

IN THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Appeal No. 154 of 2006

Date of decision : 10.8.2007

Pentamedia Graphics Ltd.

..... Appellant

Versus

The Bombay Stock Exchange Ltd.

..... Respondent

Mr. P.H. Arvindh Pandian Advocate for the Appellant
Mr. Pesi Modi Advocate with Mr. Mahesh Humranwalla Advocate and Mr.
D.D. Juvekar Advocate for the Respondent.

Coram : Justice N.K. Sodhi, Presiding Officer
Arun Bhargava , Member
Utpal Bhattacharya, Member

Per : Justice N.K. Sodhi, Presiding Officer

Pentamedia Graphics Ltd. (for short Pentamedia), is a listed company and is engaged in the business of animation and special effects for cinema, home videos, television and personal computers. Mediadreams Limited, Kris Srikanth Sports Entertainment Limited, Intelelevision Limited and Mayajaal Entertainment Limited (hereinafter referred to as MDL, KSSEL, Intelelevision and Mayajaal respectively) are its wholly owned subsidiaries. The boards of directors of these companies proposed restructuring under a scheme which, according to them, would result in greater synergies of operations and better management of the companies concerned. A composite scheme of amalgamation, arrangement and compromise (hereinafter called the scheme) between Pentamedia and its aforesaid subsidiaries and their respective shareholders and creditors was prepared. The board of directors of Pentamedia in their meeting held on January 30, 2004 approved the scheme.

Similarly, the scheme was approved by the boards of directors of the subsidiary companies as well. The scheme inter alia provided for, –

- (a) Amalgamation of MDL, KSSEL and Intelelevision with Mayajaal;
- (b) Demerger and vesting of Animation and NUM TV divisions of Pentamedia into Mayajaal;
- (c) Reorganisation of capital of Pentamedia;
- (d) Compromise between Mayajaal and holders of advances against equity of Mayajaal;
- (e) Compromise between Pentamedia and its secured creditors;

It was further provided that upon the scheme becoming fully effective, in consideration of the transfer and vesting of all assets and liabilities, duties, rights and obligations relating to the Animation and NUM TV division of Pentamedia in Mayajaal in terms of part III of the scheme, Mayajaal shall without any further act or deed issue and allot –

“(a) six equity shares of rupee one each credited as fully paid up of Mayajaal to each of the equity shareholders of Pentamedia as on the record date in respect of every ten equity shares of rupees ten each fully paid up held by them in Pentamedia;

(b) six equity shares of rupee one each credited as fully paid up of Mayajaal to each of the preference shareholders of Pentamedia as on the record date in respect of every ten- 6% non-cumulative optionally convertible redeemable preference shares of rupees ten each fully paid up held by them in Pentamedia.”

Paras 3.18 and 3.19 of the scheme which are relevant for our purpose read as under :

“3.18- All equity shares to be issued and allotted by Mayajaal in terms hereof shall rank pari passu in all respects including dividend from the date of their allotment in terms of the scheme with the existing equity shares of Mayajaal.....

.....
Equity shares issued by Mayajaal in terms hereof shall be listed by the Stock Exchange at Madras Stock Exchange Limited, Chennai, National Stock Exchange of India

Limited, Mumbai and the Stock Exchange, Mumbai.

3.19. The Stock Exchanges at Madras Stock Exchange Limited, Chennai, National Stock Exchange of India Limited, Mumbai and the Stock Exchange, Mumbai, shall list the entire Equity Share Capital of Mayajaal (including the existing paid up equity share capital of Mayajaal and the equity shares issued pursuant to this scheme) in accordance with chapter VIII of the SEBI (Disclosure & Investor Protection) Guidelines, 2000 without Mayajaal being required to make an initial public offer, as the requisite minimum of 25% of Mayajaal's paid up share capital shall comprise of equity shares allotted to the public holders of equity shares of PMGL (viz., members of the public)."

Pentamedia being a listed company, its shares are listed, among others, on the Bombay Stock Exchange (BSE)- the respondent herein. Mayajaal which is a subsidiary of Pentamedia is an unlisted company and under the scheme it had to allot its shares to the shareholders of Pentamedia. When the scheme was prepared, Pentamedia approached BSE and filed an application dated February 20, 2004 under clause 24(f) of the listing agreement executed between the former and the latter seeking approval of the scheme for the limited purpose of getting the shares of Mayajaal listed on BSE. This clause in the listing agreement made it obligatory for Pentamedia to file the scheme proposed or prepared by it under sections 391 to 394 of the Companies Act with the BSE for approval and it was required to be filed atleast a month before it was presented to the High Court for sanction. While the application seeking approval of the scheme was pending with the BSE, Pentamedia and its subsidiaries filed Company Petitions nos. 167 to 171 of 2004 in the High Court at Chennai for an order to sanction the scheme with effect from January 1, 2004 so as to be binding on all the shareholders and the creditors of the companies. The scheme was sanctioned by the High Court by its order dated

October 12, 2004. The relevant part of the order which is contained in direction no.6 therein reads thus –

“6. That, the entire equity share capital of Mayajaal Entertainment Limited, (including the existing paid up equity share capital of Mayajaal Entertainment Limited, and the Equity Shares issued pursuant to this Scheme) shall be listed at the stock exchange at Madras Stock Exchange Limited, Chennai, National Stock Exchange of India, Mumbai and Stock Exchange, Mumbai”.

It appears that on the basis of the aforesaid direction issued by the High Court while approving the scheme, Pentamedia impressed upon the BSE to allow its application under clause 24(f) of the listing agreement and approve the scheme. Approval of the scheme by the BSE would obviously mean that the shares issued by Mayajaal shall be listed. Since BSE was not a party to the company petitions filed in the High Court, it was not aware of the order dated October, 12, 2004 sanctioning the scheme. When it learnt about the said order, it filed on March 17, 2006 Company Application no. 498 of 2006 in the High Court seeking review / modification of the order dated October 12, 2004. It was pointed out in this application that Pentamedia had failed to disclose to the High Court that its application made to the BSE under clause 24(f) of the listing agreement was still pending and that BSE had not approved the same. It was also pointed out that at the time when the scheme was sanctioned by the High Court, BSE was still in the process of conducting its investigations in regard to certain aspects of the scheme and its implications on the shareholders of Pentamedia and the effect that it may have on the general investors in the stock market. Taking note of the submissions made on behalf of BSE and without examining the merits of those contentions, the learned Company Judge of the High Court directed BSE to give a check list of its requirements to Pentamedia within a stipulated time whereupon the latter was

required to furnish the details clarifying the points raised by the former and on receipt thereof, BSE was required to pass appropriate orders. The learned judge observed that it would be open to Pentamedia to challenge the order passed by BSE. The application filed by BSE was accordingly disposed of by the High Court on April 5, 2006.

It is pertinent to mention here that under the scheme framed by Pentamedia and its subsidiaries, Pentamedia had written off its assets to the tune of Rs. 690.04 crores and that it had been writing-off its assets since the year 2001-02 every year till 2003-04 which amounted to an aggregate of Rs.1153.09 crores. The fact that the assets had been written off by Pentamedia is not in dispute before us. Ever since Pentamedia filed its application under clause 24 (f) of the listing agreement, BSE has been calling upon it to furnish the rationale for the substantial reduction in its capital and also to furnish details of the fixed assets in which the future diminution of value was expected and reasons for such diminution. Several letters in this regard were written to Pentamedia but to no effect. Not only this, BSE had also informed Pentamedia by its letter dated June 29, 2004 and also by subsequent letters not to proceed further in this matter till it gives its no objection. Since Pentamedia had not furnished adequate explanation to the various queries made from it, BSE decided to reject the application under clause 24(f) and communicated its reasons by letter dated June 13, 2006. It is against this communication that the present appeal has been filed.

It is observed in the impugned communication that Pentamedia wanted approval of a scheme by which it had written-off its assets to the tune of Rs.690 crores to be adjusted against the share premium account. The total amount of assets written-off including Rs. 690 crores under the scheme

amounted to Rs. 1153 crores for the period from 2001-02 to 2003-04. BSE also referred to the interim order dated October 3, 2005 passed by the Securities and Exchange Board of India (hereinafter called the Board) by which, among others, Pentamedia and its directors had been directed not to issue any further shares or alter its share capital and they had further been prohibited from accessing the capital market or dealing in securities in any manner whatsoever till further orders. The Board found that as per the admission of Pentamedia, it had issued 34 lac fake share certificates for being traded in the market while the original ones issued earlier were under pledge with the Oriental Bank of Commerce which was not only a fraud but also a serious market irregularity. Another reason given by BSE for rejecting the application of Pentamedia is its gross mismanagement which resulted in the erosion of its assets which in turn was “detrimental to the interest of investing public and would erode investors confidence in the securities market.” Feeling aggrieved by this communication, Pentamedia filed Company Applications nos. 1077 to 1081 of 2006 in the High Court at Chennai challenging the same. It was contended before the High Court that in view of its sanction accorded to the scheme, the BSE was not justified in refusing to list the shares of Mayajaal and that such refusal meant disobedience of the sanction order. It was also pleaded that the Madras Stock Exchange had already granted its no objection. BSE, on the other hand, urged before the High Court that even after the sanction of the scheme, it was open to it to insist on compliance of its regulations as a condition for listing and in the event of any violation thereof, reject the application for listing. The learned company judge examined the contentions of both sides in detail and upheld the plea of the BSE in the following words :

“Hence, even after the sanction of the scheme, it is open to the Stock Exchange to insist on compliance of its regulations as a condition for listing and in the event of any violation thereof, reject an application.”

The learned company judge further observed in para 42 of the order as under :

It must be noted that SEBI acts in its own field, given the jurisdiction as a regulatory agency in the matter of dealing with stocks, shares and debentures. The intricacies on the listing of the Company is entirely with the Stock Exchange. Section 4 of the Securities Contracts Regulation Act empowers SEBI to recognise the Stock Exchanges. It also controls the rule-making of the said Exchanges. Stock Exchanges are held to be regulatory authorities. Their byelaws bind not only buyers, sellers and brokers, but also third parties who are affected by the transactions in the Stock Exchange. They are entitled to regulate all matters connected with the business of the Stock Exchange. The byelaws have the effect of the statutory force. Hence, given the expertise in the above filed, the exclusive province of the Stock Exchange to grant recognition subject to the compliance of the Securities Laws, the Regulations and the Listing Agreement, in the context of Clause 24(f) is not to be confused with the jurisdiction of this Court granting approval of the Scheme. The applicants have, no doubt, filed a copy of the Scheme and the petition proposed to be filed. However, considering Clause 24(g), even after the grant of approval to the Scheme, it is open to the Stock Exchange to reject the plea for listing, when it is satisfied that such listing would be violative of the Securities Laws, there is no disrespect to the order of approval granted by this Court. The authority who is to judge on the merits of listing is competent to arrive at a decision in terms of the laws pertaining to the listing. In this view of the matter, one has to look at Section 392 of the Companies Act.”

It is pertinent to mention here that while dealing with the application of Pentamedia, BSE made a reference to the Board as per its letter dated December 12, 2005 and the Board responded on December 27, 2005 by addressing a communication to the BSE as under :

“In this regard, I am directed to inform you that you may grant approval for implementation of the order dated October 12, 2004 of Hon’ble High Court, Chennai subject to your ensuring compliance of your bye-laws, regulations etc.

It was contended before the High Court that in view of the aforesaid approval granted by the Board, BSE was not justified in rejecting the application filed by Pentamedia. This plea was negatived by the High Court by its order dated October 30, 2006 in the following words :-

“45. Now, coming to the reference from the SEBI as regards the direction to the Bombay Stock Exchange to grant its approval, it must be noted that it is not a blanket direction, but an approval to be granted subject to its byelaws and if the Bombay Stock Exchange finds that the terms of arrangement are contrary to its Regulations or the requirement under the Listing Agreement, the same has to be tested in a manner known to law and as provided under the Securities and Exchange Board of India Act. It may also be noted that the Bombay Stock Exchange, apart from referring to the non-satisfaction of the listing requirement, had also pointed out to the conduct of the transferor company, namely Pentamedia Graphics Ltd., as regards issuance of fake certificates in the market. In the background of this and the view on writing off assets to a huge sum, it is better the question as to the satisfaction of the Listing Agreement and the correctness of the order of this Court is left to the expert body viz., Bombay Stock Exchange and the appellate forum, if the applicant so chooses to test the correctness of the same. In the light the view that I have taken, I do not accept the plea of the applicants. I accept the objections raised by the Bombay Stock Exchange.

46. The question is what would be the effect of the order of this Court granting approval. It must be noted that the Act provides for an appeal against the order of the Bombay Stock Exchange before the Appellate Tribunal. In the face of such an expert body to deal with matters relating to the views expressed, it is but proper that the applicants seek their remedy by way of appeal before the Appellate Tribunal. Until such time, the listing cannot take place as regards Mayajaal Entertainment Ltd., or on the question of allotment of shares to the shareholders of Pentamedia Graphics Ltd. The approval granted to the Scheme cannot stand in the way of the Stock Exchange considering the compliance of the Listing Agreement.”

It is in view of the observations made by the High Court in para 46 that Pentamedia has filed the present appeal before us.

During the pendency of the application of Pentamedia before BSE, the latter by its several communications had called upon the former to furnish the rationale and specific reasons for writing-off its huge assets which resulted in diminution in shareholder value of Pentamedia. Replies to these communications was sent by Pentamedia but the reasons asked for were not furnished. The first ground on which the impugned communication of BSE has been challenged before us is that it had no jurisdiction to ask Pentamedia to furnish the rationale and specific reasons for writing-off its huge assets. This, according to Pentamedia, is a business decision and BSE had no authority to question the same. It was argued that neither the Securities and Exchange Board of India Act, 1992 nor the Securities Contracts (Regulation) Act, 1956 and not even the rules, regulations and bylaws framed thereunder give any power to BSE to make queries from an applicant seeking its approval to the scheme under clause 24 (f) of the listing agreement. This clause required Pentamedia to file the scheme proposed by it with BSE for its approval at least one month before it was presented to the High Court for sanction. We called upon the learned counsel for the respondent to point out the provisions which enabled BSE to ask such questions and he very ably took us through the provisions of the aforesaid statutes and also Rule 19(1) of the Securities Contracts (Regulation) Rules, 1957 and By-Laws 32 & 34 and Regulation 2.4 of the Bylaws and Regulations framed by BSE. He also referred to Appendix B to the Regulations and specifically to the listing agreement and clauses 24 and 36 thereof to contend that BSE had absolute powers to make such queries as it may think necessary in order to satisfy itself that the scheme operated to the benefit of the shareholders of Pentamedia and that it did not adversely affect the interest of investors. He very

elaborately demonstrated with reference to the various provisions that BSE being a primary level regulator could ask all such questions which were asked from Pentamedia. He also contended that the Byelaws and Regulations framed by BSE and even the listing agreement executed between the parties have a statutory force and cited case law in support thereof. Though we are inclined to accept the contentions of the learned counsel for the respondent, it is not necessary for us to examine this issue in any detail as the learned counsel appearing for the appellant at this stage very candidly conceded that BSE had the power to call upon Pentamedia to satisfy it regarding the rationale and reasons for writing-off huge amount of its assets which admittedly results in the erosion of the shareholder wealth. In view of this concession made by the appellant, we have no hesitation in rejecting the first contention advanced before us.

Having failed to persuade us on the first contention, the learned counsel for the appellant then challenged the decision of BSE on merits and contended that the reasons mentioned in the impugned communication for rejecting the application filed under clause 24(f) of the listing agreement were not sufficient to reject the same. He strenuously urged before us that adequate reasons had been furnished to the BSE for writing-off the assets of Pentamedia but the BSE would not accept the same and for no rhyme or reason had wrongly rejected the application. He took us through some of the letters written by BSE to Pentamedia seeking its explanation for the write-off and also to the replies filed by Pentamedia. We have given our thoughtful consideration to this contention but express our inability to accept the same. Admittedly, Pentamedia had filed on February 20, 2004 its application seeking approval of BSE in terms of clause 24(f) of the listing agreement. The first letter which

BSE wrote to Pentamedia was on March 31, 2004 seeking, among others, the rationale for the substantial reduction in capital. Since no reasons were furnished as asked for, another letter dated May 11, 2004 was addressed to Pentamedia seeking the details of the fixed assets in which the future diminution of value was expected and the reasons for such diminution. Pentamedia sent a reply on May 21, 2004 giving its so-called reasons for diminution of value. It would be better to quote the reasons in the words of Pentamedia itself. These were as under :

S.No.	Details of fixed asset	Amount in crores	Reasons for diminution
1.	Computers (Net block)	22.63	Computers and software are generally depreciated over a period of 3 years to 5 years as per the Depreciation policy followed by the company. However, there are certain assets, which could not be out to high-end use as is required for production of animation content or for multimedia purposes. These are due to technological obsolescence. Though these assets are physically available with the company, these could be used only for general purposes and as such are not likely to be used for the purpose for which they ought to be put to. Since these assets have been identified now, these are being provided for.
2.	Digital Contents	257.99	Digital content refer to the sets, props and character etc., developed for the production of animation content. The characters developed cannot be used in other productions unless the new productions are sequel to the content already produced. All these sets, props and characters have been extensively used in the productions made by the Company, and the Company has now identified those contents which are not likely to be used extensively in future for other products. These are also being provided for.
	Total	280.62	

This explanation is only in regard to the assets worth Rs.280.62 crores. In regard to some other assets which had been written-off, Pentamedia in its letter dated November 20, 2004 had this to say –

“Further to our earlier correspondence with your office and your letter no. DCS/SMG/RRP/2004 dated 16th November 2004 asking for clarification on the amount of Rs.18 crores proposed to be written from inventories of Rs.130.26 crores on account of PMGL’s job-in-progress, we give below our explanation as follows :

S.No	Project Name	Rs. In crores	Reasons
1.	Pentacartist	Rs.6.19	This product was developed And is incomplete
2.	Mustaffa	Rs.2.43	This was a pilot project and Later abandoned
3.	Science Magazine & Science Fiction	Rs.1.71	This was developed for educational purpose. Subsequently were not able to upgrade the same.
4.	Mouse Roars	Rs.1.44	This was held for inventory purpose and was later abandoned.
5.	Safety Tips	Rs.0.82	This was a joint venture but later did not materialize.
6.	Bible Stores	Rs.3.73	This was a joint venture but later did not materialize.
7.	Vikra	Rs.1.59	This was a pilot project and later abandoned.
8.	House of Wind	Rs.1.91	This was a pilot project and later abandoned.

Please find enclosed the reasons for writing off the substantial amount of loans and advances and details of legal action taken against the defaulters.

S. No	Particulars	Rs.in crores	Reasons for writing off	Legal Action Taken
1	Exodus	Rs.14.35	Band with charges which were paid in advance for web streaming of TV channels for NUM TV Divisions. Due to the advances in technology the same could not materialize.	The company is in the process of liquidation
2	Film Roman USA	Rs.9.51	Our company acquired the company and later the acquisition did not materialize. Certain joint venture projects which were initiated had to be abandoned.	The company is in the process of trying to get back from them the digital contents created for the projects from them. Since, it has no future value, the company is proposing to write off the same.

3	Purple Drop Inc.USA	Rs.9.21	This was a joint venture project started by an ex-employee of Silicon Graphics. Since Silicon Graphics was the major supplier of technology and equipments Our company paid advance for commencement of various projects. The company did not take off	The company is not traceable
4.	WMI Tech USA	Rs.10.56	Advance paid to them for purchase of certain equipments. They could supply part of the equipments. The balance part obtained by them became obsolete because of advances in technology.	The company has made counter claim on us.”

Now when we examine the aforesaid explanations furnished by Pentamedia it is abundantly clear that, to say the least, the explanations are not only inadequate and unsatisfactory but also unacceptable. For instance, in the case of computers, the assets are available with the company which, according to its own showing, could be used for general purposes and are “**not likely**” to be used for the purpose for which they ought to be put to and, therefore, the value has been reduced to nil. This means the computers were purchased which are with the company but since they could not be put to use for which they ought to they are being written-off. By no accounting standards could the value of such assets be brought down to nil. In the case of digital contents as well, the explanation is equally unacceptable. The sets, props and characters developed for the production of animation content are all available with the company but since they are “**not likely**” to be used extensively in future their value is being reduced to zero. Assets worth Rs. 257.99 crores have been written-off in this manner. Again, when we look at the explanation furnished in the letter dated November 20, 2004 we find the same even more startling. A

project by the name of Pentacartist was started by the company and just because it was incomplete its value has been shown as nil and a sum of Rs.6.19 crores has been written-off. The questions why the project was incomplete and why its value was brought to naught remained unanswered. The other explanations offered in this letter are equally suspicious and unacceptable. During the course of arguments it was made clear to the learned counsel for the appellant that we too, were not satisfied with the explanations which were also inadequate. He then on the subsequent date of hearing produced before us the reasons for writing-off investments in the last three years and also the break-up and explanation for writing-off Rs.690 crores under the scheme. These reasons which are said to have been furnished by Mayajaal to BSE in support of its application for listing are as under :-

“ Why the write-ff of Investments in the last 3 years?

- The Pentasoft Technologies Limited write-off is due to Mark-To-Market of the consideration given to Pentamedia towards the hive-off of Software Business into a separate company during 1999-2000 as advised by the auditors Price Waterhouse and being done to be in conformance with Accounting Practices.
- Improvison Corporation acquired through GDR Share Swap in view of a Business Valuation and Potential of projects like “Access Denied” and “Sherlock Homes” and based on their business valuation. It could not deliver as per their projections and is being Mark-to-Market to be in conformance with Accounting Practices.
- The write-off has been due to Mark-to-Market of the respective investments to be in conformance with Generally Accepted Accounting Practices.

Break-up & Explanation for the 690 write-off:

- 280 Crores – Digital Assets & CWIP
 - Out of 375 Crores (as on 31st Dec 2003) 280 Crores are being written off.

- These Digital assets have been used in our movies other movies to some extent
 - Currently not able to reuse them anymore due to the reason as explained in the reason for write-off of Digital Assets above.
- 130 Crores – Inventory
 - 3 Crores NUM TV (Old Content)
 - 15 Crores CD ROM (Old CBD Games, CBT Tutorials, etc.)
 - 112 Crores Distribution Rights (Some Pilots which had to be abandoned)
 - 109 Crores – Sundry Debtors
 - Out of a turnover of 2,974 crores (1992 till 2004), 109 crores (3.6%) is being written off
 - Full Business Potential of the animation Movies could not be realized.
 -
 - 78 Crores – Loans & Advances
 - Out of 252 Crores (as on 31st Dec 2003), 78 crores are being written-off
 - Bandwidth Advances for NUM TV – EXODUS Bankrupt
 - Advances towards acquisitions/ investments in Digital Domain, Film Roman & Purple Drop which fell through.
 - 92 Crores – Investments
 - Out of 309 Crores as on 31st Dec 2003, 92 crores are being written off for the purpose of Mark-to-Market.
 - Improvisation Corporation acquired through GDR Share Swap on the business potential of projects like “Access Denied” and “Sherlock Homes” could not deliver and their business value is being Mark-To-Market upon recommendation of the auditors.”

As regards the write-off of investments in the last three years, it is said that Mark-to-Market approach was adopted in assessing the value of the assets of

Pentamedia. The learned counsel for the appellant explained that Mark-to-Market practice, according to him, means that an investment would be accounted for in the books of the company at its actual market value. To illustrate, an investment made today of Rs.1000/- may thereafter come down in value to Rs.500/- and the books of the company would be adjusted to show the value of that investment at Rs.500/-. What BSE was wanting to know from Pentamedia was as to why value of its investments had come down and the aforesaid explanation furnished on the basis of Mark-to-Market practice does not answer the query. Now coming to the write-off of Rs.690 crores worth of assets under the scheme, we find that only the break-up of the written-off assets had been furnished but no reason whatsoever is forthcoming for the write-off. This is the precise grievance of BSE and we are in agreement with the learned counsel for the respondent when he contended that no reasons had been furnished by Pentamedia.

At this stage, the chief executive officer of Pentamedia who was present in court sought permission to explain the reasons for writing-off such huge assets of Pentamedia. We heard him for some time and the only explanation that he furnished was that after September 11, 2001 when the terrorists had attacked the World Trade Centre in New York, the Islamic names given by Pentamedia to its animation programmes were not accepted in major parts of the world and, therefore, it lost heavily in its business and the investments made by it in USA went down in value. This explanation cannot be accepted for more than one reasons. Firstly, at no stage of the proceedings did Pentamedia or any of its subsidiaries take up this stand before the BSE. We cannot for the first time accept the mere ipse dixit of the chief executive officer and that too during the course of hearing of the appeal. Secondly, the

explanation is contrary to Pentamedia's own showing. Improvisation Corporation USA is one of the investments which Pentamedia made in that country by acquiring that corporation in February 2001 and if the terrorists attack in September 2001 would have had any adverse effect, then the turnover of Improvisation Corporation during the year 2002 should have considerably reduced. As per the annual report of Pentamedia which was placed before us by the appellant shows an increase in turnover of US \$3,78,000 for the 12 months ending December 31, 2002 as compared to US \$60,000 for the year 2001. It is, thus, clear that the explanation now furnished by the chief executive officer is an afterthought.

Before concluding on this aspect, it is worth mentioning that one of the reasons that was given by Pentamedia for writing-off its assets was that those would diminish in value in future. We are really amazed at this explanation. While we appreciate that most assets in future would diminish in value, we are not aware of any accounting principle or practice whereby the assets of a company are devalued in its books in presenti making provision for the future diminution. We repeatedly asked the learned counsel for the appellant to point out any accounting standard which could justify such diminution of value in presenti. He was unable to give us any convincing answer and referred to accounting standard 13 issued by the Institute of Chartered Accountants of India (ICAI) . We have examined the said standard and find that it does not permit the future diminution in the value of assets in presenti. It will not be out of place to mention that the learned counsel for the appellant during the course of the arguments made tall claims about the accounts and the methods of accountancy adopted by Pentamedia and emphasized that they were properly maintained and were in order. We do not think so and are of

the view that less said the better. Since it is not necessary for the disposal of the appeal to record a finding in this regard, we leave the matter at that.

In view of what has been stated above, we are satisfied that Pentamedia did not furnish any genuine, bonafide or adequate reasons for writing-off its assets to the tune of Rs. 1153.09 crores including the assets worth Rs.690.04 crores under the scheme and, therefore, BSE was justified in rejecting its application.

There is yet another reason why the appeal filed by Pentamedia deserves to be rejected. The Board by its order dated December 22, 2006 has found that Pentamedia had issued 34 lac fake share certificates in the name of Vijay Advertising Pvt. Ltd. in July 2004 while the original ones issued in February 2004 were still under pledge with the Oriental Bank of Commerce and it thereby violated Regulations 3 and 4 of the Securities and Exchange Board of India (Fraudulent and Unfair Trade Practices) Regulations, 2003. In other words, Pentamedia issued large number of fake shares for being traded in the market. This is a serious misconduct. The Board, among others, prohibited Pentamedia, Mayajaal and their directors from accessing the capital market for a period of 24 months. Prior to the passing of the order on December 22, 2006, the Board had by its ex-parte ad-interim order dated May 27, 2005 directed Pentamedia not to issue any further shares or alter its share capital in any manner and it along with its directors were also prohibited from accessing the capital market or dealing in securities in any manner till further orders. This ex-parte order was confirmed on October 3, 2005 after granting a post decisional hearing. This ad-interim order was operating when BSE rejected the application of Pentamedia by the impugned communication. It is common case of the parties that Pentamedia and Mayajaal both accepted the

final order passed by the Board and did not take the matter in appeal. In view of the serious misconduct of Pentamedia and Mayajaal as found by the Board, it can safely be said that they and their directors are not “fit and proper persons” to be allowed to associate themselves with the capital market in order to safeguard its integrity. The learned counsel for the appellant, however, submitted that the Securities and Exchange Board of India (Criteria for Fit and Proper Person) Regulations, 2004 (for short fit and proper person Regulations) do not apply to Pentamedia and Mayajaal as they are not intermediaries of the securities market. It is true that Pentamedia and Mayajaal are not intermediaries of the market and, therefore, the fit and proper person Regulations do not strictly apply to them. However, we put it to the learned counsel for the appellant whether the principles underlying these Regulations would apply to persons other than intermediaries and his answer was in the affirmative. We are not basing ourselves only on his concession. The object of the Securities and Exchange Board of India Act, 1992 and the regulations framed thereunder do compel us to hold that the principles underlying the fit and proper person Regulations shall apply not only to the intermediaries but also to other class of persons who may want to associate themselves with the market in any manner whatsoever. The concept of a fit and proper person is that he/it should have financial integrity, good reputation and character. He should be competent, efficient and honest in the context of the securities market and should not have been visited by any convictions involving moral turpitude. This criteria is necessary to be observed not only when a person associates himself with the market but he must continue to satisfy the same throughout the period of his association therewith. This concept is so basic and fundamental for preserving the integrity of the market that every regulator

must observe the same. Admittedly, BSE is a primary level regulator as well and, therefore, duty bound to screen all such persons who come to associate with the market. If this were not to be, the very purpose of the Act would be frustrated. The object of the Act is to protect the interests of the investors in securities and to promote the development of and to regulate the securities market. Since the capital market witnessed tremendous growth in recent times by the increasing participation of the public, investors' confidence in it has to be sustained by ensuring their protection. The Act, therefore, casts a duty on the Regulator to protect the interests of the investors by such measures as it thinks fit. It is in the discharge of this duty that the Board framed the fit and proper person Regulations which regulate only the intermediaries of the market but this does not mean that persons other than the intermediaries who associate with the market need not be fit and proper persons. The integrity of the market will not be preserved and the interests of the investors cannot be protected if persons who have committed frauds in relation to the securities market are allowed to associate therewith merely because they are not intermediaries as defined. Such an eventuality could play havoc with the market and the very purpose of the Act would be frustrated if such persons are allowed to associate with the market. In the case before us Pentamedia and Mayajaal have both been found to have committed grave misconduct in the context of the securities market for which they and their directors had been debarred from accessing the capital market for a period of two years. This order, as already observed, has attained finality because the same was neither challenged by Pentamedia nor by Mayajaal and not even by their directors. They are, therefore, not fit and proper persons to be allowed to associate themselves with the market. If the application filed by Pentamedia were to be

allowed, the result would be that the allotment of the shares made by Mayajaal in favour of the shareholders of Pentamedia would get listed on the BSE and to that extent they would be allowed to participate in the market. Should they be allowed to associate with the market is the question and in our opinion the answer has to be in the negative in the light of their proved misconduct which finding has not been challenged by them. The application filed by Pentamedia before the BSE deserves to be rejected on this ground as well.

Before concluding, we may mention that the Company Law Board has also by its order dated July 25, 2005 passed on an application filed by the Central Government for appointment of its two directors on the board of directors of Pentamedia has held that Pentamedia had committed several statutory violations which constitute gross mismanagement on its part and, therefore, it authorised the Central Government to appoint two directors on the board of directors of the company. Pentamedia has filed an appeal against this order in the High Court of Chennai and we are informed that the operation of the order has been stayed.

No other point was raised.

In the result, the appeal fails and the same is dismissed with costs which are assessed at Rs. 50 thousand. The BSE on receipt of the amount shall deposit the same in the investor protection fund by whatever name called.

Justice N.K. Sodhi
Presiding Officer

Sd/-
Arun Bhargava
Member

Sd/-
Utpal Bhattacharya
Member

10.8.2007

bbn

