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I. SEBI rules on acquisition of "control"

The Securities and Exchange Board of India (**"SEBI"**) in the matter of Kamat Hotels (India) Limited (**"KHIL"**) passed an order on March 31, 2017 on, inter alia, the issue of acquisition of control.

Background

Foreign Currency Convertible Bonds issued by KHIL were subscribed by Clearwater Capital Partners (Cyprus) Ltd. and Clearwater Capital Partners Singapore Fund III Private Limited (collectively, the **"Investors"**) with an option to convert the same into equity shares. The conversion price for conversion of bonds was later revised by the Board of Directors to INR 135/- per equity share. An inter-se agreement came to be executed amongst KHIL, its promoters and the Investors on August 13, 2010.

Bonds were converted on January 11, 2012 pursuant to the exercise of conversion rights by the Investors. The said conversion lead to an increase in the shareholding of the Investors in KHIL from 24.50% to 32.23%. Public announcement of open offer was made by the Investors on the same day for acquisition of 26% shares of KHIL from the public shareholders as was required to be made under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**"2011 Takeover Code"**).

When SEBI was forwarded the draft letter of offer, SEBI made certain observations on the same and noted that public announcement under Regulation 12 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (**"1997 Takeover Code"**) was required to be made by the Investors as SEBI took the view that the Investors had acquired control in KHIL as per certain clauses under the said inter-se agreement dated August 13, 2010. Appropriate amendment in the draft offer document was advised.

In the final letter of offer, observations of SEBI were incorporated and it was mentioned that SEBI's view was to be challenged before the Securities Appellate Tribunal ("**SAT**"). Pursuant to the order of SAT, show cause notice was issued by SEBI with respect to non-compliance with its directions. Certain clauses under the said inter se agreement must be noted here as were pointed out by SEBI:

a) KHIL and certain promoters could not enter into any agreement or arrangement conflicting with or restricting the rights of the Investors.

b) Prior approval of the Investors was required for altering the share capital, creating any new subsidiaries, entering into any joint ventures, merger or demerger, etc.

c) The Investors had the right to nominate one director on the board of KHIL.

Therefore, SEBI took the stand that such clauses showed that the Investors had a right to control the policy decisions of KHIL and thus had acquired "control" over KHIL as defined under the 1997 Takeover Code. As the Investors failed to follow the instructions of SEBI to make public announcement of open offer as per Regulation 12 of the 1997 Takeover Code, it was alleged that the Investors were in breach of the same. Further, SEBI alleged that the Investors were in breach of Regulation 16(4) of the 2011 Takeover Code as the Investors had not incorporated the changes advised by SEBI in the letter of offer.

Arguments of the parties

Investors submitted that the open offer was made in compliance with the takeover regulations and all changes suggested by SEBI were duly incorporated except reference to Regulation 12 of 1997 Takeover Code. Investors further submitted that they were under bonafide belief that they had not acquired control and accepting that they acquired control would have adversely impacted them. Investors took the stance that the said inter-se agreement contained general rights in favour of the Investors for a certain period in order to protect their interest as an investor in KHIL and could not be construed to mean vesting of controlling rights on the Investors. One important aspect pointed out by the Investors was that, *"there was no clarity/certainty regarding the impact of such affirmative rights in an agreement on the "control" of a company and that SEBI has issued a discussion paper on "Brightline Tests for Acquisition of 'Control' under SEBI Takeover Regulations" seeking comments from the public, which is still pending finalisation."*

Observations of SEBI and decision

Regulation 2(1)(c) and relevant portion of Regulation 12 of the 1997 Takeover Code must be reproduced here.

> *""control" shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by*

virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner."

(Regulation 2(1)(c))

"12. Irrespective of whether or not there has been any acquisition of shares or voting rights in a company, no acquirer shall acquire control over the target company, unless such person makes a public announcement to acquire shares and acquire such shares in accordance with the regulations.

Provided that ...."

(Regulation 12)

SEBI observed that Investors had mentioned in the offer letter that they were to challenge the observations of SEBI regarding Regulation 12 of the 1997 Takeover Code before SAT and the same was actually challenged before SAT after the disclosure. SEBI opined that such disclosure was adequate to enable the investors to take informed decision. Further, SEBI was of the view that observations of SEBI were taken into consideration while determining offer price and the investors were not adversely affected. As SEBI noted, the Investors had determined the offer price after taking into consideration the price which the shareholders would have got if the said inter-se agreement were to be held as acquisition of control under said Regulation 12 of the 1997 Takeover Code.

Most importantly, with respect to the issue of acquisition of control under the said inter-se agreement, SEBI observed, *"It is apparent that the scope of the covenants in general is to enable the noticees to exercise certain checks and controls on the existing management for the purpose of protecting their interest as investors rather than formulating policies to run the Target Company. Further, I note that the shareholder agreement got extinguished on July 31, 2014. Thus, the clauses in the agreement, alleged in the SCN to have conferred "control' on the noticees, can no longer be considered binding upon the promoters of the company and hence is not relevant for consideration at present....".*

SEBI held that it was immaterial to consider the question of 'control' at this point of time in the matter. SEBI finally dropped all the charges alleged in the show cause notice against the Investors.

VA View

In order to appreciate the significance of this SEBI ruling, it is pertinent to note the case ***Subhkam Ventures (I) Private Limited vs. SEBI*** (Appeal No.8 of 2009) here. As rightly pointed out by SEBI in this matter, provisions of agreement in consideration in the Subhkam case were quite identical to the clauses in the said inter se agreement in the present matter. SAT in Subhkam case held that none of the clauses in the agreement could be taken as acquisition of control in the hands of the appellant. On appeal, the Supreme Court of India kept the question of law open and had clarified that the SAT order will not be treated as a precedent. Thus, the issue was left undecided. Note must be taken of the discussion paper on "Brightline Tests for Acquisition of 'Control' under SEBI Takeover Regulations" issued by SEBI a while ago, the proposals under which are yet to be implemented by SEBI.

Therefore, this issue has always remained unresolved over the years. This ruling in this backdrop can be seen as loosening SEBI's stance on the aspect of acquisition of control as SEBI has observed that certain covenants are for the purpose of protecting the investor interests. This position taken by SEBI is a signal that such provisions will no longer be considered as acquisition of control in the target company. However, one aspect which reduces the significance of the aforesaid observations of SEBI is that in this case, the agreement in consideration was a term agreement and expired on a certain date making SEBI to hold that the clauses were no longer binding upon the promoters of the company and hence were not relevant for consideration. It can be said that though certain level of clarity is provided on the issue by SEBI in this order, the stand of SEBI is still not crystal clear and we might have to wait for some more time to get complete clarity on this issue.

II. Supreme Court decision on seat of arbitration and challenge to an arbitral award

The Supreme Court of India in the case of ***Imax Corporation vs. M/s. E-City Entertainment (I) Pvt. Ltd.*** (decided on March 10, 2017) has delivered an important judgment on the importance of seat of arbitration in international commercial arbitrations.

Background

The Appellant and the Respondent had entered into an agreement with respect to supply of projection systems for movie theatres. The said agreement provided for settlement of disputes through arbitration to be conducted according to International Chamber of Commerce ("**ICC**") Rules of Arbitration. When disputes arose between the parties and the arbitration clause was invoked, the ICC fixed London as the seat of the arbitration.

Partial award came to be passed in favour of the Appellant. It was observed that the Respondent was in breach of the agreement between the parties and was held liable for damages. The Appellant was awarded $9,406,148.31 as damages. Further award in relation to interest and costs was also passed in favour of the Appellant. The awards stated that the place of arbitration was London.

The arbitration awards were challenged before the Bombay High Court by the Respondent under Section 34 of the Arbitration and Conciliation Act, 1996 (the "**Act**"). Learned Single Judge of the Bombay High Court held that Section 34 petition was maintainable and this interim order of the Bombay High Court was in appeal before the apex court in this case. The question before the Court was *whether the challenge to the award made by the Respondent under Section 34 of the Act was maintainable before a court in India.*

Arguments of the parties

The Appellant pointed out that it was clearly mentioned in the Respondent's petition that *"the seat of arbitration was in London".*

It was contended by the Respondent that London being the seat of arbitration was in no manner a constraint for challenging the award under Section 34 of the Act. They also referred to the Petitioner's request for arbitration in which it was stated that the arbitration clause in the agreement between the parties was silent as to the place of arbitration. The Appellant had proposed Paris, France as suitable place for arbitration.

Observations of the Court and decision

The Apex Court referred to the ICC Rules, which provide that the place of arbitration shall be fixed by the ICC unless agreed upon by the parties. The Court further took note of the fact that, with regard to the Appellant's suggestion of Paris as venue of arbitration, the Respondent had instead suggested Singapore as the suitable venue of arbitration. However, the ICC fixed London as the seat of arbitration and this was accepted by the parties without any demur.

The Court observed that as per the arbitration clause in the agreement between the parties, arbitration was to be held pursuant to the ICC Rules but the clause did not specify the applicable law for the arbitration agreement. Therefore, the validity of award passed pursuant to the arbitration held was to be decided as per English law as the arbitration was held at London. The arbitration clause in the agreement was as below.

> *"This Agreement shall be governed by and construed according to the laws of Singapore, and the parties attorn to the jurisdiction of the courts of Singapore. Any dispute arising out of this master agreement or concerning the rights, duties or liabilities of E-City or Imax hereunder shall be finally settled by arbitration pursuant to the ICC Rules of Arbitration."*

The Court, referring to the arbitration clause as above, noted that the parties were aware that the ICC will be deciding the place of arbitration as per the ICC Rules. The Court pointed out that law of the United Kingdom was automatically attracted as London was selected by the ICC as the place of arbitration. Part-I of the Act, therefore, was excluded. As observed by the Court, the place of arbitration determines the law that will apply to the arbitration and matters like challenge to an award.

The Court took note of two reasons for the non-applicability of Part-I of the Act:

a) Parties had agreed that the seat maybe outside India as may be fixed by the ICC; and

b) It was admitted that the seat of arbitration was London and the award was made there.

The Court finally allowed the appeal and held, *"we find that the High Court committed an error in observing that the seat of arbitration itself is not a decisive factor to exclude Part-I of the Arbitration Act. We therefore set aside the judgment of the High Court and dismiss the petition filed by the respondent under Section 34 of the Arbitration Act before the Bombay High Court."*

VA View

The apex court has stressed on the significance of the seat of arbitration and has noted that choice of seat determines the curial law that applies to arbitration and matters like challenge to an award. The Court also stated that the seat of arbitration is a decisive factor to decide on the applicability of Part-I of the Act.

Therefore, it can be said that for agreements entered into prior to the BALCO judgment delivered in 2012, if arbitration is governed by institutional rules and parties have not specified seat of arbitration, then the choice of seat by the institution will determine the curial law of the arbitration and whether Part-I of the Act will be applicable or not. This will have a direct impact on whether an award passed in such international commercial arbitration will be amenable to challenge in Indian courts. However, it must be understood that the institutional rules must provide for the choice of seat by the institution.

III. "Winding up petition at the instance of a trade union and for the dues that are payable to its members is maintainable": Bombay High Court

A Division Bench of the Hon'ble Bombay High Court in the case of ***Mr. Sanjay Sadanand Varrier vs. Power Horse India Pvt. Ltd.*** (decided on March 22, 2017) decided on the question whether a winding up petition filed by a trade union for the cause of workmen who are members of such trade union was maintainable.

Background

This matter came before the Division Bench of the Hon'ble Bombay High Court as a learned Single Judge of the Court in this case had different views from the stance taken by another Single Judge of the Court in the matter of ***Mumbai Labour Union vs Indo French Time Industries Ltd.*** (2002 (2) Mah. L.J. 405) ("**Labour Union Case**").

The Petitioner had filed company petition under section 439 of the Companies Act, 1956 and sought winding up of the Respondent. The ground for seeking winding up was that the Respondent was unable to pay its debts. The Petitioner was an employee with the Respondent and his salary for the period October 2009 to March 2012 remained unpaid. The Petitioner had claimed amount of INR 39,51,558/-.

Arguments of the parties

The Respondent company argued that the company petition filed by the Petitioner was not maintainable as the Petitioner was not a creditor of the Respondent. Reliance was placed by the Respondent on the Labour Union case. In the Labour Union case, it was held that winding up petition by workers was not maintainable and therefore, even a trade union also could not file a winding up petition on behalf of unpaid employees as creditors of company. In Labour Union case the Single Judge placed reliance on ***National Textile Workers Union and Others vs P. R. Ramkrishnan and Others.*** (AIR 1983 SC 75)

The Petitioner relied upon a decision of the Hon'ble Madhya Pradesh High Court (Full Bench) in the matter of ***Jonathan Allen vs Zoom Developers Pvt. Ltd.*** (2015 (192) Company Cases 501 (MP)) and of the Delhi High Court in the case of ***Argha Sen vs Interra Information Technologies (India) (P) Ltd.*** ((2007) 75 SCL 150 (Delhi)). Decisions in both these cases distinguished the decision in the Labour Union Case.

Observations of the Court and decision

The Single Judge of the Court in this matter did not agree with the view taken in the Labour Union Case. The Court pointed out that decision in Labour Union Case was overruled by a Division Bench of Nagpur High Court in the matter of ***Khandelwal Tube Mill KamgarSangh, Kanhan vs Government of Maharashtra and others*** (2006 (I) CLR 51). The Court noted, *"On a perusal of this decision, it is clear that a workman or an individual employee, being a creditor within the meaning of the relevant statutory provisions of the Companies Act, can institute or file a Petition for winding up of a Company."*

The Court went on to decide the issue whether a trade union could file a winding up petition for the cause of workmen who are trade union members. The Court took note of the relevant provisions of the Companies Act, 1956 and the Trade Unions Act, 1926. Section 15 of the Trade Unions Act, 1926 should be particularly noted, as below.

> ***"15. Objects on which general funds may be spent.—****The general funds of a registered Trade Union shall not be spent on any other objects than the following, namely,—*
>
> *....... (c)* ***the prosecution or defence of any legal proceeding to which the Trade Union or any member thereof is a party, when such prosecution of defence is undertaken for the purpose of securing or protecting any rights of the Trade Union as such or any rights arising out of the relations of any member with his employer or with a person whom the member employs;***
>
> *(d)* ***the conduct of trade disputes on behalf of the Trade Union or any member thereof; ...."***

The Court observed that petition for winding up by a trade union was maintainable. However, the Court further observed that merit of the claim depends on the facts of every case as the Court added, *"We may add here that this* *does not mean that in every instance when a Trade Union or a workman files a winding up Petition, the Company is ipso facto to be wound up. Whether or not there is any merit in the claim made by the workman and/or employee depends on the circumstances in each case. All that we are holding is that a Trade Union, though having a legitimate claim, cannot be shut out from approaching the appropriate forum for winding up the Company on the ground that its members have not been paid their wages and/or salaries."*

Finally, the Court directed the petition to be placed before the Company Judge for decision on merits and in accordance with law.

VA View

This is a significant ruling coming from the Bombay High Court. As rightly noted by the Court, winding up petitions can be filed by trade unions for the cause of workmen as Section 15 (c) and (d) of the Trade Unions Act, 1926 specifically permit the prosecution or defence of any proceeding to which the trade union or any member thereof is a party as well as the conduct of trade disputes on behalf of the trade union or any member thereof. The Court also has rightly observed that if the workmen have not been paid their wages by a company, they would certainly be considered as creditors as contemplated under Section 439(1)(b) of the Companies Act, 1956. However, the trade unions are permitted only to file such a petition and it does not ipso facto entitle the workers to any decision in their favour as clarified by the Court. Merits of the claim will depend on the facts of every particular case.

IV. SAT decides on interest liability in case of delay in payment of penalty

The Securities Appellate Tribunal (the **"SAT"**) in the matter of ***Mr. Dushyant N. Dalal and Anr. vs. the Securities and Exchange Board of India*** (decided on March 10, 2017) decided whether Section 28A inserted to the Securities and Exchange Board of India Act, 1992 with effect from July 18, 2013 imposed interest liability on a person who fails to pay the amounts specified in Section 28A within the stipulated time and if so, whether Section 28A could be invoked for demanding interest on the amounts due to Securities and Exchange Board of India (the **"SEBI"**) pursuant to the orders passed prior to July 18, 2013.

Background

The SEBI had conducted an investigation with regard to shares of several companies being issued through initial public offering during the years 2003-05. The SEBI passed an order in 2009 whereby it prohibited the Appellants from accessing the securities market for certain period. SEBI had further directed the Appellants to disgorge the unlawful gain of INR 4.05 Crores with interest of INR 1.95 Crores. On appeal, the SAT and the Supreme Court of India held in favour of the SEBI and dismissed the appeals.

It is imperative to note that the Securities Laws (Amendment) Ordinance was promulgated by the President of India on July 18, 2013 which inserted Section 28(A) to the SEBI Act, 1992. This provision provided a mechanism for recovery of sums as specified in that Section by incorporating rights and obligations contained in Section 220 of the Income Tax Act, 1961 with retrospective effect from July 18, 2013. Thereafter, the Securities Laws (Amendment) Second Ordinance 2013 and the Securities Laws (Amendment) Ordinance 2014 were promulgated. Finally, the Securities Laws (Amendment) Act, 2014 came to be enacted. Recovery Officer (the **"RO"**) in the meanwhile under second ordinance had issued a certificate-cum-notice of demand whereby INR 6 Crores was demanded as per the SEBI order. On failure to comply with the same, the Appellants were declared as defaulters. A notice of attachment came to be issued against the Appellants under, inter alia, Section 28(A) (1) (b) of the SEBI Act, 1992 in Appeals No. 313, 314, 315 and 400 of 2014. By another separate certificate-cum-notice the other Appellants in Appeal No. 41 of 2014 were asked to deposit further interest on the amount of INR 4.05 Crores from 2009 to 2013 and further interest from 2013 till payment.

The Appellants paid INR 6 Crores on January 6, 2014. However, the interest liability from July 21, 2009 remained unpaid. For this interest liability, an order was passed by the RO against the Appellants. The Appellants challenged this order of the RO in this appeal before the SAT.

Arguments of the parties

The Appellants argued that the RO could not demand interest in case of delay in payment of due sums under Section 28A. Further, according to the Appellants, Section 28A was to apply prospectively and therefore even in case it was concluded that RO had the power to recover such interest, he could not recover interest for period prior to July 18, 2013 (the date on which Section 28A took effect). The SEBI argued that the RO had the power to recover sums due to the SEBI with interest under Section 28A in case of delay in payment.

Observations of the SAT and decision

The SAT rejected the arguments of the Appellants. The SAT noted that through the insertion of Section 28A in the SEBI Act, 1992, provisions of the Income Tax Act, 1961 with respect to collection and recovery became part of the SEBI Act, 1992. The SAT further noted that the provisions of the Income Tax Act, 1961 which formed part of the SEBI Act, 1992 pursuant to the insertion of Section 28A contained the provision for imposing interest liability in case of delay in payment of sums specified in notice of demand.

On the argument of the Appellants in Appeal No. 41 of 2014, that interest could not be demanded for period prior to July 18, 2013, the SAT held in favour of the Respondent, holding that the RO was right in demanding interest on the unlawful gain made by the Appellants for the period from July, 2009 till date of payment since the obligation to do so was specifically part of the impugned order in that appeal. In case of other connected appeals, the SAT held that interest could not be demanded in case of delayed payment as the penalty orders passed prior to July 18, 2013 did not contain any obligation to pay such interest.

The SAT held, *"Accordingly, we hold that Section 28A read with Section 220 inserted to SEBI Act with retrospective effect from 18.07.2013 imposes interest liability on a person who fails to pay the amounts specified in Section 28A of the SEBI Act within the stipulated time".*

It was finally observed, *"Since the order passed by the WTM of SEBI on 21.07.2009 contained an obligation to pay interest @ 12% per annum on the unlawful gain of INR 4.05 crore till payment, the RO was justified in demanding interest on the unlawful gain of ` 4.05 crore from 21.07.2009 till payment. Accordingly, Appeal No. 41 of 2014 is dismissed."*

VA View

The SAT has clarified on the interest liability under Section 28A of the SEBI Act, 1992 and has made it clear that Section 28A imposes interest liability in case of delayed payment of amount sought to be recovered.

The SAT has also ruled that interest liability cannot be imposed for period prior July 18, 2013. However, interest for period prior to such date is allowed in case order passed prior to the said date contains a specific obligation to pay interest not necessarily arising out of Section 28A.

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