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Between the lines...

May, 2015

Key Highlights...

- ✓ *Government liberalizes products for the MSME sector*
- ✓ *SEBI amends delisting regulations*
- ✓ *SEBI amends Takeover Code*
- ✓ *Bombay High Court on SEBI's order of arrest*
- ✓ *Deposit regulations amended*

I. Government liberalizes products in the MSME sector

The Union Government has lifted the curb on making 20 items that had been exclusively meant for micro and small enterprises. The items freed for manufacture include bread, pickles and chutneys, wooden furniture fireworks, glass bangles, mustard oil, groundnut oil, exercise books and registers, wax candles, laundry soap, safety matches, fireworks, agarbattis and steel almirahs.

The definition of what is a small unit was restrictive. As a result of this, small and medium sized companies were unable to expand production and acquire technology for fear of losing out on the right to manufacture these items. Upon removing these items from the list, these MSMEs can scale up production. Big companies will also be able to take advantage of this opportunity, using their financial muscle to set up large units. This should encourage greater investment, including the existing MSME units, to incorporate better technologies, standard and branch building to enhance competition in Indian and global markets for these products.

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The reservation of items discouraged small enterprises from transforming into medium or large enterprises for fear of losing out on the right to manufacture these items. This liberalization by the Government will facilitate the ease-of-doing business measures and will encourage greater investment to upgrade technology and standards towards enhancing competition.

II. SEBI amends Delisting Regulations

SEBI has amended the SEBI (Delisting of Equity Shares) Regulations, 2009.

Under Delisting Regulations, a delisting offer is considered successful if post-offer shareholding of the promoters is higher of (a) 90% of total shares, or (b) aggregate percentage of promoter's pre-offer shareholding and 50% of the offer size. The amendment specifies that an offer for delisting would be considered successful if post offer shareholding of promoter, along with persons acting in concert, is 90% of

total issued shares, excluding shares held by custodian towards issue of depository receipts, and, at least 25% of the public shareholders (holding shares in demat account) on the date on which the Board of Directors of the company approves the delisting, should have participated in the Reverse Book Building process. However, this condition shall not apply if it is shown to the stock exchanges that the promoters/ acquirers have delivered the letter of offer to all public shareholders through registered/speed post/courier/hand delivery with a proof of delivery or through email with a read receipt.

Under the prior Delisting Regulations, the final price at which the promoter was required to facilitate other shareholders to exit was the price at which the maximum shares were tendered under the Reverse Book Building process. This has been amended to provide that the final price shall be the price up to which the aggregate number of shares offered, if accepted, will enable the promoter along with persons acting in concert to reach the threshold of 90%.

Prior to approval of the delisting proposal, the Board of Directors of the company must make disclosure to the recognized stock exchanges that the promoters or acquirers have proposed to delist the company and must also appoint a merchant banker to conduct a due diligence of trading in shares or off market transaction, during the preceding 2 years, by top 25 shareholders as on the date of meeting convened to approve the delisting proposal.

Source: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427261684807.pdf

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These changes have been brought to make voluntary delisting easier for the companies. These amendments will reduce the time taken for completing the process and provides for relaxation on case-to-case basis. Timeline for completing the delisting process has been reduced to 76 working days from 137 calendar days (about 117 working days). These changes providing for speedy exit option, will give rise to an increase in applications for delisting giving much needed respite to foreign companies to get their local arms delisted.

III. SEBI amends Takeover Code

SEBI has amended the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

Under the amended Takeover Code, in the event the acquirer makes a public announcement of an open offer for acquiring shares of a target company in terms of regulations 3, 4 or 5, he may instead delist the company in accordance with the provisions of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, provided that the acquirer shall have declared upfront his intention to so delist at the time of making the detailed public statement.

Where an offer to delist the target company has failed, the acquirer is required to make an announcement within 2 working days of such failure. Thereafter, the acquirer shall be liable to proceed with the open offer as per the Takeover Regulations. Consequently, the acquirer will file the draft letter of offer with SEBI within 5 working days of the announcement. Shareholders who have tendered shares in the delisting offer can withdraw their shares, within 10 working days from the date of such announcement. Shareholders who have not tendered their shares in acceptance of the delisting offer shall be entitled to tender their shares in acceptance of the open offer.

In case of failure of delisting offer, offer price shall stand enhanced by an amount equal to a sum determined at the rate of 10 per cent per annum for the period between the scheduled date of payment of consideration to the shareholders and the actual date of payment of consideration to the shareholders. For this purpose, the scheduled date shall be the date on which the payment of consideration ought to have been made to the shareholders in terms of the timelines in these regulations.

In a manner similar to Delisting Regulations, amendment to the Takeover Code has permitted tendering of shares and their settlement through the stock exchange mechanism.

Source: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1427261613075.pdf

VA View

SEBI has permitted takeover and delisting to take place in a composite manner. Permitting delisting pursuant to open offers is a welcome step which may result in reduced cost of acquisition and may act as impetus for M&A activities in India.

IV. Bombay High Court on SEBI's order of arrest

In the case of **Vinod Hingorani** *v* **SEBI and Anr.**, where for the first time the Securities and Exchange Board of India (SEBI) had sent an individual, 58-year old Vinod Hingorani, to jail for defaulting on the payment of a penalty, after being empowered to do so, the Bombay High Court held that absent any findings that a person had the means to pay, mere non-payment of dues does not constitute neglect or refusal by the person to pay penalty.

The Hon'ble Court concurred with the views of the Supreme Court in the case of **Jolly George Varghese** *v*. **Bank of Cochin**, AIR 1980 SC 470, that a simple default to discharge is not enough. There must be some element of bad faith beyond mere indifference to pay, some deliberate or recusant disposition in the past or, alternatively, current means to pay the decree or a substantial part of it.

The Bombay High Court held that, the authority could not have ordered detention of the petitioner solely on the ground he had failed to pay an amount or give the proposal.

It observed that Rule 73(1) of Second Schedule read with Section 222(1)(c) of the Income Tax Act and Section 28A of the SEBI Act confers power of arrest and detention only in two situations i.e. when the Tax Recovery Officer is satisfied that (i) the defaulter, with the object or effect of any obstructing the execution of the certificate, has dishonestly transferred, property or (ii) despite having means the defaulter, refuses or neglects to pay the dues. Rule 73(1) further mandates the recording in writing of reasons of such satisfaction.

It also observed that SEBI had not arrived at a satisfaction that the conditions specified in Rule 73(1) were satisfied and had further not complied with the mandate of Rule 73(1) of recording the reasons of satisfaction in writing. The absence of satisfaction as well as recording of reasons vitiates the exercise of power of arrest. The court therefore held that the detention and arrest is patently illegal and arbitrary.

Source: WP No. 639 of 2015, High Court of Bombay; http://indiankanoon.org/doc/12212521/

VA View

SEBI's order to arrest and detention of a defaulter is an extreme step for punishing the defaulters. Under criminal law jurisprudence the test of imposing punishment is required to pass through strict standards laid down for exercise of such powers and should be invoked only when due process has been followed and the pre requisites of passing such an order have been complied with strictly.

Decision of Bombay High Court is a welcome step, making it clear in the very instance of arrest order by SEBI that exercise of new found power to order arrest and detention of a defaulter it its hands has to be done judiciously and with great care. The decision of the court has laid down a milestone to keep a check on compliance with the due process of law before resorting to imprison/detain an alleged offender.

V. Deposit regulations amended

Under Rule 2(1)(c) (vii) of the Companies (Acceptance of Deposit) Rules, 2014, companies were required to appropriate application money against the amount due on allotment of securities applied for within 60 days from the date of receipt of application money.

The Ministry of Corporate Affairs has vide notification dated 31st March, 2015 relaxed the above-mentioned compliance requirements. Unless otherwise required under the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or rules or regulations made there under to allot any share, stock, bond, or debenture, within a specified period, if a company receives any amount by way of subscriptions to any shares, stock, bonds or debentures before the 1st April, 2014 and disclosed in the balance sheet for the financial year ending on or before the 31st March, 2014 against which the allotment is pending on the 31st March 2015, the company shall, by the 1st June 2015, either return such amounts to the persons from whom these were received or allot shares, stock, bonds or debentures or comply with these rules.

Furthermore, Rule 3(8) now requires companies accepting deposits to obtain credit rating every year and to submit a copy of the same to the Registrar of Companies along with the return of deposits in DPT-3. Additionally, companies have been allowed time till March 31, 2016 to accept deposits without deposit insurance till March 31, 2016.

Source: http://www.mca.gov.in/Ministry/pdf/Acceptance_Deposits_AmendmentRules_01042015.pdf

VA View

The Companies which received money for allotment of securities (any shares, stock, bonds or debentures) under the Companies Act, 1956 but the allotment was pending in the balance sheet of the Company as on 31st March, 2015 has been given time till 1st June, 2015 to return the money to the applicants or allot shares, stock, bonds or debentures. Further, amendment in relation to credit rating of companies issuing securities has been made robust to ensure adequate safety measures. The eligible companies would be required to get credit rating from prescribed rating agencies only and the minimum investment grade for each such rating agency has also been prescribed.

VI. Tidbits

1. MCA clarifies applicability of Section 186 on tax-free bonds

   Section 186 (7) of the Companies Act, 2013 states that no loan shall be given under this section at a rate of interest lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan. The Ministry of Corporate Affairs has now clarified vide General Circular No. 6/2015 dated 9th April, 2015 that in cases where the effective yield for the tax free bonds is greater than the yield on the one, three, five, ten year Government security, there shall be no violation of the Section 186 of Companies Act, 2013.

   Source: http://www.mca.gov.in/Ministry/pdf/General_Circular_06_2015.pdf

2. The Central Government has notified the Companies (Auditor's Report) Order, 2015 dated 10th April, 2015 specifying the matters required to be specified in the Auditor's Report for the financial year ending 31st March, 2015. CARO shall apply to every company including a foreign company as

defined under section 2(42) of Companies Act, 2013. Exemptions from applicability of CARO has been granted to:

- ✓ banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949
- ✓ insurance company as defined under the Insurance Act,1938
- ✓ company licensed to operate under section 8 of the Companies Act
- ✓ One Person Company as defined under clause (62) of section 2 of the Companies Act
- ✓ Small company as defined under clause (85) of section 2 of the Companies Act
- ✓ Private limited company with a paid up capital and reserves not more than rupees fifty lakh; and which does not have loan outstanding exceeding rupees twenty five lakh from any bank or financial institution; and does not have a turnover exceeding rupees five crore at any point of time during the financial year.

As compared to CARO-2003, the reporting requirements under the CARO-2015 have been reduced considerably (i.e. from 21 clauses to 12 clauses)

Source: http://www.mca.gov.in/Ministry/pdf/Companies_Auditors_Report_Order_2015.pdf

3. The DIPP has *vide* Press Note No. 4 dated 24th April, 2015 decided to permit Foreign Direct Investment in the Pension Sector up to 49% (of which Automatic up to 26% and Government route beyond 26% and up to 49%). FDI in the Pension Funds is allowed as per the Pension Fund Regulatory and Development Authority (PFRDA) Act, 2013. Foreign Investment in Pension Funds will be subject to the condition that entities bringing in foreign equity investment as per Section 24 of the PFRDA Act shall obtain necessary registration from the PFRDA and comply with other requirements as per the PFRDA Act, 2013 and Rules and Regulations framed under it for so participating in Pension Fund Management activities in India. Wherever such foreign equity investment involves control or ownership by the foreign investor or, transfer of control or ownership of an existing pension fund from resident Indian citizens and/ or Indian companies owned and controlled by resident Indian citizens to such foreign investing entities as a consequence of the investment, including through transfer of shares and / or fresh issue of shares to Non-Resident entities through acquisition, amalgamation, merger, etc., it would require FIPB approval in consultation with the Department of Financial Services, PFRDA and other entities concerned and the onus of compliance to these conditions will be on investee Indian pension fund company. The meaning of ownership and control would be as per the Foreign Direct Investment policy.

   Source: https://dipp.nic.in/English/acts_rules/Press_Notes/pn4_2015.pdf

4. The initial validity of Industrial License for Defense Sector, as per Press Note 5 (2014 series) and Press Note 9 (2014 series), is presently three years, extendable up to seven years. In partial modification of the above mentioned Press Notes, the initial validity of Industrial License for Defence Sector is being revised vide Press Note 5 (2015 series) dated 27th April, 2015 to seven years, further extendable up to three years for existing as well as future Licenses. This is being done as a measure to further promote ease of doing business, in view of the long gestation period of Defence Contracts to mature.

   Source: https://dipp.nic.in/English/acts_rules/Press_Notes/pn5_2015.pdf

5. The Reserve Bank of India has amended the mechanism for identification of willful defaulters. Previously, except in very rare cases, a non-whole time director should not be considered as a willful defaulter unless it is conclusively established that he was aware of the fact of willful default by the borrower by virtue of any proceedings recorded in the Minutes of the Board or a Committee of the Board and has not recorded his objection to the same in the Minutes, or, the willful default had taken place with his consent or connivance. After the amendment, the above exception will not apply to a promoter director even if he is not a whole time director.

Source: https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=9681&Mode=0

6. It has been clarified by the Ministry of Corporate Affairs that that a managerial person may continue to receive remuneration for his remaining term in accordance with terms and conditions approved by company as per relevant provisions of Schedule XIII of earlier Act even if the part of his/her tenure falls after 1st April, 2014.

   Source: http://www.mca.gov.in/Ministry/pdf/General_Circular_07_2015.pdf

7. The Institute of Company Secretaries of India (ICSI) has issued the Secretarial Standard-1 for Meetings of Board of Directors and Secretarial Standard-2 on General Meetings to be effective from 1st July 2015.

   Source: http://www.icsi.edu/portals/0/Secretarial%20Standard-1.pdf

8. The Ministry of Corporate Affairs ministry will from May 1 have an integrated incorporation form to make compliance and reporting easier and convenient for corporates. "Name availability, allotment of Director Identification Number (DIN), company incorporation and commencement of business will now be possible through a single form. The new form, called INC 29, will be available on the ministry's website.

   Currently, entrepreneurs seeking to register a new company are mandatorily required to fill eight forms to complete the incorporation, a process which, besides being cumbersome, also takes a lot of time. This is part of the government's drive to improve India's ranking on the globally tracked parameter of ease of doing business.

   Source: http://www.mca.gov.in/Ministry/pdf/AmendmentRules_01052015.pdf

Book Release

The biography of our Founder, Late Shri O. P. Vaish titled *'Celebrating Life with Gratitude'* was released on Wednesday, April 29, 2015 by Justice Leila Seth at New Delhi.

'Celebrating life With Gratitude' tells the evocative story of Senior Advocate and social activist, OP Vaish, who battled difficult circumstances in his childhood to study and dream big despite humble beginnings. The book details his journey as an officer in the prestigious Indian Revenue Service, his forays into the private sector when few would have given up a government job with its clout, and later by diving into the world of tax law.

He built Vaish Associates into one of India's leading Full service law firms that attracted some of the top national and international clients. His values and insistence upon caring for his employees ensured that they stayed on with him for decades. His philosophy of being grateful for everything he had, gave him a different lens to look at the people around him. He was an active Rotarian and led Rotary in its efforts to eradicate polio. He actively campaigned to make body donation popular. He led from the front by donating his body for medical research. He was a role model for many.

Readers can obtain a copy of the book which is priced at a nominal price of Rs.295 (USD 5) by writing to Mr. Bomi Daruwala (bomi@vaishlaw.com). The proceeds from the sale will go directly to the Rotary Foundation supported by the Vaish family for charity.

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