SEBI

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Supreme Court Rules on pledge of dematerialized shares and their invocation

(PTC India Financial Services Limited vs. Venkateswarlu Kari & Another ((2022) 138 taxmann.com 248 (SC))

The Supreme Court has recently given a ruling on matters of pledge of dematerialized shares which can have far reaching implications. The primary question was whether, on invocation of pledge and resultant transfer of beneficial interest in the pledged shares, the pledgee lender is said to have transferred the shares fully to itself? And whether thus the amount of loan gets reduced to the extent of value of the shares? Or the invocation and transfer merely means that the pledgee lender has better control over the shares while the ownership (and its risks and rewards) remain with the pledgor borrower?

The Court held that invocation of pledge on dematerialized shares whereby the shares are transferred in the name of the pledgee does not result in the pledgee becoming full owner of the shares. The shares continue to remain under pledge. The Court also said that the provisions of the Indian Contract Act, 1872, have not been overwritten by the Depositories Act/Regulations and both laws are to be read harmoniously. Thus, the provisions of the Indian Contract Act also continue to apply though the procedure laid down in the Depositories Act/Regulations needs to be followed.

It is only on formal sale of the shares by the pledgee and thus realization of the sale value that the amount of loan/dues can be said to be reduced to that extent. But before making such formal sale of the shares, the pledgee is required to comply with the provisions of the Indian Contract Act and thus give prior notice to the pledgor. The pledgor could thus still pay the dues and thus re-transfer to its name the shares.

Having ruled that, the Court, however, raised some important further issues under other laws which it said need consideration by the respective regulators. For example, would the transfer of the shares to the pledgee on invocation of the shares and re-transfer to the pledgor on payment of dues attract the provisions of the SEBI Takeover Regulations? What about the tax implications of such transactions? What about the accounting implications?

One hopes that there is due consideration by the law makers and the laws duly amended so that the process of borrowing against pledge of shares, which is quite common, is not hindered.

Supreme Court Rules on certain issues in related party transactions

(SEBI v. R. T. Agro (P.) Ltd. (2022) 137 taxmann.com 496)

An interesting issue arose in this case. Briefly summarized, the facts and issues were as follows. The listed company in question proposed a material related party transaction in real estate. The relevant SEBI Regulations require that such transaction should be approved by the shareholders. Further, on such resolution, the related parties should not vote to approve such transaction.

The listed company convened a meeting of shareholders and placed the resolution before them. The related parties did not vote to approve such transaction. The shareholders approved the transaction by requisite majority. Later, however, a significant shareholder claimed that it had not received the notice of the general meeting. It convened an extra ordinary general meeting where the proposal was to reverse the original approval given.

The general meeting was duly held. At such meeting, however, it appears that the related parties did vote and it also appears that they voted against such resolution. In other words, it appears that they voted to reject such resolution proposing reversal of the original approval.

The interesting question that arose was that if the related parties could not vote to approve the related party transaction, could they vote on a resolution to reverse the original approval granted? Effectively, the issue was whether the related parties have any say in the matter of the related party transaction?

SEBI had taken a stand that the related parties could not vote on such resolution for reversal of the original approval. Since the related party did vote, it levied penalties on such related parties. The parties appealed to the Securities Appellate Tribunal which reversed SEBI's decision. It said that the bar was on voting to approve a related party transaction. This was not a case where the proposal was to approve a related party transaction. Thus, the bar did not apply.

SEBI appealed to the Supreme Court. Calling the stand of SEBI as hyper technical, it upheld the decision of the Securities Appellate Tribunal. Thus, the penalties levied were reversed.

In terms of intent, it is submitted, with due respect, that it is arguable that voting to approve a related party transaction is substantially similar as voting to reject the reversal of a related party transaction. Or, to take an analogy from mathematics, two negatives make a positive. But this view did not find favor either with the Tribunal or with the Hon'ble Supreme Court in view of the specific and clear wording of the law. It appears that the intention of the law may have been that while related party could not vote to approve a related party transaction, a related party could be allowed to reject a related party transaction. However, the wording of the law did cover a situation like this and hence the stand of SEBI was not supported by the provisions of the Regulations. If SEBI indeed believes that related parties should not have a say even in case of reversal of approval of related party transactions, the Regulations need to be amended accordingly.