
UPHOLDING SHAREHOLDER'S RIGHTS WITH SPECIAL FOCUS ON THE LIABILITY OF DIRECTORS UNDER COMPANIES ACT: PNB FINANCE CASE

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ABSTRACT

PNB Home Financing Limited (PNB Home) is a National House Bank-registered housing finance company (NHB). After incorporation under the 1956 Companies Act, it began operations on November 11, 1988. Punjab National Bank sponsors PNB Housing (PNB). In November 2016, the company sold stock. The NSE and BSE have listed its equity shares from November 7, 2016. (BSE). This firm accepts public deposits and provides housing loans and real estate-backed loans. On December 9, 2009, PNB sold DEPL its 26% interest and formed a strategic partnership with Destimoney Enterprises Private Limited (DEPL). DEPL sold all of its 49% stake in the firm to Carlyle Group-owned Quality Investments Holdings in February 2015. Punjab National Bank, the bank's parent, held 51%. In July 2022, the parent firm had 33% shares, which subsequently decreased. This research paper aims to understand the duties and liabilities of directors given under Section 166 of Companies Act, 2013 and as to study the role of a statutory body in this case, and when and how it should intervene.

INTRODUCTION

Housing finance company PNB Home Financing Limited, or simply PNB Home, is a member of the National Housing Bank (NHB). It was formed as a corporation under the Companies Act of 1956 on November 11, 1988, and it has been in operation since that day. The Punjab National Bank supports PNB Housing (PNB). In November of 2016, the company started selling equity shares to the public. Since November 7, 2016, it has had equity shares listed on the NSE and the Bombay Stock Exchange (BSE). This financial institution is authorised to take deposits from the general public and furthermore provides mortgage loans and collateralized loans secured by real property. PNB sold DEPL its 26% ownership in the company and formed a strategic partnership with Desimone Enterprises Private Limited on December 9, 2009. (DEPL). In February 2015, DEPL sold all 49% of the company's shares to Quality Investments Holdings, which is controlled by the global investment firm Carlyle Group. Punjab National Bank, the bank's parent company, controlled the other 51%. In July of 2022, the parent business owned 33% of the company's shares; this percentage gradually decreased¹.

The Company was unable to provide financing because it lacked the necessary regulatory approvals from the Reserve Bank of India (RBI). The business has proposed issuing Rs. 4,000 Crores in preferred shares to four institutional investors in order to increase its capital. These financiers include: General Atlantic Singapore Fund Foreign Investment, Salisbury Investments Private Limited, Alpha Investments Private Limited, and General Atlantic Singapore Fund, as well as Pluto Investments (Limited Liability Company), an affiliated entity of Carlyle Asia Partners IV, Limited Partnership and Carlyle Asia Partners V, Limited Partnership. More specifically, Carlyle Asia Partners, Salisbury Investments Private Limited, and the General Atlantic Singapore Fund Foreign Investment would each put in Rs. 3200 Cr, while Alpha Investments Private Limited will put in Rs. 800 Cr.

In addition, the resolution voted to convene **an EGM** (extraordinary general meeting) to seek shareholder approval. The Company informed the Stock Exchange that the resolution had been adopted by the Board of Directors and that notice of the EGM had been sent to shareholders. According to SEBI's directive, the business cannot proceed with the "EGM" resolution for the assignment of preferential shares until it receives a report from the registered valuer on the

¹ Rahmawati, S., Agustiningsih, S.W. and Setiany, E. 'The effect of earnings management with special item to investment decision: empirical study at manufacture firm listed in Indonesia Stock Exchange 2008–2010', International Journal of Monetary Economics and Finance, Vol. 8, No. 2, pp.111–125, 2016.

appropriate valuation of preferential shares, as required by the company's **Articles of Association**². An order was received before the EGM ("AOA"). The aforementioned ruling was ultimately challenged by the Company in front of the **Securities Appellate Tribunal** (or "SAT"). The author of this article hopes to zero in on the present status of this case and the Directors' responsibilities under the Companies Act, 2013 in his or her investigation.

AIM/ OBJECTIVES

1. To understand and study SEBI's stand in this case and how PNB finances were hampering with the rights of the investors.
2. To understand the liabilities of Directors under Companies Act, 2013.
3. To make a proper analysis of the case with other Acts that are applied in this case and its relevance.

RESEARCH METHODOLOGY

The study here is made through secondary data, online journals and reliable websites for academic purpose only. Therefore, the study has taken theoretical and empirical study into consideration. It talks about its relevance in the modern world, how is people try to deceive and how they are punished under some laws which are made for the same.

RESEARCH QUESTIONS

1. Which all acts can be interpreted in this case?
2. Does company law have provisions for liability of directors?
3. How and why are minority shareholders affected in this?
4. Was intervention of SEBI reasonable and just?

² Sanjai PR, Suvashree Ghosh, Indian Regulator Orders PNB Housing to Halt Fundraising Plan, 150986579, EBSCO host Bloomberg, pN.PAG-N.PAG. 1p, 2021.

CHAPTER II

LITERATURE REVIEW

(Nickolas, 2017)³- “To provide mortgage loans for homes, PNB Housing Finance Limited (PNB Housing) is a member of the National Housing Bank (NHB). On November 11, 1988, activities began after it was formally established under the Companies Act of 1956. PNB Housing Finance Ltd. primarily extends housing and non-housing loans to salaried customers whose primary source of income is salary or to self-employed customers whose primary source of income is from their profession or company. Additionally, individual investors may take advantage of PNBHFL's fixed deposit products. As of 30 September 2015, PNB Housing Finance Limited (PNBHFL) has the fifth-largest loan portfolio of any housing finance company (HFC) in India. Tier-1 capital to risk-weighted assets must be at least 6% in order to meet NHB requirements, and Tier-2 capital must not exceed Tier-1 capital.”

(Rahmawati et al., 2015)⁴- “IPO marks a crucial turn in the life of a company. The decision to tap equity markets is tough as owner’s control gets diluted and the company has to make a number of disclosures continuously”.

(Bellavite Pellegrini et al., 2017)⁵- “Once the DRHP was ready, it was filed with SEBI and was uploaded on its website for 21 days for receiving the public comments on veracity of contents therein. SEBI usually took at least one month time to give its observations on the DRHP. Further, based upon the observations and comments, SEBI submitted its replies to GCBRLM. Once the changes, if any, had been incorporated, the DRHP becomes ‘RHP’. It was now resubmitted to RoC, SEBI and stock exchanges. The office of the registrar of companies (RoC) in India supervises compliance of companies to companies act. In the meantime, the company took an in-principle approval from both the stock exchanges, NSE and BSE where the shares were to be listed (global legal insights)”.

³ Nickolas, S Tierl and 2 Capital, https://rbidocs.rbi.org.in/rdocs/content/pdfs/FBSEIII020512_I.pdf, 2017.

⁴ Rahmawati, S., Agustini Sih, S.W. and Setiany, E. ‘The effect of earnings management with special item to investment decision: empirical study at manufacture firm listed in Indonesia Stock Exchange 2008–2010’, International Journal of Monetary Economics and Finance, Vol. 8, No. 2, pp.111–125, 2016.

⁵ Bellavite Pellegrini, C., Sergi, B.S. and Sironi, E. (2017) ‘Stock returns, productivity, and corruption in eight European fast-emerging markets’, Thunderbird International Business Review, Vol. 59, No. 1, pp.15–22.

(Seth and Dhasmana, 2017)⁶- “Life after initial public offering (IPO) has been good. We are fully capitalized because it has fueled our growth and improved our profitability a lot. We were heavily leveraged for 15 times, when we went for the IPO. For 30-36 months we wouldn’t need to go to the market. In three years’ time, we will go for follow-on public offer (FPO). Presently, we have enough capital.”

RESEARCH ANALYSIS

PNB Financing Limited, also known as PNB Home, is a National Housing Bank-approved mortgage lender (NHB). After forming as a corporation in accordance with the Companies Act of 1956, it opened for business on November 11, 1988. PNBHFL is the financial institution of the Punjab National Bank (PNB). Housing and non-housing loans from this financial organisation often go to borrowers with regular, salaried income or those who are self-employed and actively running a business (PNB Housing Finance Ltd. IPO, 2016). In addition, PNBHFL provides options for fixed deposits for private investors. About 38 offices and 16 underwriting hubs make up the organisation. As of September 30, 2015, PNB Housing Financing Limited, or PNBHFL for short, has the sixth biggest loan portfolio among Indian housing finance companies. On the other hand, as of March 31, 2015, it has the second greatest amount of public deposits of any HFC in India. The National Housing Bank of India is responsible for governing the aforementioned HFCs (NHB). Tier-1 capital to risk-weighted assets must be at least 6%, and the ratio of Tier-2 capital to Tier-1 capital must not exceed 10%, as specified by the National Housing Board's standards. The NHB mandates that HFCs always keep their capital to risk-weighted assets ratio at 12%⁷.

PNB Housing Finance went through the necessary allocation procedure when they wanted to issue an IPO in order to raise funds. PNBHFL needs more funding to meet the aforementioned operating necessities and to bolster its existing capital base. An IPO was conducted to the tune of three trillion rupees. In this case study, we take a look at how PNBHCL went public in India. It detailed the lengthy chain of events leading up to an IPO, highlighting the intricate nature of

⁶ Seth, D. and Dhasmana, I. (2017) Market, 22 July, Retrieved 20 April, 2019, from www.businessstandard.com:https://martinvestor.business-standard.com/market/interviews-472293-interviewsdetPNB_not_looking_to_sell_its_7_stake_PNB_Housing_Finance_MD.htm#.XLsTtlkzBIU

⁷ Pankaj Agarwal, Shalini Agarwal, Book-built IPO of Punjab National Bank Housing Finance Company Limited', Int. J. Monetary Economics and Finance, Vol. 12, No. 6, pp.445–466, 2019.

this process. Merchant bankers were also praised for their crucial role in addressing societal issues.

In May of 2021, PNB Housing Finance said that they will be issuing preference shares to the Carlyle Group, Aditya Puri's family investment entity Salisbury Investments, and General Atlantic for a total of 4,020,000,000 rupees, or \$390,000,000. And R. 400 Cr to Alpha Investments (the balance). They did this to increase the company's capital, but the proxy advisory, Stakeholders Empowerment Services ("SES"), objected, claiming the transaction would be unfair to the company's minority shareholders and in violation of its Articles of Association. After receiving information from the proxy advisory company, SEBI requested that PNB Home Finance Company cease issuing preferential shares due to the fact that doing so would be in violation of the relevant terms of the AoA. The AoA states that the regulator required the firm to seek a professional valuation. The mortgage servicer had issues with the commitment and eventually filed a complaint with SAT. PNB Housing Finance decided on October 16th, 2021, not to take the preference matter any further. When the SEBI appealed, the Supreme Court concluded it was without merit and would not interfere with the administration of natural justice⁸.

Securities and Exchange Board of India (SEBI) wrote to PNB Housing, requesting that it hold off on the preferential allocation until it got a report from a registered valuer on the price of the issue of shares. According to the data, no such complaint had been received. However, instead of replying to SEBI's notification, PNB Housing instead filed an appeal with the SAT. Justice M.T. Joshi, a Judicial Member("JM"), differed with Justice Tarun Aggarwal, the Presiding Officer ("PO"), on the need for a report from a registered valuer throughout the decision making process. The administrative PO is now responsible for assessing the issue and determining the best way forward. Between now and then, the SAT's directive from 21 June 2021 would stay in force. As per the SAT's directive, PNB Housing was required to convene the EGM and enable shareholders to vote on the agenda item pertaining to the preferential allocation, but the results were to be kept under wraps and not made public.

On a procedural level, questions were raised as to whether SEBI's actions in blocking PNB housing from bringing the issue of preferential allocation before its shareholders was premature and a violation of the norms of natural justice. The PO ruled that the ruling was an act of

⁸ PNB Housing Finance Ltd. v. SEBI, 2021 SCC Online SAT 2435.

arbitrariness since PNB Housing was not given enough notice of it. He reasoned that as shareholders had not voted on the preferential allocation, SEBI lacked jurisdiction over the matter. To the contrary, the Judicial Member (Justice M.T. Joshi) found that the SEBI was well within its powers given the gravity of the situation.

The Securities and Exchange Board of India (SEBI) appealed the SAT's ruling to India's highest court, but by that time, PNB Housing Finance had already cancelled its agreement with the four banks. In July of 2022, the twelve directors of PNB Housing Finance agreed to pay Rs. 72.76 Lakhs to SEBI to end the legal proceedings. Companies and individuals that engage in open market trading may settle repeated violations by paying penalties "without admitting or denying the guilt." Rajneesh Karnatak, Sunil Kaul, Neeraj Vyas, CH SS Mallikarjuna Rao, Chandrasekaran Ramakrishnan, and Gita Nayyar all settled with SEBI in addition to PNB Housing Finance. Members of the team include Sudarshan Sen, Nilesh S. Vikamsey, Tejendra Mohan Bhasin, Hardayal Prasad, Ashwani Kumar Gupta, and Kapil Modi.

CHAPTER IV

FINDINGS AND SUGGESTIONS

A director must follow the company's bylaws at all times, within the bounds of this Act. Each director has a fiduciary duty to act in the company's best interest, which includes looking out for the interests of the business's workers, shareholders, customers, and the local community, as well as preserving the natural environment. A director's responsibilities require him to use his own discretion and independent judgement in carrying them out. A director of a firm must avoid any circumstance in which he has even the remotest chance of having personal interests that clash with, or even seem to conflict with, those of the company. No director may, directly or indirectly, for himself or via his family, partners, or friends, get, or seek to obtain, any undue benefit or advantage, and any director who is found to have obtained an undue gain will be required to repay the business a sum equivalent to the undue gain. Any attempt by a director to transfer his position to another person is null and invalid. Any violation of this clause by a director of the firm would result in a punishment of at least 1 lakh rupees and up to 5 lakh rupees.

Every director is expected to follow the company's articles of incorporation and bylaws and perform his or her obligations with the utmost degree of diligence and diligence. Every director,

officer, or other employee of the company must, at the request of the registrar or inspector according to **Section 206**, deliver to the registrar or inspector the books of account and other books and papers of the business. The director's responsibilities extend to a wide variety of other settings as well.

Criminal liability, responsibility on fraud, liability for breach of guarantee/ warranty, liability to third parties, liability for violation of statutory obligations, liability to the company, and liability for activities of other directors are all stated in different parts of The Companies Act, 2013. Breach of fiduciary responsibility, extra vires conduct, negligence, and malfeasance are all examples of situations in which a director might be held liable to the corporation, which is why directors must exercise extreme caution.

Any time a director takes actions that are detrimental to the business, they are in breach of their fiduciary duties. When we talk about a director's personal liability for ultra vires actions, we imply that the director's authority and activities are limited by the memorandum and articles of association, and if the director goes beyond these boundaries, he is in violation of the memorandum and articles. Each director is responsible for the company's assets, and they will be held personally liable for any losses or damages that occur as a result of their failure to exercise reasonable care. An initial investigation concentrated on **Section 6** of the Companies Act of 2013⁹, which nullifies and invalidates any term in a document signed by the Company, such as an AOA, MOA, Resolution, or Agreement, that is in conflict with the requirements of the Companies Act of 2013. This provision was the primary focus of the investigation. In a similar vein, the decision of Madanlal Fakirchand Dudhediya vs. Shree Changdeo Sugar Mills Ltd. (1962)¹⁰ states that any provision in the AOA of the Company that is in conflict with the Companies Act, 2013 is null and invalid, and that the Act would take precedence. This decision was made in the year 1962.

According to **Section 6** of companies act, If the provisions of the AOA, MOA, Articles of Association, Resolution, or any other document executed by the company are in conflict with or in violation of the provisions of the Companies Act, then the provisions of the Companies Act shall control and the provision so provided in the AOA, MOA, Articles of Association, etc., which is contrary to the Companies Act shall become null and void.

⁹ Companies Act, 2013 (Bare Act).

¹⁰ Madanlal Fakirchand Dudhediya vs. Shree Changdeo Sugar Mills Ltd. (1962), 604 SCC.

If a special resolution is passed by the Company and the valuation/price of such shares is determined by way of valuation from a registered valuer, then the Company may issue additional shares to any person for cash or anything other than cash, as provided for in **Article 19(2)** of the AoA of the present Company. Subject to the provisions of the Companies Act and the MoA of the Company, the Company may amend its Articles of Association by passing a Special Resolution, and such amendment may include the conversion of the Company from Private to Public status¹¹, as well as the effect of such amendment and certain compliances with the Registrar to have the amended Articles of Association registered.

Provisions relating to the issue and transfer of shares and the non-payment of the dividend of/by Listed Companies or those Companies that intend to get listed are set forth in Chapter III of the Companies Act, which provides provisions relating to Prospectus and Allotment of Securities, and Chapter IV of the Companies Act, which provides provisions relating to Share Capital and Debentures, as set forth in **Section 24** of the Companies Act.

SEBI and the Exchange Board shall administer the provisions of Section 127 of the Companies Act relating to the punishment for failure to distribute dividends, except as provided under the Companies Act, by making regulations to that effect, and the provisions of **Section 127** of the Companies Act relating to the matters which are not to be administered by SEBI and the Exchange Board under this Section¹².

Further shares may be issued by the Company to any person if it is authorised to do so by a Special Resolution, in exchange for cash or anything other than cash (monetary value) if the amount for shares is determined and valued by the valuation report of a registered valuer, subject to such conditions as may be prescribed. After a Special Resolution has been approved at a meeting held, the Company may issue shares in any way it sees fit, including via a preferential offer to investors, so long as the requirements set out in **Section 42** of the Companies Act, 2013 are met. Furthermore, it stipulates that a Registered Valuer's Valuation Report is not required for a Listed Company to set the price at which the share to be issued.+

It may be claimed that a preferential issue has the advantage of certainty and is also a speedier procedure when determining whether the (“**BoD**”) acted in the best interests of the firm and its

¹¹ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 (Bare Acts).

¹² The Companies (Share Capital and Debentures) Rules, 2014 (Bare Acts)

minority shareholder. Compliance with the SEBI's price standards makes it hard to condemn the BoD for any pricing mistakes, and the need for a registered valuer's valuation is waived for preferred offers by publicly traded businesses. In fact, if PNB had instead renounced its privilege to Carlyle and the envisaged money transfer had been structured as a rights issue, it could have been argued that the transaction was actually a preferential issue disguised as rights issue to avoid the need for shareholders approval.

CONCLUSION

PNB Housing Finance (PNB Home) issued its share to the general public on November 7, 2016. PNB Home was unable to secure the essential regulatory permissions from the Reserve Bank of India (RBI) and thus in order to raise its capital, the company agreed to issue preferential shares of 4,000 Crores to four institutional investors. These investors are the following: Pluto Investments (Limited Liability Company), an affiliated entity of Carlyle Asia Partners IV, Limited Partnership and Carlyle Asia Partners V, Limited Partnership; Salisbury Investments Private Limited; Alpha Investments Private Limited; and General Atlantic Singapore Fund Foreign Investment. Stakeholders Empowerment Services (SES) who was the proxy advisor had demanded proper scrutiny as they suspected certain fabrication in the dealings of PNB Home. SES stated that this deal would be unjust to the minority shareholders of the company. SEBI upon a tip from SES urged PNB Home to stop its dealings. Supreme Court eventually ruled SEBI's appeal to be futile in nature and said that PNB Home did not hamper the natural justice system.

PNB Home had opted to appeal to the SAT wherein SAT issued an order stating that PNB Housing will hold the EGM and allow the shareholders to vote on the agenda item relating to the preferential allotment, but that the results not be declared and instead be kept in a sealed cover. Disheartened by the decision of SAT, SEBI moved to the apex court of India but by then PNB Home scrapped the deal it had made with the four institutions. In July 2022, 12 directors of PNB House decided to settle the case by jointly paying Rs. 72.76 Lakhs to SEBI. A director of a firm must avoid any circumstance in which he has even the remotest chance of having personal interests that clash with, or even seem to conflict with, those of the company. No director may, directly or indirectly, for himself or via his family, partners, or friends, get, or seek to obtain, any undue benefit or advantage. Any director who is found to have obtained an undue gain will be required to repay the business a sum equivalent to the undue gain. An initial

investigation concentrated on Section 6 of the Companies Act of 2013, which nullifies and invalidates any term in a document signed by the Company. This provision was the primary focus of the investigation. In a similar vein, the decision of Madanlal Fakirchand Dudhediya vs Shree Changdeo Sugar Mills Ltd. (1962) states that any provision in the AOA of the Company that is in conflict with the companies Act, 2013 is null and invalid.