ANALYSING THE SEBI v. PAN ASIA ADVISORS LIMITED CASE

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INGREDIENTS OF THE CASE

Pan Asia Advisors Limited ("Pan Asia"), a merchant banking firm, was the lead manager in the issuance on Global Depository Receipts ("GDRs") of Asahi Infrastructure and Projects Limited ("Asahi"). These GDR issuances were followed by several on-market and off-market transactions that included the transfer of GDRs from the initial subscribers, cancellation of GDRs and conversion of GDRs into equity shares in the Indian market. The Securities and Exchange Board of India ("SEBI") investigations unearthed that in all stages of the above transactions, entities related to Pan Asia had been involved in the purchase/sale of GDRs or shares. Pan Asia had facilitated synchronized transactions of the GDR issue, arranging of investors, providing of exit options for investors and conversion of GDRs into equity shares in the Indian market. These transactions were undertaken with the underlying intention of increasing the liquidity and market reputation of the scrips of Asahi.

The SEBI, by an ad interim ex-parte order in 2013, not only prohibited the entities involved in these transactions from directly or indirectly dealing with securities, but also debarred them from accessing the securities market for a period of 10 years.

The majority opinion rendered by the Securities Appellate Tribunal ("SAT") was that SEBI was not conferred or delegated the jurisdiction to supervise and inspect matters related to the issue of GDRs. The order gave examples of certain provisions within the Foreign Exchange Management Act ("FEMA"), rules and regulations which made it abundantly clear that GDR issuances fell solely within the regulatory purview of the Reserve Bank of India ("RBI") as well as the Ministry of Finance ("MoF"). Firstly, GDRs are regulated under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993 ("1993 Scheme") which was introduced by the MoF, and the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000 ("FEMA 20"), which was issued by the RBI via Sec. 6 of FEMA. Second, a GDR is issued by an overseas bank, and not by an Indian merchant banker. Lastly, the RBI Master Circular on Foreign Investments provides for the application of SEBI rules and regulations wherever relevant, but the parts of the Circular dealing with GDR issuance have no mention of the interference of SEBI in the same. All applications and reporting with respect to GDRs are required to be made to the RBI, and not SEBI. The provisions on reporting under FEMA 20 also specify that RBI is the reporting authority. SAT emphasised on the doctrine of separation of powers, and thus concluded that it was the RBI and the MoF, and not SEBI, that had exhaustive powers on the supervision of GDR issuances.

SEBI filed an appeal against the SAT order before the Supreme Court ("SC"). The first issue pertained to whether SEBI had jurisdiction under the SEBI Act, 1992 to initiate proceedings against Pan Asia and the connected entities, with respect to the issuance of GDRs outside India, which was based on the conclusions of investigations conducted by it. The second question was whether SEBI was justified in passing the order debarring the connected entities from rendering services in connection with securities and prohibiting them from accessing the capital markets directly or indirectly for a period of 10 years.

ANATOMISING A GDR INSTRUMENT

Firstly, the SC dealt with the issue of whether SEBI had subject matter jurisdiction, i.e., jurisdiction to administer and supervise the issuance of GDRs. In doing so, the SC explored the creation, construction and design of a GDR instrument. As per the regulatory framework (FEMA 20 and the 1993 Scheme), a

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company would have to issue shares to a Domestic Custodian Bank ("DC Bank"), who will instruct an Overseas Depository Bank ("OD Bank") to issue GDRs against the shares held by the DC Bank. Such GDR (denominated in any convertible foreign currency) may be listed on an international stock exchange, and its underlying asset are the shares (denominated in Indian currency) held by DC Bank. GDRs can only be held by a Non Resident ("NR") person. GDR holders may transfer the receipts by way of sale, or request for redemption of GDRs. In case of redemption, the OD Bank requests the DC Bank to release the underlying shares in favour of the NR GDR holder, following which the name of the NR would be entered in the books of accounts of the GDR issuing company. FEMA regulations, in fact, permit two way fungibility of GDR instruments, i.e., the GDRs can be converted into equity, and vice versa at any point. The price of GDRs would be equal to the market price of the equity shares, underlying and attached to that GDR, at any given moment.

DO GDRS FALL UNDER THE DEFINITION OF SECURITIES?

After exploring a GDR instrument, the SC further went onto examine the definition of securities. The definition of securities under Section 2(1)(j) of the SEBI Act, 1992 derives from the definition of securities under Section 2(h) of the Securities Contract (Regulation) Act, 1956 ("SCRA"). The latter definition is exhaustive and includes "shares, scrips, stocks, bonds, debentures, debenture stocks or other marketable securities of a like nature in or of any incorporated company". Sub-clause (iii) of Section 2(h) states that "rights or interests in securities will also be construed as securities". Since GDR issuances are backed by underlying shares held by the DC Bank, a GDR can be construed as a right or interest in securities. Ensuing from this line of reasoning, a conjunctive reading of the phrase - other marketable securities of a like nature of any incorporated company under Section 2(h) and rights or interests in securities will also be construed as securities under sub-clause (iii), led the SC to reason that GDRs would fall within the definition of securities under the SCRA.

ANALYSING THE REASONING PROVIDED BY THE SUPREME COURT

It is interesting to note the dissenting opinion in the SAT order, which stated that since the transactions in question pertained to fraudulent activities that had impacted the investors in the Indian securities market, the question of jurisdiction of SEBI over administration of GDRs was irrelevant. SEBI could exercise jurisdiction over the above transaction because, firstly, the GDRs had already been converted into equity shares and were being traded in the Indian securities markets. Second, the activity of manipulating, deceiving, defrauding, and indulging in unfair trade practice by the acts and omissions of Pan Asia and the connected entities had impacted and influenced investors in the securities market situated in the Indian territory, over which the SEBI had jurisdiction.

The majority and the dissenting opinion in the SAT order are harmonious to the extent that both believe that SEBI does not have jurisdiction to administer the issuances of GDRs per se. In isolation, the argument that the regulations drafted were in a manner such that seemed to confer administration of GDR issuances to the MoF/RBI exclusively, seems to hold some ground. But on decrypting the nature of the a GDR instrument where the underlying security are shares, and on realising this direct correlation between GDR and shares, the argument that GDRs fall within the definition of securities and consequently within the regulatory purview of SEBI is particularly forceful.

JURISDICTION DUE TO FRAUD ON INDIAN INVESTORS

SC explained that the transaction fell within the territorial jurisdiction of SEBI. It was contended by Pan Asia and its connected parties that GDR issuances took place in a foreign jurisdiction which was beyond the statutorily imposed territorial reach of SEBI. The parties in this case were never involved in dealing with securities within the territory of India, and hence SEBI order on prohibition of transactions by these parties in the Indian securities markets was ultra vires. SEBI, on the other hand contended that Pan Asia had committed fraud on Indian investors, and that such fraudulent intention was present at every stage; beginning from the issue of GDRs outside India to the sale of the equity shares in the Indian markets. Sections 11, 11B, 11C, 12 and 12A of the SEBI Act, 1992 and Regulations 3, 4 and 5 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003

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casts a duty on SEBI to take such measures as it deems fit to ensure protection of the investors and the securities market from manipulative, deceitful and unfair trade practices. Both the Regulations specifically prohibits fraudulent practices by "any person", either directly or indirectly. This duty implies that it must also regulate the activities or brokers, agents, depositories and similar functionaries associated with the securities market.

SC placed reliance on the case of GVK Industries Officer v. Income Tax Officer (2011) 4 SCC 36, which stated that any law may proceed against an extra-territorial aspect, provided it has "got a cause and something in India or related to India and Indians in terms of impact, effect of consequence". Reliance was also placed on the effects doctrine, which meant that if the allegations of manipulation were true, it would have adverse consequences in the Indian securities market. Based on the above reasoning, the SC concluded that any fraudulent activity played against the interests of Indian investors fell squarely within the jurisdiction of SEBI.

VERDICT OF THE SUPREME COURT

SC noted that the lead managers played a pivotal role in the creation, fixation of price, arranging of investors and marketing post subscription amongst other forms of manipulation. The investors purchasing the equity on redemption of GDRs were given the impression that the GDRs issued by Asahi were fully subscribed to. But that the subscribers were parties connected with Pan Asia and that they were given financial assistance to purchase the GDRs by parties who were also connected with Pan Asia, was crucial information that was not disclosed to the Indian investors. This information was withheld with the intention of manipulating the Indian investors, to have confidence in the great market standing and high scrip liquidity of the company issuing GDRs. Pan Asia, in connivance with the connected parties were found to engage in the practice of defrauding and deceiving the Indian investors.

Section 11(1) of the SEBI Act, 1992 permits SEBI to take any action as it thinks fit to ensure that no activity is undertaken which would be detrimental to the interest of the investors and the markets. Thus the SEBI order preventing Pan Asia and the related entities from transacting in the securities markets for a period of 10 years was well within the scope of powers of SEBI.

Since SAT gave a limited ruling with respect to the jurisdiction of SEBI to adjudicate on the matter, it was sent back to SAT for disposal on merits of the case.

CONCLUDING COMMENTS

There appears to be lack of clarity from the text of the judgment if SEBI is conferred blanket powers over the administration of GDR issuances. A meticulous understanding of the rationale adopted by the Supreme Court suggests that the regulatory purview of SEBI over GDRs shall prevail only in cases where such instruments may pose adverse impacts on Indian investors. Therefore, the application of the judgment may be limited to this extent.

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