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ADR, GDR holders may get to vote

Sebi Wants Rules Tweaked To Ensure Promoters Extend Full Voting Rights To DR Holders

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THE Securities & Exchange Board of India (Sebi) has recommended a change in current rules to allow holders of American Depositary Receipts or Global Depositary Receipts issued by Indian corporates to exercise their voting rights, raising the possibility of increased shareholder activism in future.

Depositary receipts, or DRs, are securities issued to overseas investors by Indian companies. In September 2009, the capital market regulator had brought holders of such securities under the takeover code. Investors or holders of ADRs/GDRs are entitled to vote on the shares underlying or representing the receipts, but their rights are restricted by the clauses in the 'terms of issue' or agreements between the holders of these instruments and the issuers. In reality, their voting rights are as good as having none.

The regulator now wants to prevent Indian firms issuing ADRs/GDRs from incorporating provisions which curtail the voting rights of depository receipt holders and which empower the management to exercise voting rights on their behalf. The finance ministry and the Reserve Bank of India will need to amend the rules to bring into force the proposed changes.

Sebi's proposal, which was tabled at the last board meeting and formed part of the agenda notes, is on the lines of other regulators such as the US SEC, which has a similar provision. The regulator analysed the overseas offerings of some companies, including China Lodging Group, Australia's NewSat Limited and Taiwan's Shin Kong Financial Holding Company, where the depository holders are entitled to exercise their right to vote and did provide instructions to the custodian bank. **ADR/GDR terms favour mgmt**

MOST companies have issued ADRs/GDRs featuring clauses where the voting rights are in favour of the management. In some cases, the boards of issuer companies instruct the custodian bank—which holds the actual shares on behalf of ADR/GDR holders—to vote for them. In other cases, the right is vested with depository holders. However, in the event of their failure to exercise their voting right, it is deemed to have vested with the board of the issuer company. These instructions are incorporated in the agreement or 'terms of issue'.

After analysing the voting right arrangement listed in the 'terms of issue' of several companies, including Sterlite Industries (India), Tata Motors, Suzlon Energy and KS Oils, Sebi said in an internal memorandum to its board, "The entitlement of depository receipt holders on exercise of voting rights on the underlying shares is governed by 'terms of issue' of depository receipts, which is unilaterally decided by the management of the issuer, who finalises the terms of issue. The holder has no choice but to accept the terms if he is interested in subscribing to the receipts."

Former Sebi executive director (legal) and founder of Finsec Law Advisors Sandeep Parekh said there are two shortcomings in the current rules. "First, promoters who hold shares in ADRs do not disclose their shareholding to the company. This is in fact contrary to the listing agreement, which does not exclude such a fact from being disclosed. The second shortcoming is of the non-promoter shareholder, who has the power to vote, even if contracted away, and who is not obliged to make a relevant tender offer. In fact, all ADRs do have voting rights and must be subject to the impact of the takeover regulations," he said

According to the rules now in vogue, if an acquirer with voting rights takes control of 15% of the equity in a company, an open offer would have to be made for acquiring an additional stake of 20% from public shareholders. In 2009, Sebi redefined the term acquirer by including ADR and GDR holders, bringing them at par with Indian investors. Prior to this change, ADR and GDR holders were forced to make the mandatory 20% offer only when the depository receipts were converted into shares.

Mona Bhide, partner at Dave & Girish & Co, a law firm, said that ADRs form a significant minority and if the custodian votes on behalf of the ADR holders and for the management, then the incumbent obtains additional

support in its favour and would easily be able to control the company. "Once the new rule is implemented, each ADR holder can exercise his vote either in favour or against the management, allowing each to have a unilateral say in the company proposals," she said.

Mehul Savla of RippleWave Equity, a boutique investment banking firm, said, "In an increasingly transparent world, ADR/GDRs as a class of security are probably still shrouded in an element of mystery. No wonder that Sebi deemed it fit to declassify DR holdings from the public category a few years ago. The proposed move to lift the veil and track down voting rights of the DR holders will plug the regulatory arbitrage that currently exists," she said.

Mr Parekh said the Sebi board note on the issue of voting rights appears needlessly confused. "It mixes up the right to vote under the Companies Act with the power to vote under the takeover regulations. The first recognises the legal right to vote and the latter the factual right to vote. Under the takeover regulations, any voting power whether by way of agreement in writing or by agreement by a wink and a nod qualify the triggering of the disclosure and tender offer triggers. It needlessly excludes voting rights which are attached to ADRs, and the loophole was only partly fixed late last year," he said.

