
CORPORATE GOVERNANCE: DECODING THE ADANI HINDENBURG DEBACLE

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ABSTRACT

The article delves into the significance of corporate governance, outlining its role in effective company management and control. This encompasses a set of rules and practices aimed at balancing stakeholder interests and promoting economic efficiency. Guided by transparency, accountability, and shareholder protection, the system adheres to standards like the Companies Act 2013 and its amendments. The discussion also emphasizes various forms of corporate fraud, like financial statement manipulation and insider trading, underscoring the necessity of strong governance. Noteworthy scandals like ENRON and Satyam illustrate the consequences of weak oversight. Strengthening governance involves sustainable reporting, countering promoter influence, empowering independent directors, improving risk management, and external regulatory bodies. Corporate governance evolves to maintain transparency, integrity, and accountability in business operations.

The Adani Hindenburg issue revolves around allegations by Hindenburg Research against the Adani Group, a major Indian conglomerate. Accusations include financial irregularities, stock manipulation, and misleading disclosures. Hindenburg's report questions the financial health of Adani-listed companies, citing debt and liquidity problems that led to stock price drops. It also highlights the alleged involvement of Adani family members in questionable activities. Responding, India's Supreme Court established an expert committee to investigate and address regulatory failures. The committee's findings reveal potential regulatory gaps in dealing with the Adani Group, recommending actions like enhanced disclosures, manipulation prevention, scrutiny of shell companies, and better enforcement of corporate governance.

Keywords: Corporate Governance, Companies Act, 2013, Hindenburg Report, Adani Group, Stock Market, Financial Fraud

INTRODUCTION:

Corporate governance serves as the bedrock of modern business operations, defining the framework within which companies function and ensuring they meet their obligations to stakeholders. This intricate system encompasses a range of principles that facilitate transparency, accountability, and integrity in corporate affairs. The Companies Act of 2013 in India, along with subsequent regulations, marks a pivotal turning point in corporate governance, extending its reach beyond listed public entities to unlisted ones as well. These regulations have ushered in an era where adherence to governance standards is a prerequisite for sustainable growth and trust-building in the business community.

The evolution of corporate governance has been propelled by the urgent need to combat the gamut of corporate frauds that have plagued global markets. Financial statement frauds, insider trading, embezzlement, and other deceitful practices have shaken investor confidence and underscored the imperative for robust governance mechanisms. Notable corporate scandals like Enron and Satyam have cast a spotlight on the dire consequences of lax oversight and prompted a reexamination of governance norms. Stricter regulations, enhanced transparency, and ethical conduct are now central themes in reshaping the corporate landscape.

A slew of measures have emerged to strengthen corporate governance, ranging from industry-specific regulations to initiatives promoting responsible business conduct. The rise of environmental, social and governance (ESG) factors in decision-making, empowerment of independent directors, and the focus on risk management and internal controls all reflect a concerted effort to prevent financial malfeasance. The ongoing interplay between regulatory authorities, corporations, and shareholders continues to shape corporate governance as a dynamic force that safeguards businesses, upholds ethical standards, and ensures sustainable growth in a rapidly changing world.

In recent years, the Adani Group, a powerhouse in India's business landscape, has come under intense scrutiny due to allegations made by the U.S.-based investment research firm, Hindenburg Research. This clash has illuminated a complex web of financial maneuvers, regulatory responses, and corporate strategies that have shaken the foundation of one of India's most prominent

conglomerates. Founded by Gautam Adani in 1988, the Adani Group's diverse business portfolio spans across sectors such as ports, logistics, energy, and mining. Hindenburg's critical analysis has accused the group of financial irregularities, stock manipulation, and regulatory non-compliance, leading to a cascade of consequences. In this article, we delve into the origins of the conflict, the allegations made, the market impact, and the subsequent regulatory investigation. This high-stakes clash underscores the ever-evolving challenges faced by modern multinational corporations and the crucial role of regulatory bodies in maintaining market integrity.

❖ CORPORATE GOVERNANCE

The system of rules, procedures, policies, and processes by which a firm is directed, operated, and controlled is referred to as corporate governance. It entails balancing the interests of multiple stakeholders, including shareholders, management, clients, financiers, the government, and the community. In a nutshell, the basic focus of corporate governance is integrating robust management principles into the corporate framework in such a way that the firm accomplishes economic efficiency to maximize profit and promote shareholder welfare.

Corporate Governance is based on several principles that guide the way a company is governed. These fundamental principles are designed to ensure Transparency, Accountability, Protection of Shareholders' Interests, Risk Management, Independence of the Board of Directors, Legal and Regulatory Compliance, etc.

A. EVOLUTION OF CORPORATE GOVERNANCE LAWS TO COMBAT FINANCIAL FRAUD

At present The Companies Act 2013 lays down the crucial framework for corporate governance and mandates certain practices that promote transparency, accountability, and integrity in company operations. However, the real change in the corporate sector could be felt with the introduction of the 2009 Mandatory Corporate Governance Voluntary Guidelines which had to be complied with by companies listed on the stock exchange by Clause 49 of the Listing Agreement including mandatory codes to be followed by companies pertaining to board of directors, audit committees and various disclosures concerning related party transactions, whistleblower policies.

The significant provisions incorporated through the Companies Act 2013 can be seen as a contemporary introduction to Corporate Governance practice in the effective management of the company. This Act has taken a foot forward from SEBI's Clause 49 of the listing agreement by introducing provisions in the Act which promote corporate governorship code in such a manner that it will no longer be restricted to only listed public companies but also unlisted public companies along with mandatory compliance of Secretarial Standards issued by Institute of Company Secretaries of India as per Section 118 of Companies Act, 2013. The Companies Act 2013 contains various provisions that are crucial for maintaining corporate governance standards.

- One of the fundamental aspects is incorporated under *Section 134* which deals with the *financial statements* of a company. They must give a true and fair view of the affairs of the company. It requires directors to make various disclosures about the company's financial performance and internal controls, indirectly encouraging better governance and curtailing the likelihood of fraud.
- While *Section 143* deals with the powers and duties of auditors. It requires auditors to report on the company's internal financial controls and their adequacy. Adequate internal controls can act as a safeguard against financial fraud.
- Other elementary ingredients involve the *appointment of board members*, which is outlined in *Section 149* of the Act. This ensures that qualified, competent, and responsible individuals are selected to govern the company.
- Additionally, the Act emphasizes the formation of committees such as the Nomination and Remuneration Committee [*Section 178*], Stakeholders Relationship Committee [*Section 178(5)*], Corporate Social Responsibility Committee [*Section 182*], and the Audit Committee [*Section 177*]. These committees play a vital role in overseeing different aspects of the company's operations, ensuring transparency, and safeguarding the interests of stakeholders.
- To combat financial and other frauds, the Act establishes the *Serious Fraud Investigation Office* (SFIO) under *Section 211(1)*. This specialized body investigates fraudulent activities related to companies, enabling prompt action against any wrongdoers.

- *Related party transactions*, while permitted under *Section 188*, are closely monitored and subject to scrutiny. They can only occur under specific circumstances and must comply with stringent rules to prevent potential fraud and maintain the integrity of business activities involving related parties.
- *Section 245* of the Act allows for *class action suits* against directors, management, or other individuals involved in fraudulent activities. This provision strengthens accountability and provides a mechanism for shareholders and stakeholders to seek redress when corporate malpractices occur.

In summary, these provisions collectively underscore the significance of upholding corporate governance standards in companies. However, with the enactment of the Companies Act, 2013, the Securities and Exchange Board of India (SEBI) amended this clause 49 to align it with the Corporate Governance provisions specified in the Act. Subsequently, SEBI introduced the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, effective from 1st December 2015. These regulations replaced the previous provisions and imposed various substantive requirements on listed companies. Under the new regulations, companies were required to comply with principles governing disclosures and obligations, safeguarding the rights of shareholders (including minority shareholders), and outlining the responsibilities of the Board. To ensure uniformity, SEBI issued a standardized listing agreement format for all types of securities, which mandated listed entities to adhere to the provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

To comprehend the problem, it is essential to grasp the various types of corporate frauds that entities may engage in:

B. TYPES OF CORPORATE FRAUD¹

1. ***Financial Statement Fraud***: This involves deliberately misrepresenting a company's financial performance by manipulating financial statements, such as inflating revenues, understating

¹ *What Is Corporate Fraud? Author: James Chen: Available at: investopedia.com/terms/c/corporate-fraud.asp*

expenses, or overstating assets to make the company appear healthier than it actually is.

2. **Insider Trading:** Insider trading occurs when individuals with access to confidential information about a company use that information to make trades on the stock market. This type of fraud is illegal as it gives the insider an unfair advantage over other investors.
3. **Embezzlement:** Embezzlement refers to the misappropriation or theft of company funds or assets by an employee or executive entrusted with handling finances. It often involves diverting money for personal use or covering up the theft through false accounting entries.
4. **Falsification of Records:** This fraud involves altering or fabricating documents, invoices, or records to deceive auditors, regulators, or other stakeholders.
5. **Payroll Fraud:** Payroll fraud occurs when employees manipulate their timecards, alter wage rates, or create ghost employees to receive unauthorized payments or benefits.
6. **Procurement Fraud:** This involves fraudulent activities related to acquiring goods and services for the company, such as bid-rigging, kickbacks, or overbilling.
7. **Ponzi Schemes:** While not exclusive to corporations, Ponzi schemes are fraudulent investment scams that promise high returns to investors but use funds from new investors to pay returns to earlier investors, without generating *legitimate profits*.
8. **Tax Fraud:** This includes manipulating tax filings, underreporting income, overstating deductions, or engaging in other illegal practices to reduce tax liabilities artificially.

Such categories of corporate frauds involved in numerous high-profile scandals have indeed made corporate governance a significant concern.

C. NOTORIOUS CORPORATE SCANDALS: IMPACT ON GOVERNANCE

The collapse of international giants like Enron, Kingfisher Airlines, Videocon Industries Ltd, and financial scams like Satyam Scandal have been big eye-openers in the corporate arena to emphasize the emergent need to comply with Corporate Governance principles in order to protect

themselves from paying huge corporate criminal liabilities.

The ENRON scandal, in particular, highlighted the potential consequences of corporate abuse of power and fraudulent activities by corporate officers. ENRON's bankruptcy in 2001, after misreporting revenue and hiding debts, had far-reaching implications not only for the company itself but also for Wall Street and the broader economy. The severity of this scandal prompted the government to take action and enact new regulations to enhance corporate accountability and governance.²

India witnessed such drastic impacts at the time of the Satyam Scandal. Satyam Computers, once the crown jewel of the Indian Information Technology sector was involved in a massive financial fraud of over Rs 7800 crores perpetrated by its founders. This scandal shocked the market and severely affected Satyam's investors, while also tarnishing India's reputation in the global market. The incident underscored the critical role of corporate governance in setting high standards for the audit committee's functions and board members' responsibilities. It served as a wake-up call for the need to strengthen transparency, integrity, and accountability within corporate practices.³

In the aftermath of Satyam and other corporate accounting scams and scandals, there has been a growing demand for greater openness and honesty in financial reporting. These events (Satyam & Enron) have led to two contrasting yet inevitable outcomes - a push for stricter regulations and improved corporate governance practices to prevent such frauds in the future and a call for enhanced and ethical conduct to restore trust in the business community.

While on the contrary good, corporate governance often goes unnoticed in the public sphere. In its 2020 proxy statements, companies like PepsiCo demonstrate transparency in their leadership structure, compensation programs, and engagement with investors on various critical issues, including but not limited to business sustainability, human capital management, and ethical corporate culture.

² Enrol Scandal Available at: https://en.wikipedia.org/wiki/Enron_scandal

³ When The Numbers Didn't Add Up: Author: CS Madhur Gandhi: Available at: <https://taxguru.in/company-law/numbers-add-up-satyam-scandal-explained.html>

The importance of effective corporate governance solutions has expanded due to growing conflicts between ownership and management, instances of financial reporting non-compliance by auditors leading to substantial investor losses, and a lack of fair and transparent corporate culture. These issues have eroded investor confidence in a company's financial stability and ethical practices.

D. STRENGTHENING OVERSIGHT: EFFECTIVE MEASURES IN CORPORATE GOVERNANCE

Corporate governance norms in India have consistently undergone changes, reflecting a state of constant evolution. Over the last decade, changes have come through amendments and restatements of regulations and laws, as well as the introduction of mandatory business responsibility and sustainable reporting requirements. The market awareness and expectations regarding corporate governance have also increased during this period. In addition to general corporate governance regulations, certain industries have their own specific governance norms set by industry-specific regulators like the Reserve Bank of India (RBI) and the Insurance Regulatory and Development Authority of India. Recently, the RBI, in a report, recognized the necessity for the banking sector to strengthen corporate governance and risk management practices to cope with the dynamic and uncertain economic environment.

A positive change has been observed in the attitude of institutional investors, who have shifted their focus from solely evaluating financial performance to engaging with Boards on various issues. These include transparency and disclosure, diversity, climate change, environmental, social, and governance (ESG) factors, and long-term thinking. These changes are driven by the evolving regulatory requirements, which now expect institutional investors to play an active stewardship role.

Notably, in 2019, the Ministry of Corporate Affairs (MCA) released the National Guidelines for Responsible Business Conduct (NGRBC). These guidelines aim to incorporate the Gandhian principle of trusteeship into the core responsibilities of businesses towards society. They encourage businesses to contribute to broader development goals while still seeking to maximize profits.

A few other key areas that are occupying the mind space of Boards, management, and regulatory authorities to cope with the issues of corporate governance and prevention of financial fraud

include:

1. Business Responsibility and Sustainability Reporting: There is a growing global focus on Environmental, Social, and Governance (ESG) issues, leading to increased investor consciousness. In response, SEBI introduced a new framework in 2021 called the Business Responsibility and Sustainability Report (BRSR). This framework aims to bring sustainability reporting on par with financial reporting and encourages companies to disclose their efforts related to climate change, social responsibility, and governance.

2. Regulatory Proposal to Phase Out the "Promoter" Concept: The concept of "promoters" in Indian companies often grants them disproportionate influence over the Board and decision-making processes. To enhance corporate governance and regulate promoter influence, SEBI is considering a proposal to revamp the promoter regime and introduce a different concept of the "person in control." Draft amendments to relevant securities market regulations are yet to be issued.

3. Enhanced Shareholder Activism: The COVID-19 pandemic resulted in forced changes in the governance of companies, leading to an unexpected rise in shareholder activism. Shareholders are becoming more proactive in influencing corporate decisions and governance practices.

4. Empowerment of Independent Directors: SEBI amended the Listing Obligations and Disclosure Requirements (LODR) Regulations in 2021 to strengthen the role of independent directors (IDs). The amendments, effective from January 1, 2022, mandate that the appointment, re-appointment, and removal of IDs require a special resolution. The process of selecting IDs is also required to be transparent. These changes aim to enhance corporate governance by reducing promoter influence in the appointment and removal of independent directors.

5. Risk Management and Internal Controls: An effective risk management system and robust internal controls are crucial in preventing financial fraud. Identifying and assessing risks allows companies to implement appropriate controls to mitigate potential threats. Internal controls are policies and procedures designed to safeguard assets, maintain accurate financial records, and prevent unauthorized access to sensitive information.

6. External Oversight and Regulations: Government regulations and oversight bodies play an essential role in ensuring corporate accountability. Regulatory authorities, such as the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), enforce compliance with applicable laws and regulations, thus deterring fraudulent behavior.⁴

❖ ADANI HINDENBURG ISSUE

A. INTRODUCTION AND HISTORY OF THE ADANI GROUP

Adani Group is an Indian multinational conglomerate company headquartered in Ahmedabad, Gujarat, India. It was founded by Gautam Adani in 1988 and has grown to become one of India's largest and most diversified business groups. The company operates in various sectors, including ports and logistics, agribusiness, power generation and transmission, renewable energy, coal mining, and gas distribution, among others.

History:

- The Adani Group was founded by Gautam Adani as a commodity trading firm. It started as a small business in the port city of Mundra, Gujarat.
- In 1998, Adani established its first power project in Gujarat, marking the company's entry into the energy sector.
- Over the years, Adani Group expanded its operations significantly, diversifying into infrastructure, logistics, agriculture, and renewable energy projects.
- One of the major turning points for the company was in 2006 when it secured the contract to develop and operate the Mundra Port, which is now one of India's largest private ports.
- Adani continued to expand internationally and made significant investments in Australia, particularly in coal mining and infrastructure.

⁴ Financial Industry Regulatory Authority (FINRA) Available at: <https://www.finra.org/#/>

- In the late 2000s and 2010s, Adani's growth and business strategies faced both criticism and praise. Critics raised concerns about environmental issues related to coal mining projects, while supporters lauded the company's role in contributing to India's economic development.
- In 2019 the Government issued tenders for airports through Public Private Partnership. Adani pays 2440 crores to AAI and takes possession of 6 airports (Ahmedabad, Jaipur, Lucknow, Guwahati, Thiruvananthapuram, Mangalore).⁵
- Despite controversies and challenges, the Adani Group continued to expand its presence across diverse sectors, becoming a prominent player in India's business landscape. Over the last ten years Adani has expanded through the horizontal and vertical integration mechanism.

It undertook horizontal integration by acquiring companies that have a precedential foothold in the existing market.

<i>ADANI ENTERPRISE</i>	<i>ADANI TRANSMISSION</i>	<i>ADANI POWER</i>	<i>ADANI GREEN</i>
Mumbai International Airport	Alipurduar	DB Power Ltd	Wind Energy Projects
Navi Mumbai Airport	Warora Kurnool	Chhattisgarh Power Sector	SB Energy Holdings
Air Works	MMRDA Distribution	Eternus Real Estate Pvt Ltd	

⁵ Adani pays ₹2,440 crore to AAI to take possession of 6 airports. Available at: <https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/adani-pays-2440-crore-to-aai-to-take-possession-of-6-airports/articleshow/87575511.cms?from=mdr>

	Ambuja Cements & ACC- Holcim	Support Properties Ltd	
ADANI PORTS			
Abbot Point, Australia			
Ocean Sparkle			
Gangavaram Port			
Dhamra Port			
Dighi Port			
Krishnapatnam Port			

Table: The table above indicates the company acquired by Adani's major listed entities.⁶

B. INTRODUCTION OF HINDENBURG RESEARCH

Hindenburg Research was founded by Nathan Anderson, who has a background in private equity

⁶ Adani has Two sides by Abhi and Niyu (youtube) Video link: <https://youtu.be/OOnURrBhJ6I>

and distressed debt investing. It is an investment research firm known for its critical analysis of publicly traded companies. The firm gained significant attention for publishing reports that often accused companies of fraudulent activities, misleading disclosures, or questionable business practices. These reports typically resulted in substantial stock price declines for the companies under scrutiny.

HISTORY:

Hindenburg Research gained prominence in the financial world with its first high-profile report published in February 2018. The report targeted Nikola Corporation, a company focused on producing hydrogen-electric and battery-electric vehicles. Hindenburg accused Nikola of exaggerating the capabilities of its vehicles and presenting misleading information to investors. The report led to a significant decline in Nikola's stock price and raised doubts about the company's viability. The firm's research often focuses on emerging sectors, high-flying companies, and businesses with complex structures that may hide potential risks.

Hindenburg Research's reports were met with varying reactions. While some praised the firm for bringing potential misconduct to light and promoting transparency in the markets, others criticized its approach and questioned its motivations, suggesting that short-selling activities might influence the timing and content of the reports. Hindenburg has alleged fraud in 17 companies in the past six years since their incorporation. As with any investment research firm, it's essential to verify the claims made in their reports and consider potential biases before making any investment decisions based on the information provided.

C. THE HINDENBURG REPORT: HOW IT ALL STARTED

The Adani group's financial situation was criticized in a report produced by short-selling expert Hindenburg Research in late January 2023 titled "**How the World's Third Richest Man is Pulling The Largest Con in Corporate History.**"⁷

⁷ *Adani Group: How The World's 3rd Richest Man Is Pulling The Largest Con In Corporate History. Published by: Hindenburg Research. Available at: <https://hindenburgresearch.com/adani/>*

The research company said that key listed companies in the group had "substantial debt," placing the entire group on a "precarious financial footing," and that it held short positions in Adani companies through US-traded bonds and non-Indian-traded derivative instruments.

The research was made public immediately before Adani Enterprises, the parent company of the Adani Group, made a follow-on public offer (FPO) for Rs 20,000 crore (USD 2.5 billion).

D. WHAT ARE THE KEY ALLEGATIONS MADE BY HINDENBURG RESEARCH AGAINST THE ADANI GROUP?

According to the Hindenburg study, Gautam Adani, chairman of the Adani Group, has increased his wealth by more than \$100 billion over the last three years, mostly as a result of "stock price appreciation in the Adani group's 6 principal listed companies, which have spiked an average of 819% in that duration."

Name of the Stock	Price on 16th March 2020 (before Covid Crash) in Rs	Price on 23rd January 2023 (before Hindenburg) in Rs	% change
Adani Enterprises	140.4	3506.65	2397%
Adani Ports	284	779.50	174%
Adani Gas	117	3998.35	3317%

Adani Power	30.30	279.10	821%
Adani Transmission	194	2798.60	1343%
Adani Green Energy	128	2005.45	1467%

Table: The Table above indicates the percentage rise in the stock prices of the 6 listed entities over a short period of 3 years.⁸

The investigation revealed that several principal Adani companies that are publicly traded have taken on "substantial debt, including pledging shares of their inflated stock for loans, placing the entire group on precarious financial footing."

Name of Company	Non-Current Debt (in crores)	Current Debt (in crores)	Total (in crores)
Adani Ports & SEZ	₹39,691	₹5,762	₹45,453
Adani Green Energy	₹42,717	₹9,471	₹52,188
Adani Total Gas	₹352	₹643	₹995

⁸ Adani has Two sides by Abhi and Niyu (youtube) Video link: <https://youtu.be/OOnURrBhJ6I>

Adani Transmission	₹27,774	₹2041	₹29,815
Adani Power	₹37,871	₹10,924	₹48,796
Adani Enterprises	₹20,803	₹220	₹41,024
Adani Wilmar	₹45	₹2,523	₹2,568
Total		₹51,584	₹2,20,839

Five out of the seven major listed Adani companies, according to the research company, "reported 'current ratios' below 1, indicating near-term liquidity pressure."⁹

According to the Hindenburg report, Rajesh Adani, the younger brother of Gautam Adani, was charged by the Directorate of Revenue Intelligence (DRI) with being a key player in a diamond trafficking operation that utilized offshore shell companies to create fictitious turnover in 2004-2005. At least two independent claims of forgery and tax fraud led to Rajesh's arrest. He was then given a promotion to the position of Managing Director of the Adani Group, according to the report.

According to the research firm, Vinod Adani, Adani's older brother, has often been at the pivot of "the government's investigations into Adani for his alleged role in supervising a network of offshore entities used to facilitate fraud" and has thus been referred to by the media as "an elusive figure." Through several close associates, Vinod Adani "manages a vast labyrinth of offshore shell

⁹ *Adani has Two sides by Abhi and Niyu (youtube)* Video link: <https://youtu.be/OOnURrBhJ6I>

entities," the research firm stated, adding that they found "38 Mauritius shell entities controlled by Vinod Adani or close associates."

According to the Hindenburg report, Vinod Adani's shell companies "seem to serve several functions, including (1) stock parking/stock manipulation (2) and money laundering through Adani's private companies onto the balance sheets of the listed companies in order to maintain the appearance of financial health and solvency."

E. EFFECT ON ADANI GROUP

1. **Stock crash:** Following the publication of the report, the market value of all 9 of the Adani Group's shares fell by as much as \$1 lakh crore.

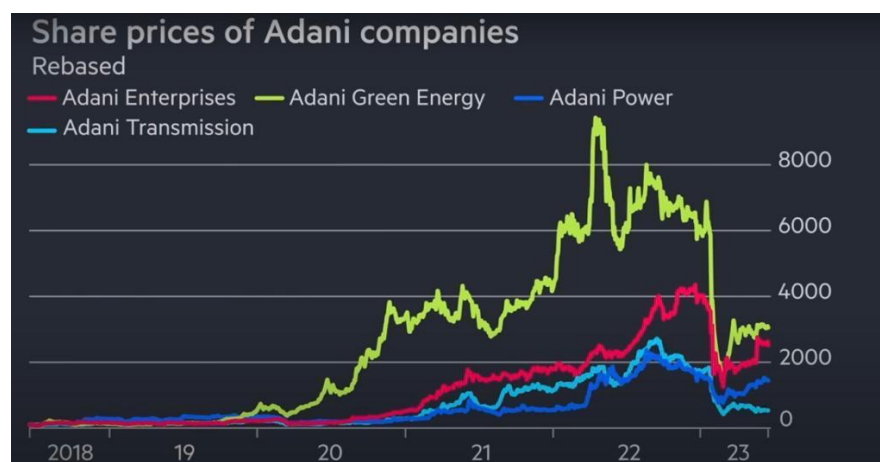


Image: The diagram above indicates the change in the stock prices and price/earnings ratio (volatility) of the Adani Group prior to and after the report.¹⁰

Source: Refinitive

2. **FPO & its Cancellation:** On January 31, the group decided to go ahead with Adani Enterprises' ₹20,000 crore follow-on public offer (FPO), which was fully subscribed thanks to the many family offices that bought into it. However, on 2nd February, the group canceled the FPO citing the 'unprecedented situation and the current market volatility'.

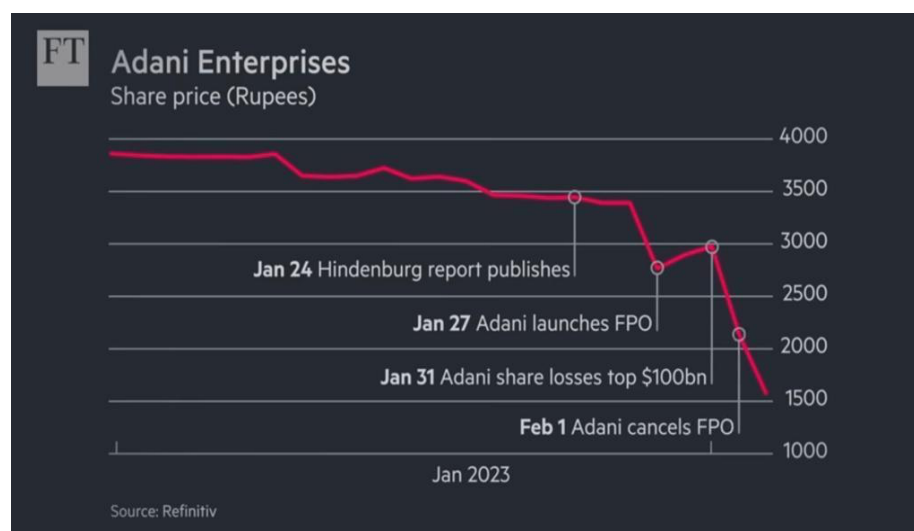


Image: The above diagram indicates the timeline until the cancellation of the FPO.¹¹

Source: Refinitive

3. **Gautam Adani loses his crown:** In early February, Gautam Adani's ranking in the global rich list fell from #3 to #21, resulting in the crash in the group's stocks. Index provider MSCI said it would announce changes in the free-float status of some Adani securities.¹²

¹⁰ Gautam Adani: the billionaire vs the short seller | FT Film (youtube) Video Link: <https://youtu.be/XrpKokMASjA>

¹¹ Gautam Adani: the billionaire vs the short seller | FT Film (youtube) Video Link: <https://youtu.be/XrpKokMASjA>

¹² Gautam Adani loses more money than Ambani, Damani post Hindenburg report: Available at: <https://www.livemint.com/news/india/gautam-adani-loses-more-money-than-ambani-damani-ytd-post-hindenburg-report-11675507259987.html>

F. LEGAL ASPECTS AFTER THE PUBLICATION OF THE REPORT

1. ***Investigation By The Sebi Directed By The Supreme Court:*** By order dated March 2, 2023, the Supreme Court bench, presided by Chief Justice of India DY Chandrachud, instructed the market regulator Securities and Exchange Board of India to wrap up its investigation into the Adani-Hindenburg case and submit its report within two months.

THE SUPREME COURT DIRECTED THE SEBI TO INVESTIGATE THE FOLLOWING ASPECTS:

- i. ***Whether there has been a violation of Rule 19A of the Securities Contracts (Regulation) Rules 1957 [MINIMUM PUBLIC SHAREHOLDING]?***

The SEBI was mandated to probe whether the Securities Contracts (Regulation) Rules, 1957, were violated. The court wanted SEBI to investigate whether Rule 19A, which stipulates that every company listed in the stock market has to maintain at least 25% public shareholding, was disregarded.

- SEBI has been investigating 13 suspected overseas entities, mostly foreign portfolio investors (FPIs), based in tax havens like Mauritius, which they suspect are front companies of the Adani promoters.
- As of March 2020, a group of Foreign Portfolio Investors (FPIs) collectively held significant shares in five Adani Group companies. Their holdings were as follows: 15.5% in Adani Enterprises Limited (AEL), 18% in Adani Transmission Limited (ATL), 17.9% in Adani Total Gas (ATG), 20.3% in Adani Green Energy Limited (AGEL), and 14.1% in Adani Power Limited (APL), as reported by SEBI.
- The shareholding of the promoter group in the five listed Adani Group companies till March 2020 was greater than 74%, as per their own disclosures. If the 13 suspected foreign entities were indeed acting as front companies for the Adani Group promoters, these publicly listed companies would be violating Rule 19A of the SCRR, 1957.

	FPI/overseas entity	Jurisdiction	Declared name of beneficial owner	Nationality
1	Elara India Opportunities Fund	Mauritius	Rajendra Bhatt	U.K.
2	Vespera Fund Limited	Mauritius	Rajendra Bhatt	U.K.
3	Marshal Global Capital Fund Limited	Mauritius	Nuni Venkata Ramana Murty	Singapore
4	Emerging India Focus Funds	Mauritius	Trident Trust Company Limited - Jimmy Ernesta as settlor	Mauritius
5	EM Resurgent Fund	Mauritius	Trident Trust Company Limited - Jimmy Ernesta as settlor	Mauritius
6	Cresta Fund Limited	Mauritius	Mark Dangel	Switzerland
7	Albula Fund Limited	Mauritius	Anna Luzia von Senger Burger	Switzerland
8	APMS Fund Limited	Mauritius	Alastair Guggenbuhl-Even & Yonca Even Guggenbuhl	Switzerland
9	LTS Investment Fund Ltd.	Mauritius	Alastair Guggenbuhl-Even	Switzerland
10	Asia Investment Corporation (Mauritius) Ltd	Mauritius	Alastair Guggenbuhl-Even & Yonca Even Guggenbuhl	Switzerland
11	Polus Global Fund	Mauritius	Yajjadeo Lotun	Mauritius
12	New Leaina Investments Ltd	Cyprus	Jan Scheelings, Margaret Ilse Sjak-Shie & Collin Peter de Wit	The Netherlands
13	Opal Investments Pvt. Ltd (FI)	Mauritius	Adel Hassan Ahmed Alali	UAE

The table lists 13 foreign entities that are under investigation by the Securities and Exchange Board of India (SEBI) in relation to the Adani Group.¹³

- SEBI, despite its suspicion and investigation, however, has been unable to unearth the “ultimate beneficial owner” of these overseas entities to date. This inability to establish prima facie contraventions, however, has been affected by successive amendments to SEBI regulations, related to FPIs as well as Listing Obligations and Disclosure Requirements (LODR regulations).
- A significant limitation on Foreign Portfolio Investors (FPIs) with "opaque structure" was removed, and modifications were made to the definitions of "beneficial owners" in FPI regulations and "related party/related party transactions" in the LODR regulations through subsequent amendments in 2018 and 2019, which resulted in a reduction of their stringency.
- These amendments to the regulations created gaps in oversight, allowing the Adani Group promoters, particularly Vinod Adani, to hide the true beneficiary of the suspected FPIs while asserting adherence to regulatory requirements

¹³ Explained|Decoding the Expert Committee report on Adani by The Hindu. Available at: <https://www.thehindu.com/news/national/explained-decoding-the-expert-committee-report-on-adani/article66985824.ece>

- Both the ED and CBDT have formally pronounced that they cannot undertake an investigation unless SEBI registers a case under the Prevention of Money Laundering Act, 2002 (PMLA 2002) and tax law violations, respectively.
- The amendments introduced by SEBI in the FPI and LODR regulations in 2018 and 2019 appear to have mala-fide intent, as evidenced by the subsequent amendments made in November 2021. These amendments, which sought to relatively plug the regulatory loopholes opened by the former amendments, were made with a deferred prospective effect when the SEBI investigation was already underway. The PMLA (Maintenance of Records) Rules, 2005 were also amended by the Department of Revenue on March 7, that is, after the SC order setting up inquiries, to amend the definition of beneficiary ownership of FPIs.
- The alterations made to SEBI regulations have led to a thorough undermining of Section 12A of the SEBI Act, 1992, which expressly forbids the creation of schemes and mechanisms designed to circumvent the legal framework, facilitating activities like securities fraud and insider trading.

ii. Whether there has been a failure to disclose transactions with related parties and other relevant information which concerns related parties, to SEBI, in accordance with law (RELATED PARTY TRANSACTIONS)?

SEBI was tasked with investigating whether there had been any failure to appropriately reveal transactions and pertinent details involving associated parties to SEBI, as mandated by the law.

- The allegations center around the disclosure of supposed relationships between involved parties and transactions involving them. The terms "related party" and "related party transaction" underwent significant changes by SEBI in November 2021, with some modifications coming into effect on April 1, 2022, and others on April 1, 2023. India's definitions for these terms are broader compared to other regions.
- There are two regulatory approaches in this context. One approach involves assessing these arrangements based on the existing regulations without amendments. Section 12A of the SEBI Act, 1992, prohibits schemes designed to evade the law, essentially an anti-avoidance

framework. The other approach involves making changes to the regulations to explicitly define what falls under legal obligations.

- SEBI has the authority to decide between these two approaches within its legislative role. The decision reflects their informed policy judgment, and as long as the choice is reasonable and not undermining, there shouldn't be negative criticism or a determination of "regulatory failure."
- By opting to establish clear requirements for the future, the viability of evaluating the fundamental principles that underlie the regulations controlling related party transactions has been diminished.

iii. Whether there was any manipulation of the stock price in contravention of existing laws (STOCK PRICE MANIPULATION)?

What forms a crucial point of the investigation to be undertaken by SEBI was the allegations pertaining to stock market manipulation.

- It was claimed that, with the intention of securing funds for their business objectives, the group purportedly disposed of 1.2 million shares of Adani to entities associated with Ketan Parekh on May 26, 2000. Subsequently, when the Adani group had excess funds, they concentrated their ownership in AEL by reacquiring 800,000 shares from the Ketan Parekh entities on July 11, 2000.
- A notable aspect of the price movement of the Adani scrips is that their sharpest rise occurred when the five listed Adani companies were already under the SEBI scanner, since October 2020.
- The price of an AEL (Adani Enterprises Limited) share surged from ₹491 on January 1, 2021, to reach a peak of ₹4,190 on December 21, 2022, marking an impressive growth of 753% over the span of nearly two years. The price increase of ATL shares from January 2021 to its September 2022 peak was by 874%. ATG shares experienced a substantial increase in value, with a 960% price appreciation observed between January 2021 and

January 2023.¹⁴

- In comparison, the BSE Sensex, which started at 47868 on January 1, 2021, surged to an all-time high of 63583 on December 1, 2022, marking a growth of approximately 32% over a span of 23 months. Therefore, Adani's stocks significantly outperformed the market during a period extending over two years, from January 2021 to January 2023.
- According to the findings of the expert committee report, SEBI's automated surveillance systems (ASM) generated a total of 849 alerts regarding Adani group companies' shares between April 1, 2018, and December 31, 2022. Out of these alerts, 603 were associated with price volume movements, while the remaining 246 were connected to suspected instances of insider trading. SEBI indicated that the 603 alerts were resolved after being processed according to approved standard operating procedures. However, ongoing efforts are being directed toward addressing the 246 alerts linked to suspected insider trading.
- While a large number of ASM alerts were clear signals of excess volatility in Adani scrips, SEBI did not find them "unusual" as long as their prices were rising. SEBI took notice of "abnormal price fluctuations" in the Adani stock only after a significant decline following the Hindenburg incident, as stated in a public announcement made on February 4, 2023.
- The Adani Group promoters have a track record of breaching regulatory norms, as evidenced by SEBI's accusation of their involvement in manipulating AEL shares along with the convicted trader Ketan Parekh. This case was resolved through a settlement involving the payment of specified sums in April 2008.
- Considering this background, SEBI's lack of public response to the exceptional surge in Adani shares starting from October 2020, despite ongoing investigations due to complaints, coupled with its reluctance to initiate legal action for regulatory breaches and violations

¹⁴ Explained | Decoding the expert committee report on Adani. Published by: The Hindu. Available at: <https://www.thehindu.com/news/national/explained-decoding-the-expert-committee-report-on-adani/article66985824.ece#:~:text=The%20price%20of%20an%20AEL,2022%20peak%20was%20by%20874%25>.

against the Adani Group promoters until now, can be seen as initial evidence suggesting a failure in regulatory oversight and SEBI's potential involvement in these breaches.

2. FORMATION OF EXPERT COMMITTEE BY SUPREME COURT.

The top court stated that several other parts of the case need to be looked into while noting that SEBI is already looking into the January 24 report on Adani Group and the charges against the power-to-port behemoth by US short-seller Hindenburg Research.

The court thus vide its order dated 2nd March, 2023 set up a six-member expert committee to review the extant framework of the stock market's regulatory mechanism. It has assigned the former Supreme Court judge Justice AM Sapre, who will be heading the committee, along with OP Bhatt, Justice JP Devadhar, KV Kamath, Nandan Nilekani and Somasekhar Sundaresan.¹⁵

The expert committee will look into the overall assessment of the situation, including the causes and factors which led to volatility in the securities market in the recent past.

The committee's mandate includes recommending steps to enhance investor awareness and examining potential regulatory shortcomings in addressing reported violations of securities market laws involving the Adani Group and other firms. Furthermore, it will propose strategies to reinforce the legal and regulatory structure and ensure adherence to the current framework for safeguarding investor interests.

G. REPORT OF THE EXPERT COMMITTEE – AN ANALYSIS

Following a Supreme Court directive on March 2, 2023, two separate investigations were initiated into the alleged violations by the Adani group of companies, as asserted by Hindenburg Research. The U.S.-based investment research firm had accused the Adani Group in January of being involved in blatant manipulation of stocks and money laundering through shell companies, although the company refuted these allegations.

¹⁵ Vishal Tiwari vs The Union of India & ors. Available at: https://main.sci.gov.in/supremecourt/2023/5354/5354_2023_1_1501_42639_Judgement_02-Mar-2023.pdf

Meanwhile, a six-member Expert Committee appointed by the court submitted a 173-page report on May 6. While it has been widely reported that the expert committee did not find any regulatory shortcomings on the part of SEBI, a closer examination of the report uncovers various facts and a series of events that not only suggest regulatory failure but also the potential influence and weakening of regulatory oversight.

In the fourth Section of the expert committee's report, which evaluates SEBI's regulatory actions, there is a suggestion of a significant scandal involving severe economic misconduct carried out by the Adani group.

According to the expert committee's findings, SEBI initiated an investigation into the Adani group companies in October 2020, prompted by complaints received between June and July 2020. Nevertheless, regulatory actions such as the issuance of show-cause notices have not been instigated by SEBI, ostensibly due to the claim of being unable to establish a clear initial case.

The expert committee has highlighted that SEBI's approach towards investigations is rooted in the belief that it is upholding the "spirit of the law." However, this stance contradicts the postponed impact of the prospective amendments that SEBI has introduced on the legislative front.

The committee has reported that most of the price rises of AEL scrips occurred between April 1, 2021, when AEL's share price was ₹1,031, and December 31, 2022, when the share price reached ₹3,859. The largest buyer of AEL shares during this period was the Life Insurance Corporation of India (LIC), buying around 4.8 crore shares. The 13 suspected FPIs were among the top net sellers during this period, having sold around 8.6 crore shares. The fluctuations in AEL share prices were primarily influenced by LIC and the 13 suspected FPIs. However, SEBI's current stance is that it cannot definitively assert that these suspected FPIs played a role in the price increase due to their status as "net sellers" during that period.

SEBI appears to be operating on the assumption that stock prices can only be manipulated through net purchases rather than net sales. Yet, it is essential to investigate these significant transactions: the suspected FPIs selling 86 million AEL shares and LIC acquiring around 48 million shares.

- **What Were the Final Remarks?**

However, to conclude the Committee has restricted itself to its stated remit of ascertaining whether there has been a regulatory failure. Despite collating and presenting a large body of evidence of regulatory failure, as stated above, the expert committee has drawn ambivalent conclusions, for example: “

At this juncture, considering SEBI's explanations backed by empirical evidence, the Committee is unable to definitively ascertain a regulatory failure in relation to the accusation of price manipulation. The responsibility now lies with the Supreme Court Bench to thoroughly examine the comprehensive report and formulate its own judgments. Given the substantial evidence of regulatory irregularities and undermining highlighted in the expert committee's report, the court should center its attention on SEBI's actions

- **Reformatory Measures Suggested:** Among a few reformatory measures suggested by the Committee, the crucial changes are highlighted below.

1. **Enhanced Disclosures:** The committee suggests that regulatory bodies like SEBI should enforce stricter rules for disclosures, particularly for related party transactions. While SEBI has introduced regulatory changes in this area in 2019 and 2021, there is room for addressing existing gaps in such transactions.
2. **Scrutiny of Shell Companies:** The committee emphasizes the need for careful examination of activities and transactions involving shell companies based outside India. Such companies often lack transparency due to undisclosed ultimate beneficiaries.
3. **Promoting Fair Competition:** To prevent large companies like Adani from gaining excessive market control and forming monopolies, it is essential for the country to encourage fair competition.
4. **Combating Stock Price Manipulation:** A significant allegation raised is related to stock price manipulation. The committee suggests that the actions taken by the

regulatory system should be more robust, and effective, and should set a strong precedent for potential violators.

5. ***Mandatory Corporate Governance Implementation:*** Corporate governance's pivotal role is highlighted in the issue. Malpractices, especially in large companies, must not be overlooked. The committee proposes that the implementation of corporate governance policies should be obligatory, rather than being at the discretion of companies. A robust mechanism should be established to monitor business activities within companies.

CONCLUSION:

The article explores corporate governance, its principles, and its significance becomes even more pronounced in an era of rapid expansion within the corporate sector. It highlights the evolution of corporate governance laws in India, particularly the Companies Act 2013, and its provisions aimed at enhancing accountability and preventing financial fraud. The text also discusses various types of corporate fraud, such as financial statement fraud and insider trading. Measures to strengthen corporate governance include sustainable reporting, regulatory changes, enhanced shareholder activism, and empowering independent directors. Robust risk management and external oversight play pivotal roles in maintaining corporate integrity.

The Adani Hindenburg issue revolves around allegations made by Hindenburg Research, an investment research firm, against India's Adani Group. Hindenburg accused the group of financial irregularities, manipulation of stock prices, and non-disclosure of related party transactions. They claimed that key listed Adani companies carried substantial debt, putting the group's financial stability at risk. The allegations caused significant stock value declines, the cancellation of a follow-on public offer (FPO), and Gautam Adani's ranking drop in global wealth lists. The Indian Supreme Court formed an expert committee to review the situation, which reported no regulatory failure but proposed measures to enhance disclosures, scrutinize shell companies, promote fair competition, and combat stock price manipulation.

The SEBI was directed to submit its report on 14th August 2023. However, they have sought a 15-day extension from the Hon'ble Supreme Court as of 14th August 2023.