

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Appeal No.107 of 2010

Date of decision: 19.11.2010

1. Dr. Arvind Kumar B Shah (HUF)
30/2 Flowers road,
Kilpauk, Chennai – 600 010.

2. Narit Tradecom Private Limited
7, Munshi Saddruddin Lane,
Kolkata – 700 007.

....Appellants

Versus

The Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4-A, G Block,
Bandra Kurla Complex,
Mumbai – 400 051.

....Respondent

Mr. P.N. Modi, Advocate for Appellants.

Mr. Kumar Desai, Advocate with Mr. Ajay Khaire and Mr. Sameer Shaikh, Advocates
for the Respondent.

CORAM : Justice N.K. Sodhi, Presiding Officer
Samar Ray, Member

Per : Justice N.K. Sodhi, Presiding Officer

Whether, in the facts and circumstances of the case, the appellants should be granted exemption from complying with the provisions of Regulations 10 and 11(1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter called the takeover code) is the short question that arises for our consideration. Facts giving rise to this appeal are not in dispute and these may first be noticed.

2. Arvind Remedies Ltd. is a company incorporated under the provisions of the Companies Act, 1956 with its registered office at Chennai and its shares are listed on the Bombay Stock Exchange Ltd. and National Stock Exchange of India Ltd. It shall be referred to hereinafter as the target company. It is operating in the pharmaceutical sector

and its main business activity is the manufacture and marketing of allopathic and ayurvedic formulations. The promoter shareholding in the target company was 25.32 per cent including 1.51 per cent of the first appellant and the remaining 74.68 per cent of the shares were held by the public.

3. The target company has a plant at Kakallur in the state of Tamilnadu which, according to it, is running in its full capacity with no scope for further expansion. Due to heavy competition in the pharmaceutical sector coupled with the escalation of the cost of raw materials and operating costs, the target company decided to expand its business in the year 2006 by setting up a plant at Haridwar in the state of Uttarakhand because of some fiscal benefits offered in the form of zero excise duty etc. by the state government. This plant in Haridwar was wound up in the year 2009 and the target company decided to set up a new project for the manufacture of value added products in the district of Kanchipuram (Tamilnadu). This project was appraised by ITCOT Consultancy and Services Ltd. This agency in its techno feasibility report observed that the project was technically feasible, commercially viable and merited consideration for the sanction of financial assistance. The cost of the project was worked out at ` 250.08 crores. With this appraisal report, the target company approached various banks for financial assistance and after discussions, three banks namely, United Bank of India, Karur Vysya Bank and Punjab National Bank agreed to sanction a term loan of ` 184 crores for the project. The consortium of these three banks imposed some pre-disbursement conditions, one of which was that the target company should raise upfront equity of ` 50 crores. This is what the United Bank of India by its letter of October 12, 2009 informed the target company.

“In this connection, you are advised to apprise us on the steps being taken by you for raising of upfront equity of Rs. 50 Crores, supported by a Chartered Accountant certificate before seeking disbursement of term loan”.

Identical communications were received by the target company from the other two members of the consortium as well.

4. Since the banks had put a condition of bringing in a margin amount of ` 50 crores in the form of equity, the target company approached its promoter group to contribute to

the extent of ` 50 crores to meet the requirement for financing the project. The appellants who are the promoters of the target company consented for contributing the necessary finance for the project. Accordingly, the Board of Directors of the target company in their meeting held on September 7, 2009 decided to issue shares on preferential basis to the appellants in order to meet the condition imposed by the banks for releasing the term loan. It is the requirement of Section 81(1A) of the Companies Act that if further share capital is to be offered to persons other than all the existing shareholders of a company, then approval of the shareholders of that company has to be obtained by way of a special resolution. The Board of Directors of the target company resolved in their aforesaid meeting to seek the approval of the shareholders by way of special resolution through postal ballot. In pursuance to this resolution, a notice dated September 12, 2009 was issued by the target company to all its shareholders proposing to issue 22,22,50,000 equity shares of ` 1 each at a premium of ` 1.25 each to the following three entities.

- (1) Dr. Arvind Kumar B. Shah (HUF), the first appellant – 3,11,46,650 shares (7.27%).
- (2) M/s. Narit Tradecom Pvt. Ltd., the second appellant and an associate of the first appellant – 12,44,43,350 shares (25.80%).
- (3) M/s. Aryaman Commerce Pvt. Ltd. – 6,66,60,000 shares (13.82%).

In the explanatory statement attached to the notice, every minute detail in regard to the preferential allotment was furnished to the shareholders and the object of the preferential issue was brought to the notice of the shareholders in the following words:

“The Banks have sanctioned the Term Loans with the condition that margin shall be brought in only by way of equity. The Balance of Rs. 50.00 crores which is required to be brought by way of equity as per the stipulation of the Banks, has to be mobilized on urgent basis as margin, without which the advance towards civil construction work, machinery, etc, which is aggregating to Rs. 214 crores in the whole project will not be released by the Banks as Term Loan. At this juncture, Rights issue if proposed may not only delay the process due to lengthy procedure involved in such issues. Further the Company since now operating, with such low margins, the capital taken by rights cannot be properly serviced and such capital had to stay invested for atleast two to three years without returns. Hence after commissioning of the project, full justification will be given on the project and intrinsic value and return will become automatically added to shareholder’s wealth. Moreover since plant in Haridwar is sold due to change in fiscal policy, the impact will be very heavy on the Company and hence there is no other option except to go in for new project, for expanded

capital and new product line to match with industry competition and growth. Thus the promoter group and associates identified have given consent to contribute Rs. 35 crores on call basis on one time by cash payment basis to enable the company to borrow for this cause envisaged above. The company had also identified new investors who will be benefitted from (sic) their new project and who have consented to invest upto Rs. 15 crores as equity in the company. The provisions of Section 372 A of the Companies Act, 1956 will not be applicable to both the companies as they are Private Limited companies.

Preferential allotment to the promoters / persons acting in concert group will increase their holding from 25.32% to 45.91%. Hence the proposed acquirers are making an application to the Securities and Exchange Board of India under Regulation 4 of SEBI (Substantial Acquisition of Shares & Takeover) Regulations, 1997 seeking exemption from the applicability of the provisions of Regulation 10, 11(1) and 12 of the SEBI(SAST) Regulations, as the proposed acquisition exceeds the limits laid down in the said regulations.”

The shareholders were specifically informed that **“There will be no change in the Management or control of the Company consequent to the Preferential issue”**. The fact that the appellants would be seeking exemption from complying with the provisions of Regulations 10 and 11(1) of the takeover code was also brought to their notice.

5. The shareholders of the target company voted by way of postal ballot and passed the resolution regarding “Issue of equity shares on preferential basis” which was item no. 4 in the notice and they approved the issue of 15,55,90,000 equity shares of ₹ 1 per share at a premium of ₹ 1.25 per share (32.26% of the post issue capital) to the appellants and 6,66,60,000 shares to M/s. Aryaman Commerce Pvt. Ltd. for financing the new project. The result of the postal ballot was published in newspapers and a copy of the resolution passed by them is on the record. As a result of the proposed preferential allotment in favour of the appellants, their shareholding alongwith other entities acting in concert with them would increase from 25.32 per cent to 45.91 per cent and would trigger the provisions of Regulations 10 and 11(1) of the takeover code. The appellants filed with the Securities and Exchange Board of India (for short the Board) an application in November, 2009 under Regulation 3(l) read with Regulation 4 of the takeover code seeking exemption from the provisions of Regulations 10 and 11(1) thereof. These provisions [Regulations 10 and 11(1)] require that when an acquirer acquires voting rights in a company crossing the threshold limits prescribed by these provisions, he has necessarily to make a public offer to the existing shareholders to acquire further shares in the company. In the exemption application, the appellants had stated various grounds on

which the exemption was being sought from the provisions of the takeover code. This application was placed before the Takeover panel which after seeking necessary clarifications from the appellants and on a consideration of the grounds stated therein recorded its findings in the following words

“The Company’s new project at Chennai costing Rs. 250.08 crores has been sanctioned by Banks, by way of Term Loan of Rs. 184 crores on Rs. 16.08 crores by way of internal accrual and the balance has to be raised by Equity of Rs. 50 crores which the Company want to raise by issuing equity shares to promoters / PAC or Rs. 35 Crores. And the necessary resolution as per Companies Act has been passed by postal ballot as funds are required immediately to provide necessary margin money for the term loan to be disbursed as per the Banks Terms of sanctions by the bank. Hence there is an urgency.

Panel noted that the Company has by way of explanatory statements to the Notice dated 12.09.2009 of the resolution to be passed through postal ballot given full details of the object of the preferential issue and also informed the shareholders preferential allotment to promoters and person acting in concert will increase the holding from 25.32% to 45.91%. Hence the proposed acquirers are making an application to the SEBI for exemption.

Panel noted that the resolution was passed by 99.1% as per the report of scrutinizer. Letter received from the applicant vide letter dated 10.12.2009 and further clarification and confirmation from acquirers by letter dated 22.12.2009 which was taken on record.

Panel also note that out of 71589 shareholders only 7586 postal ballot was received and 99.1% votes in favour. They have confirmed that they have proof of dispatch of notice to all the shareholders.”

The Takeover panel recommended that the case of the appellants was worth granting the exemption from the provisions of Regulations 10 and 11(1) of the takeover code as, in the opinion of the panel, it would enhance the shareholders’ value as the expansion and timely contributions of the equity capital by promoters was in the interest of all the shareholders of the target company. The findings and the recommendations of the Takeover panel were then placed before a whole time member of the Board who by his detailed order of April 26, 2010 did not agree with the Takeover panel and declined exemption to the appellants from complying with the provisions of Regulations 10 and 11(1) of the takeover code. It is against this order that the present appeal has been filed.

6. We have heard the learned counsel for the parties and are of the view that the appeal deserves to be allowed as the present case is a fit one for granting exemption as

sought by the appellants. There is no gainsaying the fact that the target company had decided to expand its business by setting up a new project in the district of Kanchipuram for which it required a sum of ` 250.08 crores. It needed funds urgently and approached the banks. As already noticed, the consortium of three banks had sanctioned a term loan of ` 184 crores for the project with a pre-disbursement condition that the target company raises upfront equity of ` 50 crores. Now to raise this amount by way of equity, the company could resort to any one of the three modes permitted by law. It could go to the public and ask for funds or it could approach the existing shareholders with a rights issue and raise funds from them and the third course open to it was to make a preferential allotment to a select group of persons. The target company chose the third course and made a preferential allotment to its promoters including the appellants and another entity who agreed to subscribe to the requisite number of shares to raise ` 50 crores for the project. We find that the target company did nothing wrong in resorting to this course of action. Preferential allotment is permissible under section 81(1A) of the Companies Act and the procedure prescribed therein was duly followed. The whole time member has found fault with the target company for not raising the funds through a rights issue as, according to him, the method of preferential allotment denied to the shareholders an equal opportunity in the fund raising exercise. He appears to be of the view that since the shareholders had been denied that opportunity, they be given an exit option through an open offer by declining the exemption. He is totally wrong in his approach and perception of the shareholders' interests. First of all, it is not for the Board to advise or insist on any company as to how and in what manner it should raise its further equity capital when the law gives the aforesaid three options to a company. Of course, it must ensure that whichever method a company may adopt for raising equity capital, the procedure prescribed by law for that method has been followed in letter and spirit. It is nobody's case that there was any such lapse in the present case. Secondly, the target company and its shareholders had considered the option of the rights issue for raising the equity and for good business reasons and without jeopardising the interest of the shareholders abandoned this option. The target company had been allotted in September, 2009 prime land measuring 3.8 acres in SIPCOT Industrial Park for its new project. This

allotment was made by the State Industries Promotion Corporation of Tamilnadu and one of the important conditions of allotment was that the company had to complete the implementation of the project and start commercial production within 30 months from the date of allotment failing which the allotment would stand cancelled and the price paid for the plot forfeited. This would obviously mean that the infrastructure had to be raised, the plant and machinery had to be installed and commercial production was to begin and all this had to be done within 30 months. It is needless to mention that without raising the necessary funds, even the first step towards the implementation of the project could not be taken. Since time was of the essence, the target company had to choose the quickest way without sacrificing the interests of its shareholders to raise the necessary funds including the equity of ` 50 crores which was a pre-disbursement condition imposed by the banks. We agree with the learned counsel for the appellants that preferential allotment was not only the quickest but also the surest method of raising equity. The option of rights issue if resorted to would have consumed good bit of the 30 months that were available with the target company to start commercial production. Apart from the delay which that process would have caused, there was no certainty that the target company would be able to raise ` 50 crores through that method. Even in the best case scenario of full subscription in the rights issue at 1:1 ratio, the total money that could be raised would have been ` 36 crores only leaving a deficit of ` 14 crores for the project. There was also no certainty that all the shareholders would participate in the rights issue. The average market price of the share of the target company during the last six months was around ` 1.89 and it could at the most offer shares to the shareholders in a rights issue at ` 1.39 per share, if not lower. It is axiomatic that unless the target company offers the shares at a price lower than the market price, the shareholders would not participate. If the option of rights issue had been adopted, the existing shareholders would have paid at the most at the rate of ` 1.39 per share whereas the promoters to whom preferential allotment has been made have paid ` 2.25 per share. Has the preferential allotment not added value to the company and in turn enhanced the shareholders' value. There is yet another reason why the target company did not pursue the rights issue option. This process causes not

only uncertainty and delay but also involves extra cost. The appellants pointed out and which fact has not been disputed on behalf of the Board that the total cost of the rights issue would have been close to ` 56 lakhs and the target company could ill afford at that point of time to spend this amount on this exercise as it had recently wound up its project at Haridwar and was operating at low margins. All the aforesaid facts had been brought to the notice of the shareholders in the notice dated September 12, 2009 that was issued to them for passing a special resolution. We are satisfied that the target company acted in a most transparent manner throughout and kept nothing back from the shareholders. From the sequence of events, we have no reason to believe that the interest of shareholders had been compromised at any stage of the entire process. On the contrary, timely contribution of equity by the promoters through preferential allotment for the new project of the company enhanced their share value. Having noticed the circumstances in which the preferential allotment was being made and with their eyes open, the shareholders consented to the preferential allotment in favour of the promoters. Had they been interested in participating in the fund raising exercise, the special resolution would not have gone through. Let us not forget that the shareholders are the best to judge their own interest. It is also a fact that more than 99 per cent of the shareholders who cast their ballots voted in favour of the preferential allotment. Shri. Kumar Desai learned counsel for the respondent argued that only 10 per cent of the shareholders had participated in the postal ballot and that this percentage does not represent the majority of the shareholders. This is not a ground on which the impugned order is based. Be that as it may, we cannot accept this argument. There is ample proof on the record that the target company had sent the notice for a postal ballot to all its shareholders and those who did not cast their votes were in silent agreement with the proposed resolution. Their silence cannot be taken otherwise in the absence of any statutory provision to the contrary. The matter would have been different if the majority had not been provided with an opportunity to cast their votes. That is not the case. The argument of Shri. Kumar Desai overlooks the provisions of Section 192 A read with Section 189(2) of the Companies Act which provide that where a company decides to pass any resolution through postal ballot, the said resolution should be assented to by the requisite majority of shareholders by means of postal ballot

and the same shall be deemed to have been duly passed at a general meeting convened in that behalf. A resolution is deemed to have been passed by the requisite majority if the votes cast in favour of the resolution by the members are not less than three times the number of votes, if any, cast against the resolution. As already noticed, more than 99 per cent of the shareholders who had exercised their votes had voted for the resolution and the same was validly passed as a special resolution by the requisite majority. In this view of the matter, it cannot be said that those who cast their votes did not represent the majority of the shareholders. We do not agree with the learned counsel for the respondent that the Board was trying to protect the so called interests of the silent majority by declining the exemption sought for by the appellants.

7. We also do not agree with the whole time member that, in the circumstances of the present case, the shareholders of the target company should have been provided with an exit route by requiring the appellants to make a public offer. There has been no change of management or control over the target company consequent upon the preferential allotment as notified to the shareholders. This is also not a case where a rank outsider had acquired a large chunk of shares in the company and was seeking exemption from the takeover code. Such an acquisition or change in management or control over the target company brings with it an element of uncertainty and the takeover code provides that in such an eventuality the existing shareholders be provided with an exit route by requiring the acquirer to make a public offer. In the case before us, there was no element of uncertainty and there was no change of management or control and we are satisfied that the shareholders of the target company did not get affected in any manner by the acquisition. The promoter group remains the same and the only outsider was M/s. Aryaman Commerce Pvt. Ltd. which acquired 13.82 per cent of the shares of the target company which acquisition by itself did not trigger Regulations 10 and 11(1) of the takeover code. Besides this, we cannot forget that the primary object of the acquisition was to provide additional financial assistance to the target company for its new project. In view of all the facts and circumstances of this case, we are of the view that this is a fit case where the appellants should be granted exemption under Regulation 3(l) of the takeover code from the provisions of Regulations 10 and 11(1) thereof. We, therefore, answer the question posed in the opening part of the order in the affirmative.

8. Before concluding, we may notice another contention advanced by the learned counsel for the appellants. He pointed out that in a number of cases where the facts and circumstances were identical, the Board itself has been granting exemption under Regulation 3(l) of the takeover code. He referred to an order dated September 14, 2007 passed by a whole time member in the case of Jumbo Bag Ltd. We have gone through that order and find that in that case also a promoter group of Jumbo Bag Ltd. had acquired equity capital in that company which triggered Regulations 10 and 11(1) of the takeover code. In that case also the funds were required to meet the expansion activities of the company and the promoter acquirers came forward to provide additional financial assistance as in the case before us. The promoter acquirers were granted exemption by the whole time member holding that the shareholders of the company would not be affected in any manner as there was no change of management or control and that it was a fit case to grant exemption under Regulations 3(l). Same is the position in the case before us. The learned counsel cited a few other orders of the Board as well where exemption had been granted under similar circumstances. We are not examining the details of those orders and suffice it to say that the Board has in the past been granting exemption to acquirers in circumstances that exist in the present case. Then why not in the present case as well. It must be remembered that it is in public interest that a statutory regulator like the Board should be consistent in its approach as that would send the right signals to the capital market and would also insulate the Board from the charge of discrimination.

In the result, the appeal is allowed, the impugned order set aside and the appellants are granted exemption from complying with the provisions of Regulations 10 and 11(1) of the takeover code. We make no order as to costs.

Sd/-
Justice N.K.Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

19.11.2010
Prepared and compared by:
msb