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SAHARA vs. SEBI: A Landmark Case that Paved the Way for the Protection of Investors

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ABSTRACT

The paper will discuss elaborately as to how these two companies could raise such a huge amount and violated the various provisions of the Companies Act and SEBI Act. The current Sahara case will serve as an important precedent and will be considered as one that brought the focus on investor protection, not because the deceived investors staged a protest, but because of the highest court of the land which issued landmark orders on the violation of its regulatory framework, mandated compliance, and jailed the offenders. Through the course of this paper, the idea is primarily to critically analyse this case and throw light on each of the issue covered in the judgement. I have also made an objective effort to examine the justifications put forth by both the sides in their defence.

Keywords: *Sahara, SEBI, Public limited, companies.*

I. INTRODUCTION/ BACKGROUND OF THE CASE

Sahara India Parivar is an Indian conglomerate which is headquatered in Lucknow, India and was founded by Subrata Roy in 1978. The company's business interest lies particularly in finance, manufacturing, infrastructure & housing, entertainment, consumer merchandise retail venture etc. Sahara India Real Estate Corporation Limited (hereinafter referred to as "SIRECL") and the Sahara Housing Investment Corporation (hereinafter referred to as "SHICL"), are the two companies controlled by Sahara Group herein (conveniently called Saharas).

SIRECL and SHICL (both unlisted companies) approved a special resolution u/s 81(1A)[2] in their general meeting in March 2008 and September 2009 respectively to raise funds by issuance of unsecured Optionally Fully Convertible Debentures (hereinafter referred to as "OFCDs") by way of private placement to friends, associates, workers/employees, associates and to all other individuals associated or affiliated in any manner with the Saharas.

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[2] The Companies Act, 1956 (hereinafter referred to as "Companies Act").

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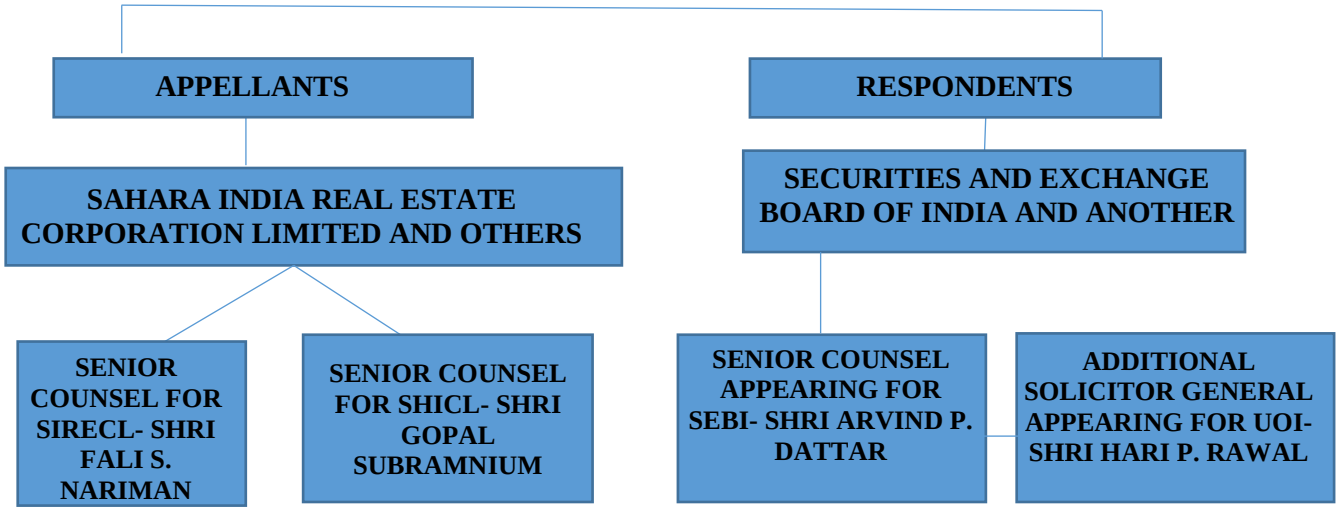
Later, after passing of the resolution, both, SIRECL and SHICL filed red herring prospectus (hereinafter referred to as "RHP") u/s 60B of the Companies Act with the Registrar of Companies (hereinafter referred to as "ROC"), Kanpur and Mumbai, respectively, and both got registered. The RHP very clearly stated that the company did not intend to list their securities on any recognised stock exchange. The only persons eligible to apply were the ones to whom the information memorandum (hereinafter referred to as "IM") was circulated and/or those connected with the Saharas. 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.[3]

After the RHPs were registered with the ROC of Kanpur and Mumbai respectively, the Saharas circulated the IMs accompanied by the application forms allegedly associated with the Saharas and this was possible due to their network of around 2900 branch offices and 10 lakh agents, raised monies under an open ended scheme. It was very clearly and specified in the IM that the issue of the OFCDS were issued on a purely private placement basis and that the OFCDs were not intended to be listed on any stock exchange. The IMs were ultimately to more than 30 million persons inviting them to subscribe to the OFCDs. It so happened that the Securities and Exchange Board of India (hereinafter referred to as "SEBI") received complaints about collection of huge sums of money from the public by means of OFCDs violating the relevant statutory provisions. This is when the SEBI decided to probe into this matter and start the investigation. The remaining part of the journey and the decision given by the Supreme Court will be analysed in the course of this paper.

II. DIAGRAMIC REPRESENTATION TO GET A CLARITY IN ORDER TO PROCEED WITH THE PAPER



[3] Mukul Aggarwal, Deepak Jodhani & Simone Reis, SUPREME COURT TO SAHARA: IT'S NOT PRIVATE!, Nishith Desai Associates, September 13, 2012 , www.nishithdesai.com.

The Supreme Court of India, while passing the judgement in this case, formulated some interesting observations on the issues raised before it. The following details need to be kept in mind while moving ahead and these are listed as follows-

(A) Issue 1

- ***JURISDICTION OF SEBI-*** Whether SEBI has the jurisdiction to investigate and adjudicate in this matter as per Sec 11, 11A, 11B of SEBI Act and under Sec 55A of the Companies Act or is it the Ministry of Corporate Affairs (MCA) which has the jurisdiction under Sec 55A (c) of the Companies Act?

The Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "SEBI Act"), is a special law which contains elaborate provisions to protect interests of the investors. The maxim '*Generalis Specialibus Non Derogant'* is used for statutory interpretation. The maxim basically states that 'the general laws do not prevail over special laws. When there is a conflict between two statutes, the provisions of the special law are preferred over that of general law because the special laws are meant to address a particular subject in greater detail. The important point that one needs to keep in mind is that the provisions of the special law have to be read in harmony along with the provisions of general law. In the same way, in this case, the SEBI Act is a special Act which deals with a specific subject viz. securities and has to be read in harmony with the provisions of the Companies Act. The main intent of the legislature here is to protect the interest of the investors which can be achieved when both of these statutes work in tandem.

When talking about the jurisdiction of SEBI in this case, Shri Fali S. Nariman, learned counsel appearing for SIRECL submitted that Section 55A[4] of the Companies Act confers no power on SEBI to administer the provisions of the Companies Act of an unlisted company or to adjudicate upon the alleged violation of provisions. He also stated that the Sections 11, 11A and 11B of the SEBI Act empower the SEBI to protect the interest of the investors but the SEBI is not empowered to administer the provisions of the Companies Act which relates to the issue and transfer of securities and non-payment of dividends, in case of an unlisted company. It was also pointed out by the appellants that the power of administration of Sections 56, 62, 63 and 73 with respect to OFCDs is vested only with the Central Government and not with SEBI. The same was contended by Shri Gopal Subramanium, learned counsel appearing for SHICL that the SEBI exceeded its jurisdiction and has no power to investigate the concerned case.

[4] The Companies Act, 1956, inserted by the Companies(Amendment) Act, 2000 (w.e.f. 13-12-2000).

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In this regard, the respondents, Shri Arvind P. Dattar, appearing on behalf of SEBI, clearly stated that the SEBI has jurisdiction to administer provisions contained under Section 55A, with matters pertaining to the issue and transfer of securities by Saharas. It was further iterated by the learned counsel that the Saharas had paid up share capital worth 10 Lakhs and virtually no assets and managed to collect about Rs. 27,000 crores from about 3 crore subscribers, through unsecured OFCDs. Which basically means that once the number reaches fifty or more persons, it ceases to be considered as private placement and falls within the ambit of an issue to the public, and an application for listing becomes mandatory and, thereafter the jurisdiction vests with SEBI. Shri Harin P. Rawal, Additional Solicitor General appearing on behalf of Union of India also supported the stand taken by SEBI and there should be no conflict between provisions of SEBI Act and the Companies Act, therefore the Section 11A and 11B of SEBI Act should be read as provisions additional to Section 55A.

The Supreme Court while analysing the case from both the sides mainly focused on two rules of statutory interpretation i.e. the *legislative intent* and the *rule of harmonious construction*. It stated that the intention of the legislature behind incorporating Section 55A was to confer jurisdiction on SEBI with regard to matters related to issue of securities, transfer of securities and non-payment of dividend. The legislative intention to entrust the powers with SEBI is to protect the interest of the investors in securities and to promote and regulate the securities market. Therefore, u/s 55A of the Companies Act, it is made very clear that the SEBI has the jurisdiction to administer and probe into this matter, rejecting all the contentions raised by the Saharas. It has to be remembered that the matters relating to prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares be exercised by the Central Government, Tribunal, Company Law Board, Registrars of Companies, as the case may be. Applying the second rule of statutory interpretation i.e. the rule of harmonious construction, the purpose of this rule is to clarify where there is any obscurity or vagueness in the main enactment then in order to make it consistent with the dominant object which it seems to serve, the statutes must be read in harmony with each other.[5] Therefore, by applying the rule of harmonious construction, both the Companies Act and the SEBI Act have to be read in harmony with each other.

(B) Issue 2

[5] Garima Soni Singh, An Analysis of Hon'ble Supreme Court Judgement dated 31.08.2012 in the matter of Sahara India Real Estate Corporation Ltd. & Others vs. SEBI, India Law Journal,2007, https://www.indialawjournal.org/archives/volume6/issue_1/article4.html.

- ***PUBLIC ISSUE VERSUS PRIVATE PLACEMENT***-Whether Section 67 of the Companies Act implies that the company's offer of shares or debentures to fifty or more persons would *ipso facto* become a public issue, subject to certain exceptions provided therein?

Section 67 of the Companies Act clearly lays down the differences between private placement and public issue. The first proviso to Section 67(3)[6], very specifically lays down that 'Nothing contained in the sub-section (3) of Section 67 shall apply in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more. It has to be kept in mind that once the number of persons to whom an offer is made crosses forty-nine, the first proviso of Section 67(3) kicks in and it is considered to be an issue to the public, which attracts Section 73(1) and therefore an application for listing becomes mandatory.

The Appellants contended that though this proviso was added by the Companies Amendment Act, 2000, but it was urged that, in view of the Unlisted Public Companies (Preferential Allotment) Rules, 2003(hereinafter referred to as "Rules 2003), preferential allotment in case of unlisted public companies by private placement was provided for and permitted without any restriction on numbers as per the proviso to Section 67(3) and without requiring listing of OFCDs on any recognized stock exchange. The Appellants also submitted that Section 67 of the Companies Act does not indicate that any offer of shares or debentures to fifty or more persons would *ispo facto* become a 'public issue' or a 'private offer'. They contended that whether an offer is a public issue or a private placement, depends on the intention of the offeror. Therefore, the Appellants submitted that the number of allottees or offerees did not determine whether an offer was a public issue-it was the intention that mattered. Hence, they relied on the Rules 2003, because it did not put any limit to the number of persons to whom preferential allotment may be made.

To this, the respondents replied that Section 67(3) clearly state the intention of the Parliament behind adding this proviso, therefore, once the number reaches fifty or more, it will be considered as an issue to the public. The respondents also submitted that Saharas basic assumption that they are covered by Rules 2003 is erroneous. It was also submitted that after insertion of the proviso to Section 67(3) in December, 2000, private placement as allowed under Section 67(3) was restricted up to forty-nine persons only and 2003 Rules were framed keeping this statutory provision in mind and were never intended for private placement/preferential issue to more than forty-nine persons.

[6] Inserted by the Companies(Amendment) Act, 2000 (w.e.f. 13-12-2000).

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The Supreme Court rejected the arguments raised by the Appellants and stated that any share or debenture issue to more than forty-nine persons, will be considered as a public issue. The Appellants although contended, could not prove in the Court that the investors were friends, associated group companies, workers/employees and other individuals who were associated/affiliated or connected with Sahara Group. It is very clear from the facts that Saharas have issued securities to the public more than the threshold limit statutorily fixed under the first proviso to Section 67(3) and hence violated the listing provisions.

(C) Issue 3

- ***LISTING IN CASE OF PUBLIC ISSUE -*** What is the scope of Section 73 of the What is the scope of Section 73 of the Companies Act and does it casts an obligation on a public company intending to offer its shares or debentures to the public, to apply for listing of its securities on a recognized stock exchange once it invites subscription from fifty or more persons?

It is the obligation of a public company to list their securities on a recognized stock exchange. Disclosure is the rule and there is no exception to it. Section 73 of the Companies Act talks about the listing provision. 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. Listing is therefore, considered to be a legal responsibility of the company which offers securities

The Appellants submitted that Sub-section (1) of Section 73 is qualified by the term "intending", which implies that Section 73(1) deals with companies that want to issue new shares or debentures to be listed, and which have declared to the investors that they intend to have those shares or debentures dealt with on the stock exchange. The Appellants had argued that since they had no intention to offer the OFCDs to the public, this provision will not apply and hence they were not obligated to apply for listing of OFCDs. The Respondents submitted that Saharas cannot be judged on what they intended but should be judged on what they did. The respondents also stated that the plea, that Saharas never wanted or intended to list their securities, hence escaped from the rigor of Sections 55A, 60B, 73 etc. of the Companies Act, cannot be sustained.

The scope of Section 73 was explained in the case *Raymonds Synthetics Ltd. & Ors. v. Union of India & Ors.*[7], it was held that "A public limited company has no obligation to have its shares listed on a recognised stock exchange. But if the company intends to offer its shares or

[7] (1992) 2 SCC 255

debentures to the public for subscription by the issue of a prospectus, it must, before issuing such prospectus, apply to one or more recognised stock exchanges for permission to have the shares or debentures intended to be so offered to the public to be dealt with in each such stock exchange in terms of Section 73.."

The Supreme Court held that a company cannot take the contention that it has no such intention or idea to make an application to the stock exchange. It also cited the case *Crofter Hand Woven Harris Tweed Co. Ltd. v. Veitch*[8], opined that in some branches of law, 'intention' may be understood to cover results which may reasonably flow from what is deliberately done, the principle being that a man is to be treated intending the reasonable consequences of his acts. It is the conduct and the action that will be taken into consideration, which in this case can be clearly seen that the Saharas had issued OFCDs to more than what is prescribed in the Act and hence violated the various provisions of the Companies Act. The Supreme Court finally stated that Saharas acts and omissions have clearly violated the provisions of Section 73 of the Companies Act, their failure to list the securities offer to the public was, therefore, intentional and the plea that they did not want their securities listed, is not an answer, since it was a statutory mandate that they had to follow.

(D) Issue 4

- ***SECURITIES INCLUDE HYBRID***-Are the hybrid OFCDs issued within the definition of 'Securities" and also within the meaning of Companies Act, SEBI Act and SCRA?

Hybrid securities are referred to as the securities which have some of the features of both debt securities and equity securities. Section 2(12) of the Companies Act deals with the definition of the word "debentures" and includes any "other securities". The word "hybrid" under Section 2(19A) was inserted in the Companies Act, vide the Companies (Amendment) Act, 2002 and stated that, "hybrid means any security which has the character of more than one type pf security, including their derivatives."[9] The Section 2(45AA) defines 'securities' as defined in clause (h) of Section 2 of The Securities Contracts(Regulation) Act, 1956(hereinafter referred to as "SCRA") and it also includes hybrids.

The Appellants contended that though through the amendments the word hybrid was included but Section 67 of the Companies Act was not amended and did not include 'hybrids' and Section 67 only referred to the offer of shares or debentures. Therefore, the appellants submitted that since the OFCDs issued by the Saharas were hybrids, they didn't fall under the

[8] [1942] AC 435
[9] Introduced through the Amendment Act No.53 of 200.

ambit of Section 67 of the Companies Act. The Appellants also went ahead to point 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.[10]

The Respondents submitted that the OFCDs are debentures by name and the nature and the definition of 'debenture' as given under Section 2(12) of the Companies Act includes any other securities. They also submitted that the securities are clearly defined in Section 2(45AA) of the Companies Act and includes hybrids and therefore, hybrids fall in in the definition of debentures and are amenable to the provisions of Sections 67 and 73 of the Companies Act.

However, the Supreme Court rejected all the contentions of the Appellants and stated that the OFCDs issued by Saharas can undoubtedly be considered as unsecured debentures by name and nature. OFCDs have the features of both shares and debentures and they continue to remain debentures till the time they are converted. The Supreme Court also pointed out that the Appellants have treated OFCDs only as debentures in the IM, RHP, application forms and also in their balance sheet.

Iterating on the argument of Appellants of SEBI’s jurisdiction over the OFCDs, the Supreme Court stated that stated that the definition of "securities" in the SCR Act is an inclusive definition and not exhaustive. The definition of “securities” in the SCR Act clearly includes any "other marketable securities of like nature". And as in this case the OFCDs were offered to millions of people so the question about the marketability of such instrument just does not arise. Therefore, these securities very much fall under the purview of “securities” in the SCR Act. Hence, these securities are hybrids and as per the Section 55A of the Companies Act, SEBI has jurisdiction over hybrids like OFCDs issued by the Appellants.

(E) Issue 5

- ***CONVERTIBLE BONDS*-** Whether OFCDs issued by the Saharas are convertible bonds falling within the scope of Section 28(1)(b) of the SCR Act, therefore, not ‘securities’ or, at any rate, not listable under the provisions of SCR Act?

[10] Mukul Aggarwal, Deepak Jodhani & Simone Reis, SUPREME COURT TO SAHARA: IT'S NOT PRIVATE!, Nishith Desai Associates, September 13, 2012 , www.nishithdesai.com.

Section 28(1) (b) of the SCR Act very clearly specifies that the Act will not apply to the 'entitlement' of the buyer, inherent in the convertible bond. Therefore, it has to be understood that 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 Act is, therefore, inapplicable to the options or rights or entitlement that are attached to the bond/warrant and not to the bond/warrant itself which has to be kept in mind.

The expression "insofar as it entitles the person" clearly indicates that it was not intended to exclude convertible bonds as a class. Section 28(1)(b), therefore, clearly indicates that it is only the convertible bonds and share/warrant of the type referred to therein that are excluded from the applicability of the SCR Act and not debentures which are separate category of securities in the definition contained in Section 2(h) of SCR Act.

It was contended by the Appellants that the OFCDs issued were clearly bonds which were convertible and therefore fall within the scope of Section 28(1) (b) of SCRA and hence were excluded from the purview of the SCRA. The Appellants also submitted that the convertible bonds issued by them were issued at a price agreed upon at the time of issue and are therefore not listable in view of the exception granted under Section 28(1) of the SCR Act.

However, the Supreme Court rejected the contentions made by the Appellants and stated that inapplicability of SCRA, 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.

III. ANALYSIS

The Saharas (SIRECL & SHICL) were directed by the Supreme Court to refund the amounts collected to all the investors with an interest of 15% per annum to SEBI from the date of receipt of the subscription amount till the date of repayment, within a period of three months, which ended the three-year long battle between the regular and Sahara. It was very much visible from the acts of the two companies, that they had clearly avoided references to the Companies and the SEBI Act and accordingly circumvented adherence to the provisions of these Acts.

The Sahara group very smartly formulated the strategy for mobilising money and it can be said that it was explicitly designed to circumvent regulations, take advantage of loopholes in the wording of various laws, and exploit the gaps in the stated jurisdictions of the MCA and SEBI.

This case was an eye-opener to the law makers to reconsider the provisions of the statutes in

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the country. It acted as an alarm in order to stop any such advantage taken of the loopholes of the law in the coming future. In this case, the fight given by SEBI in order to protect the interest of the small investors is just commendable and it is only through such cases that people gain confidence and trust in the law of the country.

The contentions given by the Saharas were prima facie devoid of any merit. They were merely put forward to defeat the whole purpose of the statutes that govern public issues and other incidental requirements. It has to be kept in mind that if in the future companies are allowed to go ahead in such a manner and raise vast sums of capital from the public in the guise of private placement, it would be a mockery of the entire capital market framework.

The need of the hour in India is to make our laws more stringent and impose criminal sanction on such offenders so that people don't even think of misleading these poor investors. The laws of countries like USA have their own Act for the protection of investors, this can also be adopted by India and a new statute protecting the investors can be passed by the Parliament. These statutes will ensure certain treatment for the investors and they will be protected. It is very important to pay attention to the interest of the investors as they are the backbone of the securities market.

IV. CONCLUSION

This Supreme Court judgement is a landmark judgement which is undoubtedly a milestone as it once again reaffirmed the role and object of SEBI as a securities market regulator and clearly laid down the inherent jurisdiction of SEBI to oversee matters concerning the public investors at large. It also reaffirmed the fact that a public issue would mandatorily have to be listed on a stock exchange.

During the course of this paper, all the five main issues are discussed elaborately focusing on the contentions raised by the appellants, respondents and followed by the judgement given by the Supreme Court. The paper also tried to clarify the significant points of law and has bridged the jurisdictional gap which previously existed between the MCA and SEBI. The paper also delved into the loopholes of the existing laws in India and how it needs to be restructured in order to put an end to people taking advantage and committing such fraud. This judgement serves as a welcome relief and also as an important precedent set in the history of Indian Corporate law.

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