ROLE OF SEBI IN PROTECTING INVESTOR RIGHTS AND REGULATING INFRASTRUCTURE FINANCING WITH SPECIAL REFERENCE TO SAHARA INDIA REAL ESTATE CORPORATION LTD V. SEBI

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1. INTRODUCTION

Public limited companies may list their shares in the stock exchange for financing real estate projects such as building construction, apartments and for infrastructure development projects. This is done by initial public offers for equity investments, rights issue or through issue of debentures/bonds, hybrid investments. A prospectus is issued for inviting offers from the public for subscription of securities.[1] This is an alternative to borrowing from banks and financial institutions since the investment required for infrastructure development projects are relatively high. In the case of unlisted companies, financing is done through private placements. The term private placement is not found in the Companies Act 1956 but its concept was introduced in section 67(3) of the companies Act 1956. Private placements take place by issuing shares or debentures to those who received an offer or invitation to offer or domestic concern of the issuer. Private placements need not be registered in the stock exchange, and it does not attract any disclosure requirements that are necessary for public offerings. The proviso to section 67(3) of the Companies Act 1956 treats an offer made to 50 or more persons as public issue, bringing such offers under the jurisdiction of SEBI. Security Exchange Board of India is the financial market regulator which protects the interests of the investors and promotes orderly growth of securities market. SEBI has jurisdiction over companies that are listed in the stock exchange and the companies that intend to list itself in the stock exchange. While private placements of unlisted companies are governed by the Central government, the question related to jurisdiction of SEBI over raising funds through private placement by unlisted companies first arose in the Sahara Group Case. The judgement of the Supreme Court is carefully examined in this article to understand the jurisdiction of SEBI over unlisted companies that raises funds through private placements. This article examines how Sahara group for the

[1] Section 26, Companies Act 2013

purpose of raising funds for infrastructure development, tried to circumvent the jurisdiction of SEBI and defrauded investors by issuing securities as private placements while its actual actions showed that it was a public offer. It further examines the amendments made to private placement in companies Act 2013.

2. BACKGROUND OF SAHARA CASE

Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited (SHICL) are a part of Sahara group, carrying on the business of construction, real estate and infrastructure development. SIRECL and SHICL were public limited companies not listed in any stock exchange.

SIRECL, on 03.03.2008, passed a special resolution under section 81 (1A) of the companies Act 1956 to raise funds through Optionally Fully convertible debentures[2] by way of private placement to friends, associates, workers, employees etc. without the need for advertising to the general public. Subscription of the securities through private placements were sought to raise funds for projects such as townships, construction activities, residential apartments, shopping complexes , infrastructural activities like constructing bridges, modernizing airports etc. The details of unsecured OFCDs were mentioned in Red Herring Prospectus[3] and filed with the registrar of companies. In the Red Herring Prospectus, SIRECL specifically indicated that it did not want to list its securities at any stock exchanges. And the eligibility criteria for applying was specifically stated in the RHP as those to whom information memorandum has been circulated and/or privately approached. Similarly, SHICL on 16.09.2009 convened a meeting and decided to raise funds for infrastructure development projects of the company by way of issue of OFCDs through private placement. RHP was filed with the Registrar of companies. The two companies, by issue of OFCDs through private placements raised more than 27,000 crores from over 3 crores investors.

3. THE CRUX OF THE ISSUE

SEBI was alerted about this large-scale investment made through private placements while processing Sahara Prime city's (part of Sahara group) RHP. SEBI issued summons to SRECL and SHICL requiring them to submit details of all the investors, their application forms,

[2] Optionally Fully Convertible debentures are Hybrid securities under section 2 (19A) of the companies Act 1956, is which at the investor's option the whole value of the debentures is converted to equity shares at a predetermined price.

[3] Explanation to section 60 B Companies Act 2013 , Red Herring prospectus means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of the securities offered.

addresses etc . In its notice, SEBI stated that the issue of OFCDs by the two unlisted companies violated statutory requirements and these companies had not filed RHP or prospectus with SEBI when the law mandated public issue compliance. The issuance of OFCDs was considered by SEBI as public issue and not as a private placement. In the case of initial public offer, the law mandates the securities to be listed in a recognized stock exchange. SEBI alleged that there was prima facie violation of sections 56 and 73 of companies Act 1956, DIP guidelines and SEBI (Issue of Capital and Disclosure Regulations) 2009 and therefore the issue of OFCDs were considered illegal.

Sahara in its reply to SEBI's summons, questioned the *locus standi* of SEBI. Sahara contended that after passing a special resolution under section 81 (1A), both the companies followed procedure under section 60 B[4] and filed RHP with the RoC. It claimed that all matters pertaining to unlisted company came within the administration of Central Government or RoC and not SEBI. [5] By way of filing RHP with RoC, it satisfied all legal requirements governing private placements by unlisted public limited company. Therefore, Sahara questioned the interference by SEBI since the two companies were not listed in any stock exchange. And it further contended that OFCDs were hybrid securities[6] and it doesn't fall under the definition of 'securities'[7] provided in the SEBI Act. And therefore Sahara, contended that SEBI (Issue of Capital and Disclosure) Regulation , 2009 will not apply to both the companies as it was not a public issue or further issue of shares but issue of OFCDs through private placement. Therefore, Sahara requested SEBI to withdraw the summons as it had no jurisdiction. However, SEBI claimed jurisdiction over this matter, and directed Sahara to furnish all information requested by it with relation to the OFCDs and further directed Sahara to refund the amount to the investors. Sahara appealed against the decision of SEBI before the Securities Appellate Tribunal.

[4] A public company making an issue of securities may circulate information memorandum to the public prior to filing of prospectus.

[5] Section 55 A Companies Act 1956 The provisions contained in sections 55 to 58, 59 to 84, 108, 109, 110, 112, 113, 116, 117, 118, 119, 120, 121, 122, 206, 206A and 207, so far as they relate to issue and transfer of securities and non-payment of dividend shall,—(a) in case of listed public companies;(b) in case of those public companies which intend to get their securities listed on any recognized stock exchange in India be administered by the Securities and Exchange Board of India; and(c) in any other case, be administered by the Central Government.

[6] Section 2 (19 A) Companies Act 1956, Hybrid means any security which has the character of more than one type of security , including their derivatives.

[7] Section 2 (h) (i) Securities contract (Regulation) Act 1956 securities include shares, Scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.

SAT looked into the definition of securities under SCRA and held that the OFCDs comes within the purview of the definition of securities under section 2(h) of Securities Contract Act as these hybrid securities are within the genus of debentures. On the question of jurisdiction of SEBI, SAT decided that OFCDs issued by Sahara invited public at large[8] and therefore Sahara was bound to comply with the provisions under section 73 of the companies Act 1956 relating to listing of securities in the stock exchange. SAT directed Sahara to refund the amount to the investors and provide details of investors and the investment. Sahara, aggrieved by the order of SAT, appealed to the Supreme Court questioning the jurisdiction of SEBI over unlisted companies which raises funds through private placement. The Supreme Court considered, *inter alia*, the scope and ambit of SEBI under section 55A Companies Act, 1956 and 11, 11A, 11 B of SEBI Act 1992.

4. JURISDICTION OF SEBI

SEBI protects the interests of the investors and promotes development of securities market. [9] It prohibits unfair trade practices and insider trading. It also regulates the issue of prospectus or advertisements soliciting money. SEBI has powers to regulate issue or transfer of shares by listed companies and those companies that intend to list itself in the stock exchange.[10] And in "any other" case , it is administered by Central Government. The court construed OFCDs as debentures which falls within the definition of securities under securities Contract Act, [11] thus the power to administer such OFCDs lies with SEBI and not Central Government. Matters excluding issue or transfer of shares are administered by Central Government. Such excluded matters are issue of prospectus, statement in lieu of prospectus, return of allotment, issue of shares and redemption of irredeemable preference shares are the ones which are governed by Central Government.[12]

4.1 DIVIDING LINE BETWEEN PRIVATE PLACEMENT AND PUBLIC ISSUE

The Supreme Court concurred with the opinion of SAT that it was a public issue and not a private placement. It held that the onus is on Sahara to show that it was a private placement that is it was issued to friends, employees etc. which Sahara failed to prove. The court held that the money collected by Sahara through their RHPs dated 13.03.2008 and 06.10.2009 were from

[8] Proviso to section 67 (3) Companies Act,1956
[9] Section 11, SEBI Act, 1992
[10] Section 55A, Companies Act, 1956
[11] Section 2 (h) (i), Securities Contract (Regulation) Act, 1956
[12] Explanation to Section 55 A, Companies Act, 1956

public at large and not a private placement. There is a fine line between what amounts to private placements and public issue. Where the number of persons who subscribed to securities exceeds 49 persons then the same would be considered as a public issue.[13] Consequently, the issue by Sahara, though it claimed it was a private placement, issued OFCDs to over 3 crore persons. This would amount to public issue, and it has an obligation to list itself in a stock exchange.[14] Any issue of shares or debentures beyond 49 persons would be a public issue attracting the provisions of SEBI Act 1992 and Companies Act 1956 pertaining to public issue.

4.2 INTENTION OF SAHARA GROUP

The law clearly states that the companies inviting subscription by issuing information memorandum is bound to file prospectus prior to opening of subscription list and the offer as RHP.[15] Sahara issued information memorandum for a private placement. Whereas section 60B (1) clearly provides for issue of Information Memorandum to public before filing prospectus. The intention of Section 60 B is that information memorandum is mainly filed by companies which are going for public issue and not for private placement. The court found from the conduct and actions of Sahara , its intention was to issue securities to the public under the garb of private placement. In Supreme court applied the maxim '*acta exterior indicant interiora secreta*' meaning external action reveals inner secret to state that Sahara has in the guise of private placement issued securities to the public. Therefore, it held Sahara companies were legally bound to list their securities in the stock exchange

4.3 OBLIGATION OF LISTING

Section 73 (1) of Companies Act, 1956 casts an obligation on companies that intend to offer share or debentures to public, to apply to any of the stock exchange for listing of securities. Listing is therefore mandatory for those companies that offer securities to the public provided that the offers are made to more than 50 persons. The Supreme Court held that by not listing its securities in any stock exchange, it contravened provisions of Companies Act, 1956 and violated the SEBI (Disclosure and Investor protection guidelines) and also ICDR regulations 2009. It further held that as per section 73 (2) every company and every director of the

[13] Proviso to section 67, Companies Act 1956
[14] Section 73 (1) , Companies Act, 1956 Every company intending to offer shares or debentures to the public for subscription by the issue of a prospectus shall before such issue make an application to one or more stock exchange for permission for the shares or debentures intending to be so offered to be dealt with in the stock exchange or ach such stock exchange.
[15] Section 60B, Companies Act, 1956

company who is an officer in default , shall be jointly and severally liable to repay that amount with interest at a rate of 15% per annum. [16] SEBI was therefore justified in directing refund of the amount with interest. The law imposes civil and criminal liability for misstatement in prospectus, fraudulently inviting public to invest in securities.[17] The Supreme Court was of the opinion that " *The provisions for imposing civil and criminal liability and refund for the amount with interest would indicate that , of late, economic offences in India like the one committed by Saharas be treated with an iron hand, or else we may land ourselves in another security market pandemonium."*[18] The companies should comply with listing provisions under SEBI (Listing obligations and Disclosure requirements) Regulation 2015 and also follow good corporate governance as agreed by the companies in the listing agreement it entered with the stock exchange.

The Supreme Court held that sections 11 A and 11 B of SEBI Act 1992 are to be read in consonance with section 55A of Companies Act 1956, thus expanding SEBI's jurisdiction over issue of securities. Ministry of Corporate Affairs does not have the machinery to deal with large scale issue of securities to public. Supreme Court upheld the jurisdiction of SEBI and directed Sahara to refund the amount with 15% interest per annum to SEBI and furnish all details of the subscribers. It further directed SEBI to freeze accounts, sell properties of Sahara for realization of the amount if the refund is not made.

5. PUBLIC ISSUE UNDER COMPANIES ACT 2013

Sections 23 to 41 of Part I Chapter III of the Companies Act 2013 govern companies that issue securities through prospectus. Where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, shall be deemed to a prospectus issued by the company, and shall be treated as if the securities had been offered to the public for subscription and as if persons accepting the offer were subscribers for those securities.[19] Where certain members of company propose to offer whole or part of their holding of share to public, they may do so in consultation with Board of Directors and any such offer document shall be deemed to be a prospectus.[20]

6. PRIVATE PLACEMENT UNDER THE COMPANIES ACT 2013

[16] Rule 4 D of the companies (Central Government) General Rules
[17] Sections 62, 63 (1) Companies Act, 1956
[18] Sahara Real Estate Corporation Ltd v. SEBI, (2012) 10 SCC 603, 116
[19] Section 25, Companies Act,2013
[20] Section 28,Companies Act, 2013

Private companies and Public limited companies can raise funds by issuing securities through private placements. Private placement means any offer of securities or invitation to subscribe securities to a select group of persons by a company through issue of private placement offer letter.[21]The offer of securities or invitation to subscribe to shares that is made to such number of persons not exceeding 200 persons in the aggregate in a financial year (in each kind of security) is a private placement.[22] Qualified institutional buyers, employees stock option are excluded. It has to be issued through private placement offer letter. Further any offer or invitation not in compliance with section 43 of the companies Act 2013 shall be treated as a public offer and the provisions under Securities and exchange Board of India 1992 and Securities and contracts (Regulation) Act 1956 should be complied with.[23] Further any subscription through private placement, shares should be allotted within sixty days from the date of receipt of application money.[24] For private placements, the companies are not allowed to advertise or inform the public at large as to the such an offer.[25] Any contravention to provisions under section 43 of companies Act 2013, the companies have to refund the amount to the subscribers. Thus, the Companies Act 2013 has regulated the procedure for private placements which was lacking in the earlier 1956 Act. The recent amendment in 2017, has further protected investor's interest by prohibiting utilization of money received through private placement until return of allotment is filed with RoC within 15 days of allotment.

7. ROLE OF SEBI IN REGULATING INFRASTRUCTURE FINANCING

Infrastructure projects have been delayed mainly due to inability to meet funding requirements. There has been severe liquidity crunch due to limited funding framework and subdued investor interest. Investments into corporate bonds issued by infrastructure company have lock in period of three years. But recently, there has been increase in private participation in infrastructure projects, thus increasing cash flow. SEBI has allowed alternative investment funds for pooling in investments for infrastructure projects and it has also brought in regulation for real estate investment trusts and infrastructure investment trusts. Alternative investment funds are privately pooled investment fund which is collected from investors, either Indians or foreigners, in the form of a trust or company or body corporate or LLP.[26] It is created for investing in accordance with a defined investment policy beneficial for its investors. It is

[21] Explanation II Section 43, Companies Act, 2013
[22] Section 42, Companies Act 2013 R/w Regulation 14, (Prospectus and allotment of Securities Rules,2014
[23] Section 43 (4),Companies Act, 2013
[24] Section 43(6), Companies Act, 2013
[25] Section 43 (8), Companies Act, 2013
[26] Section 2 (1) (b) SEBI (Alternative Investment Funds) Regulations 2012.

governed by SEBI (Alternative Investment Funds) Regulations 2012. Applicants may seek registration from among various categories, which also includes infrastructure funds.

8. REAL ESTATE INVESTMENT TRUSTS (REITs)

REITS like mutual funds is an investment scheme by which investors pool in money but in the case of REITS the money is invested in secured commercial properties like residence, hotels, warehouses, commercial building, Industrial parks etc. to generate income. REITS are governed by SEBI (Real estate Investment Trusts) Regulations, 2014 and the amended Rules,2020. REIT has to be registered with the Board . Funds are raised through initial offer by way of public issue only. Thereafter, the units of REITS are listed in stock exchanges and traded like securities. REIT assets are held by trustee for the benefit of the investors. The value of REIT asset shall not less than 500 crore rupees. The trust distributes 90% of income among the investors as dividends. The minimum public holding of REITS shall be 25% of total number of outstanding units at all times and the number of unit holders shall be 200 at all times.[27] REIT consists of three parties, namely sponsor, manager and trustee who are all distinct entities. The sponsor of the Trust is the Real estate company which is responsible for setting up REIT, and should be having atleast five years' experience in real estate development or fund management in real estate industry. The 'management company' is responsible for making investment decisions and operating the properties. The trustee holds the assets of REITs in trust, ensuring that the money is managed in the interest of unit holders and also plays a supervisory role, by overseeing the activities of the manager of the trust. An independent valuer ensures valuation of REITs is fair and impartial. REIT invests in properties through Special Purpose vehicles. The sponsor or sponsor groups are required to hold collectively a minimum of 25% of units of REIT on post initial offer basis. The amendments to the Regulation in 2020, has allowed declassification of sponsors subject to certain conditions if their units have been listed in stock exchanges for at least 3 years. This amendment has given much needed liquidity to sponsors. Further, any change of sponsors is to be approved by 75% of unit holders and if such change is not approved, the inducted sponsor has to provide exit option to the dissenting unit holders, thus protecting rights of investors. The manager applies for delisting of units when there are no projects remaining under the REIT or when REIT does not propose to invest in

[27] Section 16 (7) SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2016.

any project sin future. The valuer and auditor play an important role in protecting rights of investors. Above all the Board ensures that the interest of the investors is protected.

9. INFRASTRUCTURE INVESTMENT TRUSTS (InvITs)

Infrastructure investment trusts facilitates investment into eligible infrastructure project.[28] The investment is similar to that of mutual funds, small amount of money is pooled by many investors into infrastructure projects. InvITs are for investors who are looking for long term investment. InvITs invest in infrastructure projects either directly or through special purpose vehicles. In case of PPP model, funding is done only through special purpose vehicle. SEBI (Infrastructure Investment Trust) Regulation, 2014 as amended in 2020, regulates Infrastructure investment trusts. An Invit should obtain certification of registration from the Board. The investment is in the manner of public offer for completed and revenue generating projects while investment is through private placement for under construction projects. . It shall be mandatory for units of all InvITs to be listed on a recognized stock exchange, whether publicly issued or privately placed. The value of assets owned by the InvITs shall be atleast Rupees five hundred crores. And minimum issue size for initial offer is Rs. 250 crores. There are four parties to the trust namely Sponsor, investment manager, project manager and trustee. Sponsors are promoters of the infrastructure company which sets up the trust. An InvIT shall not have more than three sponsors. The trustee plays a supervisory role by overseeing the working of Infrastructure investment trust and ensures that all rules are complied with. Project managers is responsible for the execution or management of the project. Investment manager is a body corporate /company/LLP that manages the assets and investment of the trust. The investment manager shall make the investment decisions with respect to the underlying assets or projects of the InvIT including any further investment or divestment of the assets, also ensures that holdco or SPV have proper legal titles, and oversees activities of the project manager. Trust raises capital by selling units to mutual funds, pension funds etc . The trust then buys sponsor's assets like roads, telecommunications etc. which are cash generating infrastructure projects.. The sponsor shall have a sound track record in development of infrastructure or fund management in infrastructure. The amended regulation in 2020 has

[28] "eligible infrastructure project" means an infrastructure project which, prior to the date of its acquisition by, or transfer to, the InvIT, satisfies the following conditions,– (i) For PPP projects–(1) the Infrastructure Project is a completed and revenue generating project, or the Infrastructure Project, which has achieved commercial operations date and does not have the track record of revenue from operations for a period of not less than one year, or (2) the Infrastructure Project is a pre-COD project; (ii) In non-PPP projects, the infrastructure project has received all the requisite approvals and certifications for commencing construction of the project.

provided for De-classification of the status of a sponsor(s) of an InvIT whose units have been listed on the stock exchanges for a period of three years with approval from 75% unit holders. When InvIts raise funds by way of private placement it shall do it through a placement memorandum from institutional investors and body corporate only, whether Indian or foreign (c)with minimum investment from any investor of rupees one crore from not less than five and not more than one thousand investors. A privately placed InvIT shall ensure that the disclosures in the placement memorandum are in accordance with the guidelines issued by the Board. The offer document or placement memorandum of the InvIT shall contain material, true, correct and adequate disclosures to enable the investors to make an informed decision. SEBI requires that shareholders agreements shall provide for an appropriate mechanism to resolve disputes between InvITs and other shareholders in holding company or Special purpose vehicle. Thus, the investment through SPV or holdco is strictly regulated by the Board.

10. CONCLUSION

The companies Act 2013 states that a public limited company can raise capital through public offer, private placements or through rights or bonus issues.[29] And that, SEBI shall administer provisions relating to prospectus and allotment of securities; Share capital and debentures; issued by listed company and about to be listed company.[30] The Sahara case has shown how SEBI has acted as a regulatory body of financial market preventing unlisted companies from inviting public issue under the guise of private placement through the loophole in the 1956 Act. The SC has directed the two companies to refund the amount with interest and SEBI has filed Contempt petitions against Sahara for violation of SC orders. SEBI as a regulator has thud strongly acted against companies that try to circumvent disclosure guidelines imposed by it.

While raising funds for infrastructure development projects, it is difficult for companies to limit itself to private placements. Public limited companies that are looking for large scale investment for infrastructure development projects should issue prospectus and list itself in stock exchange and should also comply with disclosure guidelines. Further, proper legal framework and with SEBI as a market regulator, the interest of the investors are not only protected but has helped in raising funds for the necessary infrastructure projects. The

[29] Section 23, Companies Act, 2013
[30] Section 24, Companies Act,2013

companies are under an obligation to comply with the provisions of SEBI Act and regulations, Companies Act 2013 while making a public offer.

Several infrastructure development projects have been stalled in India due to lack of necessary funds. However, the Public private partnership model has removed this difficulty, and raising funds through public issue has brought in investment in this sector. SEBI by allowing to trade in REITs and InvITs has provided an opportunity for investors to participate in real estate sector and infrastructure projects and at the same time helped companies to get liquidity for projects. The enforcement of Real Estate (Regulation and Development) Act 2016 has provided for transparency in real estate market, creating favourable environment for investments. And InvITs aids long term financing of infrastructure projects, and reinvestment in new projects. InvITs has attracted investors through its diverse portfolio of infrastructure assets. SEBI has brought in number of reforms in financing of infrastructure projects and real estate projects. SEBI has now eased its norms so as to create an enabling environment for REITs to flourish, encouraging investments into commercial real estate properties. SEBI now allows the REITS and InvITs whose securities are listed in stock exchange can now issue debt securities.[31] These debt securities are non-convertible debt securities and include debentures, bonds, and such other securities. Any debt securities issued by REITs or InvITs shall be secured by creation of charge on the assets of REITs/ InvITs or SPV. It has also permitted single asset REITs. It has further allowed scheduled commercial banks and non-banking finance companies to invest in REITs. SEBI has eased its fundraising norms for REITs and InvITs, thus facilitating growth of infrastructure sector. The challenges and risks involved in infrastructure sector are plenty. Therefore, SEBI has placed strict reporting and disclosure mechanism to ensure protection of investors. The Board or the designated stock exchanges strictly acts against REITS and InvITs by delisting them for violation of the listing agreement or any of the REITS/InvITs regulations. The Board may suo motu or upon receipt of information or complaint appoint one or more persons as inspecting officers to undertake inspection of the books of accounts, records and documents relating to activity of the REITS and InvITs for protecting the interest of the investors.

[31] SEBI guidelines for issuance of debt securities by REITs and InvITs Circular No. SEBI/HO/DDHS/CIR/P/2018/71