

Faulty exchange

Apart from being totally one-sided, the FTIL-NSEL merger sets a dangerous precedent

The Centre's draft order merging the National Spot Exchange Ltd with its parent Financial Technologies (India) Limited is an ill-conceived document and sets a dangerous precedent. It is one thing to try and redress the grievances of those who lost money trading in paired commodity contracts on the NSEL, but quite another to do this in a manner that harms the shareholders of FTIL. Section 396 of the Companies Act has been used before to amalgamate companies, but never before to feed off the assets of one (FTIL) to recover the liabilities of another (NSEL). The Centre has used this provision only four times in the last three decades, but judiciously and in wholly different circumstances. In these cases, the merger had the interest of both the companies in mind. While the weaker company gained by being merged with a stronger company, the other benefited from the synergies arising from the merger. But the NSEL-FTIL merger is totally one-sided; NSEL, which has been shut down, does not add any value to FTIL. A merger will hurt the consolidated entity, which will bear liabilities and face pending litigation.

The order is also quite likely to fail in achieving its aim — help NSEL's investors recover the ₹5,300 crore due to them. These dues have to be recovered from the broker-members of NSEL, who were counter-parties in the trades in which investors lost money. NSEL is only an exchange that facilitated these trades and is not liable to repay these investors. It can only help in recovering these dues. Even if NSEL is merged with FTIL, it is doubtful whether the traders who have lost money on NSEL will be able to recover it from FTIL's assets.

The Centre is also treading on the sensitive turf by threatening to pierce the corporate veil through this move. It is important to uphold the sanctity of this principle — that establishes a company as a separate entity distinct from its promoters and other stakeholders — in order to retain the trust of the investors in equity markets. There have been rare instances in the past when the corporate veil was pierced to hold a parent company responsible for the misdoings of a subsidiary; but in these cases it was established that the subsidiary was set up with the sole intent to gain illegal benefit or to defraud others. In situations of mass disaster, such as the Bhopal Gas Case, the corporate veil was ignored since the assets of the subsidiary were insufficient to redress the victims. But such intent is hard to establish in FTIL's case and the plight of those trading in commodity contracts is hardly comparable to the innocent victims of the gas tragedy. If angry investors of companies that are in deep financial trouble began seeking merger with other group companies, and the Government started acceding to such requests, the result would be anarchy.