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## Legal Update for the month of December 2009

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Note: This Newsletter is a compilation derived from various sources, and is meant only for private circulation to the addressee upon its request.

## **EXECUTIVE SUMMARY**

*It is a pleasure to bring to you the Legal update for the month of December 2009. The various writings herein consisting of Press Release, Notifications, Circulars, Case Laws and Daily News Snippets bring to you the present Indian Legal scenario and the proposed changes in the same.*

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- NEWS SNIPPETS

*We hope you continue to find this legal update informative and enjoyable.*

## PRESS RELEASE

### SEBI BOARD MEETING DATED 9 NOVEMBER 2009

**Press Release No. 344/2009 dated – 9 November 2009, issued by Securities and Exchange Board of India**

The SEBI Board met today and took the following decisions:-

**A. SME Exchange/ Platform:**

- ◆ Companies listed on the SME exchanges would be exempted from the eligibility norms applicable for IPOs and FPOs prescribed in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 (ICDR).
- ◆ In order to have informed, financially sound and well-researched investors with a certain risk taking ability, a minimum IPO application size of Rs. 1 lakh would be prescribed.
- ◆ The minimum trading lot would be Rs. 1 lakh.
- ◆ An upper limit of Rs. 25 crore paid up capital would be prescribed in order for a company to be listed on the SME platform/exchange and a minimum paid up capital of Rs. 10 crore would be prescribed for listing on the main boards of NSE and BSE.
- ◆ The offer document will have to be filed with SEBI and the exchange. No observations would be issued by SEBI on the offer documents filed by the Merchant Bankers (MBs).
- ◆ The MB to the issue will bear the responsibility for market making for a minimum period of three years. MBs would be allowed to do market making along with a disclosed nominated investor (like PE, VC, HNI and QIB). Under this arrangement, all the stock being bought and sold as part of market making will ultimately get transferred to the disclosed nominated investor with whom the Merchant Banker has a contractual agreement. Merchant Banker would have to disclose their intention of this arrangement and have it approved by stock exchanges where the issuer SME is listed.
- ◆ Certain well capitalized registered entities like Venture Capitalists may be allowed to have a contractual agreement with the Merchant Banker to share the burden of devolvement of underwriting obligation.
- ◆ During the compulsory market making period, promoters/acquirers will be allowed to dilute their shareholding only through offer for sale or to an acquirer and not to a market maker.
- ◆ SEBI regulations on Takeover (Substantial Acquisition of Shares and Takeovers Regulations) will not be applicable to acquisition of shares through Merchant Banker/Market Maker provided that the Merchant Banker/Market Maker does not have the intention of taking over the management and there is no change in control (direct/indirect) of the company.

- ◆ Merchant Bankers who have the responsibility of market making and have a firm allotment made in IPO for purpose of market making may, at their option, be represented on the board of directors of the company in view of the commitment of market making subject to agreement of the issuer. However this will not be mandatory on the Merchant Banker.
- ◆ No separate category of Merchant Bankers will be created.
- ◆ Merchant Bankers will be required to ensure that the issue is 100 per cent underwritten. However only a minimum percentage (15 per cent) of the issue size will be mandated to be compulsorily underwritten by the Merchant Banker itself.
- ◆ A minimum number of investors (say 50) shall be specified for the IPO only. There shall be no continuing requirement of maintaining the minimum number of investors. However, compliance with the requirements of Companies Act, 1956 needs to be ensured at all times.
- ◆ No separate registration will be required for brokers intending to service companies listed on the SME exchange/platform.
- ◆ Companies listed on the SME exchange/platform shall compulsorily migrate to an equity exchange/segment (main board) on exceeding the Rs. 25 crore post issue paid up capital limit. Further also, if follow on offer/rights issue results in triggering of the above limit (of Rs. 25 crore) then the company would have to migrate to the main board.
- ◆ Companies listed on the SME exchange/platform of an existing exchange may send to their shareholders a statement containing the salient features of all the documents as prescribed in section 219(1)(b)(iv) of Companies Act, 1956. This information shall also be displayed on the website of the exchange. Further the Company shall compulsorily maintain a website on which this information can be displayed.
- ◆ Investors with holdings of value less than Rs. 1,00,000 (such reduction in the holding may have been due to fall in prices or his having offloaded a part of the holdings previously), are allowed to offload their holding to the Market Maker in that scrip (provided that the investor sells his entire holding in that scrip in one lot). Market Makers will be authorised to buy these shares from such investors.
- ◆ Preparation and submission of financial results (as mandated in the listing agreement) on a “half-yearly basis” for SMEs, instead of “quarterly basis”.
- ◆ All the provisions of clause 49 (corporate governance) need to be complied with.

**B. Amendments to ICDR Regulations/Listing Agreement**

- (a) QIB Status to insurance funds set up by armed forces - The Board decided to accord QIB status to insurance funds set up by armed forces such as Army Group Insurance Fund.
- (b) Reservation to employees-Currently the ICDR regulations permit reservation up to 10 per cent of issue size to employees in public issues. However, there is no ceiling on number of shares that could be allotted. The Board decided to put a ceiling of Rs. 1 lakh on the value of allotment that can be made to an employee under employee reservation category

and to permit reservation up to 5 per cent of the post issued capital instead of 10 per cent of issue size.

The Board also decided to extend reservation to employees along with rights issue.

The ICDR Regulations also provide for discount up to 10 per cent of issue price to retail individual investors and shareholders but not to employees. The Board decided to allow discount of not more than 10 per cent to employees also under the reserved category only in public issues for application size up to Rs. 1,00,000.

- (c) Voluntary adoption of IFRS by listed entities having subsidiaries - The Board observed that providing a voluntary option to all listed entities which consolidate their books of account to submit their financials as per IFRS would be in line with the objective of achieving convergence to IFRS by 2011 and would help in preparing corporate entities well in advance for compliance with IFRS requirements. The Board, therefore, decided to provide an option to all listed entities with subsidiaries to submit their consolidated financial statements as per IFRS. However, such entities shall continue to file their stand alone financials as per Indian GAAP in line with the Companies Act requirements.
- (d) Interim disclosure of Balance Sheet items by listed entities - Taking note that internationally most jurisdictions require disclosure of Balance Sheet items on an interim basis whereas in India companies disclose only interim financial results, the Board decided to mandate half-yearly disclosure of Balance Sheet items with audited figures or unaudited figures with limited review.
- (e) Timelines for submission of financial results by listed entities - Currently, there are varying timelines for disclosure of unaudited/audited/limited review results. The Board decided to make it mandatory to disclose only limited review or audited results within 45 days of the end of the quarter. The Board also decided to reduce timeline for disclosure of audited annual results from 90 days to 60 days to those companies which opt to submit their annual audited results on a stand-alone basis in lieu of the last quarter unaudited financial results.
- (f) Requirements for Fast Track Issues - In order to enable well established and compliant listed companies to access Indian primary market in a time effective manner through follow-on public offerings and rights issues, SEBI introduced the concept of Fast Track Issues (FTIs) in November 2007. SEBI Board on a review decided to relax certain requirements of FTIs such as reducing the average market capitalization of public shareholding of the issuer to five thousand crore rupees from ten thousand crore rupees, pegging the annualized trading turnover to free float for companies whose public shareholding is less than 15 per cent of the issued capital. The Board also decided that in case the clause relating to composition of Board of Directors has not been complied with in one or more quarters, it need not be deemed as non-compliance, provided the company is in compliance in this regard at the time of filing the offer document with stock exchange/ROC and adequate disclosures are made in the offer document in this respect.
- (g) Relaxation from restatement of financial statements - SEBI had recently rationalized financial disclosure requirements for rights issues on the ground that much of the information of a listed company is available in public domain. For rights issues, the issuer is now required to give only the audited accounts of last financial year and audited or unaudited

financials with limited review results for the stub period instead of 5 years restated financials required earlier.

Extending the same logic, the Board decided that the requirement for disclosure of financials in FPOs of identical instruments quoted on a stock exchange may be brought on par with rights issues, to start with for companies that are eligible to make an issue under fast track, subject to certain conditions.

- (h) Introduction of pure auction as an additional book building mechanism - The Board decided to introduce an additional method of book building, to start with, for FPOs, in which the bidders would be free to bid at any price above the floor price and allotment would be on price priority basis and at differential prices. However, retail individual investors in such cases would be allotted shares at the floor price.

The Board further decided that if the issuer desires to place a cap either in terms of number of shares or percentage to issued capital of the company in order that a single bidder does not garner all shares on offer and there is wider distribution, the same may be permitted.

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## **LIBERALIZATION OF FOREIGN TECHNOLOGY AGREEMENT POLICY**

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### **Press Note No. 08 (2009 Series) dated – 17 December 2009**

The existing policy of Government of India on the payment of royalties under Foreign Technology Collaboration provides for automatic approval for foreign technology transfers involving payment of lumpsum fee of US\$ 2 million and payment of royalty of 5% on domestic sales and 8% on exports. In addition, where there is no technology transfer involved, royalty up to 2% for exports and 1% for domestic sales is allowed under automatic route on use of trademarks and brand names of the foreign collaborator. Separate norms are available for the hotel sector vide Press Note 18 (1991 Series) and Press Note 1 (1995 Series). Technology transfers involving payments above these limits required prior permission of the Government of India (Project Approval Board, Department of Industrial Policy and Promotion).

The Government of India has reviewed the extant policy and it has been decided to permit, with immediate effect, payments for royalty, lumpsum fee for transfer of technology and payments for use of trademark/brand name on the automatic route i.e. without any approval of the Government of India. All such payments will be subject to Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time.

A suitable post-reporting system for technology transfer/ collaborations and use of trade mark/ brand name will be notified by the Government separately.

These guidelines issue in modification of provisions relating to foreign technology proposals/approvals contained in paragraph 3 of Press Note 10 (1991), para 7 of Press Note 11 (1991), para 4 & 5 (a) of Press Note 12 (1991), para 2-6 of Press Note 20 (1991), para 2 of Press Note 5 (1992), para 4 of Press Note 4 (1994), para 3 of Press Note 18 (1997) and paragraphs III and IV of Press Note 9 (2000). These guidelines will issue in supersession of provisions of Press Note 18 (1991), Press Note 4 (1992), Press Note 1 (1995), Press Note 4 (1996), Press Note 1 (2002) and Press Note 2 (2003).

## NOTIFICATIONS

### **FOREIGN EXCHANGE MANAGEMENT (ACQUISITION AND TRANSFER OF IMMOVABLE PROPERTY IN INDIA) (SECOND AMENDMENT) REGULATIONS, 2009-AMENDMENT IN REGULATION 2**

**Notification No. G.S.R. 813(E) [FEMA 200/2009-RB] dated – 5 October 2009, issued by Foreign Exchange Department, RBI**

In exercise of the powers conferred by clause (i) of sub-section (3) of Section 6, and sub-section (2) of Section 47 of the Foreign Exchange Management Act, 1999 (42 of 1999), the Reserve Bank of India hereby makes the following amendment in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000 (Notification No. FEMA 21/2000-RB dated May 3, 2000), namely:

#### **Short title and commencement**

1. (i) These Regulations may be called the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) (Second Amendment) Regulations, 2009.
- (ii) They shall come into force from the date of their publication in the Official Gazette.

#### **Amendment of regulation 2**

2. In the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000 (Notification No. FEMA 21/2000-RB dated May 3, 2000, in regulation 2, clause (c), sub-clause (ii) shall be substituted by the following, namely:—

“(ii) who or either of whose father or mother or whose grandfather or grandmother was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955 (57 of 1955).”

### **SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) (THIRD AMENDMENT) REGULATIONS, 2009-AMENDMENT IN REGULATIONS 3, 7, 11 AND 14**

**Notification No. LAD-NRO/GN/2009-10/20/182131 dated – 6 November 2009, issued by Securities and Exchange Board of India**

In exercise of the powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board hereby makes the following regulations to amend the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, namely:—

1. (i) These regulations may be called the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulations, 2009.
- (ii) These regulations shall come into force on the date of their publication in the Official Gazette.
2. In the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997:—

- (i) in regulation 3, for sub-regulation (2), the following sub-regulation shall be substituted, namely: -
- “(2) Nothing contained in regulation 10, regulation 11 and regulation 12 of these regulations shall apply to the acquisition of Global Depository Receipts or American Depository Receipts unless the holders thereof: -
- (a) become entitled to exercise voting rights, in any manner whatsoever, on the underlying shares; or
- (b) exchange such Depository Receipts with the underlying shares carrying voting rights.”
- (ii) in regulation 7, in sub-regulation (1A), after the word and figure “regulation 11” and before the mark and words “, shall disclose purchase”, the words and figure “or under second proviso to sub-regulation (2) of regulation 11” shall be inserted;
- (iii) in regulation 11:-
- (a) in sub-regulation (1), after the words and figure “of the voting rights,” and before the words “in any financial year”, the words and mark “with post acquisition shareholding or voting rights not exceeding fifty five per cent.,” shall be inserted;
- (b) in sub regulation (2),
- A) after the words “either by himself or through” and before the words “persons acting in concert”, the words “or with” shall be inserted;
- (B) in second proviso, after the words, “such acquirer may,” and before the words “without making a public announcement”, the words “notwithstanding the acquisition made under regulation 10 or sub-regulation (1) of regulation 11,” shall be inserted;
- (iv) in regulation 14,-
- (a) in sub-regulation (2), the mark “.” occurring at the end shall be substituted with the mark “.”;
- (b) after sub-regulation (2), the following proviso shall be inserted, namely:-
- “Provided** that in case of American Depository Receipts or Global Depository Receipts entitling the holder thereof to exercise voting rights in excess of percentage specified in regulation 10 or regulation 11, on the shares underlying such depository receipts, public announcement shall be made within four working days of acquisition of such depository receipts.”

## CIRCULARS

### EXTERNAL COMMERCIAL BORROWINGS (ECB) POLICY

**Circular No. 19 A.P. (DIR Series) RBI/2009-10/252 dated – 9 December 2009, issued by BRI**

1. Attention of Authorized Dealer Category – I (AD Category – I) banks is invited to the A.P. (DIR Series) Circular No. 46 dated January 2, 2009, A.P. (DIR Series) Circular No. 64 dated April 28, 2009 and A.P. (DIR Series) Circular No. 71 dated June 30, 2009 relating to External Commercial Borrowings (ECB).
2. On a review of the prevailing macroeconomic conditions and developments in international financial markets, it has been decided to modify some aspects of the ECB policy as indicated below:

**(i) All-in-cost ceilings**

As per the extant policy, the all-in-cost ceilings have been dispensed with, under the approval route, until December 31, 2009. In view of the improvement in the credit market conditions and narrowing credit spreads in the international markets, it has been decided to withdraw the existing relaxation in the all-in-cost ceilings under the approval route with effect from January 1, 2010. Accordingly, the all-in-cost ceilings under the approval route for the ECBs, where Loan Agreements have been signed on or after January 1, 2010 will be as under:

<b>Average Maturity Period</b>	<b>All -in-cost Ceilings over six month Libor*</b>
Three years and up to five years	300 basis points
More than five years	500 basis points

\*for the respective currency of borrowing or applicable benchmark.

Eligible borrowers proposing to avail of ECB after December 31, 2009, where the Loan Agreement has been signed on or before December 31, 2009 and where the all-in-cost exceed the above ceilings, should furnish a copy of the Loan Agreement. Such proposals would continue to be considered under the approval route.

**(ii) Integrated township**

As per the extant policy, corporates, engaged in the development of integrated township, as defined in Press Note 3 (2002 Series) dated January 04, 2002, issued by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India are permitted to avail of ECB, under the approval route, until December 31, 2009. On a review of the prevailing conditions, it has been decided to extend the current policy until December 31, 2010, under the approval route. All other terms and conditions, stipulated in the A.P. (DIR Series) Circulars referred to above, remain unchanged.

**(iii) Buyback of the Foreign Currency Convertible Bonds (FCCBs)**

In terms of A.P. (DIR Series) Circular No. 39 dated December 8, 2008, read with A.P. (DIR Series) Circular No. 58 dated March 13, 2009 and A.P. (DIR Series) Circular No. 65 dated April 28, 2009, Indian companies have been allowed to

buyback their Foreign Currency Convertible Bonds (FCCBs) both under the automatic route and approval route until December 31, 2009. Keeping in view the prevailing macroeconomic conditions and global developments, especially the improvements in the stock prices, it has been decided to discontinue the facility with effect from January 1, 2010.

**iv) ECB for the NBFC Sector**

As per the current ECB norms, Non-Banking Finance Companies (NBFCs), which are exclusively involved in the financing of the infrastructure sector, are permitted to avail of ECBs from multilateral / regional financial institutions and Government owned development financial institutions for on-lending to the borrowers in the infrastructure sector under the approval route. In view of the thrust given to development of infrastructure sector, it has been decided with immediate effect to allow NBFCs exclusively involved in financing the infrastructure projects to avail of ECB from the recognized lender category including international banks under the approval route, subject to complying with the prudential standards prescribed by the Reserve Bank and the borrowing entities fully hedging their currency risk. The AD Category-I bank should certify the compliance with the prudential norms by the borrowing NBFCs.

**(v) ECB for Spectrum in the Telecommunication Sector**

As per the extant policy, as indicated in A.P. (DIR Series) Circular No. 26 dated October 22, 2008, payment for obtaining license/permit for 3G Spectrum is considered an eligible end-use for the purpose of ECB under the automatic route. It has now been decided to permit eligible borrowers in the telecommunication sector to avail of ECB for the purpose of payment for Spectrum allocation. This modification will come into effect with immediate effect.

3. All other aspects of ECB policy such as USD 500 million limit per company per financial year under the automatic route, eligible borrower, recognised lender, end-use, average maturity period, prepayment, refinancing of existing ECB, reporting arrangements and terms and conditions stipulated in the A.P. (DIR Series) Circulars shall remain unchanged.
4. AD Category-I banks may bring the contents of this circular to the notice of their constituents and customers concerned.
5. The directions contained in this circular have been issued under sections 10(4) and 11 (1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions/approvals, if any, required under any other law.

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**SIMPLIFIED DEBT LISTING AGREEMENT FOR DEBT SECURITIES –  
AMENDMENTS**

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**Circular No. IMD/DOF-1/BOND/CIR-5/2009 dated – 26 November 2009, issued by  
Investment Management Department, Division of Funds-I, SEBI**

1. SEBI vide circular No. SEBI/IMD/BOND/1/2009/11/05 dated May 11, 2009 put in place the Simplified Listing Agreement for Debt Securities. Pursuant to suggestions from various market participants received subsequently, it has been decided to amend the said Listing Agreement as given in the **Annexure**.

**2. The amendments are briefly summarized as under:**

- (a). 100% Asset Cover:** To align the Listing Agreement with the provisions of the Companies Act, 1956, the amended Listing Agreement requires issuers to maintain 100% asset cover sufficient to discharge the principal amount at all times for the debt securities issued. Further, to provide more information to investors, the periodic disclosures to the stock exchange shall now require disclosure of the extent and nature of security created and maintained.
  - (b). Submission of certificate on maintenance of security:** As against half-yearly certifications on security cover in respect of listed secured debt securities, the amended Listing Agreement provides for submission of such certificates regarding maintenance of 100% asset cover, and the time limit of submission in respect of the last half year has been aligned with the option provided for submission of annual audited results at a later date. In addition to Banks and NBFCs being exempt from submitting such certificates, issuers of Government guaranteed bonds shall also be exempt.
  - (c). Statement on Use of Issue Proceeds:** In order to enhance the quality of disclosures made to investors, issuers shall be required to furnish a statement of deviations in use of issue proceeds, if any, to the stock exchange on a half yearly basis. Also, the same is required to be published in the newspapers simultaneously with the half-yearly financial results.
  - (d). Deposit of 1% of issue proceeds:** So as to ensure that the interest of investors investing in public issues of debt securities is protected, the issuer shall be required to deposit an amount calculated at 1% of the amount of debt securities offered for subscription to the public. It is refundable or forfeitable in the manner stated in the Rules, Bye-laws and Regulations of the Exchange.
  - (e). Submission/ publication of Financial Statements:** The time-lines for disclosure of financial statements have been aligned with the proposed changes to the Equity Listing Agreement. Accordingly, issuers would now have to publish/ furnish to the Exchange, either audited half yearly financial statements or unaudited half yearly financial statements subject to a limited review within 45 days from the end of the half year. In case of the last half year, issuers may opt to submit their annual audited results in lieu of the unaudited financial results for the period, within 60 days from the end of the financial year.
- 3. Since Part-A of the Listing Agreement for debt is applicable for debt issuers with already listed equity, it is clarified that the covenants in the Equity Listing Agreement that require submission of a draft offer document to SEBI for observations or obtaining of an acknowledgement card are not applicable in case of an issue of debt securities which is made in terms of the SEBI (Issue and Listing of Debt Securities) Regulations, 2008.
  - 4. The amendments made to the simplified listing agreement for debt securities vide this circular shall be applicable with immediate effect.
  - 5. All other terms of the circular No.SEBI/IMD/BOND/1/2009/11/05 dated May 11, 2009 remain unchanged.
  - 6. The Stock Exchanges are directed to:

- (a). Give effect to the abovementioned policies and make amendments to the Simplified Listing Agreement for debt securities as set out at **Annexure**.
  - (b). Make consequential amendments, if any to the bye- laws and other rules and regulations for the implementation of the above decision.
  - (c). Bring this to the notice of all issuers listed with the exchange.
  - (d). Disseminate the same on their websites for easy access to investors.
7. This circular is issued in exercise of powers conferred by sub-section (1) of section 11 and section 11A of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

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### **EXPIRY DATE FOR EQUITY DERIVATIVE CONTRACTS**

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**Circular No. DNPD/CIR-48/2009 dated – 13 November 2009,  
issued By SEBI**

Based on recommendations of the Secondary Market Advisory Committee, it has been decided to allow flexibility to the Stock Exchanges to set the expiry date / day for equity derivative contracts. While doing so, the Stock Exchanges are devised to ensure that there is no change in the contract specifications or the risk management framework and the integrity of the market is not affected in any manner.

This Circular is being issued in exercise of the powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act 1992, read with Section 10 of the Securities Contracts (Regulation) Act, 1956 to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

This Circular is available on SEBI website at [www.sebi.gov.in](http://www.sebi.gov.in) under the category “Derivatives- Circulars”.

## **CASE LAWS**

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### **OPPRESSION AND MISMANAGEMENT**

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**Section 404, read with section 237, of the Companies Act, 1956 – Oppression and Mismanagement**

**[2009] 96 SCL 207 (DELHI)  
HIGH COURT OF DELHI**

**V.L.S. Finance Ltd.  
Vs.  
Union of India**

**FACTS:**

The Petitioner, a shareholder in second respondent company, filed a petition under sections 397 and 398 before the Company Law Board alleging oppression & mismanagement but same was dismissed. Meanwhile, the Central Government ordered inspection of the accounts of the respondent under section 209A. The petitioner aggrieved by the order of the CLB appealed to the High Court. When the appeal was pending, the petitioner filed the instant writ petition alleging that reports of an inspection into the affairs of the respondent were not pursued vigorously; that the Central Government had improperly and willfully omitted to exercise its discretion in

accordance with law by not proceeding under section 401; and that the High Court by its order had observed that the petitioner could approach the appropriate Court by way of writ petition to compel the Government to take necessary action against the other respondents. The first respondent denied that it had acted in a capricious manner and stated that it had already filed an application under section 237 (b) seeking an investigation of the matter before the CLB on the basis of the report filed under section 209A; and that said petition was pending.

**HELD:**

Section 237 and 242 give wide discretion to the Government to pursue necessary remedies and, in fact, it had reasonably exercised that discretion by moving an application before the Company Law Board for an investigation. The petitioner could have definitely resorted to efficacious remedies before the same forum instead of agitating before the High Court for two years.

Not only had the petitioner been unable to prove that the Government had taken irrelevant consideration into account but also had deliberately sought to mislead the Court by submitting that the High Court by order dated 25.9.2005, observed that it could approach the appropriate Court by way of a writ petition to compel the Government to take necessary action against the other respondents.

In views of the multifarious litigations pending between the petitioner and the contesting respondents, the Central Government had already filed an application before the Company Law Board for action, though not under Section 401; no merit could be found in the contention that its decision not to do so was a willful omission to exercise discretion which it was lawfully bound to, in the circumstances of the instant case.

In the light of the above findings, the writ petition had to fail. The petitioner had indulged in speculative litigation, by seeking to use the jurisdiction of the High Court under article 226, when plainly there was absolutely no occasion to seek resource to it, as the facts did not justify entertainment of such proceedings. Besides, it did not disclose that several litigations were pending inter se with the contesting respondent. In the circumstances, the petitioner was to be saddled with costs. The petition was accordingly to be dismissed, with the direction to pay costs.

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**LIABILITY OF DIRECTOR - LIQUIDATION OF A COMPANY**

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**Section 179 of the Income-tax Act, 1961 – Company-in-liquidation – Liabilities of Directors**

**2009] 185 TAXMAN 11 (KAR.)  
HIGH COURT OF KARNATAKA**

**H.EBRAHIM**

**Vs.**

**Deputy Commissioner of Income- tax, Circle-I, Shimoga\***

**FACTS:**

The first petitioner was the managing director and petitioner Nos. 2 and 4 were the directors of a company which had not filed returns of income since its inception in 1991 till date of search conducted on it on 18.1.2001. Pursuant to the said search, the Assessing Officer passed an assessment order determining undisclosed income of the company and the net tax payable by it. The petitioners being the directors of the company, proceedings were initiated against them under section 179 on the ground that if the company was not in a position to meet the demands of payment of income tax, the directors were personally liable to satisfy the said claim. The petitioners' case was under section 179 only the amount of tax could be recovered and the said amount would not include the interest and penalty. It was their further case that none of the three ingredients under section 179, viz, gross neglect, misfeasance or breach of duty on the part of the directors in relation to affairs of the company was satisfied before initiation

of proceedings under section 179 and, therefore they were liable to be absolved of the proceedings under section 179.

**HELD:**

Before invoking section 179, the directors of the company are required to prove that they were not in a position to file the return and the same could not be attributed to any gross neglect, misfeasance or breach of duty on their part in relation to the affairs of the company. Indeed, before invoking section 179 it is not necessary that all the three ingredients are required to be satisfied. Indeed, it is sufficient if it is held that there has been a gross neglect or misfeasance or breach of duty on the part of the directors in relation to the affairs of the company. The directors of the company are liable to satisfy the claim in their capacity as directors. In the instant case, there were as many as three claimants for the amount due to the statutory authority. Indeed, the bank had advanced credit facility and the same was not discharged. Thus, in that background, one would have to see whether gross, misfeasance or breach of duty could be attributed to the directors. In that regard, the reply filed by the petitioners had been considered by the respondents. It was not in dispute that the company was incorporated in the year 1990 and it started production in the year 1991. It was trite that the company had not filed returns of income from its inception till the search under section 132 conducted on 18.1.2001. That would be 10 years. Indeed, in the instant circumstances and having regard to the large sums of money due to the statutory authorities, the petitioners could not be heard to say that there was no gross negligence, misfeasance or breach of duty on their part. In this regard, it is to be noticed that in the first instance, sub-section (1) of section 179 casts a burden upon the director to prove that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part.

As per the dictionary meaning, 'gross negligence' means lack of diligence and care; a conscious voluntary act or omission in reckless disregard of legal duty. Further to observe a duty imposed by law will amount to negligence. If a lawful act is performed in a wrongful manner, it would amount to misfeasance; more broadly, a transgression or trespassing of law. As per dictionary definition 'breach of duty' is defined as violation of legal obligation. The words 'breach of duty' is defined as violation of legal obligation. The words 'breach of duty' is wide enough to comprehend the cause of action for negligence.

The burden being on the directors, they ought to have established the requirements of the sub-section (1) to escape the liability and the petitioners had failed to do so. The question as to whether the petitioners had discharged the burden was a pure question of fact and could not be examined in a writ petition under article 226 of the Constitution of India. The company was not in a position to meet the obligation of payment of tax due to the statutory authorities, which would necessarily mean that it was not in a position to pay the tax/amount to the statutory authorities. Hence, at that point of time, the petitioners could not be heard to say that the company did have assets by sale of the said assets, the tax due could be recovered from the assets of the company. Indeed that contention was also urged before the competent authority indicating that 90,000 sq. ft of land and several buildings were available. In fact, that had been rightly rejected by the respondent inasmuch as the company had availed various types of loans from the banks and also had not paid the tax due to the Commercial Tax Department. It was not in dispute that the banks as well as the Commercial Tax Department had initiated recovery proceedings. The petitioners had failed to discharge the burden cast on them that the said non-payment of dues could not be attributed to gross negligence, misfeasance or breach of duty. Indeed, every citizen of the country is required to file his tax returns whether taxable or not. The company had slept over for almost more than a decade and the petitioners could not be heard to say that since the company did not make any profits, it was not obliged to file returns. That itself was sufficient to hold that there was a gross neglect on the part of the directors of the company. Hence, all the ingredients of section 179 were satisfied.

The phase 'tax' as contemplated under section 179 does not include penalty and interest, insofar as the directors of the company are concerned. However, this interpretation of phase 'tax would not be' under section 179 and does not encompass

the company. Indeed, the company was liable to pay all the three components, i.e. 'tax' 'interest' and 'penalty' and any other sum due or recoverable from it as contemplated under section 222.

## **NEWS SNIPPETS**

### **COMPETITION REGULATOR LIKELY TO KEEP OFF KEY SECTOR M&As**

The Government is considering whether the Competition Commission of India's (CCI) mandate to regulate corporate mergers, acquisitions and amalgamations should be restricted to sectors where the new regulator does not come in conflict with other regulators. The fledgling regulator's role is being reviewed at the level of Cabinet Secretary, after powerful sections within Government expressed divergent views. As per the Competition Act, 2007, prior approval from CCI is required for mergers, acquisitions and amalgamations have specified thresholds. The idea is to ensure that the combined entity's market power would not harm competition in the relevant market. Acquisition plans involving Indian and foreign entities would also come under the Commission's lens if a strong domestic nexus in terms of market share is established.

### **GOVERNMENT PLANS SINGLE PLATFORM FOR FDI RULES, TO DO AWAY WITH PRESS NOTES**

In an attempt to ensure better understanding of Foreign Direct Investment (FDI) related procedures amongst prospective investors, the Department of Industrial Policy and Promotion (DIPP) is exploring the Possibility of doing away with Press Notes released in the past two decades, and instead have a single platform that specifies overseas investments rules. This would be done by amalgamating provisions of the Press Notes in to FDI rules. The move comes at a time when Prime Minister, Manmohan Singh has called for simpler FDI-released guidelines to attract foreign investments into the country.

### **M&A LAW IMPACT ON ONGOING MERGERS TO BE MINIMAL: MCA**

The Ministry of Corporate affairs will ensure that the notification of sections 5 and 6 of the Competition Act, which pertain to Mergers and Acquisitions (M&As), will have minimal impact on the ongoing merger or acquisition deals. Industry circles have been lobbying with the Corporate Affairs Ministry to take a lenient view of the ongoing M&A deals, as they may not be able to take into consideration the kind of rules that are being envisaged by the Government. The Government will announce some mechanism wherein existing mergers and acquisitions, which are inked before the new law comes in place, will not be reviewed on the basis of the rules that will be notified. The notification of M&A rules has been one of the most contentious issues before the industry. While all other portions of the Competition Act have been notified, the Government has delayed these specific clauses to see that they take industry on board while framing the laws.

### **WIDER CORPORATE e-SURVEILLANCE ON CARDS**

The Government is planning to expand its electronic surveillance to include more listed and big unlisted companies to detect quickly any fraud or mala fide action, told a Governance official. The wider surveillance is aimed at protecting the interests of minority shareholders in listed companies and to check if the unlisted ones are creating risks for others such as banks or creditor. The Government is currently running the electronic surveillance on 50 companies on a pilot basis. Satisfied with the outcome, the Government is now planning to run the electronic check on more companies well before the fourth quarter results fall due at end of April, 2010. The electronic surveillance is carried out through a scan of data submitted to the Registrar of Companies (RoC). The system is designed to create alerts on unusually high jump in

profits, suspect related-party transactions and huge amounts of unutilized cash and bank balance. The need for an early warning system has become even more acute after the accounting fraud at Satyam Computers came to light.

### **LISTED OR NOT, GOVERNANCE CODE FOR ALL**

The Ministry of Corporate Affairs is all set to introduce a governance code for unlisted companies on the lines of the one for the listed firms to encourage more companies to register on the stock exchanges. Elaborate disclosures and compliance with governance code is seen as one big reason why many companies do not want to raise public funds and list on exchanges. Once the listed and unlisted companies are brought on par in terms of regulatory requirements more companies would want to list. The Government is also talking to the capital markets regulator, SEBI to work out ways to reduce compliance costs for meeting mandatory requirements for getting listed. Minister for Corporate affairs, Salman Khurshid had recently hinted on the possibility of introducing norms that will remove the regulatory loopholes, which unlisted firms tend to us. Data shared by the Ministry showed that out of over seven lakh companies in the country, only 6,000 are listed on the NSE and/or the BSE. Compliance costs for listed entities includes expenses for carrying out legal formalities, communicating quarterly and annual financial results to stockholders, preparing annual reports and sending them to shareholders, listing fee to the exchanges, and reporting board decisions to the exchanges. Encouraging corporates to get themselves listed on the stock exchanges has been a priority for the Government. Recently, SEBI relaxed the listing norms for small and medium enterprises (SMEs), including measures that will reduce compliance costs. SMEs have, for instance, been exempted from the quarterly preparation and presentation of financial results to keep their compliance costs low.

### **ASBA TO COVER NON-RETAIL INVESTORS TOO**

In a move that may lead to faster primary market issuances, Securities and Exchange Board of India Chairman, CB Bhave said the ASBA (applications supported by blocked amount) facility would extended to non-retail investors. He, however, did not say when this would be done. Experts said if most applications came through ASBA, the allotment process would be faster and SEBI would be able to reduce the time between the closure of an issue and listing.

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