LEGALFOXES LAW TIMES

Legal Reformsin Security Law After Sahara and Satyam Scams

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Introduction

If anyone wants to start their business, he needs money (capital) for subsequent purpose or arrangement. There are some options for raising money, one is to take loan and second is to issue shares/bonds etc. If the person wants to raise money, he has to comply with various norms, guidelines of norms for a legal way but if he decides to raise money without complying any law or partial law, then problem arises for that person, investor, government and regulator. Sahara case is one of them where he raised money without complying most of the norms of capital market but pretended that he was doing private placement and not public placement. Several questions were raised on issue of private placement and collection of huge money by his company. When your business got established, now you are required to do business with compliance of law like corporate governance, proper reporting etc. Satyam case is one of them where various internal mandatory norms were not complied and occurs in a big accounting scam. Accounting or auditor is also a part of internal structure. In Sahara case The Apex Court has done good job with keeping in mind the protection of interest of investor. There have been various amendments in corporate laws with respect to substantive and procedural but corporate field is so dynamic that it requires each and every time changes in laws. For that purpose SEBI i.e. the watch dog of security market is doing good job by releasing papers, circulars etc.

SAHARA CASE[1]

Sahara India Real Estate Corporation Limited and Sahara Housing Investment Corporation Limited are managed by Sahara group. SIRECL passed special resolution under section 81(1A)[2] for issuing the Optionally Fully Convertible Debenture (OFCD) through a private placement to

[1] Sahara India Real Estate Corporation Limited & Ors. v. Securities and Exchange Board of India & Anr., CIVIL APPEAL NO. 9813 OF 2011.
[2]Companies Act, 1956, Section 81A.

its friends, associates etc. but not made advertisement to public, for the same purpose Red Herring Prospectus filed with Registrar of Company (RoC) in 2008. SIRCEL collected almost 19 Thousand Cr. Rs from 2 Cr. investors from 2008 to 2011. In 2009 SHICL also issued OFCD through private placement with RHP registered with RoC. In prospectus it mentioned that both companies did not intent to get register its securities on any stock exchange. Very late in 2010, SEBI got to know about the scam when Sahara Prime City Limited submitted its RHP for public issue and through complaints.

Summon and Show Cause Notice:

SEBI issued summonsunder 11C[3] and thereafter the show cause notice that the issuance of OFCD was a public issue and, therefore, securities were liable to be listed on a recognized stock exchange. From the preliminary analysis it is found that these provisions of Companies Acthad been violated i.e. Sections 56[4]has not been complied with any disclosure guideline under DIP or ICDR, Sec 56(3)[5] as it did not comply with furnishing details in Form No. 2A[6][7],Sec 67(3)[8] Proviso and Sec 73[9] by not listing securities on stock exchange, Sec 62[10]&Sec 63[11] as RHP provided along with the letter of SIRCEL contained untrue statements, sections 117A[12], 117B[13] and 117C[14]and as it did not comply with various clauses of DIP Guidelines and Reg. 4(2)[15], 5(1)[16], 6[17], 7[18], 16(1)[19], 20(1)[20], 25[21], 26[22], 36[23], 37[24], 46[25] and 57[26].

[3]Securities and Exchange Board of India Act, 1992, Section 11C.
[4]Companies Act, 1956, Section 56.
[5]Companies Act, 1956, Section 56(3).
[6] Rule 4CC of the Companies (Central Government's) General Rules and Forms, 1956.
[7] DIP Guidelines and ICDR 2009.
[8]Companies Act, 1956, Section 67(3).
[9]Companies Act, 1956, Section 73.
[10]Companies Act, 1956, Section 62.
[11]Companies Act, 1956, Section 63.
[12]Companies Act, 1956, Section 117A.
[13] Companies Act, 1956, Section 117B.
[14]Companies Act, 1956, Section 117C.
[15] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation4(2).
[16] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 5(1)
[17] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 6
[18] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 7
[19]Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 16(1)

Reply of Sahara:

Detailed reply was sent by SIRCEL that it had complied with section 60B[27] regarding procedure, 81(1A)[28] for special resolution and also filed RHP under 60B[29] with RoC and clarified that since it did not intended to get its securities listed on any stock exchange so it would not be governed under section 55A(a)[30] or (b)[31] rather 55A(c)[32]will apply. It also stated that Reg. 3[33], 6[34] of ICDR will not be applicable as it was not a public offer as defined under 2(zc)[35],(p)[36], (n)[37]and also SCRA, 1956 because it would apply to non-convertible debt securities, whereas the OFCDs issued by SIRECL were convertible securities. OFCDs issued were in the nature of "hybrid" so SEBI did not have jurisdiction to administer those securities since Hybrid securities.

Order of SEBI:

SEBI examined the nature of OFCD issued by Sahara and came to the conclusion that it is security even it issued in nature of hybrid security. Thus it is having jurisdiction over this matter.

Sahara was bound to comply with listing requirement by virtue of the proviso to Section 67(3)[38] as it was issued as public offer. It ordered to refund the money with interest.

Appeal/order of Tribunal:

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[20] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 20(1)
[21] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation25
[22] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation26
[23] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation36
[24] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation37
[25] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation46
[26] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation57
[27]Companies Act, 1956, Section 60B.
[28]Supra at 2.
[29]Companies Act, 1956, Section 60B.
[30]Companies Act, 1956, Section 55A(a).
[31]Companies Act, 1956, Section 55A(b).
[32]Companies Act, 1956, Section 55A(c)
[33] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 3.
[34] Supra at 6.
[35] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 2(zc).
[36] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 2(p).
[37] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 2(n).
[38]Supra at 8.

The Tribunal took the view that OFCDs issued were securities within the meaning of Clause (h) of Section 2[39]. SAT also confirmed that it was public offer as IM was issued through 10 lakh agents and more than 2900 branch offices to more than 30 million persons. It was public issue so RoC was required to forward the RHP to SEBI thus has done infringement.[40]

Tribunal also examined the scope and ambit of Sections 55A[41]and Sections 11[42], 11A[43] and 11B[44] and concluded that SEBI has jurisdiction over this issue.Tribunal extended its discussion to Section 28(1)(b)[45]and held that 'the exclusion in the said Act is not available to OFCD that issued by the appellants'. Finally it also directed to return the money.

Supreme Court:

Appeal from an order of SAT was made to SC, which did good job in interpretation of various terms, provisions, and having harmonious interpretation with respect to keep the interest of investors in mind.

The most important discussion was with respect to nature of OFCD because it will also determine the jurisdiction of SEBI.

Sahara contented that 'OFCD is hybrid and section 67[46] is only restricted to the share, debenture but not cover hybrid, thus it will not be applicable'. Amendment made in definition of 'security' in Companies Act i.e. it also include hybrid but that was not simultaneously made in SCRA, hence in SEBI, SEBI is not having jurisdiction over issue of OFCD.

SC discussed that OFCDs issued by SAHARA were unsecured debentures by name and nature refer as under definition of hybrid. Thus interpreted that 'hybrid securities' generally means securities, which have some of the attributes of both i.e. debt security and equity security. The definition of security under section 2(h) of SCRA was discussed in case Sudhir Shantilal Mehta

[39] Securities Co0ntract (Regulation)Act, 1956, Section 2(h).
[40] Circular dated 1.3.1991 issued by the Department of Company Affairs, Government of India.
[41] Companies Act, 1956, Section 55A.
[42] Securities and Exchange Board of India Act, 1992, Section 11.
[43] Securities and Exchange Board of India Act, 1992, Section 11 A.
[44] Securities and Exchange Board of India Act, 1992, Section 11 B.
[45] Securities Contract (Regulation)Act, 1956, Section 28(1)(b).
[46]Supra at 46.

v. Central Bureau of Investigation[47] and concluded that 'definition is inclusive and not limited to that mentioned one as it is having term "other marketable securities of a like nature"'. Other than these discussions it also emphasized that "OFCD issued having the characteristics of debenture & share both as it is debenture at present but may be share if converted and also SAHARA has treated OFCD as debenture in IM, RHP, through this interpretation it can be said that OFCD wouldfall under 2(h)[48]." Very impactful interpretation was made by SC that the term "Securities" defined in the Companies Act has the same meaning as defined in the SCRA and since the term 'Security' also covers hybrid, SEBI will be having jurisdiction and also section 55A[49] has the term 'security' that will be taken in amended version.

SC interpreted **the power of SEBI** with respect to the matter other than mentioned under section 55A i.e. issue, transfer of securities and non-payment of dividend, like power with respect to prospectus etc. SC drew a connection between the section 60B(9) and explanation of section 55A and concluded that "explanation appended to section 55A does not mean/ interpreted in a manner that if offer has been made to more than 50 persons then in that case SEBI will be having no power in relation to prospectus and issue of securities with respect to unlisted public company."

SC further discussed the aspect of **'intention'** as to what it should regulate. Sahara saying that it was not its intention to get securities listed on any stock exchange, thus it should not be governed by laws/regulations with respect to that. The maxim **'acta exterior indicant interiora secreta'** that means external action reveals inner secrets[50] as the issue by SHARA was public offer so it was on their part to mandatorily register securities on stock exchange.

Subsequentlywith respect to **applicability of Unlisted Public Companies (Preferential Allotment) Rules, 2003 and the Unlisted Public Companies (Preferential Allotment) Amendment Rules 2011**, SC emphasized that 'rules are under the Act soit should be read subject to the proviso to Section 67(3)[51] and 73(1) and other related provisions. Further,if a co. is going for issue as per section 81[52]or 81(1A)[53] all these allotments are subject to proviso of

[47] Sudhir Shantilal Mehta v. Central Bureau of Investigation (2009) 8 SCC 1.
[48] Securities Contract (Regulation)Act, 1956, Section 2(h).
[49] Companies Act, 1956, Section 55A.
[50] Ref. Bennion on Statutory Interpretation, 5th Edn., p. 1104
[51] Supra at 8.
[52] Companies Act, 1956, Section 81.
[53] Supra at 2.

section 67(3)[54] as it is neutral provision'. Apex court clarified that even before the application of 2011 rule 'it was implicit that if co. is going for public issue, it has to follow provision of 67[55]& 73[56]. 2011 rule has only made explicit'.

Regarding contention of Sahara that DIP guidelines are departmental and having no force of law, thus it should not be applied on OFCD, SC concluded that "it is made under sec 11 so having force of law. With respect to non-applicability of ICDR as that time DIP was in enforcement, SC attracted their attention on Regulation 111[57] i.e. saving clause according to which any action taken for act/omission under DIP will be continued under ICDR."

The argument from Sahara was that OFCD is convertible thus fall under Section 28(1)(b)[58].Therefore, the inapplicability of SCRA. SC interpreted that this provision is not applicable to the convertible bonds, but to the entitlement of a person to whom such share, warrant or convertible bond has been issued.Section 28(1)(b)[59], 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 SCRA and not debentures.

Court finally ordered to refund almost Rs. 17 Thousand crore with interest.

Satyam Computers Scam

Satyam Computers Service Limited was India's 4th rank IT industry. It was having good reputation at global level. Mr. Raju achieved various awards but within 5 month after achieving Global Peacock Award for global excellence in corporate accountability, the scam got revealed. In the period of 2003-08 its total sale computed was around $467 million, share price got raised about 300% etc. but the numbers does not show the true picture. In 2008 Mr. Raju sent a letter to Board of Director in which he confessed about the whole scam, accounting fraud, failure of corporate governance and the reason behind such fraud. The reason was to acquire the Maytas Infrastructure Limited and Maytas Properties that was mostly owned by his family member, in

[54]*I*bid.
[55]Supra at 46.
[56]Supra at 9.
[57] Securities and Exchange Board of India(issue of capital disclosure Requirement), Regulation, 2009, Regulation 111.
[58] Securities Contract Regulation Act, 1956, Section 28(1)(b).
[59]*I*bid.

which he was having shareholding of 35% and 37% respectively. Thus he wanted to replace the fake assets with real one. But this plan did not get succeeded as it was without the consent of the stakeholder and at the same time the suit was filed in US by stakeholders.

Items Rs. in crore	Actual	Reported
Cash and Bank Balances	321	5361
Accrued interest on bank Fixed Deposit	N/A	376.5
Understated Liability	1230	N/A
Overstated Debtors	2161	2651

(Falsification in balance sheet)

The other interesting fact is that promoter's shareholding got down from 25.6% to 2.18%.

There are various factors responsible for this fraud, focusing mostly on the corporate governance issue as at that clause 49 of Listing Agreement, 2005 was there. It was having certain key requirements of corporate governance that every co. has to follow. But all these factors got violated.

1. **Failure of objective behind Independent Auditors:** SEBI said that there must be minimum number of independent director in co., they can ensure corporate credibility, governance and act like watchdog inside a com. But in case it did not perform any such function.[60]
2. **Failure of concept of Audit Committee:**objective was to oversee the financial reporting and disclosure process and to ensure that the financial reporting is not fraudulent. But in Satyam case the auditing committee was prima facie negligent as it was not having any check & balance on reported sum.[61]
3. **Failure of the duties of CEO/CFO:**They are entrusted with duty of confirming financial report and internal management. In Satyam case the Mr. Raju and Srinivas Vadlamani was himself implicit in fraud so how can it be expected that he would perform his best for corporate governance.

[60] Khurana Arpit, CORPORATE GOVERNANCE: - A CASE STUDY OF SATYAM COMPUTERS SERVICES LTD., Scholarly Research Journal For Human Science & English Language, ISSN: 2338:3083.
[61] *I*bid.

4. After all the most important concept was that co. has to disclose the report that it has complied corporate governance but it was also presented fake.

Auditor's Role:

World's best accounting firm i.e. Pricewaterhouse Coopers was the accounting firm in Satyam industry since 10 years. But it was not able to discover the discrepancies happening in balance sheet. It did not cross check with the bank regarding the deposit. It did not have attention on 'Non Interest Bearing Deposit' whereas it is reasonable step by any co. that excess amount whether it will deposit for interest or return it to investor. The large amount of such sum never created problem for it that it felt to check the balance sheet. It also signed and approved the financial statements. The reasonable skill applied by PwC can be understood very well that Investment bank DSP Merill Lynch found scam within 10 days that was appointed for founding the partner of co. SEBI based its jurisdiction by saying that it is the authority to protect the interest of investors which is one of the objectives of SEBI Act, 1992. By virtue of section 11, it interpreted 'any such other intermediary' and put auditor under that term that it is associated with market and can influence the decisions of investor. But SAT has quashed the order of banning of 2 year from auditing of any listing firm but allowed the disgorgement of the 13 crore. SAT also ordered that ICAI can take any action against its members.

Reformation in Laws: Impact of Sahara and Satyam Scam

After both the scams, legislature made a lot of changes here I am focusing only relevant changes with respect to paper:

1. **Concept of Hybrid Securitie**s: Under Act, 1956, definition of securities as per section 2(45AA) included the hybrid, term hybrid was also defined as per section 2(19A). Now the companies Act, 2013 under its definition part for 'securities' has deleted the hybrid nature of security.
2. **Definition of prospectus**: Section 2(36)[62]&2(70)[63] define 'prospectus'. The two major changes have been made as *firstly* shelf prospectus, red herring prospectus expressly

[62] Companies Act, 1956, Section 2(36).
[63] Companies Act, 2013, Section 2(70).

included that were not in 1956 and *secondly* the prospectus is not restricted to share or debenture rather extended to any type of security.

3. **Concept of Private placement:** The previous Act does not define the private placement whereas explanation II appended to section 42[64] of the 2013 Act defines it properly.
4. **Number of person to whom it can be issued:** Prior 1956 Act has limitation of 49 persons for private placement but now as per Companies Rules it has been extended to 200.
5. **Conditions of private placement:** The Act, 2013 contains some stringent condition which were not there in 1956 Act like as payment received from applicant shall be made in cheque or demand draft etc. but not in cash, there is also limitation of time period of one financial year i.e. only 200 persons in one financial year etc.
6. **Power of SEBI under Companies Act:** section 55A[65]did not specifically connect the SEBI Act and companies Act with respect to the power of SEBI as no such express provision there but 2013 Act clause 2 of section 24[66] expressly mentioned that SEBI can take action for contravention of any requirement of section 24.
7. **Information memorandum:** Section 60B of Act, 1956 mentioned about the IM that a co. may issue this before filing of prospectus to know the demand, price etc. but in 2013 Act the concept of IM has been restricted to shelf prospects only.
8. **Matters in Prospects:** Section 56[67]states that matters stated in prospectus will be that is defined in part I & II of schedule II of Companies Act whereas the 2013 Act laid down the subjective aspect that to state whatever SEBI specifies in consultation with CG. Fine in case of non-compliance with the requirements stated for prospectus under 1956 Act was limited to 50,000 whereas it has been extended from 50,000 to 3 Lakh with criminal punishment.
9. **Scope of dematerialization:** Earlier it was limited to listed public company with public offer of more than 10 crore as per section 68B[68] but now the condition has been changed and it is applied on every company immaterial the worthy of public offer as per sec. 29[69].

[64] Companies Act, 2013, Section 42.
[65] Companies Act, 1956, Section 55A.
[66] Companies Act, 2013, Section 24(2).
[67] Supra at 4.
[68] Companies Act, 1956, Section 68B.
[69] Companies Act, 2013, Section 29.

10. Power of arrest is given to SEBI for recovery of amount under section 28A of SEBI ACT.
11. Statutory status granted to Serious Fraud Investigation Organization (SFIO) in 2013 under section 211[70]. It has been entrusted with investigation in affairs of companies in various circumstances among which public interest is also there.
12. **Stringent Corporate Governance:** Various amendments have been made for proper corporate governance in Companies Act like related party transactions, CSR, disclosure and reporting, class action suit, number of independent director increases.SEBI in 2015 enacted the SEBI (LODR) 2015 that is applicable to all listed companies and having strong corporate governance norms.[71]
13. The Act, 2013 provides corporate fraud as a criminal offence under section 447[72].
14. The amendment has also increased responsibility of auditors for reporting functions to government under section 143 clause12[73] that will simultaneously apply to cost accountant, company secretary, and branch auditor.[74] The auditors are also obligated now to report instances of fraud noticed by them during the performance of their duties by virtue of ICAI Guidance Note, 2016.
15. **Vigil Mechanism:** Section 177[75]has provided that every listed company and such class or classes of companies, as may be prescribed to establish a vigil mechanism for the directors and employees to report genuine concerns in such manner as may be prescribed. This provision was not in 1956 Act.[76]
16. Clause 49 of listing agreement has been amended and made more stringent provision of ID, RPT, improved disclosure norms and mandatory E-voting for listed co. as compare to 2013 Act.

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[70] Companies Act, 2013, Section 211.
[71]Pushkar Susmit, Naushad Susanah, What changed in the legal landscape post Satyam scam, 8 Oct, 2019 (12:05AM), https://www.moneycontrol.com/news/business/companies/what-changed-in-the-legal-landscape-post-Satyam-scam-2480623.
[72] Companies Act, 2013, Section 447.
[73] Companies Act, 2013, Section 143(12)
[74]Goyal Divesh, Fraud Reporting Under Companies Act, 2013, 9 Oct, 2019 (11;23AM), https://www.google.com/amp/s/taxguru.in/company-law/fraud-reporting-companies-act-2013.html/%3famp.
[75] Companies Act, 2013, Section 177.
[76]Pushkar Susmit, Naushad Susanah, What changed in the legal landscape post Satyam scam, 8 Oct, 2019 (12:05AM), https://www.moneycontrol.com/news/business/companies/what-changed-in-the-legal-landscape-post-Satyam-scam-2480623.

Conclusion &Suggestionsto fill the Gaps

After Sahara & Satyam case, many changes have been brought in corporate laws but there are still some more changes needed to be made to make more strengthen this aspect. The reason being the India as developing country needed a lot of economic growth that is possible only after if investor protection norms will be there and a very less possibility of frauds such as above mentioned.

With respect to company, the suggestion will be that if any discrepancies are happening in account of co. or accounts are not balancing or something seems inaccurate then it is required to do proper and full investigation.High need of skilled professionals that can identify, expose weakness in these three important areas such as poor corporate governance, mistaken internal control and financial statements. [77]There is need of co-ordination between different financial sector regulators as if that had been present in that SAHRA scam then it was possible that it could be got known very early.

The Financial Stability and Development Council (FSDC) is not a sufficient framework to cop up such work as it focuses on macro-prudential matters. There is need of authority that can ensure better co-ordination.There is need to remove the bar on regulation of unlisted companies by SEBI to ensure more favorable framework for investors.

Do the implementation of the recommendations of FSLRC i.e. Financial Sector Legislative Reform Commission, some of them are:

- They recommended that the definition of securities should be i. entity-neutral and ii. Do broad enough to incorporate new instruments that emerge as a product of financial innovation as financial market is dynamic one.[78]
- To do more strengthen the registration requirement and that should be more disclosure based regulation as compare to merit oriented. It suggested that registration requirement should be entity-neutral and not only restricted to companies.[79]

[77]Bhasin Lal Madan, Corporate Accounting Fraud: A Case Study of Satyam Computers Limited, Open Journal of Accounting.
[78] Banerji Deboshree , Impact of FSLRC on Indian Market and Securities Regulations: Legal implications, National Law University, Jodhpur.
[79]Supra at 71.

- It recommended that there must be criminal market abuse as distinct part of market abuse that will include a. Abuse of information and b. Securities market abuse. It also had the provision of criminal punishment.[80]
- FSLRC recommended for consumer/'investor protection through its some mechanisms that are Financial Redress Agency, create market integrity, make high standardization of contract in security market and dissemination of market information to all players.[81]

There is need of guideline regarding remuneration of director, key managerial personnel, Chief Executive Officer. Otherwise the 'who pay & accountability' will be in question.There is need to have focus on liability of independent director.There is need of rethinking regarding the composition of board, as the increase the number of Id to have more accountability and to limit the directorship which an individual can hold.

[80] *Ibid.*
[81] *Ibid.*