The saga continues

The government has proposed a merger of FTIL and NSEL.

Far from the gaze of the country's breaking headlines, a debate is raging in the corridors of power in the Indian Capital, its content too serious for the common man to comprehend.

The debate, interestingly, has its origins in Mumbai, in the precincts of a grey glass panelled multi-storied building popularly known in Andheri as The Exchange Square.

The case - details of which have reached the offices of Prime Minister Narendra Modi - is interesting for corporate entities - both Indian and multinational corporations - and revolves around the proposed merger of the Mumbai-based Financial Technologies India Limited (FTIL) with the crisis-hit National Spot Exchange Limited (NSEL) that many argue is actually a case of unwarranted government activism.

In simple terms, NSEL does not want the merger, making detailed representations to the ministry of corporate affairs (MCA) that the merger decision would hamper the recovery of ₹5,600 crore from defaulting members who had plunged the exchange into its worst payment crisis in 2013.

The government (read corporate affairs ministry) has not reacted after it ordered the merger of NSEL with its parent firm FTIL last year. The matter, challenged by the NSE, is now pending before the Bombay High Court.

"The merger is in bad shape in law and will have bad consequences," said Prakash Chaturvedi, MD & CEO, NSEL, in a brief interview.

"The merger is mainly to raid the treasury of FTIL and distribute lost cash to investors," says Chaturvedi. He backs his argument by drawing parallels with a similar crisis that engulfed UTI, a 100 per cent government subsidiary, more than a decade ago. Then, the finance ministry did not honour its commitment of assured returns to its investors. In short, the government did not stand by its assurance and commitment.

Chaturvedi says the finance ministry split UTI into two entities, UTI Mutual Fund to recover losses. "It has always been the government's policy to hive off or de-merge companies to recover lost cash, allowing market forces and legal remedies to work."

But is that happening at NSEL, asks Chaturvedi?

"We (NSEL) have been victimised," says Chaturvedi, reminding the government it has not yet acted against 24 defaulters.

And if the companies are merged, the new entity would not have "any interest and urgency" in recovering the lost cash. Worse, the defaulters could go scot-free.

On paper, FTIL owns a little over 99 per cent stake in NSEL, currently non-operational, due to a draft order for merger - following a recommendation from the FMC - issued by the corporate affairs ministry in October 2014.

Worse, there is now evidence that the FMC and MCA are pushing for the suppression of FTIL's board and declaring its directors - introduced on 14 November 2015 - as "not fit and proper" as they are opposing the proposed merger of NSEL with FTIL. The matter is currently in the Bombay High Court.

The new board includes luminaries such as Venkat Chary, former chairman of FMC; A. Nagarajan, ex-IAS; Justice (ret'd) R.J. Kochhar; advocate Berjis Desai and managing partner of J. Sagar Associates; and Anil Singhvi, CEO, Ambuja Cement, and chairman, Ican Investment Advisors, an agency specialising in the interests of minority stakeholders.

What is surprising is that this board took over after more than a year of the crisis, which unfolded in July 2013. But this fact was ignored by the MCA and it held responsible the new directors of FTIL for the NSEL payment crisis.

There's more. The MCA had also alleged that FTIL and its new board of directors are mismanaging NSEL and selling its 26 per cent stake in MCX at a loss of ₹290 crore. On the contrary, it was the FMC that directed FTIL to sell its entire holding (26 per cent) in MCX by declaring it a "not fit
and proper" entity. In the language of Delhi's bureaucracy, it stands for a company incapable of running its operations.

The final government order on the merger is expected on 30 October 2015. If the merger happens, it would be the first major government intervention in a scam-hit private sector entity since the Satyam case rattled corporate India in 2009.

What would happen if the merger takes place?

Pursuant to the merger, FTIL must absorb NSEL along with all its liabilities including payments due to be paid to brokers, investors and others. Of the missing ₹5,600 crore, ₹750 crore has already been paid, and properties worth about ₹1,225 crore would have to be liquidated towards repayment to about 13,000 investors.

No wonder then, the merger proposal has turned into a case study of sorts on the dos and don’ts of handling a corporate crisis, and whether or not the government is empowered to recommend a forced merger of two private companies - thereby violating the concept of Limited Liability, the very basis on which corporate entities function across the world.

Experts feel a forceful merger of two private corporate entities under section 396 of the Companies Act can seriously undermine the basic principle of Limited Liability in corporate structure leading to grave uncertainty in the Indian corporate world.

"Destruction of Limited Liability under the guise of amalgamation will open the floodgates of similar actions against parents whose subsidiaries are facing an unproven potential liability," says Tushad Cooper, a seasoned Mumbai lawyer.

Cooper further argued that such an action by the government, despite the issue being sub-judice in the Bombay High Court, could even undermine judicial supremacy raising concerns about the executive's interference in the judicial process.

The undermining of "Limited Liability", says Anup Bose, a veteran lawyer, could even "push Indian corporate law back to the dark ages and hinder seamless development of companies".

"Such a precedence, if set, could always be misused to amalgamate subsidiaries into parent companies leaving the domestic companies with no option but to shift overseas," argues Bose.

In all probability, foreign investor companies looking to invest and open subsidiaries in India would reconsider their decisions and either cancel or postpone plans fearing similar action against them in case their Indian subsidiaries face any problem in India.

This is not all

Bose feels the flow of Foreign Direct Investments (FDI) will be the first casualty of MCA's action. According to Moody's, the global credit rating agency, the net FDI in the first five months of 2014-15 stood at $14.1 billion. Industry expectation is that such flows will be more than $60 billion during the year as foreign investors gain confidence in the new government.

"This merger would definitely send the wrong signals," argues Bose.

High-handed executive action like a forced amalgamation may adversely affect foreign investors' perception of the country and curtail India's growth trajectory. Uncertain conditions would erode global giants' perception of ease of doing business in India. For the record, India ranks 142 in the Ease of Doing Business index compiled by the World Bank, benchmarked to June 2014.

Business decisions, such as amalgamations and acquisitions, are best when taken by companies involved keeping in mind economic and strategic factors. A forced amalgamation involving "public interest", which is not clearly defined and has room for ambiguity, could drive down India's ranking in the index.

The verdict will be out soon; there's a kind of hush in Delhi's air.

Suspense has gripped members of the grey-blue structure of FTIL and, most importantly, the man who worked hard for over two decades to shape it into The Exchange Square that housed MCX, Asia's second largest commodity exchange, and its stock exchange, MCX-SX, whose licence was procured after a protracted legal battle.

He is Jignesh Shah, whose life's work of starting exchanges and robust financial institutions, has virtually come to a standstill ever since the NSEL payment crisis hit the headlines.

Shah, caught in the cross-fire between government and regulatory agencies and the NSEL in the payment crisis, has almost been written off by Mumbai's commodity brokers. And he knows that the merger, if pushed through by the mandarins in the Indian Capital, could have a devastating impact on his career.

Unless, of course, he can rise like a phoenix from the ashes and create his next vision - 108 digital disrupters for 12 different industries - that will help create Asia's biggest digital wonder and sustain India till 2025.