in so far as mobilisation of capital from the public or their investor protection is concerned.

- There are no valid grounds to infer that the expression "and in any other case with the Registrar only" that appears Section 60B(9) was intended in Law to curtail the powers of SEBI conferred on it under Section 55A of the Companies Act.

Hence, I am of the considered opinion that the two Companies have violated the legal provisions under Section 67(3) and 73 of the Companies Act, and have acted *ultra vires* of the law, in using Section 60B(9) for their OFCDs to bypass the regulatory framework applicable to them, relying solely on the expression "and in any other case with the Registrar only" that occurs in this subsection.

21. Section 60B of the Companies Act and raising capital through issue of 'securities'

21.1. The Learned Counsel for the two Companies while making his submissions painstakingly emphasised that Section 60B of the Companies Act is the only provision for issue of securities like hybrids and that Sections 67 and 73 therein, speak only of issue and transfer of shares and debentures. Since the Learned Counsel has raised this issue, I shall briefly address the same below.

21.2. I observe that Section 60B in the Companies Act came into effect on April 1, 2003 through the Companies (Second Amendment) Act, 2002. Hybrids were introduced in the Companies Act with effect from December 13, 2000 through the Companies (Amendment) Act 2000. It is hard to imagine that for over two years, the introduction of hybrids in India suffered because there was no mechanism in the Companies Act that provided for the same. As mentioned elsewhere herein, the term 'hybrid' itself is contained nowhere in the Companies Act other than in the definitions. In any case, to say the least, Section 60B did not come, as an answer to this problem – if at all there was one!

21.3. Admittedly, the two Companies themselves have issued the OFCDs relevant to these proceedings before me, under resolutions passed under Section 81(1A) of the Companies Act. This Section provides that "the further <u>shares</u> as aforesaid may be offered to any persons …… if a special resolution to that effect is passed by the company in general meeting… ". Ironically, this Section, under which the two Companies have decided to raise capital through an issue of OFCDs, neither envisages issue of debentures or hybrids including OFCDs.

21.4. Similarly, Section 108 of the Companies Act, which governs transfer of the securities issued by the two Companies, also mentions only shares and debentures and not any other security. I also note that Section 2(36) which defines the prospectus and Section 56, which defines the contents of a prospectus, addresses only the issue of 'shares' and 'debentures'. If one were to quibble on words and phraseology, then one will be dangerously close to arguing that a prospectus as we understand it under the Companies Act cannot be issued for any hybrid or for that matter any security other than shares or debentures! What is needed is a harmonious interpretation of the statutes, if one is to have the best interest of the markets and investors in mind. Section 68A which specifies the penalty for impersonation by the investor, and which has been specifically quoted by the two Companies in their prospectus too, also refers to shares and debentures alone. Section 113 which sets the time limits for issue of certificates also refers to shares and debentures alone. These are but few sections in the Companies Act, which on a plain reading refers to shares and/or debentures, but where the context would demand that they are equally valid and intended for other securities as well. If one were to carp on the construction of sentences in the statute, then this could lead to an interpretation that there are serious fissures in the applicable law caused by unintended omissions of words. I shall simply put this issue to rest by turning to the guidance given by the **Honourable Apex Court in Tata Engineering and Locomotive Co. Ltd vs. State of Bihar, (2000) 5 SCC 346 para 15),**

> **"Statutes, it is often said, should be construed not as theorems of Euclid but with some imagination of purposes which lies behind them and to be too literal in the meaning of words is to see the skin and miss the soul."**

22. Powers of SEBI under Section 11A of the SEBI Act

22.1. Notwithstanding all the arguments about what exactly falls within the regulatory remit of SEBI under the Companies Act, a provision in law of far reaching consequence that often does not get as much discussed, is the powers of SEBI under the SEBI Act itself, to regulate matters relating to issue of securities. These were conferred through the SEBI (Amendment) Act, 2002. Evidently, Parliament had, on the basis of the experience that Government and SEBI had acquired over the years, deemed it necessary to extend SEBI's regulatory reach specifically into the terrain of capital mobilisation in the financial markets.

22.2. Section 11A(1) in the SEBI Act, defines the powers of Board to regulate or prohibit issue of prospectus, offer document or advertisement soliciting money for issue of securities. It is clearly stated, that such powers is without prejudice to the provisions of the Companies Act. Under Section 11A(1) of the SEBI Act, the Board may by general or special orders prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities as well as specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

23. Applicability of the DIP Guidelines and ICDR Regulations to the two Companies

23.1. The Learned Counsel for the two Companies, during the course of his submissions also contended that the DIP Guidelines and the ICDR Regulations do not apply to the OFCDs issued by them. According to him, the DIP Guidelines do not have any statutory force and cannot be enforced as they have not been laid before the Parliament. He further argued that Sections 29, 30 and 31 of the SEBI Act provide that the rules made by the Central Government and Regulations made by SEBI shall be laid before the Parliament and only after the same are passed by both the Houses, the Rules or Regulations shall have effect.

23.2. The Learned Counsel referred to the Order of the Honourable Securities Appellate Tribunal in the matter of **Toubro Infotech and Industries Limited vs. SEBI,** in support of the said contention. However, I find that issue of enforceability of the DIP guidelines is well settled in law. There are a plethora of judgments of more recent origin of the Honourable Courts, which establish beyond doubt that these guidelines are <u>statutory</u> in nature.

- In **Gold Multifab Limited and others vs. SEBI** (decided on September 19, 2003), a case where the company was alleged to have contravened the DIP Guidelines, the Honourable Securities Appellate Tribunal had granted liberty to SEBI to initiate proceedings against the appellants therein "for violation of the SEBI Guidelines on Disclosure and Investor Protection ….".
- Further, in **Satish R. Shah and another vs. SEBI**, the Honourable Tribunal had observed that since at the time of allotment, the shares were not fully paid-up (as required in terms of Clause 13.4.2 of the DIP Guidelines), there is a clear violation of the DIP Guidelines.

- In the matter of **Mawana Sugars Limited vs. Bombay Stock Exchange Limited** (decided by the Honourable Tribunal on June 6, 2008), the dispute was regarding the manner of pricing of shares (to be allotted on preferential basis). The Honourable Tribunal, while recognizing the statutory force of the said guidelines had observed that the price of preferential shares has to be determined in accordance with the DIP Guidelines and further observed "**This is the mandate of clause 13.0 of the guidelines which have been issued by the market regulator under section 11 of the Securities and Exchange Board of India Act, 1992**."
- In **Aastha Broadcasting Network Limited** (decided on February 6, 2006), the Honourable Tribunal upheld the finding that the appellant had contravened the relevant guidelines of the DIP Guidelines.
- The Honourable Securities Appellate Tribunal in the matter of **Yogesh M. Bhansali (HUF) and others vs. SEBI** (decided on September 23, 2009), held that the SEBI DIP Guidelines of 2000 were statutory in nature.

Further the Honourable Delhi High Court in the matter of **Kimsuk Krishna Sinha vs SEBI and Ors**, (W.P.(C) 7976 of 2007 & CM APPL No. 15084/07) observes that **"It hardly needs to be stated that the SEBI (DIP) Guidelines are relatable to Sections 11 and 11-A of the SEBI Act and are of statutory character. They are enforceable as such."**(Emphasis supplied)

In view of these findings and observations of the Honourable Securities Appellate Tribunal and the Honourable Delhi High Court, I am unable to accept the contention that the provisions of the DIP Guidelines are unenforceable, or not applicable in this instant case.

23.3. On behalf of SIRECL, it has also been contended that OFCDs were issued in 2008 and that no action was taken then under the DIP Guidelines, when the same were in force. It was submitted that the ICDR Regulations would not be applicable to the said issue as they came into force only on August 26, 2009 and these regulations does not have any retrospective effect. It was further contended that Regulation 111 of the ICDR Regulations provides for rescinding the DIP Guidelines and saves anything done or action taken under the DIP Guidelines, as the same shall be deemed to be taken under the ICDR Regulations. The Learned Counsel argued that since no action was taken under the DIP Guidelines, the saving clause is not applicable and therefore no action could be taken under the ICDR Regulations. SIRECL had filed its RHP and issued OFCDs in the year 2008, when the DIP Guidelines were in force. Needless to say, no action could be taken at that point in time, as SEBI was simply not aware of these issuances which were in contravention of the securities laws. However, SIRECL continued to mobilize funds from the public under the RHP and the information memorandum. Unmistakably, this is a continuing violation. SEBI cannot be precluded from intervening under the ICDR Regulations, just because such a continuing violation had its genesis somewhere in the past. Therefore, this contention put forward by the two Companies lacks merit.

23.4. The Learned Counsel also contended that since SEBI Act does not confer jurisdiction on SEBI over 'Hybrid securities', the DIP Guidelines and the ICDR Regulations cannot regulate such securities, as they are subordinate legislations to the SEBI Act. As I have already addressed these earlier in this Order, as to the nature of the OFCDs issued by the two Companies and SEBI's regulatory jurisdictions over them, I do not see any merit in the above argument.

24. Risks to Investors in the OFCD issues of the two Companies arising from bypassing the Investor Protection framework prescribed under law

24.1. The two Companies, as stated in the interim order as well as in the additional Show Cause Notice, are without doubt, clearly in gross violation of the provisions of the laws applicable to public companies making offers of securities to the public. I have referred earlier to how the two Companies, seem to be unable to furnish even basic data on the identity of its own investors. The letters sent by SIRECL to various accounting firms in January 2011, seeking professional services seem to suggest a woeful lack of compiled and authenticated data on their investors and the funds. If the identity of the investors and addresses themselves are not readily available with the firm – and the compilation and authentication of the data across the thousands of service centres will have to, as admitted by SIRECL, require the support of professional accounting firms at this stage, then I wonder what real safeguards can possibly be there in place for investor protection.

24.2. I observe here that only one company viz. SIRECL has furnished information about its investors. SHICL has not, despite reminders from SEBI, cared to furnish the requisite information. Despite instructions from the Honourable Supreme Court of India and the Honourable High Court of Lucknow directing SIRECL to be forthcoming on the data on its investors, there still is little clarity in the statements furnished by it. This is seen particularly in the absence of details on the actual quantum of funds that has been mobilized. All that has been declared clearly in the RHP is that both the companies together need ₹40000 cr. for their projects. Additionally, I also observe that the data furnished by SIRECL in the Compact Disk, are in the form of scanned images, which are not amenable to easy analysis on a Computer. SIRECL has not supplied the data in standard spreadsheet form or as regular documents for word processing. Thus, based on what has been furnished by the Companies, SEBI has little means to find out cumulative totals of funds mobilized or do further useful analysis on the data itself, as part of its investigation, should any such future requirements arise. The Honourable High Court of Allahabad, as quoted supra above, had expressed its displeasure at the rather blatant unwillingness of SIRECL to comply with its directions and cooperate with the investigations. There seems to be an unstated resolve on the part of the two Companies not to part with data in any meaningful manner. The thrust seems to be on concealment and obfuscation rather than openness and transparency.

24.3. The Learned Counsel, at one point in the submissions before me, mentioned the fact that there are no investor complaints at all, from any investor in the OFCDs raised by the two Companies. Going by the history of scams in financial markets across the globe, the number of investor complaints has never been a good measure or indicator of the risk to which the investors are exposed. Most major 'Ponzi' schemes in the financial markets, which have finally blown up in the face of millions of unsuspecting investors, have historically never been accompanied by a gradual build up of investor complaints. But when financial catastrophes have indeed finally erupted, they do so with little warning and lead to major collapses in the financial markets with disastrous consequences to investors.

24.4. I have examined the copies of the RHPs filed by the two Companies. Against all the major investor protection measures contemplated (for e.g. appointment of debenture trustee, credit rating, underwriting, utilization of funds collected), I see the entry "Not applicable". Some of them, as stated therein, are declared inapplicable because the issue will not be listed. Others are declared inapplicable, because the issue is not of debentures. If such vital regulatory requirements themselves have all been declared superfluous or unnecessary, and have not been complied with on one pretext or the other, what then exactly are the protective measures that the two Companies can possibly have in place for its investors? The records furnished to SEBI shed little light on this. Neither have the two Companies come forward to allay the legitimate concern of SEBI as a regulator in this regard, duly reflected in the show cause notices issued to the two Companies and their promoters and directors.

24.5. SIRECL did not have any distributable profit for the financial year ending 31st March, 2008. SIRECL had a negative net worth at the time of the offer and the net worth of SHICL was around ₹11 lakh. The subscribed capital of the two Companies is very small in comparison to the liabilities on their balance sheets. OFCDs raised are of the order of at least a few thousand crore of rupees, with the requirements for funds indicated at ₹40000 cr. To compound these concerns, all the OFCDs are unsecured – there is no charge on either the assets of the companies or on the revenue streams from the various projects undertaken by the two Companies. Given the large scale of fund raising that has been resorted to by the two Companies, and the fact that particulars about these funds and their utilization are not available with SEBI, at this stage one can, for the sake of the investors, merely fervently hope that the two Companies have taken some other reasonable measures, albeit not very evident to me, for protecting its investors.

24.6. Clearly, a precise measure of the magnitude of the risks to investors has never been designed anywhere. For these proceedings, it is necessary to assess the investor protection framework which the two Companies have subverted by violating the laws and regulations applicable to them. The closest, we can come to gauging the risks involved when any company does not conform to the investor protection framework is to examine the importance of the measures that have been circumvented and assess the implications caused by their absence. The elaborate investor protection framework that SEBI has put in place for public issues by public companies is the product of years of observation and learning by SEBI and regulators across the world.

24.7. In this case, the salient investor protection measures that two Companies have not conformed with are listed below. A cursory reading of the RHP filed by the two Companies, contrasted against the elaborate investor protection measures outlined below, vividly exposes the huge information gaps in them. As the issues have been kept open for several years now, even the scanty and sketchy information in these documents might have lost all its currency and utility to investors.

1. **Filing of draft offer document with SEBI:**

   Every issuer making public issue of securities has to file a draft offer document with SEBI through SEBI registered Merchant Banker. The draft offer document will be put-up for public comments for at least 21 days. SEBI examines the draft offer document with an objective for ensuring compliance with the investor protection measures prescribed by SEBI and for enhancing disclosures based on understanding of the matter contained in the prospectus or based on comments/complaints, if any, received from public, on the document. The Merchant Banker then incorporates necessary changes in the offer document.

2. **Eligibility requirements for making a public issue:**

   An unlisted issuer to become eligible for making a public issue should have: net tangible assets of at least ₹ 3 crore in each of the preceding three full years, distributable profits in atleast three of the immediately preceding five years, net worth of at least ₹ 1 crore in each of the preceding three full years, issue size should not exceed 5 times the pre- issue net worth as per the audited balance sheet of the last financial year etc. If the issuer is unable to comply with any of these conditions, it can make a public issue, provided if at least 50% of the issue is allotted to the Qualified Institutional Buyers or if project is appraised and participated to the extent of 15% by Financial Institutions / Scheduled Commercial Banks of which at least 10% comes from the appraiser(s). This helps a retail investor subscribing in the issue, to derive the benefit of the more informed investment decisions that would be typically be made by institutional investors.

3. **Minimum Promoters' Contribution and lock-in:**

In a public issue by an unlisted issuer, the promoters should contribute not less than 20% of the post issue capital, which should be locked in for a period of 3 years. "Lock-in" indicates a freeze on the shares. In case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters should bring in a contribution of at least 20% of the project cost in the form of equity shares, subject to contributing at least 20% of the issue size from their own funds in the form of equity shares. Promoters' contribution shall be computed on the basis of the post-issue expanded capital assuming full proposed conversion of convertible securities into equity shares. The remaining pre-issue capital should also be locked in for a period of one year from the date of listing.

4. **Credit rating:**

Companies making public issue of convertible debt instruments or non-convertible debt instruments, should obtain a credit rating from at least one credit rating agency (CRA) registered with the SEBI and disclose the rating in the offer document. A credit rating is a professional opinion regarding the issuer's ability to make timely payment of interest and principal on a debt instrument, given after studying all available information at a particular point of time. It is reviewed periodically during the tenure of the debt instrument. CRAs are specialized independent bodies registered and regulated by SEBI. SEBI specifies the eligibility criteria for their registration, monitoring and review of ratings, requirements for a proper rating process, avoidance of conflict of interest, code of conduct and inspection of rating agencies by SEBI.

5. **IPO Grading:**

Under the SEBI Guidelines/Regulations, no issuer shall make an initial public offer, unless as on the date of registering prospectus (or RHP) with the Registrar of Companies, the issuer has obtained grading for the initial public offer from at least one CRA registered with SEBI. IPO grading was made mandatory by SEBI as an endeavour to make additional information available to the investors to facilitate their assessment of the security on offer. It is intended to provide the investor with an informed and objective opinion expressed by a professional rating agency, after analyzing factors like business and financial prospects, management quality and corporate governance practices etc.

6. **Creation of debenture trust and appointment of Debenture Trustee:**

   Under Section 117B of the Companies Act, 1956 and SEBI Guidelines/ Regulations, no company can issue a prospectus to the public for subscription of its debentures, unless the company has, before such issue, has appointed one or more debenture trustees and the company has, on the face of the prospectus, stated that the debenture trustee or trustees have given their consent to the company to be so appointed. Debenture Trustees are registered and regulated by SEBI. Only scheduled banks /public financial institutions/insurance companies etc. can act as debenture trustees. A Debenture trustee is obligated under the provisions of the Companies Act, 1956 and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993 *inter alia* to exercise due diligence to ensure compliance by the company issuing debentures with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed and to take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice. A debenture trustee should ensure that SEBI is promptly informed about any material breach or non-compliance by the company of any law, rules, regulations and directions of the SEBI or of any other regulatory body. Further, every debenture trustee should ensure that the trust deed executed between a body corporate and debenture trustee, amongst other things, contains the information required under the Regulations.

7. **Creation of debenture redemption reserve:**

   Under Section 117C of the Companies Act, 1956 and SEBI Guidelines/ Regulations, where a company issues debentures, it should create a debenture redemption reserve for the redemption of such debentures, into which adequate amounts should be credited, from out of its profits every year, until such debentures are redeemed.

8. **Appointment of Monitoring Agency:**

The SEBI Guidelines/ Regulations stipulates, that if the issue size exceeds ₹ 500 cr., the issuer should appoint one public financial institution or scheduled commercial banks, named in the offer document as bankers of the issuer, as a monitoring agency, to monitor the use of proceeds of the issue. The monitoring agency should submit its report to the issuer in the specified format on a half yearly basis, till the proceeds of the issue have been fully utilized. Such monitoring report should be placed before the Audit Committee. This mechanism is in built-in to avoid siphoning of the funds by the Promoters by diverting the proceeds of the issue later-on to some other objects, other than what is disclosed in the offer document.

9. **Appointment of SEBI registered Merchant banker and Registrar to the issue for the issue:**

In case of public issues, issuing company should appoint one or more merchant bankers to carry out the obligations relating to the issue. Merchant bankers should independently exercise due diligence and satisfy himself about all the aspects of the issue including the veracity and adequacy of disclosure in the offer documents and to ensure the interest of the investors are protected. The merchant banker should call upon the issuer, its promoters or directors to fulfil their obligations as required in terms of these Regulations and continue to be responsible for post-issue activities till the subscribers have received the securities certificates, credit to their demat account or refund of application moneys and listing/ trading permission is obtained. Merchant banker should submit a due diligence certificate to SEBI at the various stages of the issue *inter alia* stating that they have exercised due diligence including examination of various documents of the company and have satisfied themselves about the compliance with all the legal requirements relating to the issue, that disclosures which are fair and adequate to enable the investor to make a well informed decision and all applicable disclosures mandated by SEBI have been duly made. Further, in case of Public offers, an issuer is required to appoint a Registrar to the issue, which has connectivity with all the depositories. Both Merchant bankers and Registrars to the issue are intermediaries under Section 12 of SEBI Act, registered and regulated by SEBI. They are required to comply with the code of conduct and other obligations as prescribed by SEBI.

10. Violation of disclosure requirements:

The present legal and regulatory framework is primarily based on disclosures. The offer document is required to contain all disclosures and undertakings specified in the Schedule II of the Companies Act read with the erstwhile DIP Guidelines and the ICDR Regulations and also additional disclosures as deemed fit, by Merchant Banker to enable investors to make an informed investment decision. Such disclosures include internal and external risks envisaged by the company including risk factors which are specific to the project and internal to the issuer company and those which are external and beyond the control of the issuer company, offering details, details of capital structure, promoters build-up, details of shares to be locked-in, details of business of the company, basis of issue price, accounting ratios, comparison with peer group, history and corporate structure, management and board of directors, direct or indirect interest of promoters, directors, key managerial personnel in the company or in the issue, financial information, details of the promoters, their photographs, Permanent Account Number (PAN), details regarding their driving license, passport etc. their background, Management Discussion and Analysis of Financial Statements, details of group companies, pending approvals, outstanding litigations etc. Further, the offer document should also contain elaborate disclosures pertaining to the object of the issue, details of the projects in which the investment is to be made, funding plan for the project, schedule of implementation etc.

Further, as per Section 56 (3) of the Companies Act, no one should issue any form of application for shares in or debentures of a company, unless the form is accompanied by an abridged prospectus, containing details specified in Form 2A. Additional disclosure requirements for abridged prospectus are specified in SEBI Guidelines/Regulations.

11. **Opening and Closing of the issue:**

    Regulation 46 (1) of the ICDR Regulations (Clause 8.8.1 of the erstwhile DIP Guidelines)mentions that a public issue should be kept open for at least three working days but not more than ten working days. In the case of the two Companies and another of its Group Companies, the issue has been kept open for years on end.

12. **Firm arrangements for finance:**

    An issuer cannot make a public issue, unless firm arrangements of finance through verifiable means towards 75% of the stated means of finance (excluding the amount to be raised through the proposed public issue or rights issue or through existing identifiable internal accruals) have been made.

13. **In-principle approval for listing from recognised stock exchanges:**

    Issuers are required to obtain in-principle listing permission from the stock exchange, before making a public issue, as per SEBI Guidelines/Regulations.The requirement of listing in respect of a public issue is to ensure that the subscribers to the shares or debentures have a facility to approach a stock exchange for having their holdings converted into cash, whenever they desire and to provide liquidity and exit opportunity to the investors, especially in case, when the offer is made to large number of investors (50 or more). Further once listed, the Companies need to comply with the stringent provisions of the Debt Listing Agreement, including provisions relating to disclosure of periodical information to Debenture trustee, maintenance of maintain 100% asset cover sufficient to discharge the principal amount of the debt, periodical disclosure of financials, disclosure of statement of deviations in use of issue proceeds, timely disclosure of price sensitive information.

14. **Scrutiny by Regulated intermediaries at all stages**: ICDR regulations in addition to various other regulations framed by SEBI ensures that in the process of public issue starting from drafting prospectus till allotment/refund and listing, all specified tasks are performed only by registered intermediaries. These intermediaries are bound by rules and regulations framed for them by SEBI as well as the code of conduct prescribed for each.

15. **Post issue transparency, marketability, corporate governance and listing requirements**. Equally important is the elaborate protection measures that are available to the investor after the issue is closed and listed on a Stock Exchange. Transactions in the securities carried out on stock exchange are transparent with a well settled price discovery process. Information including quarterly results, shareholder details, and annual report are periodically made available to shareholders. All price sensitive information is disseminated through Stock Exchanges. Transactions carried out on stock exchanges are guaranteed by Stock Exchanges and these are under the vigilant surveillance of concerned stock exchange and SEBI. Stock Exchanges have Investors Protection funds which protects investor against default by brokers and there are well laid out mechanisms for the redressing investors grievance.

16. **Other miscellaneous requirements:**

- Issuer should, after registering the red herring prospectus, with the Registrar of Companies, make a pre-issue advertisement in one English national daily newspaper with wide circulation, Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated.(**Regulation 47 of the ICDR Regulations/Clause 5.6A of the DIP Guidelines)**

- The issuer should appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.**(Regulation 63 of the ICDR Regulations/Clause 5.12 of the DIP Guidelines)**

- The issuer and lead merchant bankers should ensure that the contents of offer documents hosted on the websites as required in these regulations are the same as that of their printed versions as filed with the Registrar of Companies, Board and the stock exchanges**. (Regulation 61(1) of the ICDR Regulations/Clause 5.6 of the DIP Guidelines)**

- Issuer should enter into an agreement with a depository for dematerialisation of specified securities already issued or proposed to be issued. **(Regulation 4(2)(e)of the ICDR Regulations/Clause 2.1.5of the DIP Guidelines)**

24.8. I also note that in the RHPs filed by the two Companies, it is stated that **"The money not required immediately by the company may be parked/invested *inter alia* by way of circulating capital with partnership firms of Joint Ventures or in the fixed deposits of various Banks."** This means that such funds mobilized beyond the pale of law, could be potentially diverted into various activities of the group companies, without any significant accountability or reporting requirements. Such diversion, in the case of debentures would not have been permissible under the ICDR Regulations. In the entry in the RHP for "Means of Financing", where the total project cost is indicated at ₹20000 cr. for each of the two Companies, it is stated that "The projects are being financed partly by this issue as well as with the Capital, Reserves and other sources of the Company." From an examination of the financial statements of the two Companies, it seems that the Capital and Reserves of the two Companies are miniscule in proportion to the funds required for the projects.

24.9. The Show Cause Notice issued to the two Companies refers to an allegation to the effect that funds of the two Companies are collected in bank accounts of associate Companies. In the notice it had been alleged that the cheques were issued in the name of "Sahara India" whereas certificates were issued in the name of "Sahara Housing Investment Corporation Limited". In their replies of the two Companies, it was submitted that they had an understanding with M/s. Sahara India, a registered partnership firm, having infrastructure throughout the country which is being used for providing personalized services to the investors willing to invest in OFCDs by way of private placement, keeping control of expenses on account of administration and management of the funds collected including having strict control thereof. It was further submitted that the companies have taken assistance of the said firm as per the terms of the agreement/understanding between the companies and the firm duly approved by the board of directors. According to them, the funds so collected were being transferred to them by the firm and on receipts of the funds, allotments of OFCDs were made to the investors against their subscription. So details on the supplementary source of financing of the projects are sorely missing.

24.10. Presumably following a complaint from an investor, an article appeared in a leading financial daily on May 12, 2011 that

> "A Sahara group company, which has raised Rs 4,843 crore by issuing optionally fully convertible debentures (OFCDs), is not using its own bank account to handle this money."

The said article refers to a written response dated April 19, 2011, where the Sahara India Real Estate Corp has reportedly told the Registrar of Companies, that

> "Sahara India Real Estate Corporation, through an agreement with M/s Sahara India, has agreed to utilise infrastructure, **including bank accounts** and other services, of the firm for private placement of optionally fully convertible debentures."(Emphasis supplied)

What is gathered from all this is that the bank accounts of one company are shared as part of the infrastructure, with their associate companies? I fail to appreciate, how by any stretch of imagination the bank accounts of one entity can be lent as shareable infrastructure to another. A Bank Account is more than a mere vehicle for holding money. It is an integral part of the basic books that are to be maintained by the Company under Section 209 of the Companies Act. It signifies certain legal rights of ownership over the funds deposited. The sanctity attached to bank accounts into which funds are collected may be appreciated from a mere reading of Section 73(3A) of the Companies Act. If a Company collecting huge sums of money from its investors through OFCDs does not use its own bank accounts into which the funds are deposited, needless to say, that would be a serious cause for worry about the legal protection and safeguards available to their investors. Overall there seems to be a callous lack of transparency regarding the source, collection and utilization of funds- which in fact are some of the areas where the Companies Act and the ICDR Regulations have prescribed provisions with the interest of the investors in respect of a public issue utmost in mind.

24.11. Clearly, investors into the OFCDs of the two Companies are denied the benefit of the robust investor protection framework that has been described above. I cannot visualize any alternate set of measures that the two Companies can possibly put in place, (nor have they advanced any claims in this regard) to compensate for such an unbridgeable chasm in the protective measures that should have been available for investors into these OFCDs. Needless to say, the seriousness of this deficiency and the grave consequences that may potentially ensue cannot be overemphasized. Furthermore, the absence of such protective measures for investors should be viewed against the backdrop that the amounts raised by the two Companies from investors in India through their OFCDs are sizable in comparison to funds raised by other issuers in India**.**

25. Other Legal Issues raised by the two Companies

25.1. It was contended by the two Companies that SEBI had been called upon to decide the issues as directed by the Honourable Supreme Court of India and that SEBI should not have leveled fresh allegations in the notice and that the same was in excess of jurisdiction and beyond the scope of the Order of the Honourable Court. In this regard, I have perused the said notices issued to SHICL and SIRECL. The allegations in these notices are not extraneous to the matter under consideration here. During investigations into the same, SEBI had *prima facie* found that

a. SIRECL had issued OFCDs to more than 6.6 million investors and that SHICL had not provided any information about the number of investors of the OFCDs issued by it.
b. The RHPs of SIRECL and SHICL contained untrue statements and mis-statements.
c. SIRECL and SHICL have not executed debenture trust deed; not appointed debenture trustee and have not created any debenture redemption reserve.
d. The forms issued by the two companies did not enclose an abridged prospectus.
e. The two companies continued to solicit subscriptions to their OFCDs in violation of the Court's order in vacating the stay imposed on the SEBI Order.
f. The balance sheets and profit and loss accounts (for the relevant period) of the companies were not filed with the concerned RoC.
g. The sums subscribed in the OFCDs varied from ₹200/-, 300/-, 400/- etc whereas the minimum application size for the bonds issued by SIRECL

were 5000/- (for Abode and Nirmaan Bonds) and ₹12,000/- for the Real Estate Bond.

h. From the list of accredited agents through whom subscriptions for OFCDs was sought and the proforma of application forms from which subscription for OFCDs were sought, it was observed that subscription was sought from the general public across the country, without adequately informing them of the risk factors involved in such a complex financial product.

25.2. Since all these issues/allegations and the responses to the same from the companies had a bearing on the matter, SEBI had thought fit to issue the said notices to the companies *inter alia* alleging the aforesaid issues, seeking their responses on the allegations contained therein, in addition to the prima facie findings mentioned in the SEBI Order dated November 24, 2010. Further, the Honourable Supreme Court had directed SEBI to examine what OFCDs are and the manner in which investments are called for, apart from other issues. I, therefore, find that neither has SEBI been unreasonable in the exercise of its powers nor has it trespassed beyond the boundaries of its jurisdictions.

25.3. The Learned Counsel referred to the provisions of the Sections 11(2A), 11C, 11D and 15C to submit that SEBI can exercise jurisdiction only over listed companies. It was also argued, (referring to the decision of the Honourable Securities Appellate Tribunal in the matter of **Gold Multifab Limited and others vs. SEBI** referred to *supra*), that Section 55A of the Companies Act does not empower SEBI to invoke the provisions of the SEBI Act to administer what it has to perform under its powers in the Companies Act. It was further submitted that Section 11B of the SEBI Act cannot be invoked to take action to deal with the contravention of the provisions of the Companies Act. I have given thoughtful consideration to these submissions and find the same to be misplaced. Here are two companies, who have made debenture issues to more than fifty persons. Their issues are public issues under the proviso to Section 67(3) of the Companies Act. But nevertheless, both of them had failed to comply with all the relevant legal provisions contained in the Companies Act, SEBI Act, SCR Act, DIP Guidelines, the ICDR Regulations etc. that govern public issues by companies. Clearly, in this case, provisions mentioned in Section 55A of the Companies Act that pertain to issue and transfers with respect to public issues have been contravened. It is only natural that these contraventions might also attract Section 11A of the SEBI Act, if the laws provide for that. There is nothing in law that stipulates that contraventions under one Act cannot be the basis for action under another. Therefore, I find that, to this extent, SEBI is well within its right to invoke its powers under the SEBI Act to take appropriate action. I agree that the only forbearance that SEBI will have to show is that it cannot impose a penalty prescribed under the Companies Act by channelling or directing the same through the provisions in the SEBI Act. In any case, the primary question before me is whether the issue made by the two Companies are **public** issues or not. Therefore, I do not see how the aforesaid submissions of the Learned Counsel would be relevant to these proceedings.

25.4. It was also submitted that Section 32 of the SEBI Act provides that SEBI Act shall be in addition to and not in derogation of the provisions of any other law for the time being in force. Hence, the SEBI Act does not have overriding effect upon the Companies Act and the provisions of Section 55A therein. This submission is also of little relevance in the context of the case for the reasons stated above. Further, when unlisted public companies float issues, which are intrinsically “public issues” where other attendant provisions also need to be complied with, the stand that the two Companies are unlisted companies and hence outside the regulatory reach of SEBI is most certainly a misplaced one. Further, it is untenable to maintain that provisions of the Companies Act pertaining to listing and the provisions of SEBI Act are in conflict. They are to be viewed as provisions that run concurrently to serve the common objective of investor protection.

25.5. The Learned Counsel also referred to Section 16 of the SEBI Act to submit that this provision empowers the Central Government to issue directions on questions of policy from time to time and that the decision of the Central Government on whether a question is one of policy or not shall be final. He contended that on February 8, 2011, the Central Government opined through the Additional Solicitor General and the Honourable Minister of Law and Justice that SEBI has no jurisdiction over unlisted public companies.

25.6. In any case, I need only to direct the attention of the Learned Counsel to the Order of the Honourable Supreme Court of India in the matter (vide Order dated May

12, 2011 in Petition for Special Leave to Appeal (Civil) No.11023/2011). The Honourable Apex Court has specifically directed SEBI, being the custodian of investor's interest and as an expert body to examine what an OFCD is and the manner in which investments are called for, apart from other issues. Therefore, at this stage, in compliance with the directions of the Honourable Supreme Court, it is a solemn duty cast on SEBI to consider the pertinent issues in the matter, decide them and thereafter place its findings/observations before the Honourable Supreme Court of India for their respectful consideration.

25.7. In the notice dated May 20, 2011, it has been alleged that the two Companies have contravened Sections 117A, 117B and 117C of the Companies Act as the companies allegedly have not, with respect to their OFCD issues,

- Not executed any debenture trust deed;
- Not appointed any debenture trustee; and
- Not created any debenture redemption reserve.

Section 117A casts a duty on the company to execute a trust deed for securing any issue of debenture. Section 117B of the Companies Act stipulates the appointment of a debenture trustee and specifies their duties and Section 117C requires a company issuing debentures to create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited. The companies had maintained that these Sections do not apply to OFCDs, which are hybrid securities. As already observed in this Order, we have already seen that OFCDs are Debentures. The companies have therefore not complied with the aforesaid provisions and clearly are guilty of contravening them. The same holds in respect of the allegation that the two Companies have not filed an abridged prospectus in contravention of Section 56(3) of the Companies Act.

25.8. As regards the allegation that the two companies had continued to solicit funds in disregard to the Honourable High Court's Order dated April 7, 2011, it was submitted that by the time the said Order could be communicated, the Mumbai office had inadvertently received an application from an investor and had accepted the subscription amount through a cheque. It was submitted that subsequently on receiving the information of vacation of the interim order, the application was rejected and the cheque was returned. While I do not want to dwell any further on this, I wonder why, after the company became aware of the order of the Honourable High Court vacating the interim stay, it did not inform its various branches promptly.

25.9. An issue was raised, *inter alia*, that the ICDR Regulations do not allow listing unless there are more than that public shareholder, while Section 67(3) of the Companies Act prescribes the minimum number of 'fifty' as the threshold for a public issue. Regulation 26(4) of the ICDR Regulations in fact stipulates that an issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand. This means that SEBI in the ICDR regulations imposes a more rigorous yardstick that there has to be at least 1000 allottees for listing. This of course means that, in effect companies cannot expect to list if they only have less than 1000 allottees. I do agree that this subclass of companies will then be unable to comply with listing requirements in the ICDR Regulations. In effect, what this translates to is that there cannot be any public issue to less than 1000 investors within the current legal framework. However, all this obviously is only of some theoretical interest at best and irrelevant to these proceedings because the two Companies, admittedly have an investor base that runs into several millions.

25.10. In passing, the Learned Counsel mentioned that as OFCDs are hybrids, even if they had wanted to, the Stock Exchanges could not have listed them. For the record, I merely state here that hybrids are currently listed on Stock Exchanges in India.

PART C

OBSERVATIONS AND FINDINGS

26. Further observations on OFCDs issued by the two Companies

26.1. Before, I record my findings on the issue of OFCDs by the two Companies itself; I make some observations that are pertinent in the context of these proceedings before me. I raise them without any prejudice whatsoever to the two

Companies or their Promoters and Directors, or to the findings in these proceedings before me.

26.2. I note that Sahara India Financial Corporation Limited (SIFCL), a Residuary Non-Banking Company (RNBC) registered since December 8, 1998, has been directed by the Reserve Bank of India (RBI) on June 17, 2008 not to accept any new deposits which mature beyond June 30, 2011 and also stop accepting instalments of existing deposits, with a roadmap prescribed to bring down its Aggregate Liability towards Depositors (ALD) to zero on or before June 30, 2015. The RBI found that deposit taking activities of this company were not in conformity with prudent practices and violated norms issued by them.

26.3. I also observe that Non-Banking Financial Companies accepting deposits need to follow Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 issued by RBI and Non-Banking non-financial companies accepting deposits are to follow Companies (Acceptance of Deposits) Rules, 1975. However, both these exempt any amount raised by the issue of bonds or debentures secured by the mortgage of any immovable property of the company and those with an option to convert them into shares in the company, from the definition of deposits.

26.4. From the details of the investors provided by two Companies, I understand that there are a very large number of entries, where the amounts subscribed in OFCDs are in the order of ₹ 200, 300, 400, etc. In its reply, SIRECL submitted that one of their bonds was a flexible one with facility to make instalment payments of ₹100 or ₹200 per month with an option to the investor to make payments on weekly/monthly/quarterly/half yearly/annual basis. I find that such a scheme is akin, if not practically identical to a typical recurring deposit scheme. The mobilization into the OFCD schemes of the two Companies has been admittedly, through thousands of agents all over the country. Neither is the application form accompanied by any abridged prospectus nor does it contain disclosures specified for issuance of debentures/shares with the relevant risk factors attached.

26.5. A debenture scheme or a series has invariably an opening date and closing date. Technically speaking, the valuation of a debenture, and the interest outstanding computed on it, has to be with reference to the date of maturity. This is part of the basic principles of valuation of debt instruments. The OFCD schemes of the two Companies do not specify a tenor with a firm closing date. This means every time an investor purchases a bond (say Nirmaan Bond of tenure of 48 months described in Paragraph 9.2.c above), the maturity date is reckoned as 48 months from the date of the purchase or investment. Clearly, such a scheme is a recurring deposit scheme and not issued as a true debenture should have been. In fact, when a sale of bond is made by the two Companies to investors each day, it is tantamount to floating a new debenture series.

26.6. From the details available with SEBI, I find that the scheme in fact allows a running account in the nature of a passbook. Lending against OFCDs is permitted. As seen above, payments are permitted in instalments. Certainly this seems to have the characteristic features of parabanking activities. It is evident, from the manner in which such funds are being raised, that the OFCDs raised by the two Companies are **<u>in effect</u>** no different from deposits from the public, except that they come with an 'option to convert' appended to it. I have to remark here, that it seems that under the guise of OFCDs, the two Companies are extensively taking up parabanking activities and running deposit schemes.

26.7. For the purpose of my own understanding, I had directed the Investigating Authority to do a snap verification of any four addresses from a randomly selected locality in Mumbai itself (as the Learned Counsel had submitted that complete addresses are given in respect of investors in urban areas). Out of four investors, the Investigating team tried to identify, even after strenuous efforts with the Post Office, two of them were simply not traceable. As to the two investors who were identified, both of them invested in the OFCDs, just because they were approached by the <u>Agents</u> in their locality. They had no prior association with the issuer or the Sahara Group. Evidently, on the face of it, the OFCDs are subscribed to, not by persons belonging to the Sahara India Parivar as claimed, but by the public, and such subscriptions are solicited through the usual marketing efforts that are typically needed to canvass deposit business from the general public. Both of them had hardly any awareness of the convertibility in these instruments.

26.8. Going by the financial statements, the two Companies do not have adequate fixed assets to secure their OFCD issuances, even if they choose to do so. In other words, the magnitude of fund raising through these unsecured vehicles exceeds the assets of the two Companies by far. Further, for issuances of secured debentures, a charge needs to be created on the assets of the company and Form 8 and Form 10 have to be filed with concerned Registrar of Companies (pursuant to Section 125 read with Section 128 of the Companies Act, 1956). Consequently, details regarding the same would also have to be placed in the public domain, where it would attract public scrutiny. Issuances of Equity shares require filing of Form 2 within 30 days from the allotment (Section 75 of the Companies Act), in which case the details regarding the investors would also be available in the public domain. Therefore I find that a secondary but nevertheless important consequence of these OFCDs issued by way of private placements is that details of investors do not get the public scrutiny that is so vital in enhancing transparency in our financial markets.

26.9. The OFCD designed by the two Companies (and SICCL - one of its group companies) has a convertible option. Appending such an option to the debenture has resulted in moving the instrument completely beyond the boundary of the definition of 'deposits' itself. I observe here that in this manner, the two Companies have been able to raise funds through schemes that are practically identical to Deposit schemes. In sum, the two Companies have been able to skirt the stringent requirements of Companies (Acceptance of Deposits) Rules, 1975. The two Companies have adopted the modus operandi of raising funds through 'OFCDs' made on 'private placement basis' to individuals who are associated/affiliated or connected in any manner with Sahara India Group of Companies'. I have little hesitation in observing that in effect this has resulted in circumventing the various provisions of law applicable to the two Companies.

26.10. Section 11A of the SEBI Act and Section 55A of the Companies Act impose a very sacrosanct duty on SEBI, in the matter of resource mobilization by companies. In this context, I am constrained to take note of the contents of a Newspaper Article that appeared in a leading financial daily on April 26, 2011.

> "Sahara agents will now peddle several new investment schemes to raise money under the name Sahara Credit Co-Operative

> Society. The society has its headquarters and registered office in Sahara India Bhawan, Lucknow, where most Sahara group entities are based.
>
> In an emailed response, Sahara group spokesperson Abhijit Sarkar said, "The cooperative has been developed by around 3,800 workers of the company. Our Managing Worker and three Deputy Managing Workers are not members of the cooperative, which is running some schemes towards financial inclusion of un-bankable people in rural and semi-urban areas who do not go to the bank or are visited by the bank.""

This article refers to what appears *prima facie* to be an attempt by companies within the fold of the Sahara India Parivar, to adopt a new mode of fund mobilisation through Cooperatives formed under the Cooperative Societies Act. I do not make any comment or cast any imputation on the legality of this, should such a route be actually adopted, as it is not within the purview of the proceedings now before me. Nevertheless, from a complaint received in SEBI, I understand that the schemes for fund raising under the newly adopted cooperative route have exactly the same features as the OFCDs in question.

26.11. RBI declared that deposit taking by SIFCL (an NBFC related to the two Companies is illegal) in July 2008, after presumably, some months of investigation and scrutiny. Two of its Group Companies, viz. the two Companies in the proceedings before me, took recourse to mobilising funds through OFCDs approximately around this period. Thus, I note that the six OFCD schemes of the two Companies were introduced almost shortly after or thereabouts (2008-2009), when the RBI ordered SIFCL to wind down the deposit taking of one of the Group Companies. Now, a few months after SEBI issued its interim order to the two Companies and their promoters and directors, one reads in the newspaper, that a new mode of fund mobilisation through the Cooperative Societies might be in the horizon.

26.12. In the larger role enjoined on SEBI, particularly under Section 11A of the SEBI Act, to regulate issue of capital by individuals and corporate bodies, it is my duty to raise a few very important but disturbing questions that emerge in the context of these proceedings before me.

> **Are there wide differences between regulatory requirements and standards, prescribed by various regulators for mobilization of resources by entities in India? If there are such differences, do they give rise to regulatory arbitrage opportunities that an entity can exploit to its advantage and to the detriment of investors? Are such opportunities currently escaping the collective attention of the concerned regulators? Can such a strategy of successively altering the preferred mode adopted for mobilization of resources, potentially be used by entities to thwart the regulatory framework in the country? If indeed, there is such a deficiency, will this subject our investors to undue and undisclosed risks? Do such lacunae pose any grave risk to financial governance in the country? Can this lead to significant amounts of money flowing into the Securities Market of India itself? Can these become vehicles for money laundering punishable under the Prevention of Money Laundering Act? Can such financial flows, if any, imperil the integrity of the Securities Markets of our country? What are its implications for other financial and real sectors in India? If an entity has been restricted by one regulator in raising funds from the public, should there be a collective mechanism to keep watch on the further activities of such an entity and its associate bodies?**

26.13. Needless to say, all these are extremely important questions. But clearly, all of them are not entirely within the regulatory remit of SEBI and would require concerted inter-regulatory efforts and cooperation to find answers. But, I think nevertheless, that these are very serious questions that a country like ours which is engaged in the process of shaping its own governance systems in our financial markets, cannot afford to ignore. In the light of these questions, I direct SEBI to furnish a copy of this order to the Ministry of Finance, Ministry of Corporate Affairs, the Reserve Bank of India, the Central Board of Direct Taxes and the Enforcement Directorate, for further necessary action that these wings of Government may deem fit to initiate.

27. FINDINGS

27.1. Prior to recording my findings in this matter before me, I turn for guidance to the observations of the Honourable Delhi High Court in the matter of **Kimsuk Krishna Sinha vs. SEBI [2010 (155) CC 295]** which underscore the role of SEBI as a 'sentinel' in protecting investors from any potential wrong doing by issuers in raising capital in the securities markets:

> "…………**The purpose of inserting Section 55A in the Companies Act was to empower the SEBI to take both corrective and preventive action.** This is perhaps because as a regulatory body SEBI gets to see the draft prospectus preceding a public issue by a company even before the public gets to see the RHP. SEBI is enabled and empowered to examine the DRHP and **insist on complete and truthful disclosure of all relevant facts therein. The very purpose of having an independent regulatory authority like SEBI, and vesting it with statutory powers of inquiry, is to enable it to take prompt action in matters relating to issue and transfer of shares. Particularly, SEBI is expected to be the sentinel, read the fine print of prospectuses keeping the investors' interests in view**……" (Emphasis supplied)

27.2. From the discussions and observations set out in Part A and B of this Order on the basis of detailed consideration of all the issues that have arisen in the matter and the submissions made by the parties and all other relevant material, I summarize the salient conclusions below:

1. OFCDs are hybrid instruments, and are 'debentures'.

2. The definition of 'securities' under Section 2(h) of the SCR Act is an inclusive one, and can accommodate a wide class of financial instruments. The OFCDs issued by the two Companies fall well within this definition.

3. The issue of OFCDs by the two Companies is **public** in nature, as they have been offered and **issued to more than fifty persons**, being covered under the first proviso to Section 67(3) of the Companies Act. The manner and the features of fund raising under the OFCDs issued by the two Companies further show that they cannot be regarded to be of a domestic concern or that only invitees have accepted the offer.

4. Section 60B deals with the issue of information memorandum to the public alone. Therefore the same cannot be used for raising capital through private placements as the said provision is exclusively designed for public book built issues. When a company files an information memorandum under Section 60B, it should apply for listing and therefore has to be treated as a listed public company for the purposes of Section 60B(9) of the Companies Act. Further, Section 60B has to be read together with all other applicable provisions of the Companies Act and cannot be adopted as a separate code by itself for raising funds, without due regard to the scheme and purpose of the Act itself. The same evidently has never been the intention of the Parliament.

5. The two companies, in raising money from the public, in violation of the legal framework applicable to them, have not complied with the elaborate investor protection measures, explained in Paragraph 25 above. This, *inter alia,* also means that the rigorous scrutiny carried out by SEBI Registered intermediaries on any public issue by a public company have been subverted in the mobilization of huge sums of money from the public, by the two Companies.

6. The two Companies have not executed debenture trust deeds for securing the issue of debenture; failed to appoint a debenture trustee; and failed to create a debenture redemption reserve for the redemption of such debentures.

7. The two Companies have failed to appoint a monitoring agency (a public financial institution or a scheduled commercial bank) when their issue size exceeded ₹500 cr., for the purposes of monitoring the use of proceeds of the issue. This mechanism is put in place to avoid siphoning of the funds by the promoters by diverting the proceeds of the issue.

8. The two companies failed to enclose an abridged prospectus, containing details as specified, along with their forms.

9. The companies have kept their issues open for more than three years/two years, as the case may be, in contravention of the prescribed time limit of ten working days under the regulations.

10. The two companies have failed to apply for and obtain listing permission from recognized stock exchanges.

27.3. In view of the foregoing findings, I find the following contraventions and non-compliance of the statutory provisions by the two Companies, SIRECL and SHICL, which issuing their OFCDs in the manner observed above, to the public:

a. SIRECL and SHICL have contravened the provisions of Sections 56, 73, 117A, 117B and 117C of the Companies Act;

b. SIRECL has contravened the provisions of Clauses 2.1.1., 2.1.4., 2.1.5., 2.2, 2.5, 2.8, 4.11, 4.14, 5.3.1., 5.6.2, 6.0 to 6.15, 8.8.1, 8.17, 10.0 to 10.6 and 10.9 of the DIP Guidelines read with the provisions of the ICDR Regulations;

c. SHICL had not complied with the provisions of Regulations 4(2), 5(1), 5(7), 6, 7, 16(1), 20(1), 25, 26, 36, 37, 46 and 57 of the ICDR Regulations.

27.4. Having arrived at the findings above, the next consideration before me would be to decide the nature of directions that warrant to be issued in the present matter. Clearly the two Companies have mobilized huge public money in the guise of private placements. This mobilization was done without adhering to the regulatory framework established under the Companies Act and the SEBI Act and the guidelines and regulations framed thereunder. Further, though the two Companies have issued securities in the manner discussed above, they have not sought listing permission from any of the recognized stock exchanges, even when their issuances were public issues and the two Companies were bound to seek listing permission from stock exchanges for such issuances.

27.5. In this regard, I refer to Section 73 of the Companies Act. In terms of Section 73(2) of the Companies Act, where the permission (to deal such shares or debentures on a stock exchange) has not been applied under sub-section (1), the company shall forthwith repay without interest all moneys received from applicants in pursuance of the prospectus, and, if such money is not repaid within eight days after the company becomes liable to repay it, the company and every director of the company who is an officer in default shall, on and from the expiry of the eight days, be jointly and severally liable to repay that money with interest at such rate, not less than four per cent and not more than fifteen per cent, as may be prescribed, having regard to the length of the period of delay in making the repayment of such money.

27.6. Therefore, in terms of the provisions of Section 73(2) of the Companies Act, as the two Companies admittedly have not made applications for listing with any of the recognized stock exchanges, they become liable to forthwith refund the amounts collected from its subscribers pursuant to their RHP, along with interest payment, as warranted. Section 73 of the Companies Act is crystal clear in this respect. Any company not making a listing application should necessarily refund all the amounts collected in pursuance of the prospectus.

27.7. In this regard, I shall rely for guidance on a two important judgements of the Honourable Courts. The Honourable Supreme Court of India [in the matter of **Raymond Synthetics Limited and others vs. Union of India and others (1992) 2 SCC 255]**, while discussing the provisions of Section 73(2) of the Companies Act, had observed the following:

> "………Sub-section (1A) of Section 73 postulates two circumstances in which interest becomes payable, namely, where the permission has not been applied for before issuing the prospects and the company has thus acted in violation of the law or where permission, though applied for, has not been

> granted. In the former case, apart from the other consequences which may flow from the company's disobedience of the law, **the liability to pay interest arises as from the date of receipt of the amounts, for the company ought not to have received any such amount in response to the prospectus issued by the company** in disobedience of the requirements of subsection (1)…" (Emphasis supplied)

27.8. In the Order dated July 27, 2000 of the Honourable Securities Appellate Tribunal in the matter of **Bank of Baroda vs. SEBI** (wherein an order of SEBI directing the bankers to an issue to refund the application money collected by them from the subscribers in a public issue, was challenged), the Honourable Tribunal while upholding the impugned SEBI Order, observed that:

> "The impugned direction cannot in any view be considered as a penalty or decree for recovery of funds, issued without authority of law. The direction is to return the money which the investors had put in the custody of the banker, in good faith against allotment of shares. It is the obligation of the Bankers to an Issue to return the money as the allotment could not take place. In fact a right did accrue in favour of the applicants to get the money back, the moment BSE declined to accord listing approval to the company's shares. …………..The investors are aggrieved as they have not been refunded the money due to them. Since the money belongs to them it has to be refunded to them. The direction is only for this purpose………"

The Honourable Tribunal had also observed the following with regard to the payment of interest:

> "……… Since the repayment is delayed, liability to pay interest @ 15% per annum on the defaulted amount has automatically arisen, as provided in section 73".

27.9. Therefore, in the facts and circumstances of the present matter and in the interest of the investors who had subscribed to the OFCDs allotted by such companies, it would be just and equitable in directing SIRECL and SHICL to refund the monies collected by them (under the prospectus dated March 13, 2008 and October 6, 2009 issued respectively by them) till date to such investors who had subscribed to their OFCDs. Further, as provided under Section 73 of the Companies Act, 1956, the companies are also liable to pay interest on the delayed payment.

27.10. The need for issuing necessary directions for refund of the investors' money has been clearly established above. The next step would be to identify the persons against whom such directions are to be issued. The Directors, in their replies *inter alia* stated that in none of the companies is there any managing director and one of the three directors chair the board meetings as and when it is convenient. I observe that these Directors had in fact signed the Declaration in the RHP and had given consent for RHP and final prospectus for the OFCDs issued by the two Companies. In terms of Section 73(2), the company and every Director who is an officer in default is jointly and severally liable to repay the subscription money. Therefore, the two companies, SIRECL and SHICL and their directors namely, Ms. Vandana Bhargava, Mr. Ravi Shankar Dubey and Mr. Ashok Roy Choudhary, are liable for the same.

27.11. In reply to Show Cause Notice dated May 20, 2011 , Mr. Subrata Roy Sahara, *inter alia* stated that he is only a shareholder and neither a director nor hold any executive, managerial or other position in either of the said two companies. Hence, he mentioned that the notice is unwarranted and liable to be withdrawn. However, Mr. Subrata Roy Sahara, apart from being the founder of Sahara India Group, is admittedly a major shareholder (holding about 70% of capital in each of the two companies). He can be reasonably regarded as a person in accordance with whose directions or instructions, the Board of Directors of the two Companies were accustomed to act and therefore fall within the ambit of "officer in default". Furthermore, with the 70% ownership or holding in the two Companies, he is definitely in a position of control and has the power direct the management policy and appoint the majority of directors to the Board.

27.12. As stated above, cheques towards OFCD subscription for both the companies were collected in the name of M/s. Sahara India, a partnership firm. The name of this entity would indicate that it is a group entity of the Sahara India Group, and the founder and promoter of the said Group is none other than Mr. Subrato Roy Sahara. In Annexure 4 of the RHP, "Sahara India" has been designated as "arrangers of private placement". As seen above, the prospectuses do not contain the required disclosures and includes wrong declarations. In terms of Section 62 of the Companies Act, every person who is a director of the company at the time of the issue of the prospectus and every person who is a promoter of the company, are liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of any untrue statement included therein.

27.13. Further, for the purpose of the said section, the expression "promoter" means a promoter who was a party to the preparation of the prospectus or of the portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity for persons engaged in procuring the formation of the company. Mr. Subrato Roy Sahara's name is mentioned in the RHPs of both the companies as being the first generation entrepreneur who has promoted Sahara India Group. It is also stated that he holds 70% stake in SIRECL. From the RHP of SIRECL, it is mentioned under the head "Promoters and their background" that "Sahara India Real Estate Corporation Limited is a company promoter by Shri Subrata Roy Sahara. Shri Subrata Roy Sahara is founder of Sahara India Group…".

27.14. Given the holding of Mr. Subrato Roy Sahara in the two companies and his position as a promoter of the companies, it is reasonable to conclude that he was a party to the preparation of the prospectuses issued by the companies. Therefore, it would be fair and proper that the directions are issued to Mr. Subrato Roy Sahara also along with the aforesaid directors of the two companies. Accordingly, I hereby conclude the present proceedings and issue the following directions.

28. ORDER

28.1. In view of the foregoing, I, in exercise of the powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992 read with Sections 11, 11(4), 11A and 11B thereof and Regulation 107 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 hereby issue the following directions:

1. The two Companies, Sahara Commodity Services Corporation Limited (earlier known as Sahara India Real Estate Corporation Limited) and Sahara Housing Investment Corporation Limited and its promoter, Mr. Subrata Roy Sahara, and the directors of the said companies, namely, Ms. Vandana Bhargava, Mr. Ravi Shankar Dubey and Mr. Ashok Roy Choudhary, jointly and severally, shall forthwith refund the money collected by the aforesaid companies through the Red Herring Prospectus dated March 13, 2008 and October 6, 2009, issued respectively, to the subscribers of such Optionally Fully Convertible Debentures with interest of 15% per annum from the date of receipt of money till the date of such repayment.
2. Such repayment shall be effected only in cash through Demand Draft or Pay Order.
3. Sahara Commodity Services Corporation Limited (earlier known as Sahara India Real Estate Corporation Limited) and Sahara Housing Investment Corporation Limited shall issue public notice, in all editions of two National Dailies (one English and one Hindi) with wide circulation, detailing the modalities for refund, including details on contact persons including names, addresses and contact details, within fifteen days of this Order coming into effect.
4. Sahara Commodity Services Corporation Limited (earlier known as Sahara India Real Estate Corporation Limited) and Sahara Housing Investment Corporation Limited are restrained from accessing the securities market for rasing funds, till the time the aforesaid payments are made to the satisfaction of the Securities and Exchange Board of India.
5. Further, Mr. Subrata Roy Sahara, Ms. Vandana Bhargava, Mr. Ravi Shankar Dubey and Mr. Ashok Roy Choudhary are restrained from associating themselves, with any listed public company and any public company which intends to raise money from the public, till such time the aforesaid payments are made to the satisfaction of the Securities and Exchange Board of India.

28.2. In view of the fact that Sahara India has collected the subscriptions to the OFCDs, I direct SEBI to initiate appropriate proceedings in accordance with law.

28.3. After completing the aforesaid repayments, the two Companies shall file a certificate of such completion with SEBI from two independent peer reviewed Chartered Accountants who are in the panel of any public authority or public institution. For the purpose of this Order, a peer reviewed Chartered Accountant shall mean a Chartered Accountant, who has been categorized so by the Institute of Chartered Accountants of India (ICAI).

28.4. In case of failure of the parties to comply with the aforesaid directions, the Securities and Exchange Board of India shall take appropriate action including launching of prosecution proceedings against them and other persons who are in default, in accordance with law.

28.5. The Honourable Supreme Court of India vide its order dated May 12, 2011 has directed SEBI to "expeditiously hear and decide this case so that this Court can pass suitable orders on re-opening. However, effect to the order of SEBI will not be given." Therefore this Order will be given effect to only subject to the directions of the Honourable Supreme Court.

28.6. In respectful compliance with the Order dated May 12, 2011 of the Honourable Supreme Court of India, a copy of this Order shall be placed before the Registrar of the Honourable Supreme Court of India immediately.

DR. K. M. ABRAHAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

PLACE: MUMBAI
DATE: JUNE 23, 2011