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"Green Shoe Option- A Price Stabilizing Agent"

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ABSTRACT

This study solicits the necessity to include GSOs in their initial public offerings, and explores the reasons for the indifference on part of Issuer Company and merchant banks in India towards GSO. For analysis, both doctrinal and empirical research methodology will be adopted and the data of the previous years of the companies that issued equity shares on GSO will also be analyzed. In addition to this, the guidelines issued by SEBI on this aspect will also be considered and loopholes in various situations will also be solicited. Detailed study of cases with reference to fraud by companies in case of GSO and impact on the price of share due to unexpected developments are the chief motive of the project.

Keywords: Over-allotment of shares, Incorporated Companies, Initial Process Outsourcing, Retail Individual Investors, Pricing of shares

INTRODUCTION

Green Shoe Option- A Price Stabilizing Mechanism in Capital Market is a critical issue of today as retail investor's confidence or trust is gradually decreasing and this is the time to meet the challenges with a view to regain the investor's confidence in corporate finance and establishing a healthy corporate and financial environment. SEBI introduced this option in the Chapter VIII A of SEBI Guidelines with a view to boost investor's confidence by arresting the speculative force, which work immediately after listing and thus result in short term Stability in post listing price.

STATEMENT OF PROBLEM

As investor's are losing confidence in the share markets, there is a need to evaluate the concept and solicit the mechanism of Green Shoe Option. It is the concept to regain the confidence of the investor's in the capital markets and building the healthy corporate and financial environment and hence, there is the need of hour to look into the working of such mechanism so that people can regain such confidence. In addition to this, Green Shoe Option is a new concept and still the public is unaware of impact on over-allotment of shares on the economy.

In process of rectifying the demand and supply imbalances, any possibility that the Stabilizing

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Agent or Company suffers loss or any inconsistency in the guidelines issued by SEBI are key concerns of this paper.

SURVEY OF THE EXISTING LITERATURE

Ramaiya A., Guide To Companies Act, Green Shoe Option.

The guide gives whole guideline of the mechanism, their working and all the guidelines issued by SEBI and also provide detailed explanation of each and every guideline. From this, it could be easily analyzed the result of this mechanism in the economy and inconsistencies in the policy.

- **Alle Naveen, Green Shoe Option, NESI,**

https://www.nseindia.com/research/content/RP_6_Mar2012.pdf

The Research Paper Focuses on the result of the mechanism by green shoe option to the economy including the positions of stabilizing agents as they are not allowed to trade in case of this mechanism. Stabilizing agents cannot earn profit by issuing the shares at prices higher than the market price and also give various suggestions so as to make this mechanism effective in the economy. This paper also focuses on the mandate to be there in every IPO, especially small IPO, so that the purpose of this mechanism could be achieved.

- **Kapoor G.K. & Dhamija Sanjay, COMPANY LAW, TAXMANN, 2015, Ed. 18.**

This literature gives the basic guidelines and clearly gives the meaning of the Green Shoe Option with respective amendments up to 1.8.2014 and signifies the relation of GSO with Initial Process Offer (IPO).

- **Time to Rescind FRBM and Stabilisation Policies, EPW Research Foundation,**

http://www.jstor.org.spicework.ddn.upes.ac.in:2048/stable/pdf/40278549.pdf?_=147 2126835208

This paper analyses the Money Markets Operations by various previous data analyses and confesses that there is a greater need for the economy to have a look on the stabilizing policies and need for the RBI in involvement of Credit. Money market review is also the chief concern of this paper.

- **Nayak Alok & Chakravarti Devaditya, GREEN SHOE OPTION: NOVEL BEACON OF PROTECTION OR SUPERFICIAL CONSIDERATION,**

https://www.taxmann.com/filecontent.aspx?Page=ART&isxml=N&id=10501000000 0006179&PageType=1&search=green%20shoe%20option&tophead=true&login=tr ue.

This article concluded that Green Shoe Option has indeed come out to be a watershed development in the Indian IPO scenario, where such a price stabilization activity has been acknowledged as an approved means of market manipulation. After- market short covering, being one of the stabilization activities is a tool that is utilized to stimulate demand, and is less risky; the costs of such an Endeavour is further reduced by a selective use of the over-allotment option.

- **Sankar Siddhartha & Saha, CAPITAL MARKETS & SECURITY LAWS, TAXMANN New Delhi, 2015.**

This Literature gives the core analysis with hypothetical analyses of the Green Shoe Option and the working of the mechanism. In addition to this, Model of Green Shoe Option is also very well explained in this literature along with specifically working of this mechanism in India. Importance, Functions and Genesis of this mechanism is also very well exerted in this book.

IDENTIFICATION OF ISSUES

- Analysis of GSO- Price Stabilizing Agent
- Need for Stabilizing Agent
- Assurance by the Stabilizing Agent for maintenance of market price of equity shares

OBJECTIVE AND SCOPE OF RESEARCH

The chief objective of this project is to observe that is there any type of assurance that could be given by the Stabilizing Agent for maintenance of market price of equity shares to the company through stabilizing activities. In addition to this, another objective is to conquer the situations of loss to the stabilizing agent in such activities. Guidelines issued by SEBI in this aspect will also be analyzed and situations of inconsistency will be solicited inclusive of situation of fraud by the companies or stabilizing agent resulting in loss to investors is key concern of this project.

HYPOTHESIS

It is quite clear from the research that there are various aspects in mechanism of Green Shoe Option (GSO) and key problem being the inconsistency still in price stabilizing of equity shares. As the economy is progressing day by day, there are various unexpected launches or developments in the economy that ultimately result in fall in price of shares by market price. GSSO could help in stabilizing the price of the company but to some extent only.

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PROBABLE OUTCOME

On the analysis of various existing guidelines, research papers, articles and case studies, it is thereby found out that there may be a possibility that GSO is a great tool for the Companies to gain the Confidence of Investors as a price stabilizing agent as there are fluctuations due to the unexpected developments in the economy. But it may result in loss to the stabilizing agent in case the prices of the shares go below the issue price (i.e. listing price of Public Issue). It may be a negative point as seen from the perspective of overall economy.

RESERCH METHODOLOGY

The research methodology adopted is doctrinal. Here, the different articles, books and legislature have used with the theory to analyze the topic, understand it in a clear manner and solicit the chief objective of the research. Comparative analysis with different hypothetical case studies to solicit the mechanism of Green Shoe Option.

The Foundation:

The first issue of capital by the public limited companies is popularly known as the Initial Public Offer or IPO. One of the most successful and used methods of initial issue of capital is through book-building method, it is a process which aids in price and demand discovery.

It is a mechanism where, during the period for which the book for the IPO is open, bids are collected from investors at various prices, which are above or equal to the price of the stock. At times in order to bring stability in the prices of the stock in the market some companies opt for an over-allotment of shares. Therefore, the idea of over-allotment of shares which is popularly referred to as a green shoe option has become useful for all the companies. Now, a concept called a Reverse Green Shoe has also come into use. A Reverse Green Shoe is a special provision in an IPO prospectus, which allows underwriters to sell shares back to the issuer. Reverse green shoe has exactly the same effect on the share price as a traditional option but is structured differently. It is used to support the share price in the event that the share price falls in the post-IPO aftermarket. In this case, the underwriter buys shares in the open market and then sells them back to the issuer, stabilizing the share price.

GREEN SHOE OPTION

Company that wants to venture out and start selling their shares to the public has ways to stabilize their initial share prices. One of these ways is through a legal mechanism called the *green shoe option (GSO).* A green shoe is the clause obtained in the underwriting of the initial public offering that allow underwriters to buy up to an additional 15% of company shares at offering price. The investment banks and brokerage agencies that take part in the green shoe process have the ability to exercise this option if public demand for the shares exceeds expectations and stock trades above the offering price.

Going by the statutory aspect, Regulation 45[1], contains the provision relating to implementation of Green Shoe Option in the public offerings. A trio of, (1) the issuer-company, (2) the Stabilization Agent who would be usually one of the Merchant Bankers, and the (3) lender, is involved in the mechanism and usually one of the pre-issue holder/promoter of the issuer-company who holds significant portion of the shares. The GSO is an option vested in the issuer of securities wherein the issuer can opt for over allotment of shares beyond the issue size to the investing public. In other words, the issuer is permitted while issuing securities to the public to allocate shares in excess of the issue size (public issue) and is also permitted to operate a post-listing price stabilizing mechanism through the Stabilizing Agent. The GSO is a clause contained in the underwriting agreement of an IPO and the promoters of the company enter into an agreement with the Stabilizing Agent to lend some of their shares to the latter. In India, ICICI Bank was the first one to come up with GSO in the year 2005 after the SEBI allowed it from August, 2003. Later on, other companies followed suit. In India, the GSO is not very popular among the companies and underwriters, unlike in the USA and the European Capital market wherein majority of the issues are built with GSO.

Origin of Mechanism

The term "Green Shoe" came from the Green Shoe Manufacturing Co. (now called Stride Rite Corporation), founded in 1919. It was the first company to implement the green shoe clause into their underwriting agreement. In a company prospectus, the legal term for the green shoe is 'over-allotment option', because in addition to the shares originally offered, shares are set aside for underwriters. This type of option is the only means permitted by the Securities Exchange Board of India (SEBI) for an underwriter to legally stabilize the price of a new issue after the offering price has been determined. The SEBI introduced this option in order to enhance the efficiency and competitiveness of the fund raising process for the IPOs.

Price Stabilization

As mentioned above, the SEBI guidelines permit exercise of the Green Shoe Option by a company making a public issue of securities. The Issuer-company shall appoint one of its Investment Bankers as the Stabilizing Agent in its proposed public issue of securities. The Stabilization Agent's job is to conduct price stabilization activities and also to provide price support during the stabilization period, which according to the guidelines shall be a period of 30 days from the date of receipt of the trading permission from the Stock Exchanges for trading of shares. The shares can be lent up to a maximum of 15% of the total issue size of the securities. The shares borrowed from the promoters shall be in the dematerialized form and these shares will be kept in separate Green Shoe Option De-Mat Account. The following

[1] SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2009 (ICDR Regulations).

accounts would be opened for implementation of the GSO:-

(a) A special Escrow Account – where funds from the maximum of 15 % of over allotment would be credited.

(b) A special De-Mat Account would also be opened with the depository for crediting any of the shares which may be bought back during the stabilization period.

During the stabilization period, if any of the shares are to be procured in order to stabilize the price of the shares, then the amount in the Escrow Account would be utilized to procure the same.

During the issue period, the issuer-company shall allot the total shares to the investors including the over allotment shares. Thereafter, the issuer-company in consultation with the Merchant Bankers / Stock Exchanges would complete the allotment of shares and the shares (equity) would be listed within the time line prescribed by the ICDR Guidelines.

The Stabilization Agent's job starts once the shares are listed on the Stock Exchange and the shares are being traded well below their issue price. The stabilization period is the period of 30 days commencing from the date of receipt of trading permission for trading. In case the share prices of the issuer-company fall below the issue price, then the Stabilization Agent shall start purchasing the equity shares at the prevalent market price (*i.e.*, lower price than the issue price) and the said shares would be credited to the special depository account.

A situation may arise that the Stabilization Agent in order to stabilize the price of the shares, may be required to purchase a part of extra shares (as it may be the case that in the initial stage of the stabilization period the market rate of the shares trades below the issue price and later on improves) then in that case, these shares shall be returned within the time limit as above. In the case of part procurement of shares by the stabilization agent, there shall be a shortfall in number of shares. The said shares would be issued by the issuer-company at the issue price only and not at market price. On receipt of the said shares, the same would be returned to the lender/ promoter by the Stabilization Agent. The Stabilization Agent shall utilize the funds lying in the special Escrow Account to meet the consideration for such issue of shares by the issuer-company.

In case the share prices of the issuer-company do not fall below the issue price, the Stabilization Agent does not purchase any shares of the company from the market. After receipt, Stabilization Agent returns these shares to the lender/promoter who lent the said shares. The issuer-company is responsible for making a separate application to list all the shares issued due to the option exercised under the mechanism of GSO. After reconciliation, the balance in the account after remittance of the proceeds for the issue of shares and after meeting the expenses of the Stabilization Agent, shall transfer to the Investor Protection and

Education Fund per under the Regulation 45(9)[2].

Three possible scenarios under the mechanism of GSO

- *Scenario 1 (Stabilization Agent could not buy any of the shares a very unlikely event)* - This situation is a very precarious one; as the share price falls below the issue price, the Stabilization Agent cannot find any seller in the market, who is willing to sell the shares, which is a very unlikely event. Further, this situation may also arise, in the event before Stabilization Agent acts in furtherance of price stability, the share price which has fallen below the issue price, again rises and continues to trade above the issue price and, hence, the Stabilization Agent does not exercise the option under GSO. But in any case, the Stabilization Agent is under an obligation to return the shares that was borrowed from the promoters / pre-issue shareholders. From the shares issued, the Stabilization Agent would return the shares borrowed back to the promoters/ pre-issue shareholders. Further, the Issuer-company has to apply to the Stock Exchanges for listing / trading permissions for the incremental shares issued pursuant to the GSO.
- *Scenario 2 (Stabilization Agent buys all the shares under the GSO)* - In this scenario, since the price of the shares is well below the issue price and sufficient sellers are there in the market, the Stabilization Agent uses the funds available in the Account to buy entire shares from the market and these shares would then be held in the temporary depository account. The shares so purchased would be returned back to the promoters from whom the shares were borrowed.
- *Scenario 3 (Stabilization Agent could buy only some of the shares under GSO mechanism)* - This situation would arise when the Stabilization Agent starts buying the shares under GSO mechanism when the share price falls below the issue price in the initial period of the stabilization period but recovers and rises above the issue price during the later part of the stabilization period, leaving to the Stabilization Agent only partial purchase. In this case, the issuer-company would allot the differential quantity of shares into the Green Shoe De-Mat account as it was done in scenario 1, the underlying consideration being the amount lying in the De-Mat Account. One more obligation is also cast on the issuer- company, *i.e.*, to apply to the Stock Exchanges for listing and for trading permissions for the incremental shares allotted pursuant to the GSO.

After reconciliation of the amounts lying in the Green Shoe Escrow Account, if any surplus is left after meeting the expenses of the Stabilization Agent it would be transferred to the Investor Protection Fund.

[2] ICDR Regulations.

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Purpose of GSO

The primary objective of any price stabilization mechanism is to foster confidence in the market for freshly issued shares. This is where the good offices of an underwriter kicks into action, insofar as the confidence is assured by absorbing the increase in supply of then newly issued securities and temporary downward pressure that usually accompanies the excess of supply. Investors, in a manner of speaking, would by then be empowered not to make the mistake of taking the additional supply of newly issued securities to be a causative factor for a deflation of the price.[3] Issuers, on the other end of the transaction, would want to partake in the process of issuing more shares as the additional shares, to the best of their knowledge, would not lead to a downward pressure on the shares.[4] This underlies the accepted fact that initial public offerings being shrouded in mystique as they are, for individual investors such a mundane world is risky business and, thus, despite the allure and hype and the unimpeachable promise of big returns, it is important for them to be educated about the facts.

Or we can say that, going in for GSO is that the company intends to ensure that share price on the Stock Exchange does not fall below the issue price, thus, wants to increase its reputation as a blue chip company. A company can issue only 15% of the total number of shares of the IPO. Thus, it can be seen that the entire process of GSO works on over allotment of shares *e.g.,* a company planning to issue only 100,000 shares but in order to utilize the GSO, it actually issues 115,000 shares, *i.e.,* over allotment to the tune of 15000 shares. It should be noted that the company does not issue any new shares for the over allotment. As stated earlier, 15000 shares issued for the over allotment are actually borrowed from the promoters with whom the Stabilizing Agent enters into a separate agreement. For the stabilization of a public issue, it makes no difference whether the Company is allotting shares out of the freshly issued 100,000 shares or from the 15000 shares borrowed from the promoters. Once a share is allotted, it is just a share for an investor. But for the company, the situation is totally different; as the money received from the over allotment is required to be kept in a separate bank account. As mentioned earlier, the main job of the Stabilization Agent begins only after trading in the shares starts at the Stock Exchange. The rule is, in case the shares are trading at a price lower than the issue price, the Stabilization Agent starts buying the shares by using the money lying in the separate bank account. Thus, by buying the shares when others are selling, the stabilizing agent tries to put the brakes on falling prices. If any shares have been purchased, the shares lying in the De-Mat Account will be transferred to the lender (who has lent the shares) and additional shares to the extent of the shares lent *less* those purchased will be allotted by the issuer-company for which necessary funds will be transferred from the bank

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[3] Lawrence M Benveniste, Walid Busaba,& William J. Wilhelm, 1996, "Price stabilization as a bonding mechanism in new equity issues", *Journal of Financial Economics* 42,223-255.

[4] Daniel Asquith, Jonathan Jones, & Robert Kieschnick, 1998, "Evidence on price stabilization and under-pricing in early IPO returns", *Journal of Finance* 53, 1759-1773.

account by the Stabilizing Agent to the issuer-company. New shares allotted will be at the original issue price. Balance lying in the bank account will be transferred to the Investors Protection Fund.

The other rule is that in case the newly listed shares start trading at a market price higher than the issue price, the Stabilization Agent will not purchase any shares and the Stabilizing Agent will transfer the entire funds from the bank account to the issuer- company who, in turn, will allot fresh shares to the lender to the extent of the shares originally lent by him. The idea in either case is to bring the secondary market price to the level of the offer price.

Statutory Requirements of Green Shoe Option

The following are the requirements to be fulfilled in order to have a Green Shoe Option in a Public Issue/ Follow on Public offer:

(a) Shareholders' approval for allotment of further shares.

(b) One of the Book Running Lead Manager should be appointed as Stabilization Agent.

(c) Stabilization Agent to enter into contract with the promoter, Stabilization Agent enters into an agreement with any one of the promoter shareholder holding more than 5% of the share capital. The terms and conditions would be captured in the agreement including the maximum number of shares that can be borrowed under GSO.

(d) Maximum of 15% of the shares can be allotted over and above the issue size of securities.

(e) Disclosures of specified details in the offer documents.

(f) Stabilization mechanism available only for 30 days after the trading starts.

(g) Shares to be transferred to the lenders who have given the shares not later than two working days after the stabilization period, subject to the remaining lock in.

(h) Stabilization Agent to file daily and final report to the Stock Exchanges / SEBI.

(i) The Issuer-Company is required to make a separate application with the Stock Exchange in order to list all the shares issued pursuant to the option exercised under GSO.

(j) Any surplus amount in Account after the remittance relating to the issue of shares under the GSO mechanism shall be transferred to the Investor Protection & Education Fund established by the SEBI.

The Need for Such a Mechanism

The necessity behind utilizing a GSO by the underwriter is signified by the requirement to see to it that the share price on the Stock Exchanges does not come below the issue price after issue of shares. To bring some clarity to the aspect, it is to be understood that in most of the cases, when a company goes for public issue through book building, share prices are kept conservatively. This very share price is lower than market price. The prices from thereon are bound to plummet down and there can be no technical justification which could rationalize such a descent. However, in order to propose a rationale that comes close to vindicate such a tendency is to interpret the behavior of a special class of shareholders, *i.e.*, the speculators.[5] The speculators are devoid of a carrying capacity and, thus, they will be predisposed to sell their holding, irrespective of the price prevailing in the market. The demand and supply mismatch results in the price to come down will be absence of enough buyers in the market. The GSO has come to serve as a standard instrument the world around in allocating shares if there is a strong demand. This, called in legal parlance, as the over allotment option is to be exercised in a scenario where the price weakens in the market and then the underwriter is to allocate his shares up to a 15 per cent of the shares offered to buy-back and retire the shares, as if they had never been offered in the first place.

The role of the Bear also serves as an important antecedent for the option to be exercised. This is because upon his arrival, the share prices see a more concerted, downhill fate as he sells the shares repeatedly, in effect damaging the goodwill of the company and the reputation of the directors.[6]

This is where the buyer comes in picture unleashing a spate of share buying spree and ensures that the prices go up yet again to stave off a situation that deems imminent the loss of crores of rupees of damage to real investments due to fall in prices.

Benefits of GSO

- The introduction of GSO mechanism has brought the Indian Primary markets at par with global markets such as USA, Canada and others where over 90% of primary issues is through the book building route having the Green Shoe Option.
- The GSO is expected to work as price stabilization mechanism post-public issue and address the chronic problem of price volatility which is witnessed immediately after the listing of the shares takes place.
- The company which adopts GSO will be able to maintain and to put a break on the falling price and, thus, the company's reputation is maintained. This helps in building image of the company's stock as more stable. It should be noted that the company does not go for GSO just to raise additional capital.
- In case the primary market is going to witness heightened activity, then the only way to

[5] Lawrence M. Benveniste, Sina M.Erdal,& William J. Wilhelm, 1998, "Who benefits from Secondary market price stabilization of IPOs?", *Journal of Banking and Finance* 22,741-767.
[6] Bhagwan Chowdhry, & Vikram Nanda, 1996, "Stabilization, syndication and pricing of IPOs", *Journal of Financial and Quantitative Analysis* 31,25-42.

check and moderate volatility of the share prices is to adopt the GSO.

- With the adoption of GSO, it will increase the appetite of the IPO investors and improve the investors' sentiments and will also overcome the apprehension of the investors at the time of listing of the securities.
- The GSO shall encourage increased participation from investors in an IPO market. It is believed amongst the analysts that in developed markets, the investors tend to give a little higher price, if they are assured that book-runners have the GSO at their disposal to stabilize the price.
- The Investor is benefited, as this GSO helps to preserve his capital as buying of excess shares limits panic selling in the market as and when the stock gets listed on the bourses.
- It may be quite possible that even the IPO's of well renowned companies do not perform on the very first day of their listing and in this case GSO or over allotment comes into play a vital role in bringing up the value of the stock.

Indian companies' preference for Green Shoe Option to help get past listing blues

It would be ideal here to cite certain instances where the GSO has come to be exercised by the Indian companies. IDBI by having come out with a debt-instrument called as the Flexi Bonds (Series 4 and 5) had each of its series floated for Rs. 750 crores initially. With the approval of the SEBI it retained an excess of an equal amount of Rs. 750 crores.[7] ICICI by way of unsecured redeemable debentures of Rs. 200 crores launched its first batch of safety bonds with a GSO for an identical amount.[8] In the recent past, Infosys Technologies had made use of the GSO to obtain 7,82,000 additional ADS (American Depositary Shares) representing 3,91,000 equity shares.[9]

As the report brought out by the Financial Chronicle indicates, realty companies in India are increasingly harboring a tendency to raise funds from the primary market by opting for the GSO to stem volatility in share prices following their listing on the Stock Exchanges. In their draft red herring prospectus filed before the SEBI, companies of the likes of Sahara Prime City, DB Realty, Lodha Developers and Ambience have opted for the GSO. Ambience, a boutique entity with a clearly-driven focus towards development of premium commercial and luxury residential property, has intended to raise around Rs. 1,125 crore with an option running up to Rs. 168.75 crore; DB Realty has allocated Rs. 150 crore while. Sahara Prime

[7] "IDBI Flexibonds to offer 5.50-7.20%", Business Standard, January 13, 2005, available at http://www.business-standard.com/india/news/idbi-flexibonds-to-offer-550-720/203756/ (last accessed on 15 October, 2011)
[8] Suresh Krishnamurthy, "ICICI Safety Bonds- A mixed bag", Business Line, February 25, 2001, available at http://www.thehindubusinessline.in/businessline/iw/2001/02/25/stories/0125a301.htm.
[9] "Underwriters exercise green shoe option with Infy ADS", TNN, August 4,2003, available at http:// articles.economictimes.indiatimes.com/2003-08-04/news/27559183_1_equity-shares-infy-ads-offering.

City has cornered around 15 per cent from its total issue size.[10]

A comparative study of other Jurisdictions

By the fact that the over-allotment option encourages new issues and the raising of new capital, the feature has come to be rather favorable in being adopted in jurisdictions such as Australia, US, UK, Thailand and Hong Kong.

In order to be a desirable tool for the financial markets, the fluidity of the capital markets must be stabilized to act as a "safe harbor" from penalization of market abuse. Thus, post- listing price stabilization has come out to be necessary for ensuring an orderly operation of the market, as well as reducing the prospects of short selling and investor's nervousness. By this, the overall picture in the market seems to be conducive, for the investor then feels encouraged to use the stable securities for capital gain. In Australia, the provision as to a "safe harbor" to the market manipulation and insider dealing offences is facilitated by the issuance of a no-action letter.

Position in other jurisdictions

- *Australia* - The Corporations Law in Australia prohibits a person from indulging in deceptive or misleading conduct that may be best manifested through false trading, market rigging and insider trading. To address a latent fear as to whether market stabilization arrangement like GSO would breach any of these prohibitions, the Australian Securities and Investment Commission undertakes restraint by issuing a no action letter only in specified circumstances.[11] To minimize the risk of a spurious market developing in the relevant shares on the Stock Exchange and to allow the Exchange to take an appropriate action when deemed necessary, Australian Securities and Investment Commission calls for a judicious mix of issuer disclosure to the Exchange and to the market so created in the broad framework of the existing rules of the Australian Stock Exchange. As

to the proposition, whether refreshment of GSO is permitted, the stabilizing agent is barred from offering to sell shares that have been previously purchased in connection with the market stabilization arrangements.[12]

- *United Kingdom* - The Financial Services Authority in the UK hasn't set out in express terms the factors that are to be considered when ascertaining as to whether a buy-back arrangement falls within the provisions of the buy-back safe harbor, and if not, how it

[10] Vikas Srivastav, "Real estate players opt for green shoe option in IPOs", Financial Chronicle, October 1st, 2009, available at http://www.mydigitalfc.com/real-estate/real-estate-players-opt-green-shoe-option -ipos- 296 .

[11] ASIC Interim Guidance on Market Stabilization, Australian Securities & Investments Commission, September 13, 2000, available at http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ir00-pdf/$file/ir00-031.pdf .

[12] ASIC Conditions for Market Stabilization Arrangements, Attachment A, Condition 5.

amounts to market abuse under the Code of Market Conduct. Article 3[13] mandates that the sole purpose of the buy-back must be to reduce capital of the issuer, in value or in number of shares. The Commission Regulation, as best reflected in MAR 2, imposes a limitation as to the propensity to have a naked short position of 5%.[14] Sales that establish a short position, *i.e.*, their short not being covered by the green shoe are regarded not to be meant for the purpose of price support as they run the risk of depressing the price itself.

The FSA has rather been uncertain as to the meaning of "refreshing the green shoe".[15]

The price stabilization rules are embodied in the Financial Services and Markets Act, 2000 (Market Abuse) Regulations, 2005, which came into force on 1st July, 2005.[16]

- *Hong Kong* - The capital markets in Hong Kong have seen a revolutionary transition with the passing of The Securities and Futures Ordinance which came into force on 1st April, 2003. It consolidates and substantially revises the framework as market misconduct. The Price Stabilizing Rules recognize the over allocation securities mode undertaken by the underwriters as an ancillary stabilizing action.[17] The novel requirements were modeled closely on the UK's Price Stabilizing Rules and specify circumstances in which stabilizing action may be taken by a stabilizing manager. Here also, though the traditional view held by the Securities and Futures Commission was that where underwriters exercise the GSO in an IPO, any legitimate purchases effected in the secondary market solely for the purpose of covering such over-allotment do not by themselves infringe the market manipulation provisions of the erstwhile pre- Securities and Futures Ordinance.[18]

- *United States of America* - Stabilization is permitted in the US. The Securities Exchange Act of 1934 regulates transactions of securities in the secondary market[19], wherein the Securities and Exchange Commission established under Section 4 is to ensure that companies meet the Exchange Act's disclosure requirements and brings enforcement actions against those who disseminate inchoate or fraudulent information in violation of the Federal Securities Laws.

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[13] Article 3, Commission Regulation 2273/2003.

[14] S. 118(8), Financial Services and Markets Act, 2000, MAR 2: Price Stabilising Rules, Financial Services Authority Handbook.

[15] Implementing the Market Abuse Directive: FSA Handbook changes, Market Watch, Markets Division: Newsletter on Market Conduct Issues, Issue No. 12 (special edition) June 2005, available at http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter12.pdf#search=%22refreshing%20the%20greensho e%22.

[16] Financial Services and Markets Act, 2000 (Market Abuse) Regulations, 2005 (S.I. 2005/381), available at http://www.legislation.gov.uk/uksi/2005/381/contents/made.

[17] Securities and Futures (Price Stabilizing) Rules, Chapter 571W, available at http://www.hklii.org/hk/legis/en/reg/571W/.

[18] s. 282 and 306, Securities and Futures Ordinance (Cap. 571) available at http://www.hklii.org/hk/legis/en/ord/571/.

[19] S. 9a(6), Securities and Exchange Act, 1934; Rule 104 of Regulation M, Securities Exchange Commission 17 F.C.R. §242.104 (2003).

Critical analysis of the mechanism of GSO

The Stabilization Agent cannot push the price of the shares to match the issue price beyond certain point, in case the company is having weak financials and it is a fundamentally weak company or if the IPO is badly priced. There is no guarantee that the Stabilization Agent can definitely stabilize the price of the shares to match the issue price.

Since the stabilization period is limited to 30 days, it may not yield the desired benefit as envisaged by GSO.

The foremost occasion where the option was witnessed to have been exercised was in the case of the Agriculture Bank of China IPO managing a stellar $22.1 Billion after allowing its top three lenders to exercise the over-allotment option in order to douse the overheated market caused by an unprecedented demand for shares[20]. Pandora's exercise helped in raising additional capital with its IPO to a subscription of 54.09 million.[21] On the other end, Enel Green's IPO exercised the option for professional investors to the tune of 210 million shares making it Europe's biggest IPO offering in decades.[22]

Conclusion

The Green Shoe Option has indeed come out to be a watershed development in the Indian IPO scenario, where such a price stabilization activity has been acknowledged as an approved means of market manipulation. After- market short covering, being one of the stabilization activities is a tool that is utilized to stimulate demand, and is less risky; the costs of such an endeavor is further reduced by a selective use of the over-allotment option. The exercise of such an option also is relatively inexpensive for companies as the entire process is managed by the underwriter and has a pronounced effect on investors. Further, since these activities are performed in ways that are not transparent to investors and regulators, need to evolve a flexible and effective policy of disclosure is imperative on the part of companies exercising the GSO. Though the SEBI Guidelines of the 2000 and 2009 variety do provide a comprehensive framework for disclosure and modalities to be fulfilled, it is noteworthy to take into account some of the procedural principles that foreign jurisdictions have adopted, the leading among them being the use of a no-action letter to stave off potential spurious misuse of such capital generated from the public. Further, the pending issue of refreshing a Green Shoe ought to be addressed to by the SEBI by bringing forth necessary amendments to the Guidelines, keeping in view the prevailing market conditions and the need to minimize market

[20] "Agricultural Bank of China Sets IPO Record as Size Raised to $22.1 Billion", Bloomberg New, August 16, 2010, available at http://www.bloomberg.com/news/2010-08-15/agricultural-bank-of-china-sets-ipo- record-with-22-1-billion-boosted-sale.html.

[21] "A Review of Pandora's IPO", New Millionaire Magazine, June 14, 2010, available at http://newmillionairemagazine.com/?p=6898.

[22] "Enel's Green Power IPO greenshoe optsion exercised", Reuters U.S.A, November 24,2010, available at http://www.reuters.com/article/2010/11/24/enel-idUSN2421715820101124.

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impacts. All said and done, the beneficial aspects of the GSO cannot be more emphasized, considering the promise it holds both for the company and investors to be assured of their stocks and investments as the indication brought about by such post-listing stabilization activity is that the issue is not overpriced, renewing investor confidence in the secondary market.

Such price support has been evidenced to act as a reward for certain kinds of investors for their adverse selection costs and *bona fide* information during the book-building process.

Unfortunately, law on finance in India is not sufficiently empirical in its outlook as opposed to the Europe or the US, but the necessity to have such a view of how regulations actually work out in foreign jurisdictions, can help the Indian legislator to understand and create more dedicated legislation, and to this effect, our study of such mechanisms in other countries only hopes to arm the Indian lawmaker with a better understanding of how empirical research serves to help the Securities Commissions of the respective countries.