

# Supreme Court verdict on transfer of securities of unlisted companies – A game changer

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The Securities Contracts (Regulation) Act, 1956 ('SCRA') was legislated with an intention to prevent undesirable transactions and regulating dealings in securities. On 15th July, 2013, the Single Bench of Supreme Court widened the scope and applicability of the SCRA by bringing into its purview unlisted public companies. In this article, the authors have analysed the impact of the decision of the Supreme Court in the case *Bhagwati Developers (P.) Ltd. v. Peerless General Finance & Investment Co. Ltd.*<sup>1</sup>

## Facts of case

1. A loan was provided by Bhagwati Developers (P.) Ltd. ('Bhagwati') to Tuhin, and Tuhin bought the shares of the Peerless General Finance & Investment Co. Ltd ('Peerless') from the loan amount. As a repayment of the loan provided by Bhagwati, Tuhin agreed to transfer the shares of Peerless to Bhagwati but same were never transferred. During the pendency of loan, there were two bonus issues due to which there was an increase in the market price of the shares ; and the total value of the shares of Peerless increased substantially. At a later stage when Bhawati brought an injunction and filed for getting the shares transferred in his name, a settlement was reached between Bhagwati and Tuhin whereby the shares would be transferred to Bhagwati and a certain amount was paid as consideration. The Board of directors of Peerless refused to register the transfer of shares on the basis that it was not a spot delivery contract.

## Issues involved

2. Following are the issues which came up before the Supreme Court :

- Whether the SCRA is applicable for transfer of shares of unlisted public limited companies?
- Whether the transfer is a spot deliver contract and is the action taken by Peerless to reject the transfer of shares justified?

## Issue 1

3. Section 13 of the SCRA relates to applicability of the SCRA to areas and regions specified. From the plain reading of the section, it means that contract in relation to securities in notified areas is illegal if made otherwise than between the members of recognised stock exchange (SE). The question is not about the place where the contract for sale is entered. The question is whether contracts, other than those entered between SE, can be governed under the SCRA ? Thus, it is necessary to understand the meaning and definition of 'securities'. Sub-clause (i) of clause (h) of section 2 defines 'securities' as including 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; But, the term 'marketable' is not defined in the SCRA.

3.1 Black's Law Dictionary (6th edn.) explains the word 'marketable' as saleable. Such things as may be sold in the market, those for which a buyer may be found ; merchantable. Therefore, it is evident from the dictionary meaning that the expression 'marketable' has been equated with the word 'saleable'. In other words, whatever is capable of being bought and sold in a market is marketable. The size of the market is of no relevance. The essence is free transferability. Subject to certain limited statutory restrictions, the shareholders possess the right to transfer their shares, when and to whom they desire, i.e., free transferability.

3.2 Fortified by its own decision in *Naresh K Aggarwala & Co. v. Canbank Financial Services Ltd.*<sup>2</sup>, the Supreme Court, observing that the SCRA was enacted to prevent undesirable transaction in securities by regulating business of dealing therein and from that one cannot infer that it was to apply only to the transfer of shares on the stock exchange, held that the provisions of the SCRA would cover the shares of public limited company not listed in the stock exchange within the ambit of the Act.

## Issue 2

4. The second issue relates to section 16 of the SCRA and definition of 'spot delivery contract'. From a plain reading of that section, it is understood that in order to prevent undesirable stipulation in specified securities the Central Government has been given the power to declare that without its permission no person in any State or area specified shall enter into any contract for the sale or purchase of any security specified in the notification. The Central Government, in exercise its power, has notified and declared that in the whole of India 'no person' shall, save with the permission of the Central Government, deal in securities other than such spot delivery contract. Therefore, the contract entered into by the parties can be held legal only when it comes within the definition of 'spot delivery contract'. 'Spot delivery' has been defined in clause (i) of section 2 of the SCRA as a contract which provides for –

(a) actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual periods taken for the dispatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality ;

(b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository.

When we compare the facts of the case with the definition of 'spot delivery contract' ; we find that the contract in question is not a spot delivery contract. Though a formal agreement had been executed between them as per which Tuhin has agreed to transfer the shares of Peerless to Bhagwati. However, the agreement entered later between Bhagwati and Tuhin which formed part of the compromise decree provides that the

sale of shares took place earlier and in consideration thereof Bhagwati paid a sum and further the dividend on the entire shares to be retained by Tuhin. In the face of it, the plea of Bhagwati that the payment was made to buy peace is not fit to be accepted and, in fact, that forms part of the consideration for the sale of shares. Once we take this view the plea that it is a spot delivery contract is liable to be rejected.

## Conclusion

5. The object of the SCRA is to curb undesirable speculation but that can happen only if you have a market price through a price discovery. There can be price discovery only when there is liquidity in the market, which in the case of private companies is absent as the free transfer itself is restricted by the Companies Act. In the case of unlisted public companies, even though the securities are freely transferable, there is no market like the stock exchange for the securities to be traded. So ideally, the SCRA should not apply because there is no ready market with all the facilities like stock exchange which ensures quick transferability of funds and shares for unlisted public companies' share.

5.1 Following are the two aspects that have arisen from the case :

- If the SCRA is applicable to unlisted public companies, then the scope will increase to such an extent that it will govern almost all the transaction in securities in the country where most of the transactions are credit transaction and the condition of spot delivery contract will be a hindrance.
- If the SCRA is not made applicable to unlisted public companies, then it will defeat the Legislative intention.

Thus, if this case is held to be the conclusive interpretation of the legislation, the contracts in securities have to be made on spot delivery basis even if they are in the physical form. Few corporates may misuse the judgment by rejecting the share transfer form lodged with the Board of directors of the company for registration of the transfer of shares under the guise of spot delivery. But, the ulterior motive of the Board of directors would be to not allow the transferee become the member of the company. The Board of directors would give a reason for not approving the transfer of shares as the transfer not being a spot delivery contract. It would be difficult to prove the mala fide intentions of the Board for rejection of share transfer. Therefore, the Supreme Court decision would be a game changer; because it depends a lot on the companies whether they interpret the decision in letter or in spirit.

### FOOTNOTES

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- [2013] 115 CLA 353 (SC).
- [2010] 6 SCC 178.

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