Contract cancellation having material impact warrants disclosures on immediate basis, SAT upholds penalty for non-disclosure

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Introduction:

A disclosure-based regulatory regime is founded on timely and adequate disclosure of all events material to a company or to its securities in any manner – This statement is valid for SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and also erstwhile Listing Agreement. According to Clause 36 of erstwhile Listing Agreement, apart from complying with any specific requirements (as prescribed in Listing Agreement), the issuer company was under an obligation to intimate to the stock exchanges, where the company is listed *immediately* of events such as strikes, lock outs, closure on account of power cuts, etc. and all events which will have a bearing on the performance / operations of the company as well as price sensitive information both at the time of occurrence of the event and subsequently after the cessation of the event. The objective of such disclosure was to enable security holders and public to appraise the position of issuer company and to avoid the establishment of false market in its securities. In addition, the issuer company was required to furnish to stock exchange(s) on request such information concerning the issuer company as stock exchange(s) may reasonably require. Several material events were prescribed under clause 36 of erstwhile Listing Agreement. Such information was required to be made public *immediately*.

This article is an analysis of observations of the SAT order (*Suzlon Energy Limited* v. *SEBI*, Appeal No. 201 of 2018, order dated May 3, 2021). Clause 36 of erstwhile Listing Agreement has been discussed in detail in the SAT order. I will attempt to compare the said provisions with the corresponding provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('SEBI Listing Regulations'). The observations of SAT in this case (even if under erstwhile Listing Agreement) are still relevant under extant SEBI Listing Regulations.

Facts of the case:

1. Suzlon Energy Limited ('Company') provides end solutions in wind energy generation. The said Company has a presence in various countries. The Company from time to time receives orders for manufacture and installation of wind turbines which are normally disclosed to the stock exchange under Clause 36 of Listing Agreement;
2. On October 12, 2015, SEBI issued a show cause notice was issued in respect of certain orders which were cancelled in the year 2007 – 2008, the valuation of the contract was worth Rs. 1506 crore;
3. The show cause notice alleged that corporate announcement of cancellation / truncation of

the orders was not made known to the stock exchange and that in respect of certain orders so received no announcement whatsoever was made to the stock exchange;

4. The show cause notice alleged violation of Clause 36 of Listing Agreement read with Section 21 of SCRA and relevant provisions of SEBI (Prohibition of Insider Trading) Regulations, 2015.
5. The appellants (i.e. Company and Company Secretary) contested the matter and denied the charges. They submitted that truncation of the orders was not a 'material information' which was required to be announced on the platform of stock exchange and that it was also not a price sensitive information which required a disclosure under Clause 36 of the Listing Agreement;
6. SEBI AO after considering material evidence on record found that Appellants while receiving the orders had made corporate announcements and therefore when these orders were cancelled or truncated the said information was required to be disclosed on stock exchange platform so that information would be made known to shareholders and investors. SEBI AO further held that cancellation / truncation of orders was a price sensitive information and such information should have been disclosed on an immediate basis;
7. SEBI AO held that Clause 36 of Listing Agreement provides that any information / event which is price sensitive should be reported to the stock exchange immediately and since the truncation of the orders was not disclosed it was violative of Clause 36 of the Listing Agreement;
8. SEBI AO[1] imposed a penalty of Rs. 5 lacs under Section 23A(a) of Securities Contracts (Regulation) Act, 1956 ('SCRA') on the Company and further a sum of Rs. 1 crore was imposed upon the Company under Section 23E of SCRA. SEBI AO also imposed a penalty of Rs. 5 lacs upon the Company and Company Secretary under Section 15HB of the SEBI Act.

SAT's observation and analysis:

There are two parts of the SAT's observations, namely: (i)Whether contract cancellation having material impact warrants disclosures on immediate basis? and (ii) Penalty imposed under section 23E of SCRA. Both are discussed as follows:

(*i*) SAT noted that Clause 36 of the erstwhile Listing Agreement has been considered in a number of cases by it. Primarily, SAT relied on 2 of its orders: *New Delhi Television Li**m**ited* v. *SEBI* [2019] 108 taxmann.com 141 (SAT) and *ICICI Bank Limited* v. *SEBI* (Appeal No. 583 of 2019 decided on July 8, 2020) and observed that "*the words material / materiality means anything which is likely to impact an investor's investment decision and depends on the facts of each case. In the instant case, we find that when the appellants received the contract the said information was disclosed on the stock exchange platform and which was rightly done but when the orders were cancelled or truncated on three occasions the cancellation / truncation orders were not disclosed on the stock exchange platform.*"On non-disclosure of material information, SAT observed that "*Non-disclosure of this information was a material information which could have an impact on the financials of the Company. In our view the objective of Clause 36 of the Listing Agreement is to enable the shareholders and the public to appraise position of the Company and enable investors to take an informed decision. In our view the cancellation / truncation of the contracts has a material impact which warrants a disclosure on an immediate basis. The responsibility was on the appellant no. 1which it failed to do so.*"With respect to the duty of Compliance Officer, SAT perused Clause 3.2 of the Code of Conduct under the PIT Regulations of 1992 and stated that "*... it is the duty of the Compliance Officer to ensure that the Company complies with all the legal obligations. In the instant case as*

we have held the cancellation / truncation of the orders had a material impact and was price sensitive information which could have an impact on the financials of the Company. Thus, Clause 3.2 of the Code of Conduct was violated."SAT upheld the amount of penalty imposed by SEBI and observed that since there is no separate provision for imposition of penalty the provisions of Section 15HB of the SEBI Act was invoked and the penalty was rightly imposed.

(*ii*) SEBI AO had also imposed penalty under section 23E of the SCRA. Section 23E of the SCRA relates to 'Penalty for failure to comply with provision of listing conditions or delisting conditions or grounds' and according to the provisions if a company or any person managing collective investment scheme or mutual fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty which shall not be less than Rs. 5 lacs but which may extend to Rs. 25 crores (provisions prior to the amendment by Finance Act, 2018, w.e.f. 8-3-2019).SAT held that the penalty under section 23E of SCRA is erroneous and that SEBI AO has committed a manifest error in invoking Section 23E of the SCRA. SAT held that "*Section 23E has nothing to do with the violation of the provisions of the Listing Agreement especially Clause 36. Section 23E provides that where a Company fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof then penalty would be a minimum of Rs. 5 lakh upto maximum of Rs. 25 crore. The words "fails to comply with the listing conditions" cannot mean failure to comply with the conditions in the Listing Agreement. One of the requirements in the Listing Agreement which is required to be complied with is Clause 36 whereas Section 23E refers to the conditions which are imposed upon a Company when it is applying for its shares to be listed on the stock exchange platform. Section 23E has to be read along with Rule 19 of the Securities Contracts (Regulation) Rules, 1957*". Rule 19 of Securities Contracts (Regulation) Rules, 1957 provides that certain requirements with respect to listing of securities on recognized stock exchange. Rule 19A provides that a company has to continuously maintain listing requirements. SAT stated that "*Failure to comply with the listing conditions which are stated in Rule 19 would entail a penalty as provided under Section 23E*". SAT concluded that penalty of Rs. 1 crore under Section 23E of SCRA cannot be imposed and the order to that extent cannot be sustained.

Analysis &Conclusion:

The relevant provisions of erstwhile SEBI PIT Regulations, 1992, relating to 'Code of internal procedures and conduct for listed companies and other entities' states that the official shall be responsible for ensuring that the company complies with continuous disclosure requirements. Overseeing and co-ordinating disclosure of price sensitive information to stock exchanges, analysts, shareholders and media and educating staff on disclosure policies and procedure. In my view, there is very less discussion in the SAT order w.r.t. the violation of the relevant provisions of SEBI PIT Regulations, 1992. Such discussion would have been relevant under the extant SEBI PIT Regulations, 2015.

Regulation 30 of SEBI Listing Regulations relates to 'Disclosure of events or information'. According to the said provisions, every listed entity shall make disclosures of any events or information which, in the opinion of the board of directors of the listed company, is material. Certain events are specified in Para A of Part A of Schedule III to SEBI Listing Regulations. Such events are deemed to be material events and listed entity shall make disclosure of such events i.e. disclosures without any application of guidelines for materiality.

Regulation 30(4) of SEBI Listing Regulations states that the listed entity shall consider the following criteria for determination of 'materiality of events/ information': (a) Omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or (b) Omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date, (c) In case where the criteria specified in sub-clauses (a) and (b) are not applicable, an event/information may be treated as being material if in the opinion of the board of directors of listed entity, the event / information is considered material. The listed entity shall frame a policy for determination of materiality, based on criteria specified, duly approved by its board of directors, which shall be disclosed on its website.

With reference to Schedule III, Part A: Disclosures of Events or Information: Specified Securities, Part B disclosure under Regulation 30(4) of the SEBI Listing Regulations, there is a similar clause to the given facts of the case *"Awarding, bagging/ receiving, amendment or termination of awarded/bagged orders/contracts not in the normal course of business"* Therefore, orders/contracts bagged or terminated may be material as Regulation 30(4) of SEBI Listing Regulations is applicable which is dependent upon the 3 criteria (as mentioned above) along with materiality policy. Further it is interesting to note that the orders/contracts bagged or received or terminated are 'not in the normal course of business'. This phrase brings in more subjectivity to the disclosures as only exceptional orders/contracts are material. Therefore, SAT order in the present case is important for compliance officers of all listed companies.

Taking into consideration the above discussion, it is very important to compile and rationally align disclosures, content of disclosures, timing of disclosures under SEBI Listing Regulations and SEBI PIT Regulations. Broadly, under both regulations, the purpose of disclosure is to ensure that material information is disseminated on time and the insider does not take an unnecessary advantage of such information. Such alignment of Regulations would also reduce litigation and the resources of Regulator would be effectively utilised. There are several instances and orders, wherein compliance officers have complied (in letter and spirit) with a particular regulation (say, SEBI Listing Regulations) however, other regulation on similar lines (say, SEBI PIT Regulations) is not complied. In several instances SEBI and Appellate Tribunal have not considered such non-compliance as technical violation and imposed penalty. The rational alignment of the disclosure regime would be in the interest of shareholders as well. Interestingly, the concept of materiality can also be made uniform for the relevant SEBI Regulations.

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1. SEBI Adjudication Order No. EAD-12/ AO/SM/23 –26/2018-19 dated April 20, 2018.