

M&A Hotline

July 16, 2009

ARE GDR HOLDERS MEMBERS OF THE COMPANY?

The Ministry Of Corporate Affairs ("MCA") has in its Circular No. 1/2009 No. 17/67/2009 CL-V dated June 16, 2009 ("Circular") clarified on why the holders of Global Depository Receipts ("GDRs") should not *per se* be considered as the members of the issuing company¹ ("Issuing Company").

BACKGROUND

Under Section 41 of the Companies Act, 1956 ("Companies Act"), a member of a company is a person who:

- (1) subscribes to the Memorandum of Association (charter documents) of the company; or
- (2) agrees in writing to become a member of a company and whose name is entered in the register of members; or
- (3) holds equity shares capital of the company and whose name is entered as beneficial owner in the records of the depository.

Depository Receipts and ADR / GDR Mechanism

Issuance of depository receipts facilitates Indian companies to raise capital in a foreign jurisdiction. The most commonly used depository receipts are Global Depository Receipts ("GDRs") and American Depository Receipts ("ADRs")².

Typically in an ADR / GDR mechanism, the equity shares of the Issuing Company are held by a Domestic Custodian Bank³. The Domestic Custodian Bank would in turn instruct the Overseas Depository Bank⁴ to issue depository receipts in the form of ADRs / GDRs to the offshore investors. Each ADR / GDR represents certain number of underlying equity shares held by the Domestic Custodian Bank and the ADR / GDR holder would be entitled to those underlying equity shares at the time of conversion of ADRs / GDRs. The underlying equity shares of the Issuing Company are registered in the name of the Overseas Depository Bank.

WHY WAS THIS CIRCULAR ISSUED?

There existed an element of ambiguity on treatment of holder of GDR as members of the company and whether they can be regarded as the beneficial owners of shares for the purposes of Section 41 (3) of the Companies Act, which was clarified by MCA *vide* this Circular.

WHO IS A BENEFICIAL OWNER?

The concept of beneficial ownership⁵ was introduced with the enactment of Depositories Act, 1996 ("Depositories Act") which facilitates conversion of shares held in physical form into demat (electronic) form. Upon such conversion, the depository⁶ ("Depository") viz. National Securities Depository Limited (NSDL) and / or Central Depository Services (India) Limited (CDSL) would be entered as the registered owner of such equity shares in the registers of the Company and the name of the actual shareholders would be recorded as the 'beneficial owners' in the records of the Depository.

However, through a special statute the law provided a look through by the company and all the rights and benefits attached to the shares, including voting and dividend rights, vests with the beneficial owners.

THE CLARIFICATION ISSUED BY MINISTRY OF CORPORATE AFFAIRS

MCA has, *vide* this Circular, clarified that a holders of GDR⁷ not a member of the Company under Section 41 of the Companies Act, till such GDR is converted into underlying equity shares. This interpretation is based on the following analysis:

- A Holder of GDR is not subscriber to charter documents of the company: In its analysis, MCA discussed that a holder of GDR not a subscriber to the charter documents of the Issuing Company and hence does not qualify under Section 41(1) of the Companies Act.
- A Holder of GDR is not a holder of equity share: Another essential requirement for being a member of a Issuing Company is that the person should agree in writing to become a member of the Issuing Company and his name should be entered in the register of members. In the instant case, a holder of GDR merely holds an instrument whose economic value is derived from the underlying equity share of the Issuing Company and does not entitle such holder of GDR to ownership over the underlying equity share of the Company. Thus, a holder of GDR fails to conform to this prerequisite as well.

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iii. Overseas Depository Banks are not 'Depository' in terms of Indian Companies Act / Depositories Act: MCA has clarified that the Overseas Depository Banks defined under the Scheme cannot be equated with Depository defined under the Depositories Act / Companies Act. Further, unlike the Depositories Act, where an actual subscriber of equity share is regarded as beneficial owner of equity share and is entitled to all the rights of a shareholder, a holder of GDR does not get any rights on the underlying equity share. The said equity share is issued in the name of Overseas Depository and they would continue to exercise rights on the same including voting rights till the GDR is converted into underlying equity share by the holder of GDR. Accordingly, such GDR mechanism should not fall within the purview of Section 41 (3) of the Companies Act and a holder of GDR cannot be deemed to be a member till the conversion of such GDR.

CONCLUSION

The ownership of a company is primarily determined by the shareholding and each member holds a certain percentage of ownership in the company to the extent of shares held by him. This Circular seems to clarify that the basis of determining ownership in a company is essentially the number of shares held by a person in the company and a holder of GDR is merely holder of an economic instrument, which derive their value from the underlying equity share of the Issuing Company.

This view of MCA is also in line with the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, which recognizes acquisition of voting rights / control and mandates the open offer requirement only at the time of conversion of ADRs/ GDRs into underlying equity shares⁸.

- **Shikhar Kacker, Vaidhyaradhan Iyer & Nishchal Joshipura**

¹ As per Section 2(d) of the Scheme Issuing company means an Indian company permitted to issue Foreign Currency Convertible Bonds or ordinary shares of that company against Global Depository Receipts

² Issuance of ADRs / GDRs are governed by Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 ("**Scheme**")

³ As per Clause 2(a) of Scheme Domestic Custodian Bank means a banking company which acts as a custodian for the ordinary shares or foreign currency convertible bonds of an Indian company which are issued by it against global depository receipts or certificates

⁴ As per Clause 2(e) of Scheme Overseas Depository Bank means a bank authorized by the issuing company to issue global depository receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company

⁵ As per Section 2 (a) of the Depositories Act, "beneficial owner" means a person whose name is recorded as such with depository

⁶ As per Section 2(e) of the Depositories Act, "depository" means a company formed and registered under the Companies Act, 1956 (1 of 1956) and which has been granted a certificate of registration under sub-section (1A) of section 12 of the Securities and Exchange Board of India Act, 1992

⁷ This interpretation should also equally apply to holders of ADRs

⁸ Regulation 3(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997

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