

Consequences of Improper Disclosures in Shareholding

Issue

It is a well-known fact and practice that as per the requirements of the SEBI Takeover Code, Insider Trading Code, Listing Agreement (now under the Companies Act, 2013 also) there is a requirement of a timely disclosure of acquisition or change in shareholdings beyond certain thresholds by substantial shareholders and promoters. But there have been instances where certain corporate have given imprecise disclosures, very recently Securities Appellate Tribunal (SAT) in the case of GHCL Limited have ruled on the consequences of such erroneous disclosures. In the case under study the Company had clubbed certain shares which were held not in the name of the promoters as shareholding of the promoters as such the Company had relied on the information provided by the promoters that there was an understanding with those other persons who held shares in the company in their own right but for the purpose of disclosures they were to be reflected in the name of the promoters.

SEBI Decision

SEBI has concluded and held that the promoters “wrongly and illegally projected their shareholdings far in excess of their real shareholding by taking into consideration shareholdings of third parties as part of their own shareholding in an illegal manner and as a result order was passed against the company, its company secretary, chairman and several promoters in connection with disclosures of shareholdings made by them.

SAT Decision

In arriving at its decision, the SAT paid specific attention to the policy and philosophy behind shareholding disclosures and viewed that through such disclosures the investors take an informed decision in a given situation to invest in the scrip of that company or even to exit. This is extremely important for the growth of a healthy capital market and thus, true and correct disclosures as to the exact shareholding pattern of promoters assume greater significance. Hence, SAT found that the company as well as the chairman and company secretary bore the primary responsibility to ensure proper disclosure in consonance with the applicable SEBI regulations.

Applicability of PFUTP Regulations

It is interesting to note that what appears to have been a case of mis-disclosure got elevated to a case of fraudulent and unfair trade practice. The appellants were therefore also charged under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 2003 (the PFUTP Regulations). What is worrying here is

that if one is to go by the rationale of the SEBI then every deliberate non-disclosure or mis-disclosure of shareholding by substantial shareholders or promoters could potentially amount to a fraudulent or unfair trade practice.

Does Legal Advice has legal validity?

Other vital thing to be noted here is that the categorical stance of the SAT is that the company's or promoter's reliance on legal advice in making the disclosure is not an excuse for facing the consequences and the parties should have acted more diligently and responsibly and should not have been guided by mere legal opinions. It is settled law that legal opinions are only advisory in nature and not binding on anyone and such view implies that the point that violators of securities laws cannot escape blame by simply passing it on to their legal advisers. They ought to take full responsibility, and cannot seek any excuse or safe harbour in civil penalty cases.

Effect of Clubbing vis-à-vis Takeover Code

Further it was held that the clubbing of the shareholdings of various promoter entities, without proving that they were persons acting in concert with each other by cogent and convincing evidence is untenable in law and such a finding is liable to be quashed and set. As a matter of law, the SAT also clarified that Reg. 7(1A) of the Takeover Regulations are in *pari materia* with Regs. 13(3) and 13(5) of the PIT Regulations, due to which there is no violation of the latter as well.

Conclusion

This decision of SAT is significant from the view point that it underscores the importance of disclosures and warns against simply relying on legal advice to exclude regulatory sanctions but what is worrisome is that it seems that the matter has been elasticated a bit far by concluding that a deliberate mis-disclosure of the present kind also amounts to a fraudulent and unfair trade practice.

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Mumbai
159/11, Amar Brass Compound,
Vidya Nagari Marg,
Kalina, Santacruz (E),
Mumbai – 400098
Landline: 022-26528671-72
Fax: 022-26528673

New Delhi
Anthem House,
E-360, 1st Floor,
Nirman Vihar, Delhi - 110092
Landline: 011-22449817,
011-22449815
Fax: 011-22439816

CONTACT US
Please write to us with your feedback,
suggestion or query at smelisting@sarthiwm.in
www.sarthiwm.in | www.smelisting.net

Sarthi Capital Advisors Pvt Ltd
SEBI Registered Category I Merchant Banker
SEBI Registration No: INM000012011