Securities Law

The e-Newsletter

An Effort of the National University of Advanced Legal Studies, Kochi

CONTENTS

Securities Laws: Vol. 2, February 2016

All views expressed are those of the authors. The newsletter is for private circulation and not for sale

1. Interview with Hon'ble Mr. Justice K. S. Radhakrishnan…………………………………………...*Pg. 1*

2. Interview with Mr. Rajat Sethi, Partner, S&R Associates…………………………………..……..…*Pg.3*

3. Crowdfunding models in India and their regulation
Anjana Ravi, Student, The National University of Advanced Legal Studies, Kochi……………..…………………….*Pg.5*

4. ESOP's Foibles: The Case of Phantom Stocks and SAR's
Srinivas Raman, Student, National Law University, Jodhpur…………………………………………………....*Pg.6*

5. India's encouragement to VCFs/AIFs in foreign companies with 'Indian connection' – analysing SEBI circular dated Oct. 1st, 2015
Yudhvir Dalal, Student, The National University of Advanced Legal Studies, Kochi………...………………..……...*Pg.7*

6. The NDTV Case: Determining delay in disclosure of litigation information to the stock exchange
Bhagirath Ashiya, Student, School of Law, Christ University…...…………………………………………………....*Pg.8*

7. Women directors and the national stock exchange
Aarushi Anand, Student, VIT Law School, Chennai……………...……………………………………...…………..*Pg.9*

8. Shifting to a new 'well guarded' house: "Prohibition of Insider Trading Regulations, 2015"
Aishwarya Dhakarey, Student, Symbiosis Law School, Pune……………………………………..……....………*Pg.10*

9. Securities Updates……………………………………………………………………………………..*Pg.11*

10. Securites Moot 2015 Highlights………………………………………………………………………...…*Pg.13*

11. Best Article, September 2015 ed...*Pg.15*

NATIONAL SECURITIES LAW MOOT 2015 DURING SEPTEMBER 2015 AT NUALS, KOCHI

INTERVIEW WITH HON'BLE Mr. JUSTICE K. S. RADHAKRISHNAN

Judge (Retd.), Supreme Court of India

Question: Sir, what did you think of the competition, in terms of the quality of the teams?

Answer: Subject is innovative, the participants are seen to be well prepared. Generally judges and lawyers are not as exposed to these topics (securities law) as compared to other areas like criminal law, civil law, property law and so on. Most of the courts, including the Supreme Court, are flooded with cases on constitutional law, property law, contracts, criminal law and so on.
There are a lot of emerging areas like Energy law, Securities Law, Intellectual Property Rights (IPR), Company law, etc. which find minimal mention in the curriculum. It is good that NUALS has adopted a new emerging field for the students who participate in these competitions have to spend a lot of time on research, prepare memorials and so on. Apart from the participants, other students will also be benefitted by these types of competition.

NEWSLETTER TEAM: Aakash K., Apoorv K.C., Bipluv J., Krittika C., Namratha K., Nilima R., Niranjan S., Raviteja P.A.N.V., Yudhvir D.

Q: Do you think Moot Court Competitions (MCCs) are useful in a law student's career?

A: A Moot Court Competition (MCC),in my opinion, gives students a good exposure to the court like proceedings and will instil confidence in them to concentrate on law and take law as profession, as a lawyer or as a judicial officer. In my view it is not only useful, but also essential to mould the career of a law student.

Q: How closely would you say MCCs resemble real life practice?

A: I have had occasion to participate in several MCCs' in Law Schools in the country. The atmosphere is very much like that of a court and students themselves playing a part in the proceedings only add the authenticity of the experience. In fact, I often find that there is no difference from an actual court, in the way in which is conducted.

Q: If you had any pointers on how to approach a competition such as this, what would they be?

A: The Students approaching the competition must do so in a professional manner. They have to be familiar with the facts and the legal position as well, which requires a lot of research especially when called upon to deal with a subject (like Securities Law) which they are not familiar with.

Q: What weight would you give to participation/achievement in an MCC while evaluating the merit of a practicing lawyer?

A: In a MCC, the judge can always make out whether the participants would, in the years to come, be a successful practitioner. This becomes apparent from the knowledge of law, analytical capability, manners and temperament, etc. which can be evaluated by a judge. MCC can serve as indicator of future success.

Q: What advice would you give to young lawyers, setting out to litigate in India?

A: Young law students have a great future, if they take up law as a career. Every lawyer can now be a specialist. In fact it is appropriate to say that a lawyer can no longer be a generalist. This specialisation is not limited to law but also to other professions as well. It is impossible for a generalist to be abreast with the latest developments; especially in areas such as IPR, Securities Law, Competition Law and the like. So I would advise a lawyer to be a specialist in whatever field that they may choose.

Q: How would you see the legal profession in India developing over the next decade?

A: I would advise the Bar Council of India (BCI) and other professional bodies to improve the standard of legal education in the country. Law should be taken as a serious subject or else our lawyers will lag behind in the international arena. Our lawyers have to compete with their counterparts around the world, and our lawyers also deserve the respect that is given in other countries as well. Only a lawyer who is professionally well equipped can command respect, because credibility must be built up first. BCI has a tremendous role to play in moulding the careers of lawyers not just inside the court but in the world at large as well.

As I mentioned before, legal profession in India has a bright future. India stands to gain a lot of FDI (Foreign Direct Investment) in the years to come. Subjects like International Taxation, Mergers and Acquisitions and various other issues will emerge, which Indian Lawyers should face and gain international acceptance.

Q: How different is the field from when you first entered the profession?

A: I did my law in the Government Law College, Ernakulam later I did my masters in the Cochin University of Science and Technology. When I was a law student there was not much opportunity for students to participate in competitions like MCCs. It used to be like any other college. And even the teachers were not too exposed to the profession and actual legal practice. Students did not have national or international exposure.

The BCI, in my opinion, should live up to the expectations of students and move with the times. The conduct of the California Bar Association is exemplary, especially their enrolment examination. We have to find the means to improve our legal education to a similar standard.

Q: Do you think that MCCs have an appreciable impact on policy issues?

A: Students who are exposed to Securities Law as well as participate in MCCs would definitely influence policy matters. They have a responsibility to the general public, to see that they do not fall prey to the big industrialists who float shares in the market. In our country a large number of innocent persons deposit money either in shares or in securities. It is the responsibility of the lawyer to safeguard the members of society against unscrupulous persons.

Q: Do you think Academicians should have a prominent role in policy making?

A: Academicians should have a decisive role in policy decisions like in the USA and other countries. It is well known that in many legal issues even the President of US consults academicians and not members of the Congress nor the Senators in the Senate. Educational institutions like Harvard, Yale, Stanford, etc. contribute immensely to policy decisions which we seldom see this in India. Of course, it goes without saying that our academics should be equipped to properly advice on law and policy matters as well.

INTERVIEW WITH Mr. RAJAT SETHI, PARTNER, S&R ASSOCIATES

Question: What did you think of the competition (Securities Law Moot Court Competition, at NUALS, Kochi) in terms of the teams and how the problem was tackled?

Answer: I think the quality of the teams was good. The areas of law covered in the problem are relatively new areas in India. These are not taught in much detail in law school. Given all of this, I think the level attention to detail and awareness of concepts was pretty good. I was quite happy with the overall quality.

Q: Do you think moot court competitions are useful in a law student's career?

A: Yes. Absolutely. They provide a wonderful opportunity to give an experience to law students, which is closer to real life. It gives them confidence. One of the skills which you need as a lawyer, whether in court or on the negotiation table, is to be quick on your feet, and to have an ability to react to questions for which you may not be fully prepared. Moot court competitions assist in developing that skill. Some thought could be given to making participation in moots a part of every law student's curriculum.

Q: How closely would you say moot court competitions resemble real life procedures?

A: If there are experienced judges and enthusiastic students, and the quality of the problem is good, you can create a learning environment where you are able to simulate a real life experience. I don't think the idea is to make it exactly identical to a court atmosphere. The objective is to give the students a flavour of what it could be like, and also to benefit students who are watching the moot court competition as much as to those who are participating in it.

Q: If you have any pointers as to how to approach a competition such as this, what would they be?

A: While obviously precedents are important, I think the approach has to be based on principles and not be clouded over by precedents because the judges are also looking at the ability to think on first principles and the ability to approach an argument in a logical manner rather than having ten precedents to back up each proposition even if it is well settled. Given the limited time available, it would also be useful to identify the core issues and focus on those rather than spending any significant portion of the allotted time on ancillary matters.

Q: And when you were evaluating the merit of a practising lawyer, what weight would you give to his participation and achievement in a moot court competition?

A: I think it certainly signifies that the lawyer has attempted to develop his or her advocacy skills and make use of opportunities available in law school. If it is coupled with excellence in other areas, then that is a good combination. Some people are stronger in mooting than other areas and that is also something you need to keep in mind and give appropriate weightage for. I think several factors work together.

Q: Could you tell us how you got involved in the area of Securities law?

A: I practise corporate law. I advise on mergers, acquisitions, private equity and general corporate matters. I started off as a litigating lawyer. I did litigation work for about three years. To some extent, it was just one thing leading to another. I got an opportunity to work in a corporate firm after three years of litigation, which I took up. After a period of time, I was doing more mergers and acquisitions and private equity work than work in other areas. I would like to think that it was all planned, but it was not. It was just one thing leading to another and over a period of time people start perceiving you as being skilled in a particular area.

Q: Would you say the field of securities law is lucrative or emerging?

A: I think it has emerged already. It is not in the emerging category anymore. There is an extensive set of regulations. We have a strong and vibrant regulator. So there has been a lot of movement, a fair bit of deal activity, and this area will continue to be busy as the rules evolve and the regulator gets feedback from market participants. Certainly for a young practitioner, it's an area of law that holds a lot of potential.

Q: What would be your advice to a budding lawyer? Anything he has to be sure to do?

A: My advice to a budding lawyer would be on certain very basic points that may seem elementary. One would be to develop the skill of listening carefully, whether it is to the opposing lawyer in a moot court, a courtroom or in a transaction.

Often, the subtext, the context and the nuance will be as important as the substance. This skill enables a good lawyer to address the points in issue effectively. A lawyer needs to remain a lifelong student, and be receptive to new ideas, perspectives and interpretations. What may be the settled rule today will be different tomorrow, so the focus has to be on the process and the approach rather than the conclusion. The other advice would be to focus on the written work product. It should be crisp and clear with a high level of attention to detail, and avoid surplus words and legal jargon. Use short sentences to the extent possible. A good lawyer needs to be equally comfortable communicating verbally or in writing. Inevitably, many lawyers will be stronger in one area than the other, but often proficiency in one can be harnessed to develop skills in the other.

One other thing that helps a lawyer is being well informed in areas which may seem unrelated at first blush, such as accounting or finance. All of these areas have an important bearing on any practice of law. One has to make an effort to acquire some working knowledge of those areas as well if you want to be a well-rounded lawyer.

Finally, I would emphasize ethics and integrity as the hallmark of a good lawyer. A related aspect is being circumspect and discreet. A client will share a lot of information with his or her lawyer in strict confidence. A lawyer needs to respect that confidence.

Q: What do you say the challenges faced by the Securities law in India, currently?

A: The challenges, like in any emerging economy, are that we have too much flux. New regulations are framed as a reaction to particular events rather than being based on a broader vision for the way forward. We need to think about long term road maps rather than looking at this episodically and reacting to particular situations. Successive governments are giving a push to larger reforms across the financial sector. We have a new set of takeover code that was adopted in 2011. We have a new insider trading code which was adopted earlier this year. The regulator has recently revamped the disclosure rules for listed companies. There is a lot happening. However, there is still some way to go to make it a well oiled and well regulated securities market.

Q: Where do you see this field in the next 10 or 20 years?

A: The developments in this field will overlap with the journey of the country. As we increase our presence on the world stage, even our securities market will develop along with that.

Q: Do you see it resembling any particular market or any other country's market?

A: I would like to see it resemble some of the developed markets. But I think we still have some work to do before we start to get there.

Q: If you would choose some country other than India to practice securities law, what would it be and why?

A: The advantage with choosing a country like India would be that you are doing a lot of things for the first time. In that type of an environment, one literally tends to grow up faster. The opportunities are greater if one is willing to take them. However, the growth is unstructured. If one is looking at a more organized and encouraging work environment and a more disciplined approach, then you have to consider one of the more developed markets. In the areas of corporate and securities law, the United States is the most advanced in certain concepts.

Q: Are you in favour greater regulation of the financial sector?

A: Not greater regulation but we certainly need well thought out regulation which is principle-based. Having more compliances or a lot of committees doesn't add value. Ultimately one has to take a more purposive approach and figure out the long term objectives one wants to achieve, and what are the fundamentals and focus regulations on that. Some of our regulations get into this approach of having elaborate rules for every aspect of business. I am not a big supporter of those type of regulations.

Q: Do you think competitions such as this have an impact on the eventual policy making procedures or aspects in terms of generating interests or niche experts, inculcating this interest?

A: I think they serve as a good platform. They encourage discussion. They offer a wonderful opportunity for people to exchange ideas, to test the limits of those ideas and to think about areas of improvement. On a slightly unrelated point, one thing that has been lacking in some of our law schools is an emphasis on legal writing. In some other jurisdictions, legal writing through journals has contributed much more to be development of law by testing new theories and proposing new ideas. I don't think legal writing in India has reached anywhere close to that yet. There is a lot of potential in that area which is waiting to be tapped. In this context, I welcome the initiative by NUALS to introduce a securities law newsletter. We need many more such initiatives.

Q: Do you think there should be greater involvement of technocrats in the policy making process? At least greater emphasis to technocrats than what is being given right now. Academicians, experts in the field?

A: One needs a cross section of views to have any sensible policy. You need people from very broad spectrum. You need practitioners, people from the government, technocrats as you said. To have a well-rounded policy you need to hear different views before putting something down. If you don't do that, then the policy is often found wanting.

CROWDFUNDING MODELS IN INDIA AND THEIR REGULATION

By Anjana Ravi

Crowdfunding as an alternate source of finance finds its roots in artists and musicians being funded for their work by the public. The advent of internet and social media has resulted in crowdfunding growing into a popular source of finance, especially for start-ups and small and medium enterprises. Crowdfunding can be defined as 'solicitation of funds from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause.' The IOSCO paper on crowdfunding explains crowdfunding as an 'umbrella term' that describes the use of money, obtained from a large number of individuals or organizations, to fund a project, loan or business through an online web-based platform.

Crowdfunding is divided into four types- donation crowdfunding, reward crowdfunding, peer to peer lending (P2P lending) and equity crowdfunding. While the former two are categorized into community crowdfunding, the latter two fall under Financial Return crowdfunding (FR crowdfunding). FR crowdfunding involves returns on the fund, constituting an investment or loan.

P2P lending involves the use of an online platform where lenders are connected to borrowers in order to provide loans. The platform involved in this, aggregates the amount given by different lenders and generates the loan, also setting the interest rate. Equity crowdfunding on the other hand, involves individuals investing in a business, through an online platform and gaining an equity stake, typically seen in funding of start-ups.

FR crowdfunding, unlike community crowdfunding has legal implications. Although the crowdfunding industry is very small in comparison to other lending and investment activity, it has been growing at a fast pace, especially in the aftermath of the 2008 financial crisis, after which banks have restricted lending to high-risk start-ups and enterprises. Hence, there has been a call for its regulation across the globe. The platforms are either regulated as banking or other investments, depending on the business model and type of crowdfunding. However, very few countries have come out with satisfactory regulations owing to uncertainties in the business models of crowdfunding platforms.

Crowdfunding Business Models:

There are various types of business models followed by crowdfunding platforms. While some business models can be categorized into P2P lending or equity crowdfunding, making their regulation easier, there are platforms that follow business models unique to them and are hybrid of the two, making it difficult to regulate them. These platforms have business models that contain characteristics of banking activity along with other modes of financing. Therefore, they cannot be strictly regulated as banking or as other intermediary. Lending platforms usually have the following types of business models:

- Client- segregated account model: The platform plays an intermediary between the lender and the borrower, matching them after which a contract is formed between the lender and the borrower. The platform does not have any further participation. An administration fee is charged by the platform. The platform has a negligible role to play in the transaction.
- Notary model: This model involves the lenders bidding for the loans that they want in their portfolio, after which the loans are originated by banks and a note is issued by the platform to the lender for the value of his/ her contribution. This note is treated as a security.
- Guaranteed Return Model: This model involves a set rate of return on the investment guaranteed by the platform to the lenders.
- Equity Model: This is similar to buying stock in a company. The investors gain some equity stake in the venture and can gain profits through dividends, but also take on the risk involved in the venture.
- Hybrid Models: This model involves platforms that have characteristics of both P2P and lending models, thereby making it difficult to categorize them.

Regulation of Models in India:

Although crowdfunding is new to India, it has been growing at a steady pace and regulators have felt the need to bring in laws for ensuring investor protection and proper capital. There is also fear that placing restrictions on a largely community based activity will take out the benefits of a diverse investor/lender pool and easy access of capital. There have been many crowdfunding platforms that have been successful in the country like *ilend* that is involved in P2P lending as well as equity platforms like *fundmypitch*. Most P2P lending platforms in India follow the client- segregated account model, as most of them are involved in matching lenders and borrowers and executing agreements between them. There are also platforms that have hybrid characteristics of both P2P lending and equity crowdfunding. These platforms may be advantageous for the borrower; however, they are a dilemma from regulation point of view. These hybrid models may treat funds as loans but also ensure rewards in the form of pre- sales, discounts, etc. In such instances, the question arises as to whether these rewards are treated as investments.

SEBI came out with a Consultation Paper on crowdfunding in June, 2014. This paper addressed the need for regulation of crowdfunding, but restricted its scope to equity crowdfunding as being under SEBI's jurisdiction, leaving P2P lending and other types to be taken care of by RBI. RBI has also acknowledged the need to regulate the same. The US and EU have come out with some stable regulations.

The JOBS Act in the US regulates equity crowdfunding through regulation of platforms as broker/ dealer by SEC. In UK, the Financial Control Authority came out with an authorization process for P2P lending platforms in 2014. Countries that have brought out regulations have eliminated ambiguities with respect to hybrid-models to some extent, as the regulations pave way for the platforms to structure their business model accordingly.

Conclusion:

The operation and business models of the existing platforms have not been considered in the need for regulation. This can result in shortcomings in the regulations and may also lead to jurisdictional clash between the regulators. The classification of business models of the platforms need to be considered for their effective regulation. Regulations must be framed, accommodating all models which may prove cumbersome or eliminate ambiguous hybrid models through clear regulations.

ESOP's Foibles: The Case of Phantom Stocks and SAR's

BY Srinivas Raman

Introduction

Employee stock option plans commonly called ESOP's are schemes strategically devised by employers of various types of companies to simultaneously realize diverse key short term and long term business goals. These schemes are given to employees in addition to or instead of a part of their salary in various combinations as payment in kind in order to remunerate, reward, rally and retain employees.The main advantages of issuing ESOP's are:

There is no cash outflow for the company.

Helps in retaining and attracting talented employees.

Section 2(37) of the new Companies Act defines employees' stock option (ESOP) as-

"The option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price."

Though traditional ESOP's have been used successfully by several companies especially start ups, they do have certain inherent drawbacks. The main drawback of ESOP's is the problem of dilution of equity. If ESOP's are not well organized, a company may face difficulties when it comes to making important decisions. This is because, most employees who become shareholders may not be prudent decision makers and this may prevent a company from passing important resolutions in statutory meetings.

To combat the inherent limitations posed by ESOP's., companies worldwide have been using other instruments such as phantom stocks and stock appreciation rights (SAR's). A phantom stock is simply a promise to pay a bonus in the form of the equivalent of either the value of company shares or the increase in that value over a period of time.

A stock appreciation right (SAR) is much like phantom stock, except it provides the right to the monetary equivalent of the increase in the value of a specified number of shares over a specified period of time. As with phantom stock, this is normally paid out in cash, but it could be paid in shares. Both phantom stocks and SAR's help companies avoid the risk of equity dilution and also protect employees from risks of owning volatile stocks.

The trend of using phantom stocks and SAR's has recently caught up in India as more and more start-ups are emerging and founders and owners are exploring cost efficient ways to retain talented personnel and mitigate risks associated with dilution of ownership. However, unlike many other developing countries, phantom stocks and SAR's lack adequate statutory recognition and regulation.

SEBI's regulatory muddle

Recently, SEBI issued two informal guidance letters in response to certain specific queries raised by Mindtree Limited and Saregama India Limited. The queries pertained to the question of applicability of The SEBI (Share Based Employee Benefits) Regulations, 2014 (the "Regulations") in the context of phantom stocks and stock appreciation rights. SEBI answered in the negative by clarifying that phantom stock option and stock appreciation rights did not fall within the ambit of the Regulations and therefore companies issuing such stock options would not be required to comply with the Regulations.

The apparent confusion in interpreting the Regulations was created due to Regulation 1(3)(iii) of the Regulations which provides that the Regulations apply to stock appreciation rights schemes in addition to other types of employee share benefit schemes. In addition, stock appreciation rights have been specifically stipulated in the Regulations. However, in the subsequent proviso of the Regulations, i.e. Regulation 1(4) it is stated that the applicability of the Regulations is restricted to companies whose shares are listed on a recognized stock exchange in India and which *inter alia* involve dealing in or subscribing to or purchasing securities for the company, directly or indirectly.

SEBI seems to have relied on this proviso while issuing its guidance as it indicates the necessity for actual subscription or purchase of shares by employees, which obviously is impossible under phantom stock schemes.

From a review of the Regulations and SEBI's interpretation, either of the two possibilities emerges. Either SEBI has erroneously interpreted the Regulations; or there is a serious lacunae in the Regulations which has the effect of contradicting itself and rendering it infructuous. On a bare reading of the Regulations, it seems the case of the latter as the two conflicting provisos, i.e. 1(3) and 1(4) nullify each other and ultimately leave the issue of stock appreciation rights in a state of legislative limbo!

Conclusion

In fact, it is confusing why the Regulations would expressly deal with phantom stock and stock appreciation rights if the legislative intention was to exclude them from the purview of the Regulations. While intricate tools of statutory interpretation may be used to untangle this piece of contorted legislation in order to give recognition to phantom stocks and SAR's, such a recourse should not be resorted to as it will leave open future risks associated with alternate interpretations of the ambiguous Regulations.

What is actually needed is a separate set of rules governing phantom stocks and SAR's in India. While it is important to allow companies flexibility in designing their own employee stock option schemes and allowing them exemption from compliances in cases of phantom stocks or stock appreciation rights, there must be definitive rule regarding phantom stocks and stock appreciation rights.

SEBI should clearly define phantom stocks and stock appreciation rights and should provide an unambiguous regulatory framework which adequately addresses the challenges and issues which may arise from the use of such emerging stock options.

INDIA'S ENCOURAGEMENT TO VCFs/AIFs IN FOREIGN COMPANIES WITH 'INDIAN CONNECTION' – ANALYSING SEBI CIRCULAR DATED OCT. 1ST, 2015

By Yudhvir Dalal

Development of VCFS/AIFS under indian securities jurisprudence

The concept of 'Venture Capital Funds' (hereinafter 'VCFs') is prevalent in various jurisdictions, especially in USA, where it is thriving for a long time. The origin of 'Venture Capital Funds' (hereinafter 'VCFs') in Indian Securities Law can be traced back to SEBI (Venture Capital Funds) Regulations, 1996 (hereinafter 'VCF Regulations, 1996'). Presently, VCF Regulations, 1996 have been repealed and replaced with SEBI (Alternative Investment Funds) Regulations, 2012 (hereinafter 'AIFs Regulations'). Basically, 'venture capital' is money that is given to help build new start-up firms that often are considered to have both high-growth and high-risk potential. And start-ups cordially welcome venture capitalists for money because their company is so new, unproven and risky that more traditional forms of financing, such as through banks, wouldn't be ready to assist. According to section 2 (z) of the AIFs Regulations, "venture capital fund means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model".

Obtaining venture capital is substantially different from raising debt or a loan. In case of a loan, the lender has a legal right to interest on the loan and repayment of the capital irrespective of the success or failure of a business. Venture capital is invested in exchange for an equity stake in the business. Similarly, venture capitals are different from 'angel investors'. Venture capital generally comes from a firm or a business, while angel investments come from individuals. Another difference is that while new start-ups typically receive millions of dollars in venture capital, angel investors typically never invest so much into a project.

SEBI's boost for vcfs/aifs in foreign companies with 'indian connection'

The representations from various stakeholders in industry stated that there has been a major shift of Indian entrepreneurs outside India. Many Indian entrepreneurs have been setting up their headquarters outside India with back end operations and/ or research and developments being undertaken in India. Therefore, there is a need to allow higher overseas investment from VCFs and AIFs. Until now, in terms of SEBI Circular no. SEBI/VCF/Cir no.1/98645/2007 dated August 09, 2007 VCFs were restricted to invest only 10 per cent in Offshore Venture Capital Undertakings, while AIFs had no specific provision with regard to the quantum of such investments. The industry also stated that such investments would provide opportunities to the funds to generate better returns globally, getting exposure to the international markets practices, etc.

After receiving representation from various stakeholders, the Securities and Exchange Board of India (hereinafter 'the SEBI') realised the need for enhancing the cap on India-based Venture Capital funds for Offshore Venture Capital Undertakings with 'Indian connection'. Consequently, SEBI through its Circular CIR/IMD/DF/7/2015 dated Oct. 1, 2015 (hereinafter 'the Circular') permitted VCFs to invest up to 25% of their investible funds in Offshore Venture Capital Undertakings which have an Indian connection. And for the purpose of such investment, the Circular *per se* clarified that "Offshore Venture Capital Undertakings" means a foreign company whose shares are not listed on any of the recognized stock exchange in India or abroad.

The Circular specified that the VCFs shall adhere to FEMA Regulations and other timely guidelines specified by RBI. Further, VCFs shall not invest in Joint venture/Wholly Owned Subsidiary while making overseas investments. The Circular also provided that AIFs desirous of investing in Offshore Venture Capital Undertakings having 'Indian connection' can invest up to 25% of the investible funds of the scheme of the AIF. And the allocation of investment limits would be done on 'first come- first serve' basis, depending on the availability in the overall limit of USD 500 million.

Comments on the circular

In the opinion of the author, SEBI's initiative of raising cap on VCFs and AIFs for Offshore Venture Capital Undertakings with 'Indian connection' is apt and desirable for our economy. In our present globalised economy, when Indian entrepreneurs were looking outside India this step by SEBI will surely help in bringing new technology in India. As envisaged by SEBI, the mandate of such investors having an 'Indian connection' will generate indirect benefits to India through bringing in non-debt creating foreign capital resources, technology up-gradation, skill enhancement, new employment, etc. The fact that VCFs help in generating employment and revenue is *prima facie* evident from USA's economy. According to the National Venture Capital Association, 11% of private sector jobs i.e. 12.1 million jobs, come from venture backed companies and venture backed revenue accounts for 21% of US GDP. More importantly, this encouragement by SEBI will prevent Indian firms from shifting to foreign countries. This initiative of encouraging VCFs/AIFs in foreign companies with 'Indian connection' will surely lead to positive aftermaths.

THE NDTV CASE: DETERMINING DELAY IN DISCLOSURE OF LITIGATION INFORMATION TO THE STOCK EXCHANGE

By Bhagirath Ashiya

It is mandatory for a listed company to comply with the conditions of the Listing Agreement under Sec. 21 of the Securities Contracts (Regulation) Act, 1956 (*hereinafter*, '**SCR Act**'), the failure of which attracts penalty under sec. 23A and sec. 23E of the SCR Act. Sec 23A lays down that the information to be furnished under the Listing Agreement should be 'within the time specified'. Further, Clause 36(5) of the Listing agreement states that company should '*promptly* after the event inform the Exchange' of any litigation with a material impact, to which it is a party.

Therefore in a scenario where a company delays in disclosing information due to them seeking legal advice, the delay compliance with the listing agreement can be termed questionable. This is based on whether one adopts a strict approach to determining compliance with the listing agreement. Immediate disclosure to the stock exchanges of the price sensitive information has been reiterated in various cases. Thus, non-disclosure due to such a delay can be termed a violation of the listing agreement.

In the *New Delhi Television Limited case*, in which a tax demand by the Assessing Officer was not informed to the stock exchange, the Adjudicating Officer held that the Noticee is liable because it did not have evidence to prove that legal advice was being taken 'when the disclosure obligation arose'. The disclosure requirement mandatory under Clause 36(5) of the Listing Agreement of NSE, states that the Company 'will promptly *after the event* inform the Exchange' of any litigation with a material impact, to which it is a party. Thus, *inter alia*, it is important to determine when the event has occurred, in order for the information to be conveyed to the stock exchange. Although not dealt with in the Listing Agreement, SEBI in a discussion paper has clarified 'when can an event be said to have occurred?'

It states that at times, the materiality of the information cannot be determined at initial stage, and the company may need to seek 'expert advice' to 'determine the nature of the information'. In such cases, the company shall be 'construed to have become aware of the event when the probable impact of the event becomes known to the extent of 75% of materiality.'

Further, the *Guidance Note on Clause 36 of the Listing Agreement* issued by National Stock Exchange of India Ltd. lays down that 'entity may consider the impact of such disclosure on legal proceedings while making the disclosures and make the disclosure accordingly'. Therefore in such a scenario, the delay in disclosure can be allowed if the parties prove that such a delay was sought for the determination of the materiality of the information.

To justify the delay in disclosure, it can also be contended that the very object and purpose of clause 36 is ensure that only material information is disclosure. As the objective of Clause 36 of the Listing Agreement is to enable the shareholders 'to appraise the position of the Company' and also to 'avoid establishment of a false market'. Therefore the disclosure of information such as a litigation suit in isolation would have given an incorrect picture and therefore would have misled the public. It was observed in *Hindustan v State of Orissa*, that even if a penalty is prescribed for a failure of a statutory duty, a matter can be excused and condoned 'when there is technical or venial breach of the provisions…or where the breach flows from a *bonafide* belief that the offender is not liable to act in the manner prescribed by the statute'.

Therefore after the NDTV case, it is not legally tenable to justify delay by arguing that the disclosure of the information had no drastic impact on the stock market. Hence parties should err on the side of caution when dealing with the disclosure of litigation suits under the listing agreement after seeking legal advice.

This has to be done within a reasonable period, with sufficient evidence to showcase such legal advice being sought, between interim period when the company has knowledge of the suit and the eventual disclosure to the stock exchange.

WOMEN DIRECTORS AND THE NATIONAL STOCK EXCHANGE

By Aarushi Anand

Over a period of time, the Indian securities market has undergone remarkable changes and grown exponentially, particularly in terms of resource mobilization, intermediaries, the number of listed stocks, market capitalization, turnover and investor population. While the Indian securities market has tremendously focused on development in terms of market efficiency, enhancing transparency, preventing unfair trade practices and bringing the Indian market up to international standards, the gender inequality still prevails. Most board members of National Stock Exchange are men and only if there exists a regulatory directive like the one issued by the Securities and Exchange Board of India (SEBI), do we see women slowly coming up on the board of directors.

The Corporate Governance norms in India for listed companies do not mention in their clauses any specific gender to be the majority on the board of directors. Why is it then assumed that only men should be more on the board and not women? Is a person recognized only on the basis of gender? Effectiveness, efficiency, adherence to company's norms and work style should be used as a measure for evaluation. Women entrepreneurs are coming up but only some make it to the top with zeal and diligence and they are the ones who hold their ground as being equivalent to men in work. There's no competition here, only the desire to be equally recognized for their merits.

India was one of the first countries to give women equal franchise and has a highly credible record with regard to enactment of laws to protect and promote the interests of women, but women continue to be denied economic, social, legal rights and privileges. Though they are considered to be equal partners in progress, yet they are subjected to repression, marginalization and exploitation. In many companies, expectations from women are low and this affects their ability to perform. Globalization has indeed raised the hopes of women for a better and elevated status and there are increasing chances of work but at the same time, it has put them in a highly contradictory situation where they have the label of being economically independent but are not able to enjoy their economic liberty in the true sense of the term.

Moving on to the main issue which is the reason for the need to put more women directors on board ;National Stock Exchange had issued notice to 260 companies, including 145 suspended firms, for their failure to comply with SEBI norms to appoint at least one woman director on their respective boards. The total listed companies (including debt and MF) in NSE are 1,750, of which 189 were suspended due to non-compliance of various kinds.

SEBI had issued guidelines in February 2014 asking companies to appoint at least one woman director on their boards by October 1, 2014, which was later relaxed to April 1, 2015,after the Companies Act 2013 stated all listed companies and all public companies with paid up share capital of at least Rs 100 crore or turnover of Rs 300 crore have to appoint at least one woman to their boards.

Companies that missed the deadline but appointed a woman director before 30 June will have to Rs.50,000 as fine and the firms that does so between 1 July and 30 September will have to pay Rs.50,000 plus Rs1,000 a day from 1 July to the date of compliance. Companies that comply with the norm after 1 October will have to pay Rs.1.42 lakh along with a fine ofRs.5,000 a day from 1 October till the date of compliance.

Most of the companies met the SEBI deadline of April 1st 2015 by finding suitable women and some by appointing close relatives of promoters. As per nseinfobase.com, across all 1471 NSE-listed companies, even after the recent appointments of women, there are still just 893 women presently occupying 1,091 directorship positions (just 9%). Of these, while 519 women are holding 563 non-independent directorship positions, only 399 women are collectively occupying 528 independent directorship positions (25 women hold independent as well as non- independent positions).

Thus, if the requirement was for boards to have independent women directors, as many as 970 companies (or 66% of companies) would have been needed to meet the norm. Sought after women directors such as Renu Sud Karnad, Vinita Bali, Kalpana Morparia, Lalita Gupte, Chanda Kochhar and Punita Lal are among professionally qualified women executives who have worked their way up to the top stratum of corporate world.

An example of a woman who has overcome all the hurdles in her way up in NSE is Chitra Ramkrishna, who took charge as the Managing Director and CEO of the National Stock Exchange on April 1st 2013 thereby becoming the first woman to head the National Stock Exchange (NSE). Chitra Ramkrisha, a Chartered Accountant, has been with NSE since its inception in 1991. She was part of a five-member team selected by the Government of India and tasked with the creation of a modern screen-based pan-Indian stock exchange."I'm driven by the belief that more ordinary people should be able to prosper and benefit from the stock market boom in India."

In conclusion, this has been a slow but steady process, yet women must be recognized and promoted for their work, not based on any regulative but their dedication and skill.

SHIFTING TO A NEW 'WELL GUARDED' HOUSE: "PROHIBITION OF INSIDER TRADING REGULATIONS, 2015"

Aishwarya Dhakarey

I. Background

Fraudulent securities transactions or insider trading is one of the run-of-the-mill corporate phenomena today and as the number of episodes of manipulation of company securities' information was increasing at an alarming rate, it had become imperative to review the extant rules and regulations on the subject. Not much time has passed since the chief Indian Capital Market regulator, SEBI was accorded some extra teeth to prosecute and punish the offenders involved in Insider Trading.

On 15th January, 2015, Securities Exchange Board of India notified "Prohibition of Insider Trading Regulations, 2015" in exercise of its wide ranging powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992 read with S. 11(2) (g), S. 12 A (d) and S. 12 A (e) of the Securities and Exchange Board of India Act, 1992. It is also trite to cite Section 195 of Companies Act, 2013 here which provides that, "No person including any director or Key managerial personnel of a Company shall enter into insider trading." With these new regulations coming into force, the two decade old predecessor law i.e. SEBI (Prohibition of Insider Trading) Regulations, 1992 was repealed with subsequent effect on 15th May, 2015.

The new regulations strengthen and reinforce framework for prohibition of securities fraud. The new regulation consists of five chapters and two Schedules whereas the previous regulation had four chapters and three schedules. In order to elucidate upon the Regulator's intentions behind few particular provisions, SEBI has provided what are called "Notes" at about twenty eight places in the regulations. Further, there are both continuous and event based disclosures need to be complied with from the company's perspective.

II. Comparison between the 1992 and the 2015 Regulations

To begin with, Insider trading prohibits 'connected persons' (i.e., someone who has access to a company's insider information) from dealing in that company's publicly traded shares. The parallel between the two delegated legislations can be drawn under the following headings:

(A) Definitions- The concept of Insider Trading has not been given expansionist meaning as such. However, few definitions have been introduced whereas others have been modified or widened. While the erstwhile Regulation did not define Board, Compliance Officer, Trading Plans, the extant Regulation takes a step forward by including them in Regulation 2. Moreover, the scope of the terms such as 'relative' has been expounded by including phrase, "means a spouse of a person, and includes parent, sibling, and child of such person or of the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities." Likewise, more clarity is brought to the explanation of the term 'Insider' which now includes the way to procure a UPSI on the Company's securities as well. Another feature is that several terms such as officer, stock exchange are not defined under this regulation, which were earlier defined under 1992 regulations. Moreover, the term "connected" has been enlarged to include both contractual agency/employment and fiduciary relationship.

(B) Chapter II (Restrictions On Communication And Trading By Insiders Communication Or Procurement Of Unpublished Price Sensitive Information) - The new regulation is more precise and wider in scope for the purpose of prosecution. Regulation 3(2) provides that no person shall instigate insider to communicate UPSI. It also prohibits every person from procuring UPSI. Earlier, the obligation was on 'Insider' not to disclose UPSI to any person, and such person would not deal in securities. One of the other changes is seen in Regulation 3(4) which makes it mandatory to enter into contract of confidentiality and Non-Disclosure Agreement. Further, Regulation 5 (3) imposes obligation on Compliance Officer to review trading plan and also approve the same.

(C) General Comment on Chapter III, General provisions - Regulation 7(2) (a) lays down the requirement of continual disclosures by promoter, directors and employees. Disclosure has to be made within two trading days if value of trade (including trades made during the quarter) in excess of 1 million. Additionally, disclosure under Regulation 7(3) has newly found place **by other connected persons which is *per se* an enabling provision.**

(D) Chapter IV- Model Code of Conduct for prevention of Insider Trading for other entities has been newly introduced.

(E) Introduction of Chapter V- i.e. Miscellaneous Sanction for violations which are meant for Insider Trading exclusively. This chapter is followed by another chapter on Repeal and savings of the 1992 Regulation.

III. Conclusion

There are few mooting points which would require further consideration in the days to come. Firstly, Regulation 9(2) under the Code of Fair Disclosure, there is a requirement for companies to come up with codes for regulating, monitoring and reporting trading activities by connected persons and fair disclosure of material information (from the perspective of the Regulator) by the company. Compliance with such codes can be a complicated process for companies with larger employee population. Secondly, as one proceeds with regulations, there is a need felt to determine the import of the term 'legitimate purposes' as used in Regulations 3(1) and 3(2).

Regulation 3(1) reads as, *"No insider shall communicate, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed ......is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations."*

Similarly, there is a prohibition on procurement of such information except where the communication is for some legitimate purpose under clause (2). In the absence of any clarification, the expression will have vague and loose interpretation. In order to ensure complete justice, there needs to be a rule based interpretation than a non reasoned and mere principle based interpretation. However, it is a 'legitimate' expectation that there will be periodic notifications issued by the Board in the days to come so that the regulations are interpreted in a progressive and advanced manner.

SEPTEMBER, 2015

September 03

SEBI has notified SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) on September 2, 2015. The Listing regulations would consolidate and streamline the provisions of existing listing agreements for different segments of the capital market viz. Equity (including convertibles) issued by entities listed on the Main Board of the Stock Exchanges, Small and Medium Enterprises listed on SME Exchange and Institutional Trading Platform, Non-Convertible Debt Securities, Non-Convertible Redeemable Preference Shares, Indian Depository Receipts, Securitized Debt Instruments and Units issued by Mutual Fund Schemes

September 15

The Securities and Exchange Board of India released today the Development Research Group (DRG) - II Study titled, "Effectiveness of SEBI's Complaints Redress System (SCORES) in India".
The main findings of the study are: (a) SCORES fare very well on both the attributes of accessibility to investors as well the efficiency of the mechanism. (b) It is recommended that the SCORES system monitor repeat players (RP) who tend to "play for rules" to the disadvantage of individuals as „one shooters" (OSs). (c) SEBI may consider extending the mediation and arbitration model prevalent among broking community to the company level (primary and secondary market) (d) Social media could be used extensively in investor education and communicating the good news about the regulator.

September 28

Forward Markets Commission (FMC) merged with Securities and Exchange Board of India (SEBI)

OCTOBER, 2015

October 09

Shri Mohanty takes charge as Executive Director, SEBI

Shri S.K. Mohanty has taken charge as Executive Director in SEBI from September 29, 2015. Prior to this assignment, Shri Mohanty was serving as Director in Forward Markets Commission. An officer from the Indian Revenue Service (IRS), Shri Mohanty has earlier served in the Income Tax Department in various capacities at Kolkata, Nagpur and Mumbai. Shri Mohanty has been posted in the Commodities Derivatives - Market Regulation Department (CD-MRD) which has been created by SEBI for its regulatory oversight over the Commodities Derivatives Market.

October 21, 2015

Regulation of Commodity Derivatives Market

The provisions of Part I (excluding Section 132) and Part II of Chapter VIII of the Finance Act, 2015 came into force w.e.f. September 28, 2015 and the provisions of Section 132 of the Act came into force w.e.f. September 29, 2015 in terms of Central government notifications F. No. 1/9/SM/2015 S.O. 2362 (E) and F. No. 1/9/SM/2015 S.O. 2363 (E) dated August 28, 2015.

As a result, Securities and Exchange Board of India (SEBI) commenced regulating the commodity derivatives market under Securities Contracts Regulation Act (SCRA) 1956 with effect from 28th September, 2015 and the Forward Contracts Regulation Act (FCRA) 1952 got repealed with effect from 29th September, 2015.

The following departments were established as a result: Commodity Derivatives Market Regulation Department (CDMRD)**,** Market Intermediaries Regulation & Supervision Department (MIRSD), Integrated Surveillance Department (ISD), Investigations Department (IVD), Department of Economic Policy and Analysis (DEPA), Legal Affairs Department (LAD), Enforcement Department (EFD).

The Act also provides that all recognised associations under FCRA shall be deemed to be recognised stock exchanges under the SCRA. Accordingly, the following recognised associations shall be deemed to be recognised stock exchanges under SCRA w.e.f. September 28, 2015:

1. Ace Derivatives and Commodity Exchange Limited, Mumbai
2. Bombay Commodity Exchange Ltd., Vashi
3. Chamber Of Commerce, Hapur
4. Cotton Association of India, Mumbai
5. India Pepper & Spice Trade Association., Kochi
6. Indian Commodity Exchange Limited, New Delhi
7. Multi Commodity Exchange of India Ltd., Mumbai
8. National Commodity & Derivatives Exchange Ltd., Mumbai
9. National Multi Commodity Exchange of India Limited, Ahmedabad
10. Rajkot Commodity Exchange Ltd., Rajkot
11. Spices and Oilseeds Exchange Ltd., Sangli
12. Universal Commodity Exchange Ltd., Navi Mumbai

NOVEMBER, 2015

November 10

Exit order in respect of Vadodara Stock Exchange Ltd (VSEL)

The circular dated May 30, 2012 provides guidelines for exit of stock exchanges details of the conditions for exit of de-recognised/non-operational stock exchanges, facility of Dissemination Board. VSEL, will be the seventeenth Stock Exchange to exit under this policy.

November 2

SEBI cautions investors not to invest in schemes offered by entities barred by SEBI from raising money or entities not registered with SEBI

CIS offered by entities not registered with SEBI can have action taken against them. SEBI directed the entities and its Directors to stop collecting further money under existing / new schemes, not to launch any new scheme or float any new companies/firm to raise fresh money, not to divert or alienate any assets or money collected; directs winding up of unregistered schemes of the entities, repayments to investors and inter-alia also debars the entity and its Directors from accessing the Capital markets.

November 23

SEBI signs MoU on bilateral corporation with Bangladesh Securities Exchange Commission. SEBI and the Bangladesh Securities and Exchange Commission (BSEC) signed anMoU on bilateral cooperation and technical assistance at Dhaka, Bangladesh on November 22, 2015 seeking to promote further economic ties and corporation.

November 30

Board meeting took decisions regarding Listing of Stock Exchanges, Clearing Corporations, Disclosure Requirements, Public consultation process. Deemed public issues and public issuance of convertible securities.

DECEMBER, 2015

December 17

SEBI has initiated the second tranche of distribution of amount of Rs. 18.06 crores to be paid to 4.63 lakh investors from the disgorged amount in the matter of Initial Public Offerings (IPOs) irregularities.

December 19

The Raipur local office of SEBI was inaugurated.

December 23

The Sixth meeting of the International Advisory Board (IAB) of the Securities and Exchange Board of India (SEBI) was held on December 21 & 22, 2015. The issues discussed were *Implementation of OECD Principles of Corporate Governance, spot Price Determination of Commodities,* prevalent mechanism on functioning of Credit Rating Agencies (CRAs), market conduct and bankruptcy mechanism in India.

December 31

Warning to investors about unlisted companies are luring retail investors by issuing securities including non-convertible and convertible debentures/ non-convertible and convertible preference shares/ equity shares in the garb of private placement, without complying with the relevant provisions of SEBI Act and Companies Act.

JANUARY, 2016

January 11

Summary of decisions in the SEBI Board meeting:

1. Reviewed prudential limits on investments by Mutual Funds and issued fresh instructions with respect to the same.
2. Approved the proposal to introduce "Primary Market Debt Offering through private placement on electronic book".
3. Approved proposal to amend SEBI (ICDR) Regulations, 2009 for laying down framework to provide an exit opportunity to dissenting shareholders under the Companies Act, 2013.
4. Considered and approved the proposal for disclosure requirements for issuance and listing of Green Bonds, which have been formalized after consultation with the public

January 15

Steps for Curbing Volatility in Commodities Derivatives Markets

In accordance with Central government notifications F. No. 1/9/SM/2015 S.O. 2362 (E) and F. No. 1/9/SM/2015 S.O. 2363 (E) dated August 28, 2015, SEBI had commenced regulating the commodity derivatives market under Securities Contracts Regulation Act (SCRA) 1956 with effect from 28th September, 2015.

IMPORTANT CIRCULARS

November, 2015

November 4

SEBI released a circular regarding the format for the Business Responsibility Report (to be contained in the Annual Report) describing the initiatives taken by the listed entity from an environmental, social and governance perspective according to Regulation 34 (2) (f) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1446638214636.pdf]

November 16

SEBI circular issued to streamline and strengthen the framework of investor redressal and arbitration mechanism at commodity derivatives exchanges in line with the securities market.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1447679562764.pdf]

November 30

1. SEBI circular outlining the manner of representation for disclosure under Regulation 31 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 regarding shareholding pattern and manner of maintaining shareholding in dematerialized form.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1448885798277.pdf]

2. SEBI issued a circular specifying the methods to be adopted in order to achieve the minimum level of public shareholding according to Regulation 38, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1448885821812.pdf]

DECEMBER 2015

December 1

SEBI issued a circular regarding the possibility of making disclosures under the Takeover Regulations and Prohibition of Insider Trading Regulations on advanced systems and technologies.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1448970446882.pdf]

December 9

SEBI issued a circular specifying the guidelines for the outsourcing policy of the Depositories
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1449659937040.pdf]

JANUARY 2016

January 21

SEBI clarification circular for further streamlining the process of public issue of Equity Shares and convertibles to make the process more efficient and robust.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1453383072765.pdf]

FEBRUARY 2016

February 15

SEBI circular specifying guidelines for further streamlining the process of Offer for Sale of shares through stock exchange mechanism with an objective to encourage greater participation of all investors including retail investors.
[http://www.sebi.gov.in/cms/sebi_data/attachdocs/1455542994394.pdf]

SECURITIES LAW MOOT, 2015: HIGHLIGHTS

CENTRE FOR LAW AND DEVELOPMENT
NUALS

CENTRE FOR LAW AND DEVELOPMENT
Mr. RAJAT SETHI, PARTNER, S & R ASSOCIATES

BEST ARTICLE OF THE SEPTEMBER 2015 Ed. OF THE SECURITIES LAW E-NEWSLETTER

Archana Iyer is a 5th year student of NUALS, Kochi

BACK STABBING BY FRONT RUNNING: INDIAN PERSPECTIVE

(as found in page 2 of the September 2015 edition)

"*The quickest predators on the planet swim in oceans of data, move through interconnected computer networks associated with electronic trading platforms, and can place bids and offers for future contracts faster than a human can blink, all the while looking for large trades to pick off.*"

Gregory Scorpino

The phenomenon of 'front running' began to be debated assiduously in the wake of what the citizens of the finance world refer to as the epochal 'Black Monday', when on October 19, 1987, the stock markets around the world crashed, shedding a huge value in a very short time. The practice of front-running is first said to have appeared in the Chicago Board Operations Exchange (CBOE), the world's largest and first organized stock exchange, when in the 1970's, liquidity and institutional participation increased substantially as volume exploded, and which in turn developed a number of abuses with respect to listed options trading, including 'front-running' as identified by the United States' Securities and Exchange Commission in 1977.

Front Running is often defined as 'buying or selling of securities ahead of an anticipated large order, which is not known to the market, with a view to benefit from the subsequent price rise.' Another popular definition for front-running postulates, 'Front-running is a broker's or analyst's use of non-public information to acquire securities or enter into options or futures contracts for his or her own benefit, knowing that when the information becomes public, the price of the securities will change in a predictable manner.' Front running is not clearly defined by any law in India.

Front-running is closely related to the trade tactic of insider trading which is illegal, while done in breach of a fiduciary duty, in most of the jurisdictions. Insider trading is the malpractice of using unpublished price sensitive information in trading the shares of a company by an insider in the company. Insider trading is regulated by Securities and Exchange Board of India (SEBI) (Prohibition of Insider Trading) Regulations 2015.

Front running is prohibited primarily because an insider who has access to unpublished price sensitive information may misuse such information to manipulate the market and gain profits, thereby adversely affecting market integrity. Front running in India is currently regulated by SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003.

Regulation 6(b) of the former SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 stated that 'no person shall on his own behalf or on behalf of any person, knowingly buy, sell or otherwise deal in securities, pending the execution of any order of his client relating to the same security for purchase, sale or other dealings in respect of securities'. Regulation 4(2)(q) of the current Regulations states that, "Dealing in securities shall be deemed to be fraudulent or an unfair trade practice if it involves fraud and may include all or any of the following namely:- (q) an intermediary buying or selling securities in advance of a substantial client order or whereby a future or option position is taken about an impending transaction in the same or related future or options contract."

Therefore, the 1995 Regulations prohibited 'any person' from indulging in front running whereas the term used in the 2003 Regulations is 'intermediaries'. Some of the persons envisaged as intermediaries in the 2003 Regulations include stock brokers, merchant bankers, portfolio managers, investment advisors, Foreign Institutional Investors, Asset Management companies etc.

The 2003 Regulations prevented SEBI and Securities Appellate Tribunal (SAT) from booking several persons on account of front running since they would not fall under the ambit of 'intermediaries' as stated in Regulation 4 (2) (q). In the case of *Dipak Patel v. Securities and Exchange Board of India,* SAT had held that the 2003 Regulations only barred front running by intermediaries and the same would not be applicable to any other person. The order also suggested that front running by non-intermediaries would not amount to market manipulation. In the instant case, Dipak Patel was a portfolio manager with Passport India Investment, a Mauritius based Foreign Institutional Investor (FII). SEBI alleged that Patel had worked with his relatives to indulge in front-running on stocks before his FII client placed large orders. The distinction between the provisions in the 1995 Regulations and 2003 Regulations was made, with respect to the use of the terms 'any person' and 'intermediaries' respectively in the case of persons involved in front running.

On the proposal of Mr. U.K. Sinha, Chairman of SEBI, the 2003 Regulations in the context of front-running, were proposed to be re-examined, to decide whether the aspects relating to front-running would require further strengthening or improvement. Thus, on September 6, 2013, an amendment to the 2003 Regulations was notified in the way of an 'Explanation' to Regulation 4(2) which reads as follows:

"For the purpose of this sub-regulation, for the removal of doubts, it is clarified that the acts or omissions listed on this sub-regulation are not exhaustive and that an act or omission is prohibited if it falls within the purview of Reg. 3, notwithstanding that it is not included in this sub-regulation or is described as being committed only by a certain category of persons in this sub-regulation."

SAT diverged from the position taken by it in the *Dipak Patel Case,* in *Vibha Sharma & Anr. v. SEBI,* where the Tribunal held that 'front-running' even by a person other than an intermediary is illegal. The Tribunal held the following:

- **Liberal interpretation of concept of front-running –** Definition of front running cannot be put to a straight – jacket formula since front running is always considered detrimental irrespective of whether it is done by an individual or an intermediary.
- **Exchange of information –** Jitender Sharma, the spouse of Vibha Sharma, an equity dealer in securities with Central Bank of India and Vibha Sharma, a day trader, exchanged information relating to future trades and on the basis of this information, Vibha Sharma gained profits.
- **Not mere Coincidence –** Trades by Vibha Sharma was not coincidental especially since there was a 100% matching of trades between Vibha Sharma's sale orders and the Bank's purchase orders at a price significantly higher than Last Traded Price on 14 days, thereby gaining her undue profits.

The above mentioned judgment does not fully set a precedent for non-intermediaries being sanctioned under Reg. 4 (2) (q) for front running since Vibha Sharma was booked mainly under Reg. 3 of the 2003 Regulations for fraudulently dealing in securities.

One of the more recent decisions by SEBI on front-running was its impounding of unlawful gains worth nearly 15 crores from brokerage firm Sharekhan and 15 other entities with its order dated 31st Aug, 2015, when investigation revealed that the trades in the accounts of at least seven entities referred to as 'front runners' were in the nature of front-running the orders and trades of the 'Sterling Group' and the that the subsequent orders placed by the front-runners matched almost completely with the orders placed by the Sterling Group.

The Regulations provide for procedure for investigation and if the court is satisfied of the offence, take actions as given under Regulation 12 which includes suspending or cancelling the registration of the intermediary or take such actions so as to restore *status quo ante* as given under Reg. 11.

For effective prevention of front running and other fraudulent trade practices which adversely affect the market integrity and cause loses to the client companies, it is imperative that the application of the Regulations as a whole be extended to 'any person' engaging in fraudulent acts, not just to those indulging in front running. That is the most efficacious solution to keep the market predators at bay.

THE SECURITIES E-NEWSLETTER TEAM

Bipluv Jingan
5th year

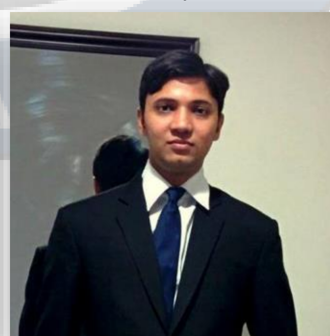
P.A.N.V Raviteja
5th year

Aakash Kumbat
4th year

Apoorv K.C
4th year

Nilima Rajdev
4th year

Niranjan Sudhir
4th year



Yudhvir Dalal
4th year

Akshay Shah
3rd year

Kritika C.
3rd year

Namratha K.
3rd year