BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.83 of 2010

Date of decision: 11.03.2011

Liquid Holdings Private Limited
217, IInd Floor, Antriksh Bhawan,
22, K.G. Marg, New Delhi. ….. Appellant

Versus

The Securities and Exchange Board of India
SEBI Bhavan, Plot No.C-4A,
G Block, Bandra Kurla Complex,
Bandra (East), Mumbai. …...Respondent

Mr. U.K. Chaudhary, Senior Advocate with Mr. Rahul Srivastava and Ms. Hina Sharif, Advocates for the Appellant.

Mr. Kumar Desai, Advocate with Mr. Karan Vyas and Mr. Mihir Mody, Advocates for the Respondent.

CORAM : Justice N.K. Sodhi, Presiding Officer
P.K. Malhotra, Member
S.S.N. Moorthy, Member

Per : Justice N.K. Sodhi, Presiding Officer

This order can conveniently dispose of a group of five Appeals no.81 to 85 of 2010 which were heard together as they arise out of similar sets of facts and raise identical questions. All these appeals are directed against identical orders of the adjudicating officer holding the appellants guilty of violating Regulations 7 and 11(1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter called the takeover code) and imposing a monetary penalty of ₹ 3 lacs on each of them.

2. The appellants in this group of appeals alongwith some others are the promoters of Blue Coasts Hotels Limited (formerly known as Blue Coasts Hotels and Resorts

Limited and hereinafter referred to as the target company). Morepen Laboratories Limited is a group company of the appellants and it shall be referred to hereinafter as Morepen. It took a loan of ₹ 325 lacs from Dombivli Nagari Sahakari Bank Limited and another sum of ₹10 crores from Lakshmi Vilas Bank Limited (for short Dombivli Bank and Lakshmi Bank respectively) in the year 2002. It hypothecated its plant and machinery to secure the loans and in addition thereto, the appellants who were holding large number of shares of the target company had pledged those shares by way of collateral security. The pledge was created in favour of both the banks. Morepen defaulted in the repayment of the loans as a result whereof both the banks invoked on March 10, 2004 the pledges created in their favour. The pledged shares were then transferred from the demat accounts of the appellants to the demat accounts of the banks. Upon the shares being so transferred, the names of the banks came to be recorded as the beneficial owners of those shares in the records of the depository. In the records of the target company as well, the names of the two banks as members of that company were reflected. After acquiring the shares by invoking the pledge, Lakshmi Bank disclosed to all the stock exchanges where the shares of the target company were listed, the aggregate of its shareholding/voting rights in the target company. This is the requirement of Regulation 7 of the takeover code. It appears that after the two banks had become the beneficial owners of the pledged shares when those were transferred in their names, the parties agreed that upon settlement of the loan account, the shares would be transferred back to the appellants and other pledgors. Lakshmi Bank addressed a communication dated December 13, 2004 to Morepen informing the latter that the shares had been transferred in the name of the former and that the shares shall continue to be the collateral security for the term loan. This is what Lakshmi Bank stated in its letter:

> "With regard to 8,07,000 shares of M/s. Blue Coast Hotels & Resorts offered as collateral security under pledge for the term Loan limit of Rs.1000.00 lakhs availed by you, we would like to inform you that we have transferred the above share in our Bank's name on 10.03.2004 and the same is continued to be the collateral security of the above term loan and the dues thereon."

It is not in dispute that subsequently the loan accounts were settled and all the debts liquidated. Lakshmi Bank as per its letter dated December 19, 2007 informed Morepen,

the principal borrower and the appellants that it had instructed its depository participant to transfer the equity shares of the target company to the appellants. It will be useful to reproduce this communication which reads as under:

> "Pursuant to the liquidation of all debts due to us by M/s. Doctor Morepen Limited, we have instructed our Depository participant i.e., M/s. Integrated Enterprises Ltd, Mumbai, to transfer the equity shares of Blue Coast Hotels & Resorts Limited, and which were held by us as security for the due repayment of loan. The details of shares pledged to us and held by us are as follows:-
>
> Pledger Cos.
>
> | | |
> |---|---|
> | 1.) M/s. Seeds Securities & Services (P) Ltd. | 167,000 shares |
> | 2.) M/s. Epitome Holdings (P) Ltd. | 250000 shares |
> | 3.) M/s. React Investments & Financial Services (P) Ltd. | 190000 shares |
> | 4.) M/s. Liquid Holdings (P) Ltd. | 200000 shares |
> | | 807000 shares " |

We have on record copies of the delivery instruction slips (DIS) duly executed by the banks in favour of the appellants transferring the shares from their demat account to those of the appellants. Since the shares that were transferred back to the appellants were in excess of the limit(s) prescribed by Regulation 11(1) of the takeover code, the Securities and Exchange Board of India (for short the Board) was of the view that the appellants on acquiring the shares from the two banks ought to have complied with this regulation by making a public announcement to acquire shares of the target company in accordance with the takeover code and not having done so, had violated this provision. The Board also felt that the appellants as acquirers should have made the necessary disclosures as required by Regulation 7 of the takeover code. Adjudication proceedings were initiated against the appellants for these lapses. A common show cause notice dated November 10, 2009 was issued to all the appellants alleging violation of Regulations 7 & 11(1) of the takeover code and they were called upon to show cause why monetary penalty be not imposed on them. The appellants filed their common reply denying the allegations. On a consideration of the material collected by the adjudicating officer and having regard to the undisputed facts as they emerge from the record, the adjudicating officer concluded as under:-

> "21. Therefore, I am of the strong opinion that the said acquisition by the promoters would definitely attract the provisions of the SAST Regulations

> and would not be exempted from the applicability of Regulation 10, 11 and 12 as provided vide Regulation 3(1)(f)(iv) of the Takeover Regulations. In my view, the proper course of action for the Promoters, in the given circumstances, would have been to make an application before the Takeover Panel under Regulation 4(2), before acquiring the shares retransferred by the banks. The Promoters having failed to do so have thus, violated Regulation 11(1) of the SAST Regulations by failing to make a public announcement to acquire shares in accordance with the said Regulations.
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> 22. In view of the foregoing, I am also of the opinion that for the aforesaid increase in share holding/voting rights, the Noticee as one of the Promoters of BCHRL and as a recipient of 1,67,000 shares out of 9,57,000 shares under reference, which were received by the promoters during December 2007, was under obligation to make required disclosures to the Company as well as to the Stock Exchanges as specified under regulation 7(1) read with regulation 7(2) of SAST Regulations. The Noticee has failed to do so, therefore, I hold him responsible for violation/contravention of the provisions of regulation 7(1) read with 7(2) of the SAST Regulations"

Accordingly by his separate but identical orders dated March 11, 2010, the adjudicating officer imposed a monetary penalty of ₹ 3 lacs on each of the appellants. Penalty of ₹ 2 lacs has been levied for the violation of Regulation 11(1) of the takeover code and another sum of ₹ 1 lac has been imposed for violating Regulation 7. Hence these appeals.

3. We have heard the learned senior counsel on behalf of the appellants and Shri Kumar Desai learned counsel for the Board. Before we deal with their contentions, it is necessary to refer to the relevant statutory provisions. Shares in dematerialised form are regulated by the Depositories Act, 1996 and the regulations framed thereunder. This Act makes a distinction between a registered owner and a beneficial owner of a security. As per section 10 of this Act, a depository is deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner. "Beneficial owner" is defined to mean a person whose name is recorded as such with a depository. A beneficial owner is entitled to all the rights and benefits and is subjected to all the liabilities in respect of his securities held by a depository. Section 12 of the Depositories Act deals with pledge or hypothecation of securities held in a depository. A beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository. The manner in which a pledge or hypothecation is created is contained in Regulation 58 of the

Securities and Exchange Board of India (Depositories and Participants) Regulations 1996 (for short the Regulations). Since we are concerned with the manner in which a pledge is created, it is necessary to reproduce Regulation 58 which reads as under:

> "**Regulation 58**
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> **Manner of creating pledge or hypothecation.**
>
> 58. (1) If a beneficial owner intends to create a pledge on a security owned by him, he shall make an application to the depository through the participant who has his account in respect of such securities.
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> (2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.
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> (3) The depository after confirmation from the pledgee that the securities are available for pledge with the pledger shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the participants of the pledger and the pledgee.
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> (4) On receipt of the intimation under sub-regulation (3) the participants of both the pledger and the pledgee shall inform the pledger and the pledgee respectively of the entry of creation of the pledge.
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> (5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.
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> (6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if the pledger or the pledgee makes an application to the depository through its participant:
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> Provided that no entry of pledge shall be cancelled by the depository with the prior concurrence of the pledgee.
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> (7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledger.
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> (8) Subject to the provisions of the plegde document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.
>
> (9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledger and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledger and pledgee respectively.
>
> (10) (a) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).
>
> (b) The provisions of sub–regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation:
> Provided that the depository before registering the hypothecatee as a beneficial owner shall obtain the prior concurrence of the hypothecator.

> (11) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a participant without the concurrence of the pledgee or the hypothecatee as the case may be."

We may also notice that section 150 of the Companies Act requires every company to keep a register of its members and enter therein their particulars as referred to in the section. The word "member" has been defined in Section 41 of the Companies Act and sub-section (3) thereof provides that every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company. We may also notice the relevant provisions of the takeover code the violation of which has been alleged in the present case. Sub regulations (1) and (2) of Regulation 7 and Regulation 11(1) concern us and they are reproduced hereunder for facility of reference:

> "**Regulation 7**
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> **Acquisition of 5 per cent and more shares or voting rights of a company**
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> 7(1) Any acquirer, who acquires shares or voting rights which (taken together with shares or voting rights, if any, held by him) would entitle him to more than five per cent or ten per cent or fourteen per cent or fifty four per cent or seventy four per cent shares or voting rights in a company, in any manner whatsoever, shall disclose at every stage the aggregate of his shareholding or voting rights in that company to the company and to the stock exchanges where shares of the target company are listed.
>
> (1A) …….
>
> (2) The disclosures mentioned in sub-regulations (1) and (1A) shall be made within two days of
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> (a) the receipt of intimation of allotment of shares; or
>
> (b) the acquisition of shares or voting rights, as the case may be.
>
> ……. ."
>
> **"Regulation 11**
>
> 11(1) No acquirer who, together with persons acting in concert with him, has acquired, in accordance with the provisions of law, 15 per cent or more but less than fifty five per cent (55%) of the shares or voting rights in a company, shall acquire, either by himself or through or with persons acting in concert with him, additional shares or voting rights entitling him to exercise more than 5 per cent of the voting rights, with post acquisition shareholding or voting rights not exceeding fifty five per cent in any financial year ending on 31st March unless such acquirer makes a public announcement to acquire shares in accordance with the regulations."

As already noticed above, the appellants had pledged their shares with the two banks as collateral security when Morepen availed the loan facilities. It is not in dispute that when

Morepen made default in repayment of the loans, the pledges were invoked by the banks and the shares were transferred from the demat accounts of the appellants to the demat accounts of the banks and they were registered as beneficial owners in the records of the depository. When the loan account was settled, the banks transferred back the shares to the appellants by executing DIS. It is argued by the learned senior counsel for the appellants that the shares throughout remained under pledge even when they were transferred in the name of the banks on the invocation of the pledge and that the banks did not acquire those shares. The argument is that the appellants throughout remained the beneficial owners of the shares and that when they were transferred back to them by the banks there was no acquisition by them so as to attract the provisions of Regulations 7 and 11 of the takeover code. The learned senior counsel very strenuously argued that the relationship between the appellants and the banks even after the transfer of shares to the latter continued to be that of pledgor and pledgee and that the banks were throughout holding the shares as collateral security which were released on repayment/settlement of the loan. In support of his argument Shri Chaudhary relied upon the two letters dated December 13, 2004 and December 19, 2007 which have been reproduced hereinabove. He also placed reliance on a tripartite agreement dated August 9, 2006 between the appellants, Morepen and Lakshmi bank titled as extension of pledge. He referred to the contents of this agreement and clause 8 in particular which reads as under:

> "8. That the Company also hereby upholds/recognizes the rights of the Bank as pledgee, as conferred under the relevant provisions of law and that the Bank can enforce its rights at any time at its discretion against any or all the shares secured."

He wants us to infer from these documents that the banks were holding the shares as collateral security and that the transfer of the shares in their names did not mean that they acquired voting rights in the target company or that they became members of that company. According to the learned senior counsel, the object of transferring the shares in the names of the banks was only to provide a certain comfort level to them so that they feel confident that they would be able to recover the amount without going back to the pledgors if and when a default in payment occurs. We are unable to agree with the learned senior counsel.

4. To begin with, the shares were pledged with the two banks as collateral security for the loans taken by Morpen. Admittedly, the pledges were created as per the provisions of Regulation 58 of the Regulations reproduced hereinabove. The pledges were created and recorded in the records of the depository and the pledgors and the pledgees were informed of the entry of creation of the pledges through their participants. As long as the shares remained under pledge, the peldgors (the appellants) were their beneficial owners and the only effect of the pledge was that the shares under pledge could not be transferred any further or dealt with in the market without the concurrence of the pledgees i.e. the banks. The pledge by itself did not bring about any change in the beneficial ownership of the shares pledged and there was no question of the provisions of the takeover code being attracted. It was somewhere in the year 2004 that default was committed in the repayment of the loans as a result whereof the banks invoked the pledges and got the shares transferred from the demat accounts of the appellants (pledgors) to their own demat accounts. On such invocation, the depository cancelled the entry of pledge in its records and registered the banks as beneficial owners of the shares in its records and made the necessary amendments therein. The depository then immediately informed the participants of the pledgors and the pledgees of the change and the participants also recorded the necessary changes in their records. Upon the banks being recorded as beneficial owners of the shares in the records of the depository, they became members of the target company and they acquired not only the shares but also the voting rights attached thereto. But for the exemption granted to them under Regulation 3(1)(f)(iv) of the takeover code, they would have been required to comply with the provisions of Regulation 11(1) by making a public announcement to acquire further shares of the target company as envisaged therein. The shares acquired by the banks ceased to be the security for the loans as the banks had become the beneficial owners thereof. In December 2007, Morpen paid the entire loan amounts to the banks and settled the loan accounts. It was then that the banks issued a ‘no dues certificate’ to Morepen, the principal borrower and simultaneously executed DIS requiring their participants to debit their accounts and transfer the shares in the names of the appellants. Accordingly, the shares got transferred from the demat accounts of the banks to the demat accounts of the appellants in the records of the depository. On this transfer being made by the banks,

the appellants acquired the shares and became their beneficial owners as their names were entered in the records of the depository. Admittedly, the shares which the appellants acquired in December 2007 were in excess of the threshold limit(s) prescribed by Regulation 11(1) of the takeover code and, therefore, the said regulation got triggered. The appellants were required to come out with a public announcement to acquire further shares of the target company as envisaged in this Regulation. This was not done. Not only this, the appellants having acquired the shares from the banks were also required to make the necessary disclosures in terms of Regulation 7 of the takeover code to the target company and the stock exchanges where the shares were listed. This, too, was not done. We are, therefore, satisfied that the provisions of Regulations 7 and 11(1) stood violated and the adjudicating officer was right in recording a finding to this effect. No fault can, thus, be found with the impugned order, in this regard.

5. The argument of the learned senior counsel that the letters dated December 13, 2004 and December 19, 2007 and the tripartite agreement executed on August 9, 2006 clearly indicate the intention of the parties that the shares were throughout held by the banks as collateral security notwithstanding the fact that they stood transferred in their names is not acceptable. Such an argument would mean circumventing the statutory provisions of the takeover code and Regulation 58 of the Regulations which cannot be permitted. The way we read these documents is that after the shares were transferred in the names of the banks on the invocation of the pledge, the parties agreed that the banks will transfer the shares back to the pledgors (appellants) upon the loan being repaid. It was open to the banks to transfer the shares to other parties and instead of doing that, they agreed to transfer the shares back to the appellants. This agreement will not override or circumvent the statutory provisions already referred to above and would only result in transfer of shares from the banks to the appellants. This transfer is altogether different from the transfer by which the shares came to the banks upon invocation of pledge and by no process of reasoning can it be said that the banks continued to hold the shares as collateral security which was returned to the appellants on the repayment of the loan.

6. We may now take note of another submission made by the learned senior counsel for the appellants. He contends that the banks may have become beneficial owners of the shares when they were transferred in their demat account but they had not become the real owners of the shares and they could not have gained title to the said shares in the absence of any consideration. There is no merit in this contention at all. The Depositories Act, 1996 provides for only two category of owners viz. 'registered owner' who has necessarily to be a depository and a 'beneficial owner' in whom all the rights vest. Once the beneficial ownership stands transferred to the banks the parties cannot circumvent the legal provisions by entering into an agreement to make a declaration otherwise. The law also prescribes a mode for the creation and revocation of a pledge. The parties cannot agree to create a pledge contrary to the provisions of Regulation 58. The present is, indeed, a case where the shares had been pledged to secure the loan and on default being made in its repayment, the pledge was invoked. Even the Contract Act entitles the pledgee to invoke the pledge when a default occurs. In the case of shares held in demat form, the Depositories Act and the Regulations framed thereunder provide the manner in which the pledge is to be created and invoked and that procedure was duly followed in the present case. As already noticed, when the pledge was invoked, the banks became the beneficial owners of the shares and thereafter on repayment of the loan the shares were transferred back to the appellants on the basis of an agreement between the parties. The appellants did not get back the shares by redeeming the pledge. If that had been the case, the matter would have been different. We fail to understand how a question of consideration arises in such cases. The learned senior counsel also referred to the provisions of Section 28 of the Depositories Act and Section 32 of the Securities and Exchange Board of India Act, 1992 and contended that the provisions of these statutes are in addition to and not in derogation of any other law in force relating to the holding and transfer of securities. He submitted that securitization under these statutes was only procedural in nature and could not override the substantial law contained in the Contract Act and The Sale of Goods Act. In our view the argument is fallacious and misconceived. There is no sale of shares involved in the present case and, therefore, the Sale of Goods Act would not apply. As regards the Contract Act, we have already noticed above that it entitles a pledgee to invoke the pledge in case of default which is

what the banks did. We see no conflict in the provisions of the statutes referred to by the learned senior counsel.

For the reasons recorded above, we find no merit in these appeals and the same stand dismissed. There is no order as to costs.

Sd/-
Justice N.K.Sodhi
Presiding Officer

Sd/-
P.K. Malhotra
Member

Sd/-
S.S.N. Moorthy
Member

11.3.2011
Prepared and compared by
RHN