

BEFORE THE SECURITIES APPELLATE TRIBUNAL
~~Case Citation: (2017) ibclaw.in 80 SAT~~
MUMBAI

Appeal No.99 of 2007

Date of Decision: 20.2.2008

HSBC Securities & Capital Markets (India) Private
Ltd.

..... Appellant

Versus

The Whole Time Member

Securities and Exchange Board of India

....Respondent

Present: Mr. Virag Tulzapurkar, Senior Advocate with Mr. Zal Andhiyarujina

Advocate and Mr. Sowmya Srikrishna Advocate for the appellant

Mr. Shiraz Rustomjee Advocate with Mr. Nishit Dhruva Advocate

and Mr. Avdhoot Prashu Advocate for the Respondent

CORAM

Justice N. K. Sodhi, Presiding Officer

Arun Bhargava, Member

Utpal Bhattacharya, Member

Per: Utpal Bhattacharya, Member

The present appeal challenges the order dated 7 March, 2007 passed by the Whole Time Member, Securities and Exchange Board of India (the Board, for short) holding that HSBC Securities and Capital Markets (India) Private Ltd (Appellant) had violated clauses 1, 2 and 7 of the

code of conduct prescribed in Schedule III to the Securities and Exchange Board of India (Merchant Bankers) Regulations (Merchant Bankers Regulations, for short) and Regulation 24(4) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations (Takeover Code, for short). The Whole Time Member of the Board, in the impugned order, imposed the minor penalty of censure on the appellant under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (Enquiry Regulations, for short).

A share purchase agreement was executed on 5th September, 2000 between Global Green Company Ltd (the acquirer, for short) and three other companies namely, Tata Tea Ltd, Tata Coffee Ltd and Conscofe Investments Ltd (the sellers, for short) for the acquisition of 1,56,47,630 shares of Saptarishi Agro Industries Ltd (target company, for short). In terms of regulation 10 of the Takeover Code, the acquirer made a public offer to the shareholders of the target company to acquire 20% of its voting capital following the share purchase agreement. The appellant was appointed the merchant banker for the open offer. The charge in the enquiry proceedings was that the appellant as a merchant banker had failed to comply with regulation 24(4) of the Takeover Code and clauses 1, 2, 7 and 9 of the Code of Conduct prescribed in Schedule III to the Merchant Bankers Regulations in as much as in the letter of offer dated 15 September, 2000 there was a wrong disclosure that all 2,44,94,200 issued equity shares of the target company were listed on the stock exchanges of Chennai, Mumbai, Delhi and Ahmedabad whereas 1,40,30,000 shares were, in fact, not listed on the Bombay Stock Exchange and these included 59,80,000 shares not listed on any stock exchange. This inaccuracy came to the notice of the Board from the letter of offer issued in August 2003 in connection with the takeover of the same target company by another acquirer. The alleged wrong disclosure was made in the following table included in the final letter of offer that was issued in September 2000.

Stock Exchange	Total shares traded during the 6 calendar months ending August 31, 2000	Total number of listed shares	Annualised trading turnover (as % of total shares listed)
Mumbai	NA	24,494,200	NA
Chennai	44,500	24,494,200	0.36%
Delhi	0	24,494,200	0%
Ahmedabad	0	24,494,200	0%

Before dealing with the arguments of the parties, it is necessary to reproduce here the relevant provisions of the Merchant Bankers Regulations and the Takeover Code for facility of reference.

Clauses 1 to 9 of the Code of conduct for Merchant Bankers

“1. A merchant banker shall make all efforts to protect the interests of investors.

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2. A merchant banker shall maintain high standards of integrity, dignity and fairness in the conduct of its business.

3. A merchant banker shall fulfill its obligations in a prompt, ethical and professional manner.

4. A merchant banker shall at all times exercise due diligence, ensure proper care and exercise independent professional judgement.

5. A merchant banker shall endeavor to ensure that

(a) inquiries from investors are adequately dealt with;

(b) grievances of investors are redressed in a timely and appropriate manner;

(c) where a complaint is not remedied promptly, the investor is advised of any further steps which may be available to the investor under the regulatory system.

6. A merchant banker shall ensure that adequate disclosures are made to the investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed decision.

7. A merchant banker shall endeavor to ensure that the investors are provided with true and adequate information without making any misleading or exaggerated claims or any misrepresentation and are made aware of the attendant risks before taking any investment decision.

8. A merchant banker shall endeavor to ensure that copies of the prospectus, offer document, letter of offer or any other related literature is made available to the investors at the time of issue or the offer.

9. A merchant banker shall not discriminate amongst its clients, save and except on ethical and commercial considerations.”

Regulation 24(4) of the Takeover Code

“The merchant banker shall ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and based on reliable sources, quoting the source wherever necessary.”

The appellant did not at any stage deny that the disclosure regarding listing of the shares was incorrect. The main thrust of the appellant’s submissions was that it had exercised due diligence in obtaining adequate information from reliable sources based upon which disclosures

were made in the letter of offer dated 15 September 2000. According to the appellant, it had studied and relied upon the following documents none of which disclosed that any share of the target company was unlisted.

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<!--[if !supportLists]-->(a) <!--[endif]-->Share Purchase Agreement dated 5 September, 2000.

<!--[if !supportLists]-->(b) <!--[endif]-->Annual Reports of the target company for 1997-98 and 1998-99.

<!--[if !supportLists]-->(c) <!--[endif]-->Annual Reports of the sellers (all three companies) for 1999-2000 which, in fact, made a positive assertion that the shares held by them in the target company were “quoted” investments meaning thereby that the shares were listed.

<!--[if !supportLists]-->(d) <!--[endif]-->Certificate of shareholding pattern issued by the statutory auditor of the target company

There was no statutory requirement of disclosure of the listing status of the target company's shares in the documents at (a), (b) and (d) above nor could anyone be faulted for not doing so. However, the documents at (c) did contain the misleading statement to the effect that the target company's shares represented “quoted” investments. Since this information was reflected in the audited annual accounts of the sellers, it can be inferred, particularly in the absence of any contrary information, that the sellers believed the information to be true. Since the information was clearly not correct, the appellant's reliance on the sellers' balance sheets became a case of one blind man being led by another.

The learned senior counsel for the appellant urged, very strenuously indeed, that as required under regulation 22(2) of the Takeover Code, copies of the draft offer letter were sent by the appellant to the target company and the stock exchanges where the shares of the target company were listed but none of those entities responded with any comment regarding the listing status of the shares though they would have had definite information in this regard. Only the acquirer responded to the draft offer letter by providing some minor clarifications on matters other than listing of shares. It was argued that the purpose of sending the draft letter of offer to these entities was that the recipients would scrutinize the same and would revert to the appellant if there was any incorrect statement therein. We are unable to accept this contention since there is no such duty or responsibility cast on the target company or the stock exchanges under any Regulation framed by the Board or any other authority. Any action to be taken by any of these entities on the copy of the draft offer letter would be independently determined by them in the light of the applicable Rules and Regulations. It would be one thing if any of them did point out any error or omission in the draft offer letter but the merchant banker was definitely ill advised to depend upon any such response for discharging his own basic responsibility. Such a passive and indirect approach can only be seen as an effort on the part of the appellant to shift the onus of due diligence on to the shoulders of others. Moreover, a perusal of the identical letters sent to the target company and the stock exchanges shows that these were written as the fulfillment of a regulatory requirement. The letters do not indicate that the

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sender expected any response; none was solicited in any case. The common text of the letters is reproduced below to make this point clear.

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“We have been appointed as Managers to the Offer vide regulation 13 of the SEBI (Substantial Acquisition of Shares and Takeovers) regulations, 1997 and subsequent amendments thereof, by Global Green Company Limited for their captioned Open Offer.

Global Green has signed a Memorandum of Understanding dated September 5, 2000, with Conscofe Investments limited, Tata Tea Limited and Tata Coffee Limited to acquire 15,647,630 fully paid up equity shares of Rs 10/- constituting 63.88% of the paid up equity capital of Saptarishi Agro Industries Limited.

Enclosed please (sic) the Draft Offer Letter that has to be sent to you under Regulation 22(2) of the Takeover Regulations.”

It was argued by the learned counsel for the Board that in terms of the Takeover Code, the appellant had to submit to the Board a due diligence certificate along with a copy of the draft letter of offer and thus, the exercise of due diligence had to be completed at the same time as the finalization of the draft letter of offer. Therefore, due diligence could not be exercised by merely sending the draft letter of offer and expecting the recipients to point out the errors.

At the beginning of the arguments, the appellant submitted that the respondent had passed the impugned order only on the basis that the appellant had failed to produce any proof of delivery of the draft letters of offer to the target company and the stock exchanges. However, the learned counsel for the Board did not press this point at all and agreed to proceed on the basis that the said letters were in fact delivered to the addressees. We need not therefore dwell on this point any further.

Considering that the sellers could, if at all, be a source of information only about the listing of those shares which were actually held by them and not about all the issued shares of the target company, the learned senior counsel for the appellant was asked about the source from which the appellant gathered the positive information that all issued shares of the target company were listed in the stock exchanges at Chennai, Mumbai, Delhi and Ahmedabad, as clearly asserted in the letter of offer. No such source could be pointed out. On the other hand, the following extract from the enquiry proceedings of 12 May, 2004 before the Enquiry Officer tells its own story.

“To a question as to how did the Merchant Banker assumed (sic) that the shares mentioned in the Auditors Certificate as listed on the relevant stock exchange, Mr. AV stated that as per the Securities Contracts (Regulation) Rules, 1957 it would be presumed that SAL would have made necessary applications and intimation to the stock exchange for listing of all shares as is required under the Regulations. In the event such applications were not made by SAL or accepted by the Exchanges, the same should have been disclosed to HSBC as an inaccuracy in the letter of offer dated

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Mr. AV appeared before the Enquiry Officer as the Head of Compliance of the appellant and his statement indicates that the appellant had basically presumed that all the issued shares of the target company would be listed. It had also expected that if that was not the case, someone else would point out the error.

The learned senior counsel for the appellant submitted that in the show cause notice issued by the Enquiry Officer on 18 March, 2004 the appellant had been charged with violation of Regulation 24(4) of the Takeover Code and clauses 1, 2, 7 and 9 of the code of conduct for merchant bankers. The Enquiry Officer, however, gave the finding that it had violated clauses 1, 2, 4, 6, and 7 of the code of conduct for merchant bankers and Regulation 24(4) of the Takeover Code. The Whole Time Member of the Board found the appellant to have violated Regulation 24(4) of the Takeover Code and only clauses 1, 2 and 7 of the code of conduct for merchant bankers. The learned senior counsel argued that in view of the fact that the appellant has not been found to have violated clauses 4 and 6 of the code of conduct, it can not be held to have violated clause 7. This seems to us to be a very restrictive view of the code of conduct. The clauses of the code of conduct overlap one another to an extent and the scope of clause 7 is wide enough to be invoked in the appellant's case even if it has not been held to have violated clauses 4 and 6 of the code of conduct.

In terms of Regulation 24(4) of the Takeover Code, it is the responsibility of the merchant banker to ensure that the contents of the letter of offer are true, fair and adequate. The learned senior counsel for the appellant argued that non-disclosure in the present case of the fact that certain shares were unlisted did not impact the shareholders' decision as to whether or not to tender shares in the open offer. The fact that trading had been suspended in the Bombay Stock Exchange since July 1998 and that the shares were infrequently traded on the other stock exchanges had been disclosed in the letter of offer. It had also been disclosed that as against the open offer price of Rs 1.32 per share, the acquirer had purchased shares of the target company from the sellers at 32 paise per share and the book value of the shares worked out to Rs 1.07 per share as on 31 March, 2000. These disclosures would have been adequate for the shareholders to arrive at a decision. In other words, according to the appellant, the adequacy of the disclosures was not impaired by the non-disclosure regarding listing of the shares and therefore, such non-disclosure need not be viewed seriously. The learned counsel for the respondent pointed out that the charge against the appellant was not one of non-disclosure but of making a wrong and categorical assertion about the listing of the shares. According to him, the listing status of the company's shares is very much a relevant factor for any shareholder to decide whether to off-load or retain the shares. He also argued that apart from being adequate, the disclosures in an open offer have to be absolutely true and fair and that the appellant had not ensured that. We are of the view that it is neither necessary nor indeed feasible to go into the mechanics of how the shareholders would take a decision on tendering their shares. However, we agree with the learned counsel for the Board that ensuring the truth and correctness of the letter of offer is a fundamental responsibility of the merchant banker which he has to discharge by exercising due diligence. In fact, an incorrect or wrong information in a letter of offer or other similar documents issued for the benefit of investors in

general could lead to serious consequences including loss of credibility for the market operators and for the regulatory system. This kind of failure has to be taken very seriously by the market regulator. In this case, there is no material before us to show that the appellant had taken any proactive step at all to find out the correct information or to independently verify the information available. No specific query in this respect was made from the right sources of such information namely the target company and the stock exchanges though it was known that information about the listing of the shares of the target company in each stock exchange was specifically required to be disclosed in the letter of offer. Instead, the appellant made a presumption that all shares were listed in the four stock exchanges of Chennai, Mumbai, Delhi and Ahmedabad and left it to others to point out if that was not the fact. This is certainly no way to exercise due diligence and we cannot but agree with the Whole Time Member of the Board that the appellant had violated regulation 24(4) of the Takeover Code and clauses 1, 2 and 7 of the code of conduct for merchant bankers.

Regarding the penalty imposed on the appellant, the learned senior counsel for the appellant submitted that there was no willful default in this case on its part nor did it gain anything from the wrong disclosure. He pointed out that it was not anyone's case that the wrong disclosure resulted in any serious loss or damage to any investor or to the market. According to him, no penalty should be imposed under such circumstances, as has been held earlier on several occasions by this Tribunal. However, in the case of *Chairman SEBI v. Shriram Mutual Fund and Another*, (2006) 5 SCC 361, the Supreme Court has held that in case of defaults or failures of statutory civil obligations, there is no question of proof of intention or any requirement of mens rea and the same is not an essential element for imposing penalty. Once the default is established, the penalty must follow. It is only the quantum of penalty that is discretionary. However, in the present case the penalty awarded is the minimum prescribed under the Enquiry Regulations and there is no occasion for us to interfere with that.

The appeal is, accordingly, dismissed with no order as to costs.

Sd/-

Justice N. K. Sodhi

Presiding Officer

Sd/-

Arun Bhargava

Member

Sd/-

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Carried out corrections only typing done by Rajlaxmi