

# Corpsec Hotline

September 13, 2012

## SUPREME COURT TO SAHARA: IT'S NOT PRIVATE!

This article has been published on [thefirm.moneycontrol.com](http://thefirm.moneycontrol.com). Herein below, is the full text of the article.

### INTRODUCTION

The Hon'ble Supreme Court of India ("SC") in its recent judgment<sup>1</sup> ("**Sahara Judgment**") has directed Sahara India Rea<sup>1</sup> Estate Corporation Limited ("**SIRECL**") and Sahara Housing Investment Corporation Limited ("**SHICL**") (both collectively referred to as the "**Appellants**") to refund to SEBI the ~USD 3.16 billion<sup>1</sup> they had raised along with an interest of 15% by November 30, 2012, and also to furnish details, along with the application forms etc., of the ~6.6million subscribers from whom the Appellants had raised the monies.

The Sahara Judgment while upholding the Securities Exchange Board of India ("**SEBI**") and Securities Appellate Tribunal ("**SAT**") order<sup>3</sup> has also clarified ambiguities in certain provisions of law used by India Inc. to raise public monies without intervention from SEBI. We have herein below in this article, discussed and analyzed some of the key issues which have been decided by the SC.

### HOW THE FUNDS WERE RAISED

SIRECL and SHICL (both unlisted public companies), in March 2008 and September 2009, respectively, in their general meeting resolved through a special resolution under Section 81(1A) of the (Indian) Companies Act, 1956 ("**Companies Act**") to raise funds through unsecured optionally fully convertible debentures ("**OFCDs**") by way of private placement to friends, associates, group companies, workers/employees and other individuals associated/affiliated or connected in any manner with Sahara group of companies ("**Sahara Group**").

Later, pursuant to their board resolutions, both, SIRECL and SHICL filed red herring prospectus ("**RHP**") under Section 60B of the Companies Act with registrar of companies ("**ROC**"), Kanpur and Mumbai, respectively, both of which got registered.

The RHPs provided that the Appellants did not intend to get their securities listed on any recognized stock exchange, and that only those persons to whom the information memorandum ("**IM**") was circulated and/or those associated with Sahara Group, would be eligible to apply. The RHPs also provided that the funds raised would be utilised for financing the acquisition of townships, residential apartments, shopping complexes etc. and to undertake construction and infrastructure activities.

Post registration of the RHPs, the Appellants circulated the IMs along with application forms to persons allegedly associated with the Sahara Group through their network of around 2900 branch offices and 10 lakh agents, and raised monies under an open ended scheme. The IMs stated that the issue of the OFCDs was purely on a private placement basis and the OFCD's were not intended to be listed on any stock exchange.

### SEBI AND SAT RULING

SEBI became aware of the large scale collection of monies from the public by the Appellants while processing the draft RHP submitted by Sahara Prime City Limited (another Sahara Group company) in respect of its proposed initial public offering dated September 30, 2009, and also from two complaints received by it from investors. On further investigation and multiple correspondences later, SEBI passed an order on June 23, 2011 ("**SEBI Order**") holding the Appellants to be in violation of various provisions of the corporate and securities laws, dealt with later in this article. An appeal was then filed by the Appellants against the SEBI Order in the SAT, which was decided in favour of SEBI vide an order dated October 18, 2011 ("**SAT Order**"). A further appeal was then filed by the Appellants against the SAT Order in the SC.

Although contended, the Appellants could not substantiate their claim that the investors were friends, associated group companies, workers/employees and other individuals who were associated/affiliated or connected with Sahara Group. Issues

Following are the key issues which were debated and decided upon by the SC:

**1. Jurisdiction of SEBI:** What companies does the SEBI have the jurisdiction to administer so far as it relates to issue and transfer of securities?

Section 55A of the Companies Act delegates certain powers relating to issue and transfer of securities to SEBI. It reads as follows:

#### "55A. Powers of Securities and Exchange Board of India –

The provisions contained in Sections 55 to 58, 59 to 81 (including sections 206, 206A and 207, so far as they relate

## Research Papers

### Fintech

May 05, 2025

### Medical Device Industry in India

April 28, 2025

### Clinical Trials and Biomedical Research in India

April 22, 2025

## Research Articles

### 2025 Watchlist: Life Sciences Sector India

April 04, 2025

### Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

## Audio

### CCI's Deal Value Test

February 22, 2025

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

April 01, 2025

to issue and transfer of securities and non-payment of dividend shall, --

1. in case of listed companies;
2. 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
3. in any other case, be administered by the Central Government.

Explanation – For the removal of doubts, it is hereby declared that all powers relating to all other matters including the matters relating to prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares shall be exercised by the Central Government, Tribunal or the Registrar of Companies, as the case may be."

From the aforementioned it can be gathered that (i) listed companies and (ii) those intending to get listed are companies subject to the jurisdiction of SEBI. What would tantamount to 'intending to get listed' was a question before the SC. The SC while answering this question described in great detail the role of SEBI as an institution to promote orderly and healthy growth of the securities market and for investors' protection. Against this backdrop, the SC analyzed the contentions of the Appellants and the relevant laws."

The Appellants argued that they never intended to list the OFCDs, and hence the issuance fell outside the purview of SEBI. This contention was rejected by the SC. The SC in analyzing this aspect went by the conduct of the Appellants and stated that a 'company's option, choice, election, interest or design does not matter, it is the conduct and action that matters and that is what the law demands'. Since, in this instant case, the issue of OFCDs was held to be a public issue, which entailed a listing, the SC held that the Appellants were seen to have intended to get their securities listed. This rationale of the SC for holding the issue of the OFCDs to be a public issue has been discussed below.

**2. Public issue versus private placement:** Whether Section 67 of the Companies Act implies that a company's offer of shares or debentures to 50 or more persons would ipso facto become a public issue, subject to certain exceptions provided therein?

As stated above, only if the Applicants issue of OFCDs was held to be a 'public issue' would the same be subject to SEBI jurisdiction. It was not in dispute that there were more than 50 offerees or subscribers to the issue of OFCDs by the Appellants. The contention of the Appellants was that the number of allottees or offerees was immaterial in determining whether an offer was a public issue – it was the intention that mattered. The intention to offer to a select or identified group would make the offer a private placement. To support their argument the Appellants relied on the Unlisted Public Companies (Preferential Allotment) Rules, 2003 which do not stipulate a limit to the number of persons that a preferential allotment may be made.

Section 67 of the Companies Act is an aid to interpreting what 'offering shares or debentures to the public' means. Section 67 (1) and (2) provides that an offer to public is one that is offered to any section of the public. Section 67(3) however excludes from the definition of 'offer to the public', an offer or invitation that is (i) 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 (ii) otherwise as being a domestic concern of the persons making and receiving the offer or invitations; except if made to 50 persons or more.

The SC rejected the arguments of the Appellants and relied on Section 67 to conclude that an offer to 50 or more persons constitutes a public issue, and hence the issuance of OFCDs by the Appellants was a public issue. To arrive at this conclusion, the SC also lifted the veil to examine the conduct and method adopted by the Appellants and placed reliance on inter-alia the following to determine that even in spirit the issuance by the Appellants was a public issue:

- In the IM circulated by the Appellants, it was stated that if the number of interested parties to the OFCD issue exceeded 50 they would approach the ROC to file RHP as per Section 67(3) of the Companies Act;
- The Appellants made disclosures that the issue was being made on a private placement basis and that OFCDs would be offered only to such persons to whom IM would be circulated. But the fact remains that it was circulated to more than three crore people inviting them to subscribe;
- Although contended, the Appellants could not substantiate their claim that the investors were friends, associated group companies, workers/employees and other individuals who were associated/affiliated or connected with Sahara Group.

**3. Listing in case of public issue:** In terms of Section 73, is every company making an offer of securities to 50 or more persons required to apply for listing of its securities on a stock exchange?

The SC stated that Section 73(1) of the Companies Act casts an obligation on every company intending to offer shares or debentures to the public to apply on a stock exchange for listing of its securities. Such companies have no option or choice but to list their securities on a recognized stock exchange, once they invite subscription from over 49 investors from the public. If an unlisted company expresses its intention, by conduct or otherwise, to offer its securities to the public by the issue of a prospectus, the legal obligation to make an application on a recognized stock exchange for listing starts.

The Appellants had argued that since they did not intend to offer the OFCDs to the public, this provision should not apply. However, as mentioned above, the SC on the basis of the conduct of the Appellants concluded that they intended to offer the OFCDs to the public and hence they were obligated to apply for listing of OFCDs.

**4. Securities include hybrid:** Are hybrid instruments also within the ambit of the SEBI to regulate?

The Appellants had contended that whereas pursuant to the Companies Amendment Act the definition of the term 'securities' was modified to include a "hybrid" instrument Section 67 of the Companies Act was not amended to include 'hybrids' and continued to refer only to offer of shares or debentures. Therefore, since OFCDs are hybrids, they should be outside the purview of Section 67 of the Companies Act.

The Appellants also pointed the difference between the definition of the term 'securities' in the Companies Act and the Securities Contracts (Regulation) Act, 1956 ("SCR Act") in that the term 'hybrid' had only been inserted in the definition of "securities" in the Companies Act and not the SCR Act, and consequently not in the SEBI Act as well

(which draws its definition of 'securities' from the SCR Act). Consequently, the Appellants contended that SEBI does not have jurisdiction over OFCDs issued by the Appellants which are hybrids.

However, the SC rejected the above contentions. It stated that the OFCDs issued by the Appellants undoubtedly were unsecured debentures by name and nature. Though, they have the dual characteristics of shares and debentures, as defined by the term "hybrids", however, they continue to remain debentures till the time they are converted. In other words, OFCDs issued by the Appellants are debentures in present and become shares in futuro. Further, the SC also stated that the definition of "debentures" in Companies Act includes 'any other securities', and noted that the Appellants have treated OFCDs only as debentures in the IM, RHP, application forms and also in their balance sheet.

Further, on the contention of SEBI's jurisdiction over OFCDs, the SC stated that the definition of "securities" in the SCR Act is an inclusive definition and not exhaustive. Further, the definition of "securities" in the SCR Act includes any "other marketable securities of like nature". The SC stated that any security which is capable of being freely transferable is marketable. Since, the OFCDs issued by the Appellants were freely transferable, therefore, they fall within the purview of "securities" in the SCR Act.

The SC also stated as Section 55A of the Companies Act, which deals with delegation of powers to SEBI refers to "securities", and the definition of "securities" in Companies Act includes "hybrids", therefore, SEBI has jurisdiction over hybrids like OFCDs issued by the Appellants.

**5. Convertible bonds:** Whether OFCDs issued by the Appellants are convertible bonds falling within the scope of Section 28(1)(b) of the SCR Act, and therefore, not "securities" or, at any rate, not listable under the provisions of SCR Act?

Section 28(1)(b) of the SCR Act provides that the provision of the SCR Act shall not apply to 'any convertible bond or share warrant or any option or right in relation thereto, insofar as it entitles the person in whose favour any of the foregoing has been issued to obtain at his option from the company or other body corporate, issuing the same or from any of its shareholders or duly appointed agents' shares of the company or other body corporate, whether by conversion of the bond or warrant or otherwise, on the basis of the price agreed upon when the same was issued.'

It was contended by the Appellants that the OFCDs issued were convertible bonds falling within the scope of Section 28(1)(b) of SCR Act and hence were excluded from the purview of the SCR Act. However, the SC rejected this contention and stated that Section 28(1)(b) makes it clear that the SCR Act will not apply to the 'entitlement' of the buyer, inherent in the convertible bond. Entitlement may be severable, but does not itself qualify as a security that can be administered by the SCR Act, unless it is issued in a detachable format. Therefore, the inapplicability of SCR Act, as contemplated in Section 28(1)(b), is not to the convertible bonds, but to the entitlement of a person to whom such share, warrant or convertible bond has been issued, to have shares at his option. The expression "insofar as it entitles the person" clearly indicates that it was not intended to exclude convertible bonds as a class.

## ANALYSIS

**1. End of road for Sahara?:** This SC judgment may not be the end of road for Sahara Group. A judgment of the SC can be reviewed by a review petition, and on dismissal of a review petition, further by a curative petition. However, the grounds for admitting such petitions are very limited, like for admitting a review petition, there should be a discovery of new and important matter of evidence, or some mistake or error apparent on the face of the record; similarly, for a curative petition, which is ought to be treated as a rarity, there should be a gross miscarriage of justice resulting from violation of principles of natural justice as mentioned in another SC case of Rupa Hurra vs. Ashok Hurra & Another, AIR 2002 SC 177, or the judgment should adversely affect a person and he should not be a party to the dispute, or if he was a party, he should not have been served with notice of the proceedings and the matter should have proceeded as if he had notice.

**2. Jurisdiction of SEBI versus ROC:** This judgment is a very crucial one for SEBI as it not only affirms its jurisdiction and power to administer various provisions of the Companies Act, but also clarifies that even unlisted companies (whether private or public) which intend to (by conduct or otherwise) get their securities listed on any stock exchange now fall within the radar of SEBI. Thus, the general perception that SEBI can only monitor listed companies and it does not have jurisdiction over unlisted companies may not be entirely correct. Also, the role of ROC in such cases may now be limited.

**3. Public issue vs. private placement debate:** By clarifying that offer of security to 50 or more persons would qualify as a public issue, the SC has brought some clarity to this long standing debate. Earlier, there was an ambiguity as to whether an offer of security to more than 49 persons would ipso facto become a public issue or not. Though the Statement of Objects and Reasons for the Companies (Amendment) Act, 2000 provided that 'any offer of shares or debentures to more than 50 persons shall be treated as a public issue with suitable modification in the case of public financial institutions and non-banking financial companies', however, the Section 67 of the Companies Act does not expressly mention so.

Having said the above, there is still an ambiguity as to whether multiple offers of security by any company at reasonable intervals of time, with each offer being to less than 49 persons but in aggregate more than 49 persons, would qualify as public issue or not.

Also, so far the emphasis has always been on an 'offer' to 50 or more persons. What constitutes 'offer' has not been addressed by the SC in the Sahara Judgement. For instance, does just addressing a gathering of persons constitute an offer / invitation, or is it the actual act of distributing an IM which constitutes an offer / invitation. Further, it is not clear as to what happens when a company does not make an offer or invitation to the public, but only issues its securities to more than 49 persons at their instance. Though unlikely, but whether such cases would fall outside the purview of public issue is yet to be seen.

**4. Transferable means marketable:** Though, not a ratio decidendi in this case, however, the SC has stated that any security which is capable of being freely transferable is marketable. This may have some implications, especially, in case of stamp duty. For instance, the Indian Stamp Act, 1899 defines the term 'marketable' as 'security of such a description as to be capable of being sold in any stock market in India or in the United Kingdom'. Sans the above statement from the SC, one possible interpretation could be that unless the security is not listed, it cannot be sold in

any stock market, and hence only listed securities should fall within the purview of marketable securities. However, as per the statement of the SC, the moment a security is a transferable, it becomes marketable. Hence, there arises an ambiguity as to whether an unlisted transferable security would also be considered 'capable of being sold in a stock market' and hence 'marketable' for the purpose of the stamp duty.

**5. Criminal sanctions:** No criminal sanction has been imposed on the Appellants or the promoters / directors in the instant case. However, the SC has directed the Appellants to furnish details with supporting documents to SEBI on the subscribers and the refunds which have been made to the subscribers, by September 10, 2012. SEBI has been asked to ascertain the genuineness of the subscribers with the help of investigating officers / experts in finance and accounts. If the event, SEBI suspects the genuineness of the subscribers, they are required to give the Appellants a hearing. However, the SC has directed that the decision of SEBI (WTM) in this behalf shall be final and binding on the Appellants as well as the subscribers.

Under the SEBI Act, SEBI has inter-alia been granted with powers to impose imprisonment up to 10 years. Though, this power is used sparingly by SEBI, however, they have not been shy when the case demands. For instance, in the past, SEBI has imposed criminal sanctions against the managing director of VR Mathur Mass Communications Limited under Sections 63 and 68 of Companies Act for material misstatements in the prospectus of the company during its public issue of shares.<sup>4</sup> It has also in case of Goldstar Teak Forest India Ltd. & others, as well as Angel Green Forest Ltd. & others, imposed rigorous imprisonment of 6 months on the accused for violation under the SEBI (Collective Investment Schemes) Regulations, 1999.<sup>5</sup>

If SEBI finds the information submitted by the Appellants about the applicants or refunds already made, to be fictitious or concocted, SEBI may be at liberty to use its powers to impose sanctions as it may deem fit.

## CONCLUSION

The SC judgment has once again reaffirmed the role and object of SEBI as a securities market regulator and emphasized upon the inherent jurisdiction of SEBI to oversee matters concerning the public investors at large. By clarifying that SEBI has jurisdiction over OFCDs, it may have in a sense indicated that usage of structured financial instruments which are not expressly mentioned in the definition of 'security' in the SCR Act to avoid the jurisdiction of SEBI, may not work, if monies are being raised from the public at large.

Further, ruling that an offer of security to 50 or more persons would tantamount to public issue, has to some extent clarified this issue which has loomed over the industry since long. Questions of what tantamounts to 'offer' and whether an issuance to more than 50 persons without an offer would still qualify as a public issue are issues that still need to be clarified.

The Sahara Judgement has also reaffirmed the fact that a public issue would mandatorily entail an application for listing on a stock exchange. With this clarity, the market players may now be able to manage their fund raising affairs with more certainty. At the same time, this ruling has also given the ammunition to SEBI to crackdown on those companies which have offered their securities to more than 49 persons without applying for listing and following other requirements. Thus, we may get to see stricter enforcement of these laws now. Having said that, to discover such instances, unless an investor complains or a public filing is made, would still be a challenge.

– Mukul Aggarwal, Deepak Jodhani & Simone Reis

You can direct your queries or comments to the authors

---

<sup>1</sup> Sahara India Real Estate Corporation Limited & Ors. versus Securities and Exchange Board of India & Anr., order dated August 31, 2012 in Civil Appeal No. 9813 and 9833 of 2011

<sup>2</sup> At an exchange rate of USD 1 = INR 55.1

<sup>3</sup> SEBI order dated June 23, 2011, and SAT order dated October 18, 2011

<sup>4</sup> [http://www.watchoutinvestors.com/Press\\_Release/sebi/2002162.asp](http://www.watchoutinvestors.com/Press_Release/sebi/2002162.asp).

<sup>5</sup> <http://www.sebi.gov.in/cis/ProsecutionConviction.pdf>.

---

## DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.