

# EXAMINING THE SCOPE AND REGULATORY FRAMEWORK CONCERNING EMPLOYEES' BENEFIT SCHEMES IN INDIA

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*With the increasing importance of human capital in the modern era, it has become quintessential for companies to shift from traditional channels of rewarding employees with cash, to channels which align the interest of the employees with long term interest of the companies. In addition to this, the need of the companies to retain their senior employees as well as attract top talents from the industry has compelled them to come out with profitable remuneration schemes. Employees' benefit schemes have, in particular, become major tools for rewarding employees, either through cash or shares of the companies, as a part of their remuneration. Traditionally offered as only employees' stock option or purchase schemes, the ambit of employees' benefit schemes has widened over time to cover various other types of benefits. Against this backdrop, I seek to expatiate upon the scope of employees' benefit schemes offered by both listed companies as well as unlisted companies in India, the manner in which these schemes are regulated and governed under the extant legal regime, and the possible drawbacks that may arise while implementing these schemes.*

## I. INTRODUCTION

The employees' benefit schemes serve as an effective non-traditional way of incentivising and rewarding employees, primarily for purposes such as attraction and retention of appropriate human talent in the employment of the company; motivation to the employees for them to contribute to the overall corporate growth and profitability; addition to the shareholder's value by aligning the interest of the employee with the long term interest of the company; enabling the employee to take part in the management decisions of the company by bringing them on Board; and addition to employees' wealth through cheaper means. Though many of the said purposes can be achieved only through schemes which offer shares to the employees, cash-based schemes have received attention in recent times due to their ease of implementation, as well as the specific objects that they may seek to achieve, which can be

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accomplished only through offering cash. Thus, the benefits that can be availed by the employees through such schemes can be either share-based or cash-based. Further, such schemes may be offered by both listed companies as well as unlisted companies, though the scope of such schemes, and the manner in which they are regulated, are different.

In this paper, I seek to examine the manner in which these schemes offered by listed and unlisted companies are regulated and governed under the extant legal regime, and the possible drawbacks that may arise while implementing these schemes. I attempt to address the issue of how these schemes differ from each other, both in terms of nature and scope, as well as the manner in which they are implemented by the company. In addition, special emphasis is laid on the stringent regulatory framework which the listed companies have to comply with, for implementing the schemes, and the description of the liberal regulatory regime adopted for unlisted companies. Finally, the paper proposes various amendments to the SEBI (Share Based Employees Benefit) Regulations, 2014 ('Regulations, 2014') for the smooth and effective implementation of the schemes.

Part II of the paper, while discussing employees' benefit schemes offered by listed companies, lays emphasis on the scope of the term 'employee', conditions precedent for the implementation of different types of schemes, and the manner in which such implementation is effectuated. It also focuses on the application of insider trading regulations and takeover regulations, which have passed by Securities and Exchange Board of India ('SEBI'), with regard to the employees who are offered these schemes. In this Part, I have attempted to give a detailed and step-by-step outline of various pertinent regulatory provisions which the listed companies have to comply with.

In Part III of the paper which analyses employees' benefit schemes offered by unlisted companies, particular emphasis has been laid on the differences that exist between listed companies and unlisted companies, insofar as the regulation and governance of the schemes is concerned.

Part IV of the paper criticises the extant regulatory framework concerning the schemes and suggests possible solutions for their smooth implementation. This is followed by the concluding remarks in Part V of the paper.

## II. EMPLOYEES' BENEFIT SCHEMES OF LISTED COMPANIES

So far as the listed companies are concerned, the law governing and regulating their employees' benefit schemes is the Companies Act, 2013 ('the Act, 2013'), the SEBI (Share based Employees Benefits) Regulations, 2014

(‘Regulations, 2014’), and the Companies (Share Capital and Debenture) Rules, 2014, as long as these rules do not contradict or conflict with the Regulations, 2014.<sup>1</sup> The Companies Act, 2013 is the primary legislation in India governing both listed as well as unlisted companies. It deals with the scheme of employees’ stock options, which essentially qualifies as an employees’ benefit scheme, although not legally labeled so. Under the Act, 2013, ‘employees’ stock option’ is defined as an

“option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.”<sup>2</sup>

The Act further provides that for the purposes of increasing its subscribed capital, a company shall offer further shares to, *inter alia*, “employees under a scheme of employees’ stock option, subject to special resolution passed by company and such conditions as may be prescribed.”<sup>3</sup> In addition, it mandates that public companies cannot give any financial assistance to a person for the purpose of purchase or subscription of any shares in the company, or in its holding company, except when such purchase or subscription is for the shares held by trustees for the benefit of the employees, or such shares are held by the employee of the company.<sup>4</sup>

Before delineating the nature and scope of various employees’ benefit schemes, it is pertinent to discuss the scope of the term ‘employee’, in order to determine who are covered under these schemes.

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<sup>1</sup> The Companies (Share Capital and Debenture) Rules, 2014, Rule 3 (However, listed companies are primarily governed by SEBI (Share Based Employees Benefits) Regulations, 2014 since it covers most of the provisions of the Companies (Share Capital and Debenture) Rules, 2014, leaving behind the rest which stand in conflict with the former, except that the company shall maintain a Register of Employee Stock Options in Form No. SH.6 and shall forthwith enter therein the particulars of option granted under §62(1)(2) of the Companies Act, 2013: *See* The Companies (Share Capital and Debenture) Rules, 2014, Rule 12(10). Hence, the provisions of SEBI (Share Based Employees Benefits) Regulations, 2014 are only dealt with while explaining employees’ benefit schemes of listed companies).

<sup>2</sup> The Companies Act, 2013, §2(37).

<sup>3</sup> The Companies Act, 2013, §62 (The aforesaid conditions are enshrined in detail under SEBI (Share Based Employees Benefits) Regulations, 2014, as well as in the Guidance notes and Circulars passed by SEBI); *See* SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 28.

<sup>4</sup> The Companies Act, 2013, §67.

### A. SCOPE OF THE TERM ‘EMPLOYEE’

The term ‘employee’ means:<sup>5</sup> a) a permanent employee of the company (irrespective of whether he has been working in India or outside India); b) a director of the company (irrespective of whether he is a whole time director or not, provided he is not an independent director)<sup>6</sup>; and c) an employee fulfilling the aforesaid criterion of a subsidiary, in India or outside India, or of a holding company of the company; but does not include:

- “(a) an employee who is a promoter or a person belonging to the promoter group; or
- (b) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.”<sup>7</sup>

Subject to the fulfilment of aforesaid criterion, the term ‘employee’ may include an officer of the company<sup>8</sup> who may be a:

- “(a) manager; b) a key managerial personnel; c) any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act;<sup>9</sup> d) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance,

<sup>5</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(f).

<sup>6</sup> However, the restriction on grant of Employee Stock Option Purchases (ESOPs) to independent directors applies only on fresh grants of ESOPs after the commencement of the aforesaid provisions. Any grant already made prior to commencement of these provisions shall remain valid i.e. an independent director can exercise such ESOPs, subject to fulfilment of terms and conditions of the ESOP schemes framed by the companies in terms of the relevant regulations issued by SEBI. See Securities and Exchange Board of India, *Frequently Asked Questions on Sebi (Share Based Employee Benefits) Regulations, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1457002837263.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1457002837263.pdf) (Last visited on December 30, 2016).

<sup>7</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(f).

<sup>8</sup> See The Companies Act, 2013, §2(37) (It entitles the officers, apart from specifically mentioning employees and directors, to the benefits of employees’ stock options. Thus, on a harmonious construction of the Companies Act, 2013 and SEBI (Share Based Employees Benefits) Regulations, 2014, officers shall be deemed to be employees within the meaning of the Regulations, 2014); See *CTO v. Binani Cements Ltd.*, (2014) 8 SCC 319 : (2014) 68 VST 459 (it provides for the harmonious construction of general law (The Companies Act, 2013) and special law (SEBI (Share Based Employee Benefits) Regulations, 2014) as a settled principle of statutory interpretation).

<sup>9</sup> See The Companies Act, 2013, §2(59) (The definition of ‘officers’ under the Companies Act, 2013 is an inclusive definition and thus the word may encompass other persons such as those mentioned under the definition of “officer who is in default” given in Companies Act, 2013, §2(60)).

filing or distribution of accounts or records; and e) share transfer agents, registrars and merchant bankers to the issue or transfer.”<sup>10</sup>

Further, the term ‘employee’ may include an employee resident in India or outside India,<sup>11</sup> an ex-employee of the company, as well as an employee and ex-employee of the erstwhile holding company.<sup>12</sup> The various types of employees’ benefit schemes, along with their nature and scope, are examined below.

## B. TYPES OF SCHEMES

### 1. Employees’ Stock Option Scheme

Employees Stock Option Scheme (‘ESOS’) is the most commonly offered scheme to the employees by companies. An ESOS refers to “a scheme under which a company grants employee stock option directly or through a trust.”<sup>13</sup>

The scheme shall entail the procedure according to which it is to be implemented and operated.<sup>14</sup> It is offered to the employees after complying with various stages. First, the company shall make necessary disclosures about the ESOS as specified by the SEBI in this regard, to the prospective option grantees.<sup>15</sup> SEBI, through its Circular,<sup>16</sup> has mandated companies to make the following disclosures in this regard: statement of risks, which include risks associated with concentration of shares, leverage, illiquidity and vesting of options; information about the company, which includes its business, abridged financial information, risk factors associated therewith as well as the continuing disclosure requirement on its part; and salient features of the scheme. Second,

<sup>10</sup> See The Companies Act, 2013, §2(60) (it enumerates various officers who are in default for the purposes of the Act).

<sup>11</sup> Reserve Bank of India, Master Circular, *Employees Stock Options Scheme and/or Sweat Equity Shares to Persons Resident Outside India*, RBI/2015-16/128 (Issued on July 16, 2015), available at <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/128A45D448713C867460CB107457DF32259C9.PDF> (The company offering ESOPs to persons resident outside India has to comply with the Reserve Bank of India Circular).

<sup>12</sup> See *Letter sent by Sunil Kadam & addressed to P. Ramanathan* (August 3, 2012), available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/multicomminformal\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/multicomminformal_p.pdf) (Last visited on December 20, 2016).

<sup>13</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(g) (“Employee stock option” is defined under §2(37) of the Companies Act, 2013 which has been dealt before). See The Companies Act, 2013, §2(37).

<sup>14</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 16(1).

<sup>15</sup> “Option grantees” means an employee having a right but not an obligation to exercise an option in pursuance of ESOS. See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(t); See also SEBI (Share Based Employees Benefits) Regulations, 2014, Reg.16(2).

<sup>16</sup> Securities and Exchange Board of India, Circular CIR/CFD/POLICY CELL/2/2015, *Requirements specified under the SEBI (Share Based Employee Benefits) Regulations, 2014* (Issued on June 16, 2015).

after the aforesaid disclosures are made, the company may grant options to the employee. Grant date is the date on which the Compensation Committee approves the grant.<sup>17</sup> The employee may be required to pay money for being granted option.<sup>18</sup>

Third, once options are granted to the employee, there is a vesting period during which he cannot exercise the option.<sup>19</sup> It is on the discretion of the company to determine the vesting period, subject to the limitation that it shall be not less than one year.<sup>20</sup> The reason for mandating a minimum vesting period of one year is meant to prevent fraudulent and unfair trade practices, for instance, to prevent cases of issue of shares to employees at a low price when stock market goes bullish, which cause undue gain to the employees and which constitute gross discrimination against prospective investors.<sup>21</sup> Subject to the mandatory one year vesting period, the conditions on which the vesting of option— which qualifies the option holder to exercise the option— will take place, may be either time-based, *i.e.* based on number of years for which the employee is required to hold the option, or performance-based, *i.e.* based on achievement of certain performance metrics, or both.<sup>22</sup> If the option is not vested due to non-fulfilment of conditions relating to vesting of option as per the ESOS, then the

<sup>17</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(n).

<sup>18</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 20.

<sup>19</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(zj) (Under this regulation, ‘vesting period’ is defined under as “the period during which the vesting of option, SAR or a benefit granted under any of the schemes takes place.” ‘Vesting’ is defined under Regulation 2(1)(zi) of the SEBI (Share Based Employees Benefits) Regulations, 2014 as the process by which the employee becomes entitled to receive the benefit of a grant made to him under any of the schemes).

<sup>20</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 18(1).

<sup>21</sup> The law prohibiting such fraudulent and unfair trade practices in cases of listed companies is the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003. Such prohibition may hold good even for other employees’ benefit schemes as well.

<sup>22</sup> For instance, Kotak Mahindra Bank Limited, in its Kotak Mahindra Share Based Employee Benefit Scheme, 2015, has specified that vesting of option would be conditional upon the fulfilment of performance criteria as determined by the Compensation Committee. See Kotak Investor Relations, *Kotak Mahindra Share Based Employee Benefit Scheme, 2015*, Article 7.3, available at [http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed\\_ESOP\\_Scheme\\_2015\\_SARs\\_Scheme\\_2015-AGM\\_2015.pdf](http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed_ESOP_Scheme_2015_SARs_Scheme_2015-AGM_2015.pdf) (Last visited on December 20, 2016). Such criteria may include the satisfactory performance of the employee and continued employment, and the vesting period could extend up to six years from the date of the grant of the options. See Kotak Investor Relations, *Explanatory Statement to the Notice of 13th Annual General Meeting of the Kotak Mahindra Bank Limited* (May 5, 2015), available at <http://www.kotak.com/annualreport2014-15/download-center/Kotak%20AGM%20Notice.pdf> (Last visited on December 20, 2016). Another company named Future Consumer Enterprise Limited, has adopted performance based vesting, subject to the upper limit of 3 years from the date of grant of option: See Future Consumer Enterprise Limited, *Explanatory Statement to the General Meeting of the Company* (March 25, 2015), available at <http://www.futureconsumer.in/pdf/future-consumer-enterprise-limited-postal-ballot-notice.pdf> (Last visited on December 20, 2016).

amount payable, if any, at the time of grant of option, may be refunded by the company to the employee.<sup>23</sup>

Fourth, after the option has been vested, the employee has the right to exercise it by making an application to the company or to the trust, as the case may be, for the issue of shares against vested options.<sup>24</sup> Fifth, an exercise period follows the vesting period. The employee can exercise the option only during the exercise period, the failure of which,<sup>25</sup> rescinds the option; and the amount paid, if any, at the time of grant of option, may be forfeited by the company.<sup>26</sup> On the other hand, if the option is exercised within the time limit, the employee may have to pay the exercise price,<sup>27</sup> which in turn is determined by the company, subject to the accounting policies in this regard.<sup>28</sup> Sixth, the company may specify the lock-in period for the shares issued pursuant to exercise of the option given.<sup>29</sup> On completion of the lock-in period, or in case there is no lock-in period, then on exercise of option, the employee is entitled to deal with shares issued pursuant to such option.

## 2. Stock Appreciation Right Scheme

A Stock Appreciation Rights ('SAR') scheme is defined as "a scheme under which a company grants SAR to employees."<sup>30</sup> SAR means "a right given to an SAR grantee entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company."<sup>31</sup> This appreciation is the "difference between the market price of the share of a company

<sup>23</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 20(b).

<sup>24</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(i).

<sup>25</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(j) ('Exercise period' is defined in this provision as "the time period after vesting within which an employee should exercise his right to apply for shares against the vested option or appreciation against vested SAR in pursuance of the schemes covered under Part A or Part C of Chapter III of these regulations, as applicable". Different ESOSs have different exercise period, for instance, the Kotak Mahindra Share Based Employee Benefit Scheme, 2015 mentions an exercise period ranging between one to five year as may be determined by the Compensation Committee, whereas the Future Consumer Enterprise Limited Employee Stock Option Plan 2014 mentions an exercise period of three years).

<sup>26</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 20(a).

<sup>27</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(k) (This means that there can be cashless exercise of option also under this framework).

<sup>28</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 17.

<sup>29</sup> It has generally been observed that companies do not specify any lock-in period: See Kotak Investor Relations, *Kotak Mahindra Share Based Employee Benefit Scheme, 2015*, available at [http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed\\_ESOP\\_Scheme\\_2015\\_SARs\\_Scheme\\_2015-AGM\\_2015.pdf](http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed_ESOP_Scheme_2015_SARs_Scheme_2015-AGM_2015.pdf) (Last visited on December 20, 2016); See also Infosys, *Infosys Limited 2015 Incentive Compensation Plan*, available at <https://www.infosys.com/investors/corporate-governance/Documents/incentive-compensation-plan.pdf> (Last visited on December 20, 2016).

<sup>30</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(zf).

<sup>31</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(ze).

on the date of exercise of SAR or vesting of SAR, as the case may be, and the SAR price.”<sup>32</sup>

There are two types of SAR that can be granted to the employee: a) equity-settled SAR, i.e., SAR settled by way of shares of a company;<sup>33</sup> and b) cash-settled SAR, i.e. SAR settled by way of cash,<sup>34</sup> also known as “phantom stock”.<sup>35</sup>

Since an option is granted to the SAR grantee to purchase or subscribe to the shares of the company through cash-settled SAR, cash-settled SAR schemes thus qualify as the schemes of “employees’ stock option” within the meaning of the Companies Act, 2013.<sup>36</sup> Such qualification is necessary for enabling the companies to do the following, which it would otherwise have not been empowered to: a) make further issue of shares to employees pursuant to grant or exercise of SAR; b) grant money for the purpose of purchase or subscription of shares pursuant to exercise of SAR;<sup>37</sup> and c) buy-back SAR.<sup>38</sup>

The SAR scheme shall contain the details of the manner in which the scheme will be implemented and operated. It shall thereafter be offered to the employee subject to following stages.<sup>39</sup>

Like in case of ESOS, the same disclosures as mentioned in the SEBI Circular<sup>40</sup> are to be made by the company to the SAR grantee<sup>41</sup> before grant of SAR.<sup>42</sup> Once the disclosures are made, the SAR may be granted to the employee on the grant date.

Furthermore, there is a vesting period attached to the SAR, during which employee cannot exercise SAR. Such period shall mandatorily be for a minimum period of one year, and may further be extended by the company,

<sup>32</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(a).

<sup>33</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Explanation to Reg. 2(1)(ze).

<sup>34</sup> See Kotak Investor Relations, *Kotak Mahindra Share Based Employee Benefit Scheme, 2015*, available at [http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed\\_ESOP\\_Scheme\\_2015\\_SARs\\_Scheme\\_2015-AGM\\_2015.pdf](http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed_ESOP_Scheme_2015_SARs_Scheme_2015-AGM_2015.pdf) (Last visited on December 20, 2016); Securities and Exchange Board of India, *Saregama India Limited Stock Appreciation Rights Scheme offered by Saregama India Limited, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/saregamamay29\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/saregamamay29_p.pdf) (Last visited on December 20, 2016).

<sup>35</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 23(2) (The company has the freedom to choose between cash-settled or equity-settled SAR scheme).

<sup>36</sup> The position with respect to “phantom stock” is dealt with in the subsequent portions of the paper.

<sup>37</sup> The Companies Act, 2013, §2(37), §62.

<sup>38</sup> See The Companies Act, 2013, §68.

<sup>39</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 23(1).

<sup>40</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(t), Reg.16(2).

<sup>41</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(z) (“SAR grantee” means an employee to whom SAR is granted).

<sup>42</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 23(3).



either by fixing a time period, known as time-based SAR, or on the basis of achievement of a certain performance metrics, known as performance-based SAR, or both.<sup>43</sup>

Once SAR is vested, it can be exercised within the exercise period<sup>44</sup> by making an application to the company or the trust, as the case may be.<sup>45</sup> On exercise of SAR, either the shares or the sum equivalent to the appreciation of specified number of the shares of the company is offered to the employee. There is no requirement of lock-in period after the exercise of equity based SAR under the Regulations, 2014, and thus companies generally do not specify any lock-in period for the shares issued pursuant to SAR.<sup>46</sup>

### 3. Employee's Stock Purchase Scheme

An Employees' Stock Purchase Scheme ('ESPS') refers to a "scheme under which a company offers shares to employees, as part of public issue or otherwise, or through a trust where the trust may undertake secondary acquisition for the purposes of the scheme."<sup>47</sup> Hence, unlike ESOS where options are granted to the employees, shares are offered to the employees under ESPS.

<sup>43</sup> For instance, Saregama India Limited Stock Appreciation Rights Scheme, 2014 mentions vesting of SAR in phases (sixty-six per cent of SAR is granted after one year from the date of grant while the rest is granted the following year), along with fulfilment of following conditions: a) continual satisfactory performance; and b) no solicitation of work of SAR grantee for a period of two years after separation from the company. See Securities and Exchange Board of India, *Saregama India Limited Stock Appreciation Rights Scheme offered by Saregama India Limited, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/saregamamay29\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/saregamamay29_p.pdf) (Last visited on December 20, 2016). On the other hand, Kotak Mahindra Share Based Employee Benefit Scheme, 2015 mentions vesting period as a period of one year after date of grant, subject to fulfilment of performance criteria as determined by the Compensation Committee. See Kotak Investor Relations, *Kotak Mahindra Share Based Employee Benefit Scheme, 2015*, available at [http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed\\_ESOP\\_Scheme\\_2015\\_SARs\\_Scheme\\_2015-AGM\\_2015.pdf](http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed_ESOP_Scheme_2015_SARs_Scheme_2015-AGM_2015.pdf) (Last visited on December 20, 2016).

<sup>44</sup> Different companies have different exercise period. For instance, in case of Saregama India Limited Stock Appreciation Rights Scheme, 2014, the exercise period is ten years from the date of vesting of SAR. Such option can be vested in trenches. See Securities and Exchange Board of India, *Saregama India Limited Stock Appreciation Rights Scheme offered by Saregama India Limited, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/saregamamay29\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/saregamamay29_p.pdf) (Last visited on December 20, 2016). However, in case of Kotak Mahindra Share Based Employee Benefit Scheme, 2015, there is no exercise period meaning thereby that SAR once granted can be exercised at any time till the continuation of the company. See Kotak Investor Relations, *Kotak Mahindra Share Based Employee Benefit Scheme, 2015*, available at [http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed\\_ESOP\\_Scheme\\_2015\\_SARs\\_Scheme\\_2015-AGM\\_2015.pdf](http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed_ESOP_Scheme_2015_SARs_Scheme_2015-AGM_2015.pdf) (Last visited on December 20, 2016).

<sup>45</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(i).

<sup>46</sup> See note 43.

<sup>47</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(h).

An ESPS shall entail the procedure according to which it is to be implemented and operated.<sup>48</sup> Though the Regulations, 2014 are not very clear on the manner the ESPS should be framed and governed, reference can be made to the “Guidance Note on Accounting for Employee Share-Based Payments” issued by the Institute of Chartered Accountants of India,<sup>49</sup> which the companies shall comply with while pricing their shares offered under ESPS.<sup>50</sup> The Guidance Note provides for situations where the ESPS would, if effected, be considered as an ESOS, and where the ESPS would be considered separate from an ESOS.

In order to qualify an ESPS as separate from an ESOS, the ESPS shall be subject to following stages:

An opportunity shall be offered by the company to its employees to participate in an ESPS. The employee can avail off such opportunity within a prescribed time period. This would, in essence, constitute an ‘exercise period’, though this is not expressly mentioned in the Regulations, 2014.

On agreeing to participate in the ESPS, the employee shall pay the purchase price of the shares offered under the ESPS. Such price effectively constitutes the exercise price, though it has not been expressly labelled in such a manner under the Regulations, 2014. Further, it shall be at a discount to the market price of the shares of the company, as on the date of acceptance of offer, and must be paid immediately upon acceptance of the offer.<sup>51</sup>

Shares offered to the employees pursuant to payment of purchase price shall be locked-in for a minimum period of one year from the date of their issuance,<sup>52</sup> which may thereafter be subject to a further lock-in period, together constituting “vesting period”.<sup>53</sup> During this period, the shares must be held by the company or the trust, and shall not be sold by them. Unlike an ESOS,<sup>54</sup> dividends paid on such shares during the vesting period shall be held in trust

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<sup>48</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 21.

<sup>49</sup> See The Institute of Chartered Accountants of India, *Guidance Note on Accounting for Employee Share-based Payments* (January 3, 2005), available at <http://resource.cdn.icai.org/23629research7.pdf> (Last visited on December 20, 2016).

<sup>50</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 22(1).

<sup>51</sup> See *supra* note 49.

<sup>52</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 22(3) (The requirement of having a minimum lock-in period does not exist in case where ESPS is part of a public issue and the shares are issued to employees at the same price as in the public issue. This is because there is no possibility of price manipulation and fraud, in case the price of the shares is determined by the market and thus is not left at the discretion of the company).

<sup>53</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(zj).

<sup>54</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 19 (It provides that under ESOS, the employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him, till shares are issued upon exercise of option).

for the employees which is paid, or to be paid by the company to the employee on the completion of the vesting period.

After the completion of vesting period, the shares are allotted to the employee who is then permitted to deal with them. Hence, there is no requirement of having lock-in period after the allotment of shares.

Since the employee has an option to subscribe to the shares offered under the ESPS at a price determined by the company,<sup>55</sup> the ESPS qualifies as a scheme of “employees’ stock option” within the meaning of the Act, 2013. This would henceforth enable the company to avail the provisions contained in the Companies Act, 2013 for the purposes of implementing the ESPS.<sup>56</sup> However, unlike an ESOS, there lies no option at the time of allotment of shares, since the shares have already been purchased by the employee at a discount to the share price on the purchase date, and the employee is thereafter not permitted to withdraw from the plan.

On the other hand, the Guidance Note also provides various instances where an ESPS would, in effect, be an ESOS.<sup>57</sup> First, where the ESPS includes a ‘lookback feature’ which gives an option to the employees to purchase shares at a discount, and grants them the right to decide whether to apply the discount to the share price of the company, as existing on the date of grant, or on the date of purchase, in practice, such purchase price is likely to be paid by the employee on the date of exercise, since on such date the employee would be in a better position to choose when to apply the discount. Such ESPS would hence qualify as ESOS except that there is no exercise period and the employee has to mandatorily purchase the shares after the completion of the vesting period; and that the employee is entitled to corporate benefits, like dividends paid on the shares, from the date on which the shares are granted to the employee.

Second, where the ESPS specifies the purchase price, and thereafter gives a sufficient period of time to the employees for choosing whether to participate in the ESPS, the shares are granted to the employee,<sup>58</sup> and are subject to lock-in during the vesting period. The time period for which the opportunity exists for the employee to participate in the ESPS may or may

<sup>55</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 22(1) (This price is not an exercise price as per SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1) (k)).

<sup>56</sup> See *supra* notes 2, 3 and 37.

<sup>57</sup> See Oracle Financial Services Software Limited, *Details of Employee Stock Option Plan (“ESOP”) and Employee Stock Purchase Scheme (“ESPS”)* (March 31, 2016), available at <http://www.oracle.com/us/industries/financial-services/esop-esps-related-disclosures-2640536.pdf> (Last visited on March 3, 2017), where the provisions under the SEBI (Share Based Employees Benefit) Regulations, 2014 which are applicable to ESOS are applied *mutatis mutandis* to ESPS, since ESPS is, in effect, ESOS.

<sup>58</sup> If shares are not granted, then there would not be any difference between such scheme and the ESPS outlined before, which is classified as separate from ESOS.

not extend beyond the vesting period. If in case it extends beyond the vesting period, then the ESPS would, in effect, be an ESOS, with an option given to the employee after the vesting period to purchase or subscribe to the shares of the company. However, unlike an ESOS, the employee would also be entitled to corporate benefits, such as dividend paid on the shares, from the date on which the shares are granted to him, irrespective of whether he decides to be a part of the ESPS or not.

Third, where an ESPS gives an option to the participating employees to rescind their participation in the scheme and to obtain a refund of amounts previously paid for participating in the scheme, such an option shall be exercised before or at the end of the specified period. In such a case, two options are available—the option to participate in the ESPS, and the option to cancel their participation at a later date which may or may not extend beyond the date on which option vests. In case the latter option extends beyond the date on which the option vests, the ESPS would, in effect, be an ESOS, except that the employee also derives corporate benefits such as dividends paid on such shares by the company.

#### 4. General Employees' Benefit Scheme and Retirement Benefit Scheme

A General Employee Benefits Scheme ('GEBS') is defined as "any scheme of a company dealing in shares of the company or the shares of its listed holding company, for the purpose of employee welfare including healthcare benefits, hospital care or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company".<sup>59</sup> A Retirement Benefit Scheme ('RBS') is defined as a "scheme of a company dealing in shares of the company or the shares of its listed holding company, for providing retirement benefits to the employees subject to compliance with existing rules and regulations as applicable under laws relevant to retirement benefits in India".<sup>60</sup> Thus, these schemes are in factum employees' benefit schemes, except that the GEBS covers benefits for various purposes, as mentioned above, whereas the RBS covers benefits only for the purpose of retirement.

The Regulations, 2014 are silent on whether such benefits should be cash based or equity based, though from a practical perspective, they should be only cash based.<sup>61</sup> Such cash may either be given to the employee or be

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<sup>59</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(l).

<sup>60</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(y).

<sup>61</sup> Since both General Employees' Benefit Scheme (GEBS) and Retirement Benefit Scheme (RBS) do not confer an option to the employee to purchase or subscribe to the shares of the company, such schemes do not qualify under the scheme of 'employees' stock options' as defined under the Companies Act, 2013: *See* The Companies Act, 2013, §2(37).

applied by the company for employees' benefit, for instance, cash being applied in buying out health insurance of the employee or paying for medical expenses directly to the hospital for the employee who has met with an accident. Further, unlike for the ESOS, SAR scheme and ESPS, the Regulations, 2014 do not specify in detail the manner of the administration of these schemes. It only provides that a GEBS or RBS shall contain the details of the scheme and the manner in which the scheme shall be implemented and operated, subject to the provisions enshrined therein.<sup>62</sup> This is subject to the condition that the shares of the company or shares of its listed holding company shall not exceed ten per cent of the book value or market value or fair value of the total assets of the GEBS or RBS, as the case may be.<sup>63</sup> Rightfully, the Regulations, 2014 do not provide much on the manner of framing and implementing such schemes, because companies should have more freedom to decide the manner in which the schemes should be framed. Further, restrictions applicable to other schemes such as the requirement of having a mandatory one-year lock-in period, fulfilment of conditions pursuant to which vesting of stock option or SAR takes place, having an exercise period, etc., may not be applicable to the GEBS and RBS. Such restrictions would certainly impede the employee to derive the benefits which the GEBS and RBS intend to give, some of which are emergency-based, such as accident, disability, death, hospital care etc. Even the Regulations, 2014 recognise such emergencies, and therefore permit trusts to sell shares in the secondary market in case of an emergency whilst implementing GEBS and RBS.<sup>64</sup>

### C. IMPLEMENTATION OF SCHEMES

After discussing in detail the various employees' benefit schemes, it is pertinent to delineate the manner in which such schemes are implemented. Essentially, a company has two options through which it can implement the scheme, i.e. either by itself or by way of trust.<sup>65</sup> However, it is obligatory on the part of the company to implement the scheme through trust, in case a secondary acquisition of shares, or gift, or both, is involved.<sup>66</sup>

These schemes are initially formulated and approved by the Board of Directors of the company. Thereafter, these are approved by the shareholders by way of a special resolution in the general meeting.<sup>67</sup> For administration and implementation of the schemes, the company constitutes a Compensation

<sup>62</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 26(1), 27(2).

<sup>63</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 26(2) SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 27(3).

<sup>64</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 15(c).

<sup>65</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(1).

<sup>66</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, proviso to Reg. 3(1).

<sup>67</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 6(1) (The explanatory statement to the notice and the resolution proposed to be passed by shareholders for the schemes shall include such information as is specified by SEBI in this regard); See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 6(2); See also Securities and Exchange Board

Committee<sup>68</sup>, which shall *inter alia* comprehensively delineate the terms and conditions of the schemes,<sup>69</sup> as specified by the SEBI.<sup>70</sup> The Compensation Committee determines the eligibility criteria of the employee for the purpose of entitling him to participate in the scheme.<sup>71</sup>

The implementation of the employees' benefit schemes through trust is discussed in detail below.

## 1. Trust Mechanism

A private trust is established under the provisions of the Indian Trust Act, 1882 for the purpose of implementing employees' benefit schemes.<sup>72</sup> It holds the shares beneficially on behalf of the company, till the Employees' Stock Option Purchases ('ESOPs')<sup>73</sup> are offered to the employees.<sup>74</sup> Since the control and management of the shares now vests with the trust, it results in better corporate governance as the shares would not be subject to arbitrary control and grant by the company, particularly by its promoters.<sup>75</sup> This better corporate governance is further substantiated by the following:

First, the trust is managed by trustees who are independent from the company. This is evident from the fact that no person shall be appointed as a trustee in case he is associated with the company, either by being a director,

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of India, Circular CIR/CFD/POLICY CELL/2/2015, *Requirements specified under the SEBI (Share Based Employee Benefits) Regulations, 2014* (Issued on June 16, 2015).

<sup>68</sup> The Companies Act, 2013, §178 (This Section provides that the Compensation Committee shall be a committee of such members of the board of directors of the company); See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 5(2).

<sup>69</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 5(1).

<sup>70</sup> SEBI, through its Circular, has enumerated various terms and conditions of the schemes to be formulated by the Compensation Committee: See Securities and Exchange Board of India, Circular CIR/CFD/POLICY CELL/2/2015, *Requirements specified under the SEBI (Share Based Employee Benefits) Regulations, 2014* (Issued on June 16, 2015).

<sup>71</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 4.

<sup>72</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(zg).

<sup>73</sup> Employee of Stock Option Purchases means purchases of stock options either through ESOS, ESPS, or equity-settled SAR scheme.

<sup>74</sup> See Indian Trust Act, 1882, §3 (A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner. In case of ESOPs, the company is the owner of the shares and it reposes or declares the confidence on the trust to hold the shares beneficially, on its behalf, till such options are exercised or on the behalf of the employee. The company is thus referred to as the "author of trust"); See also *NTPC v. Canara Bank*, 1999 SCC OnLine Del 451 : (1999) 97 Comp Cas 930 (Here, it was held that trust created under Indian Trusts Act, 1882 is not a separate legal entity, and thus trust cannot claim ownership of the shares acquired for the purposes of implementing employees' benefit schemes).

<sup>75</sup> See Securities and Exchange Board of India, *Discussion Paper on 'Review of guidelines governing stock related employee benefit schemes'* (November 20, 2013), available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1384944786125.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1384944786125.pdf) (Last visited on March 3, 2017).

promoter or key managerial personnel of the company or its holding, subsidiary or associate company, or by being any relative of such director, key managerial personnel or promoter. In addition, a person is deemed to lose his independence in case he beneficially holds ten percent or more of the paid-up share capital of the company, and therefore, such person is disentitled from being appointed as a trustee.<sup>76</sup>

Second, the trustees are not permitted to vote in respect of the shares held by the trust. This is meant to avoid any misuse arising out of the exercise of the voting rights in respect of such shares.<sup>77</sup>

Third, for the purpose of enabling the trust to implement the scheme and undertake secondary acquisition of shares, it is obligatory on the part of the trustee to ensure that the company has obtained appropriate approval from its shareholders.<sup>78</sup>

Fourth, there are limits on secondary acquisition of shares by the trust.<sup>79</sup> Such limits also automatically provide a check on the level of funding.<sup>80</sup> The secondary acquisition of shares for the purposes of implementing employees' benefit schemes is permitted only through trust,<sup>81</sup> so as to avoid manipulation of the share price by the company and its promoters. Further, such secondary acquisition is permitted only after the approval of shareholders of the company by way of a separate resolution in the general meeting has been obtained.<sup>82</sup> This will enable the shareholders of the company to keep a track of the transactions in shares of the company by the trust.

Fifth, the un-appropriated inventory of shares, which are acquired by the trust through secondary acquisition and are not backed by grants, shall be appropriated within a reasonable period. Such period shall not extend beyond the end of the financial year subsequent to the year in which shares are not backed by grant.<sup>83</sup> This ensures that the un-appropriated shares are swiftly channelised in the market so as to increase their liquidity and thereby ensures the fair price discovery of the shares of the company as a whole. In other words, it ensures that the shares are not unnecessarily being held by the trust which

<sup>76</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(4).

<sup>77</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(5).

<sup>78</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(6).

<sup>79</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(10), 3(11).

<sup>80</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 8 (This provides that the company may lend monies to the trust on appropriate terms and conditions to acquire the shares either through new issue or secondary acquisition, for the purposes of implementation of the scheme). See also SEBI, *Review of SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999* (September 21, 2014), available at [http://www.sebi.gov.in/cms/sebi\\_data/boardmeeting/1403779633189-a.pdf](http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1403779633189-a.pdf) (Last visited on March 3, 2017).

<sup>81</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, proviso to Reg. 3(1).

<sup>82</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 6(3).

<sup>83</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(12).

may have an adverse effect on price and demand of the shares of the company in the stock market.

Sixth, the shares acquired by the trust through secondary acquisition shall be held by it for a minimum period of six months, unless when they are required to be transferred by the trust when participating in open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, or when participating in an exit opportunity offered by the company to its shareholders.<sup>84</sup> This is meant to ensure that the stock markets operate in an orderly manner while the schemes are administered by the company.<sup>85</sup> Further, transfer of such shares to the employees without the completion of the said lock-in period is not permitted in order to prevent market abuse.<sup>86</sup>

Seventh, in order to prevent the trust from being a mechanism for trading in shares, the trust is prohibited to sell the shares in secondary market except in certain cases.<sup>87</sup>

Eighth, the trust is obligated to make adequate disclosures, and to comply with other requirements enshrined under the SEBI (Prohibition of Insider Trading) Regulations, 2015.<sup>88</sup>

The trust is permitted to operate several schemes at a time. Once the stock options or SAR offered under the schemes are exercised, the beneficial ownership of the shares shifts from the company to the employee, to the extent agreed to be offered to the latter under the schemes. Thereafter, the shares are transferred to the employee by the trust.

#### *D. APPLICATION OF INSIDER TRADING REGULATIONS*

The SEBI (Prohibition of Insider Trading) Regulations, 2015 ('Insider Trading Regulations, 2015') regulates the trading of securities by an employee having access to Unpublished Price Sensitive Information ('UPSI').<sup>89</sup> An employee who is offered employees' benefit scheme is categorised as an

<sup>84</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(14).

<sup>85</sup> See SEBI, *Review of SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999* (September 21, 2014), available at [http://www.sebi.gov.in/cms/sebi\\_data/boardmeeting/1403779633189-a.pdf](http://www.sebi.gov.in/cms/sebi_data/boardmeeting/1403779633189-a.pdf) (Last visited on March 3, 2017).

<sup>86</sup> *Id.*

<sup>87</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(15).

<sup>88</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 3(15).

<sup>89</sup> The SEBI (Prohibition of Insider Trading) Regulations, 2015 recently replaced the erstwhile SEBI (Prohibition of Insider Trading) Regulations, 1992.



insider, if he is either a connected person,<sup>90</sup> or has possession of, or access to UPSI.<sup>91</sup> Such an employee is prohibited from trading<sup>92</sup> in securities listed or proposed to be listed on a stock exchange while he is in possession of the UPSI.<sup>93</sup> Further, the employee, on being denominated as a ‘designated person’,<sup>94</sup> may either be required to keep the UPSI on a need-to-know basis, or be mandated to publicly disclose such information in a prompt manner.<sup>95</sup> When, on determination of the compliance officer, the designated person is reasonably expected to have possession of the UPSI, the trading window is closed,<sup>96</sup> and it remains so for a minimum period of forty-eight hours after the UPSI is generally available.<sup>97</sup> When the trading window is thereafter opened, it becomes necessary for the designated person to obtain pre-clearance from the compliance officer for the purpose of trading in securities, provided the value of the proposed trades exceeds such thresholds as the board of directors may stipulate. But the designated person is disentitled from obtaining the pre-clearance if he is in possession of the UPSI, even if the trading window is opened.<sup>98</sup> All these restrictions may prevent the employee to deal with the security of the company, which includes: trading in ESOPs, as well as exercise of ESOPs and trading in shares offered pursuant thereto. These two categories have been dealt separately in detail below.

## 1. Trading in Employees’ Stock Option Purchases

In order to prohibit an employee dealing in ESOPs from being termed as an insider, it is pertinent to classify such options as ‘security’. An ESOP is a contract which derives its value from the prices of the underlying shares proposed to be offered to the employee under the employees’ benefit

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<sup>90</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(d) (It defines “connected person” as “any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access”).

<sup>91</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(1)(g).

<sup>92</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(1)(1) (It defines ‘trading’ as meaning and including “subscribing, buying, selling, dealing, or agreeing to buy, sell, deal in any securities, and ‘trade’ shall be construed accordingly”).

<sup>93</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 4.

<sup>94</sup> See SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, ¶3.

<sup>95</sup> See SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, ¶3; See also SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 9. See also Pravesh Aggarwal, *Use of non-public information during takeover due-diligence: Analysing the position in India*, 10 LAW & FIN. MARKETS REVIEW 1 (2016).

<sup>96</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, ¶4.

<sup>97</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, ¶5.

<sup>98</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, ¶6.

schemes and, thus, constitute a ‘derivative’,<sup>99</sup> which is in turn a ‘security’.<sup>100</sup> To further clarify the position with respect to cash-settled SAR as a ‘security’, though generally there is no dealing in shares involved, and benefits to the employees are cash-based, the value of the SAR unit is derived from the appreciation in the value of the specified number of underlying shares, thereby classifying them as “security”.<sup>101</sup>

However, even if the Insider Trading Regulations, 2015 do not apply to ESOPs, the Regulations, 2014 place restrictions on their transferability to any person.<sup>102</sup> Further, such options shall not be hypothecated, pledged, mortgaged or alienated through any other means.<sup>103</sup> To conclude, trading in ESOPs granted to employees pursuant to the scheme of employees’ stock option is prohibited under the extant legal regime.

## 2. Exercise of Employees’ Stock Option Purchases and dealing in shares offered pursuant thereto

In cases where the employee is termed as an insider, he is not permitted to deal in shares offered pursuant to ESOPs, and thus, he may not be able to exercise the ESOPs within the exercise period. Further, if ESOP is exercised pursuant to the disclosure of the UPSI and fulfilment of other conditions as mentioned before, the employees would not be permitted to enter into a contra-trade transaction, for a period of at least six months.<sup>104</sup> These restrictions naturally diminish the relevance of these schemes for an employee who is termed as insider.

In order to avoid the aforesaid restrictions, SEBI released a Guidance Note in the year 2015 clarifying that the

“Exercise of ESOPs shall not be considered to be “trading”  
except for the purposes of Chapter III of the Regulations.

<sup>99</sup> See The Securities Contracts Regulation Act, 1956, §2(ac)(B).

<sup>100</sup> The Securities Contracts Regulation Act, 1956, §2(ia).

<sup>101</sup> The position in the US, on whether the cash-settled Stock Appreciation Right (SAR) should be classified as ‘security’, has changed over the period of time. Earlier, in *Clay v. Riverwood International Corpn.*, 157 F 3d 1259 (11th Cir 1998), it was held that SARs are not securities, and hence there is no insider trading with respect to dealing in SARs. However currently, under the Securities and Exchange Commission (SEC) regulations (Rule 16a-1(c), 17 C.F.R. § 240.16A-1(c)), the definition of “derivative security” includes a SAR, and hence insider trading regulations applies with respect to dealing with SARs. See also HERBERT KRAUS, EXECUTIVE STOCK OPTIONS AND STOCK APPRECIATION RIGHTS 645 (2015).

<sup>102</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 9(1).

<sup>103</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 9(3).

<sup>104</sup> SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, ¶10.

However, other provisions of the Regulations shall apply to the sale of shares so acquired.<sup>105</sup>

This clarification thus implies that the employee may exercise the ESOPs even though he is an insider; and that the contra-trade restrictions applicable for a period not less than six months, pertaining to the designated persons,<sup>106</sup> will no longer apply to the employee. To explain the exclusion of the applicability of contra-trade restrictions, the Guidance Note provides the following illustrations:

If a designated person has sold or purchased shares, he can subscribe and exercise ESOPs at any time after such sale or purchase, without attracting contra-trade restrictions.

Where a designated person acquires shares under an ESOP and subsequently sells or pledges those shares, such sale shall not be considered as contra-trade, with respect to exercise of ESOPs.

Where a designated person purchases some shares (say on August 1, 2015), acquires shares later under an ESOP (say on September 1, 2015) and subsequently sells or pledges (say on October 1, 2015) shares so acquired under the ESOP, the sale will not be a contra-trade, but will be subject to other provisions of the Regulations. However, he will not be able to purchase further shares during a period of six months from August 1, 2015, when he had sold the shares. In this illustration, the purchase of shares of the company initially, and their acquisition subsequently by the employee, can happen only in ESOPs. But, in case of ESOPs, there is already a mandatory lock-in period of one year after the grant of shares,<sup>107</sup> and hence, the Guidance Note is not of relevance for ESOPs.

Where a designated person sells shares (say on August 1, 2015), acquires shares later under an ESOP (say on September 1, 2015) the acquisition under the ESOP shall not be a contra-trade. Further, he can sell or pledge the shares so acquired at any time thereafter, without attracting contra-trade restrictions. He, however, will not be able to purchase further shares during the period of six months from August 1, 2015, when he had sold shares, since as per the Guidance Note, the provisions of the Insider Trading Regulations, 2015 shall apply to the sale of shares acquired pursuant to exercise of the ESOP.

<sup>105</sup> See Securities and Exchange Board of India, *Guidance Note on SEBI (Prohibition of Insider Trading) Regulations, 2015* (August 25, 2015), available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1440413398668.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1440413398668.pdf) (Last visited on March 3, 2017). Chapter III of the SEBI (Prohibition of Insider Trading) Regulations, 2015 mandates the employees termed as designated persons to make disclosures about their trading in the shares of the company to the latter in a timely manner.

<sup>106</sup> See SEBI (Prohibition of Insider Trading) Regulations, 2015, Schedule B, Item 10.

<sup>107</sup> See SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 22(2).

The reason why contra-trade restrictions do not apply to the exercise of ESOPs is that their price is pre-determined by the Compensation Committee at the time of their grant, along with the compulsory vesting period of one year attached thereto, and thus it remains unaffected by the UPSI in knowledge of the employee, at the time of the exercise of option or equity-settled SAR. This will henceforth enable the employee, particularly those who hold a senior position in the company and generally have access to UPSI, to exercise ESOPs without the imposition of any restrictions which are envisaged under the Insider Trading Regulations, 2011— subject, however, to the disclosures made to the company about trading in its shares.

### *E. APPLICATION OF TAKEOVER REGULATIONS*

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ('Takeover Regulations, 2011') mandates an acquirer<sup>108</sup> to make a public announcement of an open offer to the existing shareholders of the target company in case where the acquisition of shares of the company, together with person acting in concert ('PAC')<sup>109</sup> with the acquirer, results into the following— entitlement of twenty five per cent or more of the shareholding or voting rights in the target company; or where the acquirer already holds twenty five per cent or more of the shares or voting rights in the target company, entitlement of more than five per cent of shareholding or voting rights in the target company.<sup>110</sup> Such open offer shall be for at least twenty six per cent of total shares of the target company,<sup>111</sup> thereby enabling the acquirer to have a controlling stake of fifty one per cent or more of the shares in the target company. The obligation to make an open offer by the employee arises when the former acquires shares offered pursuant to ESOPs beyond the threshold limit. In such a case, it is pertinent to determine the price at which the shares shall be offered by the existing shareholders of the target company under the open offer. The question is whether such price shall be the offer price as determined in accordance with the Takeover Regulations, 2011; or the exercise price as determined by the Compensation Committee, which is generally lower than the market price; or both, in case the offer price is equal to exercise price. The Takeover Regulations, 2011 provide that the open offer shall be made at a price not lower than the price determined in accordance with the parameters laid down therein.<sup>112</sup> Importantly, such price shall be the highest of the said parameters.<sup>113</sup> One of the parameters which needs to be taken into cognizance while determining

<sup>108</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(a) ("Acquirer" means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company).

<sup>109</sup> See SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg. 2(1)(q).

<sup>110</sup> SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg. 3.

<sup>111</sup> SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg. 7.

<sup>112</sup> See SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg. 8(1).

<sup>113</sup> See SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg. 8(1), 8(2).

the offer price is the price at which any outstanding convertible instruments,<sup>114</sup> convertible into shares of the company, which are in possession of the employee or the trust, and are to be converted into shares.<sup>115</sup> In case of ESOPs, such price is nothing but the exercise price. However, since the exercise price cannot be practically higher than the other parameters laid down under the Takeover Regulations, 2011,<sup>116</sup> the offer price is either equal to or higher than the exercise price. The relevance of this lies in the fact that the employee is prevented from having a substantial stake of fifty-one percent shareholding or more, in the target company, through ESOPs, by making an open offer at a cheaper exercise price, which would be detrimental to the interest of the existing shareholders of the target company.<sup>117</sup> Moreover, the exercise price is intended to be availed only for the purpose of employees' benefit scheme and not for acquiring shares of the company beyond what are offered through the scheme.

## 1. EMPLOYEES' BENEFIT SCHEMES OF UNLISTED COMPANIES

Insofar as unlisted companies are concerned, the statutes governing and regulating their employees' benefit schemes is the Companies Act, 2013 and the Companies (Share Capital and Debenture) Rules, 2014. The provisions of the Companies Act, 2013 concerning listed companies, which have been discussed above— such as further issue of shares to employees; and grant of financial assistance by the company for implementing the schemes of employees' stock options— apply *mutatis mutandis* to unlisted companies. However, private companies need to pass an ordinary resolution, rather than a special resolution as in case of listed and public unlisted companies, for making further issue of shares to employees.<sup>118</sup>

Since there is some overlap in the nature and scope of employees' benefit schemes offered by both unlisted and listed companies, the schemes

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<sup>114</sup> The convertible instruments include ESOPs.

<sup>115</sup> SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, Reg. 8(6).

<sup>116</sup> This is because shares are offered to employees through ESOPs at a discount; otherwise, no employee would avail such schemes and rather prefer to purchase shares from the market.

<sup>117</sup> See Securities and Exchange Board of India, Nirvana Holdings (P) Ltd. v. SEBI, 2011 SCC OnLine SAT 137, where it was held that "*The primary object of the takeover code is to provide an exit route to the public shareholders when there is substantial acquisition of shares or a takeover. This right to exit is an invaluable right and the shareholders cannot be deprived of this right lightly. It is only when larger interest of investor protection or that of the securities market demands that this right could be taken away.*" This right is *inter alia* protected if the offer price is determined in accordance with the takeover regulations which in case may be equal to or is generally higher than the exercise price determined by the Compensation Committee.

<sup>118</sup> Ministry of Corporate Affairs, Exemptions to Private Companies, F. No. 1/1/2014-CL. V (Notified on June 5, 2015), available at [http://www.mca.gov.in/Ministry/pdf/Exemptions\\_to\\_private\\_companies\\_05062015.pdf](http://www.mca.gov.in/Ministry/pdf/Exemptions_to_private_companies_05062015.pdf) (Last visited on March 3, 2017).

offered by unlisted companies could hence be better explained by comparing with those offered by listed companies, as expostulated below.

#### *F. SCOPE OF THE TERM ‘EMPLOYEE’*

For unlisted companies, the definition of the term ‘employee’ is enshrined under the Companies (Share Capital and Debenture) Rules, 2014 read with Companies Act, 2013.<sup>119</sup> It is identical to the corresponding definition for listed companies; except that there is no clarification provided by the Ministry of Corporate Affairs (‘MCA’), akin to the clarifications issued by SEBI for listed companies, as to whether ex-employees of the company or employees and ex-employees of the erstwhile holding company would be under the schemes offered by unlisted companies,<sup>120</sup> and about the validity of the grant of stock option purchases already made to the independent directors prior to the commencement of the Companies (Share Capital and Debenture) Rules, 2014.<sup>121</sup>

#### *G. SCOPE AND MANNER OF REGULATION OF SCHEMES*

The scope and manner of regulating employees’ benefit schemes offered by unlisted companies is different from those offered by listed companies. First, unlike the case with listed companies, the law does not explicitly mention the ESPS, SAR, GEBS and RBS as employees’ benefit schemes, which could be offered by unlisted companies. The Companies Act, 2013 only mentions the scheme of ‘employees’ stock options’.<sup>122</sup> However, the question that arises is whether the law permits unlisted companies to offer ESPS, SAR, GEBS and RBS in the name of scheme of ‘employees’ stock options’. Insofar as the ESPS and equity-settled SAR scheme are concerned, they involve an option to purchase or subscribe to the shares of the company by the employee, and are hence categorised as the scheme of “employees’ stock options”. However, this is not true for cash-settled SAR, GEBS and RBS since no shares are offered in the first place. Hence, it is submitted that cash-settled SAR, GEBS and RBS cannot be offered to the employees of unlisted companies in the name of scheme of “employees’ stock options”.

<sup>119</sup> Companies (Share Capital and Debenture) Rules, 2014, Rule 12; *See also* The Companies Act, 2013, §§2(37), 2(59), 2(60).

<sup>120</sup> *See Letter sent by Sunil Kadam & addressed to P. Ramanathan* (August 3, 2012), available at [http://www.sebi.gov.in/cms/sebi\\_data/commndocs/multicomminformal\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commndocs/multicomminformal_p.pdf) (Last visited on December 20, 2016).

<sup>121</sup> Securities and Exchange Board of India, *Frequently Asked Questions on Sebi (Share Based Employee Benefits) Regulations, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1457002837263.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1457002837263.pdf) (Last visited on December 30, 2016).

<sup>122</sup> The Companies Act, 2013, §2(37).

Second, there are no legal provisions regulating administration of the schemes through trust in case of unlisted companies. However, the mandatory requirement of administering schemes through the trust in case of secondary acquisition of shares, as applicable to listed companies, would not arise in relation to unlisted companies, since the latter's shares are not traded on stock exchange.

Third, unlike listed companies, unlisted companies *inter alia* need not mandatorily make the following disclosures in the explanatory statement annexed to the notice for passing of the shareholders' resolution, i.e. brief description of the scheme; and maximum quantum of benefits to be provided per employee under a scheme.<sup>123</sup>

Fourth, in case of an ESOS or SAR, under a cashless exercise, there is no legal provision empowering the company or the empanelled stock brokers to fund or the payment of exercise price.<sup>124</sup>

Fifth, there is no provision for constitution of the Compensation Committee for the purposes of administration and superintendence of the schemes.<sup>125</sup> Hence, *inter alia* various questions which are decided by the Compensation Committee for the listed companies may be decided by the Board of Directors of unlisted companies, such as specific employees entitled to benefits under the schemes; grant, vesting and exercise of shares, options or SARs in case of employees who are on long leave; rights of an employee to exercise all the options or SARs vested in him at one time, or at various points of time, within the exercise period; and the kinds of benefits to be granted under the GEBS and RBS.

It is thus evident from the aforesaid discussion that lesser restrictions are placed on unlisted companies than on listed companies insofar as the regulation of the schemes is concerned. This certainly acts as an incentive for unlisted companies to offer more employees' benefit schemes; though, with regard to private companies, depending upon whether they wish to go public by increasing the number of shareholders beyond two-hundred,<sup>126</sup> and whether they wish to get listed on the stock exchanges, the utilization of these schemes will be accordingly measured or copious. The liberal regulatory regime for employees' benefit schemes may thus induce such companies to go public, which

<sup>123</sup> For listed companies, see Securities and Exchange Board of India, Circular CIR/CFD/POLICY CELL/2/2015, *Requirements specified under the SEBI (Share Based Employee Benefits) Regulations, 2014* (Issued on June 16, 2015).

<sup>124</sup> For listed companies, see SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 9(2).

<sup>125</sup> For listed companies, see SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 5.

<sup>126</sup> See SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, Reg. 106ZA; See also Companies Act, 2013, §2(68).

would not only enable the employees to enjoy the benefits of listing,<sup>127</sup> but this would also lead to greater corporate governance through the application of the Regulations, 2014 and other regulations framed by SEBI.

### III. CRITICAL ASSESSMENT AND NEED FOR REFORM

After having discussed about various employees' benefit schemes that can be offered by both listed and unlisted companies, it is imperative to critically assess the regulatory framework underpinning such schemes and highlight areas of law which need reform, as dealt with below.

#### A. NEED FOR AMENDMENT IN THE DEFINITION OF 'EMPLOYEE'

##### 1. Promoter or persons belonging to the promoter group

For both listed as well as unlisted companies, the definition of the term 'employee' includes "an employee... of a subsidiary, in India or outside India, or of a holding company of the company but does not include: (a) an employee who is a promoter or a person belonging to the promoter group..."<sup>128</sup> A careful reading of this provision would raise doubts as to whether or not the employee who is a promoter, or part of the promoter group of the company offering employees' benefit schemes, is excluded from the definition of employee. This doubt arises since it appears from the said provision that only the employee of the subsidiary or holding company, who is a promoter or part of the promoter group, is excluded. A clarification on this point was also sought by a listed company from SEBI, but it remained unanswered.<sup>129</sup>

It is submitted that the legislature may not have intended to create such discrimination between the company and its holding or subsidiary company, by excluding promoters or persons who are part of the promoter group, of only the latter. In case of listed companies, it is further evident from a Discussion Paper on the review of the erstwhile SEBI (ESOS & ESPS) Guidelines, 1999

<sup>127</sup> See Bombay Stock Exchange Limited, *Benefits of Listing*, available at <http://www.bseindia.com/Static/about/benefits.aspx?expandable=0> (Last visited on March 3, 2017).

<sup>128</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(f).

<sup>129</sup> See *Letter sent by Amit Tandon & addressed to Jagannathan Chakravarti* (July 27, 2015), available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/sebimindtree\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/sebimindtree_p.pdf) (Last visited on March 3, 2017); See also Umakanth Varottil, *SEBI Regulations Inapplicable to 'Phantom' Stock Schemes* (July 21, 2015), available at <http://indiacorplaw.blogspot.in/2015/07/sebi-regulations-inapplicable-to.html> (Last visited on March 3, 2017).



(‘Guidelines, 1999’)<sup>130</sup> released by SEBI, which specifically recommends non-inclusion of promoters/persons belonging to promoter group of the company offering employees’ benefit schemes from the definition of ‘employee’.<sup>131</sup> In addition to this, SEBI in 1999 pressed that the shareholding of the trust should be categorised as “non-promoter” for reasons *inter alia* that employees, who may be promoters or persons belonging to promoter group, are not amongst the eligible beneficiaries of the Trust.<sup>132</sup> Such categorisation is pertinent from the point of view of the Takeover Regulations, 2011, since otherwise the trust would be subject to obligations pertaining to trigger of open offer and creeping acquisition, which may not be desirable; and would also be rendered ineligible to participate in offers relating to takeover, buyback and delisting.<sup>133</sup> Since for a company implementing schemes through its trust, the promoter or person belonging to the promoter group of the company, is not an ‘employee’, such persons are not intended to be covered within the definition of ‘employee’ for the purposes of employees’ benefit schemes as well, whether administered by the company itself or through trust.

However, a question that may further arise is why the SEBI (Issue of Capital and Disclosures Requirement) Regulations, 2009 provides for disclosure of shares acquired by the promoter of the listed company, through ESOS and ESPS, in the prospectus of the company, if SEBI indeed intends to exclude promoter from the definition of ‘employee’.<sup>134</sup> It is submitted that since the promoter or person belonging to the promoter group was not excluded from the definition of ‘employee’ under the erstwhile Guidelines, 1999, but rather much later through the Regulations, 2014, the SEBI intends to exclude promoters from the ESOS and ESPS, and the shares offered under these schemes prior to the commencement of the Regulations, 2014 need to be disclosed separately.

## 2. Officers

The definition of ‘employees’ stock option’ under the Act, 2013 includes a director, officer and employee of the company as beneficiary.<sup>135</sup> The definition of ‘officer’ includes directors and other persons who may be an ‘employee’ as per the Regulations, 2014 and Debenture Rules, 2014.<sup>136</sup> There exists an overlap in the said definitions since the definition of ‘officers’ includes

<sup>130</sup> These Guidelines have been replaced by the SEBI (Share Based Employees Benefits) Regulations, 2014.

<sup>131</sup> SEBI, *supra* note 75.

<sup>132</sup> SEBI, *supra* note 85.

<sup>133</sup> If trust is categorised as promoter, then it would be deemed to be a PAC along with the employee (acquirer), unless proved otherwise; and hence various restrictions, as discussed above, get annexed to PAC in case the acquisition of shares by employee exceeds the threshold limits. This will be discussed later in the paper.

<sup>134</sup> SEBI (Issue of Capital and Disclosures Requirement) Regulations, 2009, Schedule VIII.

<sup>135</sup> See The Companies Act, 2013, §2(37).

<sup>136</sup> See The Companies Act, 2013, §2(59).

‘directors’, whereas the definition of ‘employee’ clearly excludes directors. In order to avoid such an overlap, the definition of ‘employees’ stock option’ under the Act, 2013 should exclude an ‘officer’ as a beneficiary, since they may fall within the definition of ‘employee’ given under both Regulations, 2014 and the Debenture Rules, 2014. However, to provide more clarity, a proviso should be inserted at the end of the extant definition of ‘employee’, through which the officer of the company or its holding or subsidiary company, may be termed as ‘employee’.

### 3. Employees of foreign holding and subsidiary company

The definition of ‘employee’ includes employees of a subsidiary, whether in India or abroad, or a holding company of the company offering the scheme of employees’ stock option. At first glance, the need for specifically inserting “whether in India or abroad” in this definition appears unclear, since the definition of subsidiary company under the Act, 2013 itself includes a foreign company. To substantiate this point further, reference can be made to the definition of a ‘subsidiary company’ under the Act, 2013, which includes ‘a body corporate’.<sup>137</sup> A ‘body corporate’ means a company incorporated outside India, and hence, subsidiary companies include companies incorporated in India or abroad.<sup>138</sup> Hence, there is no need to specifically insert “whether in India or abroad” in the definition of ‘employee’, while making a reference to the subsidiary company.

Another question that arises notwithstanding the fact that holding company is not accompanied by “whether in India or abroad” in the definition of ‘employee’, is whether or not the definition of ‘holding company’ under the Act, 2013 itself includes foreign holding company. If this is the case, then the employees of the foreign holding company could also be offered the schemes of employees’ stock options. However, unlike the case with a subsidiary company, the definition of “holding company” does not include the term ‘body corporate’. This definition is unlike the one provided under the erstwhile Companies Act, 1956,<sup>139</sup> which included a body corporate.<sup>140</sup> Though the intent of the legislature, by bringing such a change, could be to exclude foreign holding company from the purview of the Act, 2013<sup>141</sup> it is submitted that the MCA should issue a clarification to this effect, so as to dispel any ambiguity. However, contrary to the said intention, the Company Law Committee, in its Report in February 2016, envisaged that the exclusion of the term ‘body corporate’ from the definition of the ‘holding company’ was a minor anomaly, which should be rectified by including an Explanation that “the expression ‘company’ includes any body

<sup>137</sup> See The Companies Act, 2013, §2(89).

<sup>138</sup> See The Companies Act, 2013, §2(11).

<sup>139</sup> The erstwhile Companies Act, 1956 has been replaced by the Companies Act, 2013.

<sup>140</sup> The Companies Act, 1956, § 2(9) read with 4(5).

<sup>141</sup> See A. RAMAIA, GUIDE TO THE COMPANIES ACT (2013).

corporate”<sup>142</sup> in §2(46) of the Act, 2013 that defines “holding company”.<sup>143</sup> Until the ambiguity is resolved, it is submitted that there should not be any distinction between the employee of foreign subsidiary company and foreign holding company, so far as their inclusion under the employees’ benefit scheme is concerned. This is because Regulations, 2014 is a welfare piece of legislation, and in spite of the ambiguity, the employees of the foreign holding company should not be deprived of the social benefits which employees of the subsidiary company are entitled to. Hence, it is submitted that the SEBI should amend the Regulations, 2014 to specifically include employees of foreign holding company within the definition of ‘employee’.

### *B. OBJECTIVE OF EMPLOYEES’ BENEFIT SCHEMES UNFULFILLED*

There are several benefits that are attached to ESOPs, the primary being the benefit of gaining recognition in the company as its member, by holding its shares, which is not possible in case the company gives monetary rewards. Such recognition may be required to be given to employees enjoying key positions in the management of the affairs of the company, or to those who have come to be associated with the company in the eyes of the public, on account of their long and continued association with the company. The ownership may also boost their performance, owing to a sentimental value attached to the company that a person owns.<sup>144</sup> This will thus help achieve sustained growth of the company, and will also add to the company’s value in terms of accelerating growth and output.

These objectives may not be achieved in cases where the market price of the share, as on the date of exercise of the ESOP, is higher than its exercise price. This is because of the behavioural tendency to sell off shares when the market price exceeds the exercise price of the underlying shares by such magnitude that it meets the person’s expectations and allures him to exercise the ESOP to mint profits through the sale of underlying shares. This riddle can be solved by prescribing a lock-in period after the exercise of ESOP, as discussed below.

<sup>142</sup> See The Companies Act, 2013, §2(87), Explanation (c).

<sup>143</sup> See TAPAN RAY COMMITTEE, *Report of the Companies Law Committee* (February 1, 2016), available at [http://www.mca.gov.in/Ministry/pdf/Report\\_Companies\\_Law\\_Committee\\_01022016.pdf](http://www.mca.gov.in/Ministry/pdf/Report_Companies_Law_Committee_01022016.pdf) (Last visited on March 3, 2017).

<sup>144</sup> Pravesh Aggarwal, *Benefits to Employees by Way of Stock Options or Stock Purchase Schemes in India: Evaluating its Scope, Need and the Problems under the Extant Legal Regime*, 27 EUR. BUSINESS LAW REV. 4 (2016).

## 1. Lock-in period should be made mandatory in order to meet the objective

In order to ensure that the object of ESOPs is achieved in spirit, the shares offered pursuant thereto should be mandatorily locked-in for some time, say six months.<sup>145</sup> This will hence, confer ownership rights of shares on the employee for at least some period which may enlighten him regarding the benefits of holding shares, particularly of the company he works in. This may in turn build a sense of attachment with the company which would not only motivate him to be associated with the company on a long term and sustained basis, but would also inculcate zeal so as to boost his performance metrics, for the overall advancement of the company.

In case of an ESPS, since there is already a lock-in period attached after the purchase of shares, there is no need for amendment in the provisions of the Regulations, 2014 with respect to the ESPS. In case of the GEBS and RBS, since the benefits are given to employees for various purposes which can practically be cash-based, the need for having a lock-in period does not arise.

For unlisted companies, Rule 12(2) of the Debenture Rules, 2014 should mandate the requirement of making disclosure of lock-in period in the explanatory statement annexed to the notice for passing of the resolution. Hence, Rule 12(2)(h) should be read as ‘the Lock-in period.’<sup>146</sup>

### *C. SHARES OFFERED TO NOMINEE DIRECTORS SHOULD NOT BE TRANSFERRED TO INSTITUTION NOMINATING THEM*

A ‘nominee director’ is defined as a “director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the central government or the state government by

<sup>145</sup> However under many employees’ benefit schemes, there is no lock-in period mentioned. See for instance, *Saregama India Limited Stock Appreciation Rights Scheme offered by Saregama India Limited, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/saregamamay29\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/saregamamay29_p.pdf) (Last visited on December 20, 2016); Kotak Investor Relations, *Kotak Mahindra Share Based Employee Benefit Scheme, 2015*, available at [http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed\\_ESOP\\_Scheme\\_2015\\_SARs\\_Scheme\\_2015-AGM\\_2015.pdf](http://ir.kotak.com/downloads/annual-reports-2014-15/pdf/Proposed_ESOP_Scheme_2015_SARs_Scheme_2015-AGM_2015.pdf) (Last visited on December 20, 2016); Infosys, *Infosys Limited 2015 Incentive Compensation Plan*, available at <https://www.infosys.com/investors/corporate-governance/Documents/incentive-compensation-plan.pdf> (Last visited on December 20, 2016; and Future Consumer Enterprise Limited, *Explanatory Statement to the General Meeting of the Company* (March 25, 2015), available at <http://www.futureconsumer.in/pdf/future-consumer-enterprise-limited-postal-ballot-notice.pdf> (Last visited on December 20, 2016).

<sup>146</sup> Companies (Share Capital and Debenture) Rules, 2014, Rule 12(2)(h) (It reads as, “the Lock-in period, if any”).

virtue of its shareholding in a government company.<sup>147</sup> Since a nominee director is a director of the company, he comes within the definition of term ‘employee’ under both Regulations, 2014 and the Debenture Rules, 2014. However, some financial institutions follow the practice of routing the money received by the nominee directors, in lieu of services rendered to the company, over to themselves.<sup>148</sup> Ergo, the question that arises is whether the ESOPs or the shares offered pursuant thereto can be transferred to, or be renounced in favour of the institution nominating the director of the company respectively. Insofar as the ESOPs are concerned, they cannot be transferred to any other person, including the institution nominating the employee.<sup>149</sup> However, insofar as the shares issued pursuant to ESOPs are concerned, there is no restriction on them being renounced in favour of the institution.<sup>150</sup>

However, it is contended that the shares should not be permitted to be renounced in favour of the institution. *First*, the main object of conferring ownership rights on the employee, through the schemes of employees’ stock option, would be defeated. *Second*, the object of prohibiting the renouncement of the grant of ESOPs in favour of the nominating institution<sup>151</sup> would be defeated, as instead of the ESOPs, the nominating institution may acquire the underlying shares of the company, in lieu of the latter’s renouncement being made in favour of the former. *Third*, the fiduciary duty of the nominee director towards the company<sup>152</sup> would stand at a lower pedestal if the shares are transferred to the institution nominating him. Though the nominee director owes a fiduciary duty both towards the company as well as the institution nominating him, in case there is a conflict between the interests of the nominator and those of the company, the company’s interests must be preferred by the nominee director, as recognised in *Rolta India Ltd. v. Venire Industries Ltd.*<sup>153</sup>

<sup>147</sup> See The Companies Act, 2013, §161 (“Nominee Director” are not independent directors by virtue of The Companies Act, 2013, §149(4)).

<sup>148</sup> Aggarwal, *supra* note 144.

<sup>149</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 9.

<sup>150</sup> This is also evident from SEBI (Share Based Employee Benefit) Regulations, 2014, Reg. 4.

<sup>151</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 4(1)(b).

<sup>152</sup> See Ministry of Corporate Affairs, Master Circular, *Prosecution of Directors – Regarding*, Master Circular No. 1/2011(Issued on July 29, 2011), available at [http://www.mca.gov.in/Ministry/pdf/Circular\\_1-2011\\_28july2011.pdf](http://www.mca.gov.in/Ministry/pdf/Circular_1-2011_28july2011.pdf) (Last visited on March 3, 2017).

<sup>153</sup> *Rolta India Ltd. v. Venire Industries Ltd.*, 1999 SCC OnLine Bom 706 : (2000) 100 Comp Cas 19; See also Umakanth Varottil, *Directors’ Actions: For Whose Benefit?* (June 8, 2014), available at <http://indiacorplaw.blogspot.in/2014/06/directors-actions-for-whose-benefit.html> (Last visited on March 3, 2017); Umakanth Varottil, *Stock Options for Nominee Directors* (August 6, 2008), available at <http://indiacorplaw.blogspot.in/2008/08/stock-options-for-nominee-directors.htm> (Last visited on March 3, 2017).

#### D. CLARITY OVER REGULATION OF PHANTOM STOCK OPTIONS BY SEBI NEEDED<sup>154</sup>

Recently in the year 2015, SEBI gave two informal guidelines concerning whether or not cash-settled SAR or phantom stock options are governed by the Regulations, 2014.<sup>155</sup> In both the Guidance Notes, SEBI rejected the contention of applying the Regulations, 2014 to phantom stock options. The reasons that it gave was that there was no involvement of dealing in or subscribing to or purchasing securities of the company, directly or indirectly<sup>156</sup>, which is in fact necessary for the Regulations, 2014 to apply. This requirement finds no mention in both the Companies Act, 2013 as well as Companies (Share Capital and Debenture) Rules, 2014. Hence, currently, according to SEBI, phantom stock options should fall outside the purview of the regulatory framework.<sup>157</sup>

However by excluding phantom stock options from the purview of the Regulations, 2014, SEBI failed to take into account the following aspects: that there is express mention of SAR settled by way of cash; and that there can be dealing of shares pursuant to the exercise of the options. These aspects have been discussed below.

##### 1. Express mention of cash-settled SAR under the SEBI Regulations

The definition of SAR under the Regulations, 2014 itself mentions that entitlement of the appreciation may be by way of cash payment.<sup>158</sup> The Regulations, 2014 further stipulate that an employee can exercise the option by making an application to the company or trust, for appreciation in the form of cash.<sup>159</sup>

<sup>154</sup> In India, cash-settled SAR and Phantom Stocks are the same.

<sup>155</sup> See *Saregama India Limited Stock Appreciation Rights Scheme offered by Saregama India Limited, 2014*, available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/saregamamay29\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/saregamamay29_p.pdf) (Last visited on December 20, 2016); See *Letter sent by Amit Tandon & addressed to Jagannathan Chakravarti* (July 27, 2015), available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/sebimindtree\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/sebimindtree_p.pdf) (Last visited on March 3, 2017) (However, informal guidance given by SEBI to companies has a persuasive and not a binding value in courts).

<sup>156</sup> See SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 1(4).

<sup>157</sup> See *Letter sent by Amit Tandon & addressed to Jagannathan Chakravarti* (July 27, 2015), available at [http://www.sebi.gov.in/cms/sebi\\_data/commondocs/sebimindtree\\_p.pdf](http://www.sebi.gov.in/cms/sebi_data/commondocs/sebimindtree_p.pdf) (Last visited on March 3, 2017). Neither the provisions of the Companies Act, 2013 nor the Companies (Share Capital and Debenture) Rules, 2014 apply to phantom stocks. Hence unlisted companies can anyway not offer phantom stocks.

<sup>158</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(ze).

<sup>159</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 2(1)(i).

In addition, under the Regulations, 2014, a company has been conferred the freedom to implement a cash-settled or equity-settled SAR scheme.<sup>160</sup> However, such freedom is subject to the provisions of the Regulations, 2014<sup>161</sup> which *inter alia* require that the cash-settled SAR scheme should involve dealing in or subscribing to or purchasing securities of the company, directly or indirectly.<sup>162</sup> This condition can be fulfilled by ensuring dealing in shares of the company pursuant to the exercise of the cash-settled SAR, as discussed below.

## 2. Dealing of shares pursuant to the exercise of the cash-settled SAR permitted

In order to ensure that the cash-settled SAR involves dealing in or subscribing to or purchasing securities of the company, the company can issue fresh equity shares pursuant to the exercise of SAR, which shall be given as cash benefits to the employees, resulting from their sale in secondary market. Importantly, the company will have to adopt such a strategy if it falls short of requisite funds needed to be given to the employee exercising cash-settled SAR. Thus, SEBI should not have per se decided to exclude cash-settled SAR from the ambit of the Regulations, 2014. Rather, an explanation should be inserted under Regulation 2(1)(ze) which reads as follows: “An SAR settled by way of cash payment of the company shall involve fresh issue of shares pursuant to its exercise.”

### E. CLARITY OVER SAR AS “SECURITY” NEEDED

Notwithstanding that SAR offered to the employee is not subject to transfer to any other person, SEBI should clarify that SAR is a “derivative” and hence, a “security” within the meaning of Securities Contracts Regulation Act, 1956.<sup>163</sup>

In the US, the position on whether to classify cash-settled SAR as a “security” or not has changed over a period of time. Earlier, in *Clay v. Riverwood International Corpn.*,<sup>164</sup> it was held that SARs are not securities, and hence, there is no insider trading with respect to dealing in SARs. However, currently, under the Securities and Exchange Commission (SEC) regulations,<sup>165</sup> the definition of “derivative security” includes a SAR, and hence, insider trading regulations apply with respect to dealing with SARs.<sup>166</sup> The reason for

<sup>160</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 23(2).

<sup>161</sup> *Id.*

<sup>162</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 1(4)(ii).

<sup>163</sup> See Securities Contracts Regulation Act, 1956, §§ 2(ac)(B), 2(ia).

<sup>164</sup> *Clay v. Riverwood International Corpn.*, 157 F 3d 1259 (11th Cir 1998).

<sup>165</sup> General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. §240.16a-1(c) (1991) (U.S.A.).

<sup>166</sup> See HERBERT KRAUS, EXECUTIVE STOCK OPTIONS AND STOCK APPRECIATION RIGHTS 645 (2015).

including cash-settled SAR within the ambit of “derivative security” is that although they ultimately provide cash to the employees, their value is derived from the prices of the underlying shares.

In short, the position of SAR as a “security” has changed over the time in US,<sup>167</sup> and in order to avoid any confusion in India, there should be an explicit mention of SAR as a ‘security’ under the Securities Contracts Regulation Act, 1956.

#### *F. NEED FOR EXEMPTING LOCK-IN PERIOD IN CASE OF CASHLESS EXERCISE OF OPTION OR SAR.*

In cases of the ESOS and SAR schemes, where lock-in periods pursuant to the exercise of option are specified by the company, cashless exercise of stock option or SAR becomes difficult for the employee. A cashless exercise of stock option or SAR means exercising the option without paying the exercise price. The cashless exercise of stock option or SAR is permitted only when the schemes are implemented through trust.<sup>168</sup> Such exercise price may either be exempted by the company,<sup>169</sup> or the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price, which shall be adjusted against the sale proceeds of some or all the shares.<sup>170</sup> But, it would not be economically feasible for the employee to undertake a cashless exercise of option or SAR, in case there is a lock-in period attached, since it would add to the cost of the employee, proportional to the time period for which shares are locked-in.<sup>171</sup> Hence in such a case, no employee may want to exercise the option or SAR. It is therefore submitted that the company should not specify any lock-in period in a case of cashless exercise of option or SAR.

#### *G. OTHER REFORMS NEEDED*

For the purpose of achieving grammatical coherence and veracity, some changes need to be made under the Regulations, 2014.

First, Regulation 6(3)(d) should read as “*Grant of option, shares or [other] benefits*”<sup>172</sup> instead of “*Grant of option, SAR, shares or benefit.*”

<sup>167</sup> *Supra* note 101.

<sup>168</sup> *See* The Companies Act, 2013, §67(3). This is true for listed companies also, by way of harmonious construction of the Companies Act, 2013 and the SEBI (Share Based Employees Benefits) Regulations, 2014.

<sup>169</sup> *See* SEBI (Share Based Employee Benefits) Regulations, 2014, Reg. 2(1)(k).

<sup>170</sup> *See* SEBI (Share Based Employee Benefits) Regulations, 2014, Reg. 9(2), proviso.

<sup>171</sup> This is because interest on loan granted to the employee by the company or the empanelled stock broker(s) increases with passage of time.

<sup>172</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 6(3)(d) (It reads as: “Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of: (d). Grant of option, SAR, shares or benefits, as the



This is because the grant of option and shares themselves constitute benefits granted to the employees, and the term ‘benefits’ referred to in Regulation 6(3) (d) relate to benefits other than grant of option and shares, for instance, cash-benefits through GEBS and RBS. By making the said amendment, Regulation 6(3)(d) will also be made coherent in consonance with Regulation 6(3)(c) of the Regulations, 2014, which reads as “*Grant of option, SAR, shares or other benefits.*”<sup>173</sup>

Second, the proviso to Regulation 9(2) should read as “*Provided that in case of ESOS or SAR [scheme]*,”<sup>174</sup> instead of “*Provided that in case of ESOS or SAR.*” This is because the SAR is not a scheme per se, unlike ESOS. On the same reasoning, Regulation 12(3) should be read as “*For listing of shares issued pursuant to ESOS, ESOS or SAR [scheme]*,”<sup>175</sup> instead of “*For listing of shares issued pursuant to ESOS, ESOS or SAR.*”

Third, Regulations 26(2) and 27(3) should read as “*At no point in time, the shares of the company or shares of its listed holding company [held under the scheme] shall exceed*”,<sup>176</sup> instead of “*At no point in time, the shares of the company or shares of its listed holding company shall exceed.*” This is

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case may be, to identified employees, during any one year, equal to or exceeding one per cent capital (excluding outstanding warrants and conversions) of the company at the time of grant of option, SAR, shares or incentive, as the case may be”).

<sup>173</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 6(3)(c) (It reads as: “Approval of shareholders by way of separate resolution in the general meeting shall be obtained by the company in case of: (c). Grant of option, SAR, shares or other benefits, as the case may be, to employees of subsidiary or holding or associate company”).

<sup>174</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 9(2) (It reads as “No person other than the employee to whom the option, SAR or other benefit is granted shall be entitled to the benefit arising out of such option, SAR, benefit etc.: Provided that in case of ESOS or SAR, under cashless exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the applicable law or regulations”).

<sup>175</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 12(3) (It reads as: “For listing of shares issued pursuant to ESOS, ESOS or SAR, the company shall obtain the in-principle approval of the stock exchanges where it proposes to list the said shares”).

<sup>176</sup> SEBI (Share Based Employees Benefits) Regulations, 2014, Reg. 26(2) (It reads as: “At no point in time, the shares of the company or shares of its listed holding company shall exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of GEBS”); Reg. 27(3) reads: “At no point in time, the shares of the company or shares of its listed holding company shall exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of RBS”); See also Ernst & Young, *Securities and Exchange Board of India notifies regulations for Share Based Employee Benefits* (October 31, 2014), available at [http://www.ey.com/Publication/vwLUAssets/EY\\_Regulatory\\_Alert\\_Securities\\_and\\_Exchange\\_Board\\_of\\_India/\\$FILE/EY\\_Regulatory\\_Alert\\_Securities\\_and\\_Exchange\\_Board\\_of\\_India%20.pdf](http://www.ey.com/Publication/vwLUAssets/EY_Regulatory_Alert_Securities_and_Exchange_Board_of_India/$FILE/EY_Regulatory_Alert_Securities_and_Exchange_Board_of_India%20.pdf) (Last visited on March 3, 2017).

because the limitation mentioned under the said regulations does not apply to the shares of the company not covered under the scheme.

#### IV. CONCLUSION

The questions pertaining to the scope of the term ‘employee’, the manner in which schemes shall be implemented, the differences that exist between the schemes, the mode through which the schemes are offered, the various provisions of the insider and takeover regulations which the listed companies have to comply with, and the differences that exist between listed and unlisted companies so far as the schemes are regulated and governed, can be conclusively answered upon conducting an exhaustive perusal of the various employees’ benefit schemes that may be offered by both listed and unlisted companies, and the regulatory framework governing these schemes. The paper has also highlighted various issues imbricate in this framework, and has delineated recommendations to address them, so as to facilitate smooth and effective implementation of the schemes.

First, the definition of the term ‘employee’ is unclear in the sense that there exists ambiguity about whether the promoter or persons belonging to the promoter group of the company, as well as the employees of the foreign holding company of the company offering the schemes, are included within the definition. This issue has been addressed by proposing amendments to Regulations, 2014 and the Debenture Rules, 2014, through which it is made clear that the promoters are excluded from the definition of ‘employee’, while the employees of foreign holding company are covered within the ambit of the said definition. In addition, with respect to an officer of a company being an employee, it has been proposed that the overlap in the definition of ‘employees’ stock option’ and ‘officer’ should be extricated by deleting the term ‘officer’ from the definition of ‘employees’ stock option’, and by inserting a separate proviso in the definition of ‘employee’ through which the officers may be covered under the employees’ benefit schemes.

Second, it has been proposed that a lock-in period, following the acquisition of shares by the employees through the schemes, should be made mandatory. Such a provision would prevent frequent dealing in such shares by the employees, which tends to defeat the primary objective of offering ESOPs, viz. conferment of ownership stake in the company to the employees.

Third, the practice of the financial institutions involving acquisition of the shares offered pursuant to the employees’ benefit schemes, from the directors nominated by such institutions, is argued to be against the objects of offering ESOPs, and against the over-riding nature of the nominee director’s duty towards the company, as compared to the financial institution; and hence, this practice should be prohibited.

Fourth, it is found that clarity is needed in the Regulations, 2014 with regard to the regulation of cash-settled SARs or phantom stock options.

Fifth, it is proposed that the definition of ‘security’ should explicitly include SAR for the sake of brevity.

Sixth, in order to enable employees to meet the exercise price in case of cashless exercise of options or SAR, removal of the lock-in period following the exercise is proposed.

Seventh, some amendments have been proposed under the Regulations, 2014 for the purpose of attaining grammatical coherence and veracity. To conclude, both SEBI as well as the MCA should consider the suggested amendments and take steps for ensuring that the employees’ benefit schemes are formulated and implemented in a manner conducive to the objects that underpin them.

## ANNEXURE

### *(List of Proposed Amendments in Regulations, 2014)*

- a) The definition of ‘employee’ under Regulation 2(f) of the Regulations, 2014 as well as Rule 12 of the Companies (Share Capital and Debenture) Rules, 2014 should be amended as follows:

“...(iii) an employee as defined in clause (i) or (ii) of a subsidiary, or of a holding company[, whether in India or abroad] of the company[.]

but does not include: (a) an employee who is a promoter or a person belonging to the promoter group [of the company]...”

- b) An explanation shall be inserted under Regulation 2(1)(ze) which reads as: *“Explanation.- An SAR settled by way of cash payment of the company shall involve fresh issue of shares pursuant to its exercise;”*
- c) A proviso should be inserted within the definition of ‘employee’ under Regulation 2(f) of the Regulations, 2014 as well as Rule 12 of the Companies (Share Capital and Debenture) Rules, 2014 as follows:

“Provided that an officer of the company, or of a subsidiary, in India or outside India, or of a holding company of the company may be termed as an employee subject to the fulfilment of the aforesaid conditions.”

- d) A proviso should be inserted under Regulation 4 of the Regulations, 2014 which reads as follows:

“Provided that if shares are offered to an employee who is a director nominated by an institution as its representative on the board of directors of the company, then such shares shall not be renounced in favour of the institution under any contract, agreement or otherwise except by way of sale by such employee.”

- e) Regulation 6(3)(d) should read as follows:

“Grant of option, shares or [other] benefits, as the case may be to identified employees, during any one year, equal to or exceeding one per cent. of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option, SAR, shares or incentive, as the case may be.”

- f) The proviso to Regulation 9(2) should read as:

“Provided that in case of ESOS or SAR [scheme], under cashless exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the applicable law or regulations.”

- g) Regulation 18(2) of the Regulations, 2014 should read as: “*The company [shall] specify the lock-in period for the shares issued pursuant to exercise of option*”.

- h) A clause should be inserted under Regulation 24 of the Regulations, 2014 which reads as: “The company shall specify the lock-in period for the shares issued pursuant to exercise of cash-settled SAR.”

- i) Regulation 26(2) should read as:

“At no point in time, the shares of the company or shares of its listed holding company held under the scheme shall exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of GEBS.”

- j) Regulation 27(3) should read as:

“At no point in time, the shares of the company or shares of its listed holding company shall exceed ten per cent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purposes of GEBS.”