BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 39 of 2011

Date of decision: 15.2.2012

M/s Enam Securities Private Limited
24, Rajabahdhur Compound, Ambalal
Doshi Marg, Mumbai – 400001. ……Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. …… Respondent

Mr. Somasekhar Sundaresan, Advocate with Mr. Ravichandra Hegde, Ms. Delna Aga, Advocates for the Appellant.
Mr. Darius Khambatta, Additional Solicitor General with Mr. Madhur Baya, Ms. Aparna Kalluri, Advocates for the Respondent.

CORAM : P. K. Malhotra, Member
S. S. N. Moorthy, Member

Per : P. K. Malhotra, Member

This appeal is directed against the order dated December 31, 2010 passed by the adjudicating officer of the Securities and Exchange Board of India (for short the Board) holding the appellant guilty of violating regulation 13 of the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992 (for short merchant bankers regulations) and certain sub-clauses of clause 5 and 7 of the Securities and Exchange Board of India (Disclosure and Investors Protection Guidelines) 2000 (for short the DIP guidelines) and imposing a penalty of ₹ 25 lacs under Section 15HB of the Securities and Exchange Board of India Act, 1992 (for short the Act).

2. The facts of the case, in brief, are M/s. Enam Securities Pvt. Ltd., the appellant before us, is a merchant banker registered with the Board under Section 12 of the Act and is said to be in the business of providing merchant banking services for more than two decades. The Board conducted an inspection of the books and records of the appellant in August 2005 to examine the role of the appellant as a merchant banker in the context of management of initial public offerings, rights issues, open offers etc. A copy of the inspection report was made available to the appellant on June 28, 2006 for its comments. After considering the comments offered by the appellant, the Board issued a show cause notice dated June 14, 2007 alleging violation of certain provisions of the merchant bankers regulations and the DIP guidelines. In the show cause notice, the appellant was alleged to have committed five violations. The appellant made detailed submissions on the alleged violations vide its letter dated July 9, 2007 and denied all the allegations. The adjudicating officer, after considering the reply filed by the appellant, dropped two charges and held the appellant guilty of remaining three violations, which read as under :-

> "(i) The noticee had failed to exercise due diligence with reference to certain disclosures made in the offer documents. For example, the noticee had failed to make disclosures in respect of the entity Rabobank International Holding B.V. (hereinafter referred to as Rabobank) and certain other entities as promoters in the public issue of Yes Bank Ltd./the Bank/ the Company.
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> (iii) The noticee had failed to exercise due diligence with reference to disclosures pertaining to the allocation of shares to QIBs etc, for instance no Indian Financial Institution or Banks are considered eligible in 'Platinum Category' and preferential treatment was given to few entities. It was alleged that FII such as Goldman Sachs, BSMA, UBS etc. have been given preferential treatment in allotment of shares. It is further alleged that there is no consistency in allotment of shares within the same category. In this regard it was also alleged that the noticee had failed to fulfill its obligations as a merchant banker in a professional and diligent manner
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> (v) The noticee had failed to exercise due diligence in properly monitoring the flow of applications and other matters pursuant to closure of the public issues. For example, in the Yes Bank IPO shares were

> allotted to applicants having non existing DP IDs and other irregularities. Registrar to an issue failed to detect the same and the noticee as post issue LM failed to notice and report the same to the Board thereby alleged to have violated the provisions of Guideline 7.4.1 of SEBI (Disclosure & Investor protection) Guidelines, 2000."

Hence this appeal.

3. We have heard Mr. Somashekhar Sundaresan, learned counsel for the appellant and Mr. Darius Khambatta, learned Additional Solicitor General on behalf of the respondent Board at length who have also taken us through the records. Before we deal with the specific issues, it is necessary to have a look at the obligations and responsibilities of a merchant banker under the merchant bankers regulations. Regulation 13 of the merchant bankers regulations provides that every merchant banker will abide by the code of conduct as specified in Schedule III thereof. It places an onerous duty on a merchant banker not only of protecting the interest of the investors but also of ensuring that adequate disclosures are made in a timely manner without making any misleading or exaggerated claims and to render best possible advise to the clients. A merchant banker is required to maintain high standards of integrity, dignity and fairness in the conduct of its business and is required to promptly inform the Board any violation or non compliance of the regulatory framework that come to its notice. A merchant banker is also required to submit to the Board complete particulars of the transactions of acquisition of securities of any body corporate as required by regulation 27 and also make disclosures to the Board relating to its activities, as required under regulation 28 of the merchant bankers regulations. In a way, a merchant banker is an expert body which is also a point of contact between the regulator i.e. the Board and the corporate entity on whose behalf it is working. Therefore, a merchant banker is the eyes and ears of the regulator whose responsibility is to ensure that the corporate entity utilizing its services is acting in accordance with the laid down norms and in case of violation, bring the violation to the notice of the regulator for appropriate action. It is in this context that the

code of conduct for merchant bankers prescribes that a merchant banker shall, at all times, exercise due diligence, ensure proper care and exercise independent professional judgment. In the above background that we have to consider the rival submissions to see whether the adjudicating officer was right in arriving at the conclusion that the appellant had violated regulation 13 of the merchant bankers regulations and certain sub-clauses of clause 5 and 7 of the DIP guidelines.

4. We will first deal with the charge that the appellant had failed to exercise due diligence in not disclosing Rabobank International Holding B. V. (for short Rabobank) as a promoter of Yes Bank Ltd. in its (Yes Bank) prospectus for the Initial Public Offer (IPO). During the course of investigation, the Board found that Yes Bank Ltd. was incorporated as a public limited company under the Companies Act, 1956 on November 21, 2003. It was granted license by the Reserve Bank of India (RBI), under Section 22(1) of the Banking Regulation Act, 1949 on May 24, 2004 to commence banking operation on certain terms and conditions. One of the conditions was that the promoters' contribution shall be maintained at a minimum of 49% of the paid up capital at all points of time which will be locked in for a period of five years. It was observed by the Board that to meet 49% of the promoters' contribution requirement, 29% of share capital held by Mr. Rana Kapoor and Mr. Ashok Kapur and 20% of share capital held by Rabobank were taken into account and the same was locked in for a period of five years i.e. up to May 24, 2009. In the prospectus for the Yes Bank IPO, it was stated that the requirement of 49% of pre-issue capital held by promoters (domestic and foreign) has been made by locking in equity shares representing 29% of the share capital held by Rana Kapoor and Ashok Kapur and 20% of the share capital held by Rabobank. However, under the heading 'share capital holding pattern' as on May 24, 2005 post-issue promoters and promoter groups shareholding, Rabobank was not classified as promoter and this, according to the Board, has resulted in misrepresentation of fact whereby the investors have been

deprived of taking an informed decision for making investments in the Yes Bank IPO. According to the Board, the appellant had failed to exercise due care and diligence in this regard. It is the case of the appellant that Rabobank was not a promoter of Yes Bank and, therefore, not disclosed as promoter in the prospectus. The Rabobank was called a co-promoter in the application before the RBI for the purpose of a banking license. The intention of Rabobank to participate with the Indian promoters of the Yes Bank as a technical participant has been clearly brought out in the initial application made by the Indian promoters as well as Rabobank's letter to the RBI. The prospectus filed with the Board contained the disclosure relating to Rabobank being a co-promoter in the application made for the purpose of banking license. It also contains necessary disclosure relating to Rabobank holding a minimum of 20% shares of Yes Bank. It is, therefore, incorrect to say that any false statement was made or any misrepresentation was made in the prospectus depriving the investing public of taking an informed decision about the Yes Bank IPO. It is also the case of the appellant that the Rabobank has never been treated as a promoter of the Yes Bank as is evident from the quarterly financial statements filed with the Board/stock exchanges and it has never been objected to. Even the draft read hearing prospectus (DRHP) was cleared by the Board without raising any objection on this issue. The Rabobank was shown as a co-promoter in its application before the Reserve Bank of India for a banking license to comply with the basic licensing conditions of the Reserve Bank of India to maintain the minimum promoters' shareholding of 49% but that does not make the Rabobank a promoter within the meaning of DIP guidelines and hence Rabobank was not shown as a promoter in the prospectus of the Yes Bank IPO.

5. We have given our thoughtful consideration to the rival submissions and are inclined to agree with learned counsel for the appellant that the charge of not exercising due care and diligence is not made out. The basis of holding the appellant guilty of this violation is the correspondence with the RBI, application

made before the RBI for securing a banking license and the clarification sought by the Board from the RBI. Obviously, RBI will furnish clarification to the Board only with reference to the application that was submitted by the promoters of the Yes Bank for a banking license. The appellant has been successful in demonstrating as to why Rabobank was shown as a co-promoter in its application for banking license with the RBI. Simply because Rabobank was shown as a co-promoter of Yes Bank for getting a banking license from the RBI will not ipso facto make it a promoter for the purposes of DIP guidelines or other regulations issue by the Board. To bring Rabobank within the promoter category, it must satisfy the definition of promoter as given in the DIP guidelines. There is no general definition of promoter in the DIP guidelines. Clause 6.8.3 of the DIP guidelines prescribes the manner in which capital structure of the company is to be presented in the DRHP for IPO. Clause 6.8.3.1 thereof provides the manner in which authorised, issued, subscribed and paid up capital is to be presented. Clause 6.8.3.2 makes provision for notes that shall be incorporated with the details of capital structure. Paras (k) and (l) thereof read as under :-

> "(k) The details of:
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> (i) the aggregate shareholding of the promoter group and of the directors of the promoters, where the promoter is a company.
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> (ii) the aggregate number of securities purchased or sold by the promoters group and the directors of the promoter during a period of six months preceding the date on which the draft prospectus is filed with Board and to be updated by incorporating the information in this regard till the time of filing the prospectus with the Registrar of Companies.
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> (iii) the maximum and minimum price at which purchases and sales referred to in (ii) above were made along with the relevant dates.
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> (l) In the event of it not being possible to obtain information regarding sales and purchase of securities by any relative of the promoters, a statement to that effect shall be made in the prospectus on the basis of the transfers recorded in the books of the issuer company."

Explanation I under clause 6.8.3 gives an inclusive definition of the term 'promoter' which read as under :-

"Explanation I: For the purpose of sub-clauses (k) and (l) above, the term 'Promoter' shall include:

(a) the person or persons who are in over-all control of the company;

(b) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public;

(c) the persons or persons named in the prospectus as promoters(s):

Provided that a director/ officer of the issuer company or person, if they are acting as such merely in their professional capacity shall not be included in the Explanation.

Explanation II: 'Promoter Group' shall include:

(a) the promoter;

(b) an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse);

(c) in case promoter is a company:

(i) a subsidiary or holding company of that company;

(ii) any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the promoter;

(iii) any company in which a group of individuals or companies or combinations thereof who holds 20% or more of the equity capital in that company also holds 20% or more of the equity capital of the issuer company; and

(d) in case the promoter is an individual:

(i) any company in which 10% or more of the share capital is held by the promoter or an immediate relative of the promoter or a firm or HUF in which the promoter or any one or more of his immediate relative is a member;

(ii) any company in which a company specified in (i) above, holds 10% or more, of the share capital;

(iii) any HUF or firm in which the aggregate share of the promoter and his immediate relatives is equal to or more than 10% of the total; and

(e) all persons whose shareholding is aggregated for the purpose of disclosing in the prospectus under the heading "Shareholding of the promoter group".

Explanation III**:** The Financial Institution, Scheduled Banks, Foreign Institutional Investors (FIIs) and Mutual Funds shall not be deemed to be a promoter or promoter group merely by virtue of

> the fact that 10% or more of the equity of the issuer company is held by such institution:
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> Provided that the Financial Institutions, Scheduled Banks and Foreign Institutional Investors (FIIs) shall be treated as promoters or promoter group for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them."

We have also looked into the final prospectus dated June 24, 2005 issued by the Yes Bank Ltd. after it was cleared by the Board. In the portion dealing with the capital structure of the company, the share capital held by Ashok Kapoor and Rana Kapur as promoters amounting to 20% has been shown to be locked in for a period of 3 years as per the Sebi guidelines. It is further stated therein that in accordance with the terms and the license issued by the RBI for carrying out the business of banking, 49% of the pre-issue share capital will be locked in and this includes the share capital of Rabobank also. The shareholding of Rabobank has been shown under the column 'equity shares held by top 10 shareholders'. Similarly, on page 15 of the prospectus, shareholding of the Rabobank is shown not under promoters' quota, but under the category of other shareholders. A note has also been appended therein stating that Rabobank has indicated its intention to maintain its shareholding at 20% of the post-issue equity as mandated by the RBI approval and it may make applications for allotment of equity shares in the issue and subsequent market purchases subject to compliance with the dilution requirements as stated in the banking license.

6. It is, thus, clear if a person falls within the definition of promoter, as discussed above, only then his name will appear in the note indicating the aggregate shareholding of the promoter group. The Rabobank had two nominee directors in the Board of Yes Bank in a total composition of 12 directors. They were not instrumental in the formation of plan or programme pursuant to which the securities were offered to the public and the Rabobank had not represented itself on promoter of Yes Bank to be called as promoter in the RHP as per the DIP guidelines. In none of the documents, other than the application made before the

RBI for getting a baking license, Yes Bank has shown Rabobank in the promoter category. If the Rabobank falls within the promoter category, we fail to understand how such a vital aspect escaped notice of the regulator while clearing the DRHP where Rabobank is not shown as a promoter. We also fail to understand as to why the regulator continued to accept financial statements, quarter after quarter, year after year, without Rabobank being shown in the promoters' category and why no action was initiated against Yes bank for making incorrect disclosure in the financial statements. In this background, no fault can be found with the merchant banker of exercising due care and diligence when Rabobank was not shown in the promoter category. The conditions under which Rabobank was shown as a co-promoter by the Indian promoters for obtaining a banking license were disclosed in the prospectus and their shareholding pattern was also shown which appears to be sufficient information for the investors to take an informed decision for their investment in the IPO of the Yes Bank. Rabobank has never been treated as a promoter by the Yes Bank and the Board has not come to a conclusive finding to the effect that Rabobank falls within the definition of promoter as given in explanation 1 under clause 6.8.3.2. It is treating Rabobank as a promoter of Yes Bank solely on the basis of the application filed before the Reserve Bank of India for a banking license. In the absence of any findings on the part of the Board that the Rabobank is promoter within the meaning of explanation 1 under the clause 6.8.3.2, the findings of the Board on this charge cannot be upheld.

7. The next violation alleged against the appellant is that it failed to exercise due diligence with regard to disclosures for allocation of shares to qualified institutional buyers (QIB). The Board observed that a large chunk of shares under this category had been allotted to foreign institutional investors and other categories like, mutual funds and banks received negligible shares in this category. The appellant considered 19 foreign institutional investors eligible for platinum category whereas only two mutual funds were considered under this

category and no financial institutions or banks were found eligible in this category. According to the Board while allotting the shares under QIB category, the appellant exercised its discretion in a manner that majority of shares were allotted to foreign institutional investors and the applications of banks/mutual funds appear to have been overlooked during the allotment. It is the case of the appellant that the DIP guidelines permitted discretion in allotment under the QIB category and while exercising its discretion, it had followed certain norms. In the absence of any guidelines in the regulation as to how allotment under discretionary quota is to be made, the Board cannot question the allotment under discretionary quota on the basis of norms that were followed by the appellant. The appellant has also relied on the observations of the primary market advisory committee of the Board which reviewed the DIP guidelines and which read as under :-

> "In case of allocation to QIBs, various factors were to be considered including the quality of investor, commitment to specific sector, investment objectives, prior track record etc. These factors could vary from one issue to another. As such exhaustive disclosure of all parameters would be difficult. In the absence of discretion, any QIB investor, irrespective of quality, investment objectives etc, could get the shares allocated, which arguably may not be in the best interest of the issuer, the market and the investor."

It was further submitted by the appellant that final decision on allotment of equity shares in a public offering vest with the company's Board of Directors and the company has its own commercial considerations which have to be recognized for the purpose of allocation. According to the appellant, its role is limited to advising and recommending the desirable allocation to QIBs and final decision for allocation is determined by the Board of the issuer company. Learned Additional Solicitor General, while admitting that the DIP guidelines at the relevant time permitted the allotment to be made on discretionary basis under the QIB quota, emphasised that there was nevertheless a requirement that the discretion be exercised in such a manner to ensure that the allotment is made on a fair and proper basis. According to him, the appellant has failed to indicate the

parameters and has provided no justification for including foreign institutional investors and certain mutual funds in the platinum category. Therefore, according to the learned Additional Solicitor General, placing certain entities under platinum category was done in arbitrary, subjective and whimsical manner and allotment on that basis is in breach of the requirements of the DIP guidelines. We are unable to agree with the submissions made by the learned Additional Solicitor General in this regard. Once the company is given discretion for allotment of shares under QIB, it is for the company to decide, in consultation with the merchant bankers, as to how that discretion is to be exercised. It is not a case where no parameters were laid down by the company for exercising this discretion. What is being questioned here is that the parameters laid down by the company for exercise of its discretion are arbitrary. If that argument is accepted, then the discretion given to the company in allotting equity shares under the QIB category loses its significance. The appellant has placed on record the criteria followed by the company in allotment of shares under discretionary quota and, therefore, no fault can be found with the merchant banker on this count as well.

8. The last violation on which the appellant has been found guilty is that it has failed to properly monitor the flow of applications and other matters pursuant to the closure of the public issue. It is alleged that in the Yes Bank IPO, shares were allotted to applicants having non existing DP IDs, multiple applications having same address, allotment of shares being made to the applicants having same name, same address but different DP details etc. According to the Board, the registrar and share transfer agent to the issue (RTA) had failed to detect and withhold these applications. The merchant banker was required to exercise due diligence and was responsible for post-issue activities till the subscribers received the shares/debentures. It was also incumbent on the appellant to depute officials, as required by 7.4.1 of the DIP guidelines, to monitor the flow of applications and the allotment of the shares. According to the Board, the appellant has failed to discharge his duty as a merchant banker which resulted in allotment of shares to

multiple/fictitious and benami applicants. We have considered the rival submissions and are unable to accept the Board's contention on this issue as well. It is not a case where the appellant has not deputed its officials to the RTA. Admittedly, it is the primary responsibility of the RTA to scrutinize these applications and the job of the merchant bankers is to ensure that RTA has performed its duties. In its reply, the appellant has categorically stated that it had deputed experienced officers post closure of the offer to the registered office and on selective basis the applications were verified alongwith the complete verification of top 100 allottees. During its inspection, the officials did not notice any omission or commission which were required to be reported to the Board and in this view of the matter, we do not find the appellant guilty of violating the regulatory framework as alleged.

In the result, we allow the appeal and set aside the impugned order with no order as to costs.

Sd/-
P. K. Malhotra
Member

Sd/-
S. S. N. Moorthy
Member

15.2.2012
Prepared & Compared by
ptm