

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

IN THE MATTER OF ACQUISITION OF SHARES OF GOLDEN CARPETS LTD. SHARES THROUGH PREFERENTIAL ALLOTMENT - VIOLATION OF REGULATION 11(1) OF THE SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 1997

1.0 BACKGROUND

1.1 Shri Srikrishna Naik, (hereinafter referred to as “the Acquirer”) had acquired 6,10,000 shares representing 9.26% of the post-preferential equity share capital of Golden Carpets Ltd (hereinafter referred to as “the Target company”) through preferential allotment on 24.12.02 resulting in increase in his shareholding from 30.82% to 37.22% in the Target company. The increase in shareholding was more than the creeping limit of 5% as specified under Regulation 11(1) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as ‘the Regulations’). Hence, the acquirer/acquisition attracted the provision of Regulation 11(1) of the Regulations.

1.2 The shares of the Target company are listed at The Stock Exchange Mumbai and The Hyderabad Stock Exchange.

2.0 SHOW CAUSE NOTICE

Pursuant to the acquisition as aforesaid, a show cause notice dated 31.1.2003 was issued to the Acquirer inter alia stating that :

2.1 The Acquirer has acquired 6,10,000 shares representing 9.26% of the voting capital of the Target Company on 24.12.2002 .

2.2 Pursuant to the acquisition of 9.26% of the voting capital on 24.12.2002, the Acquirers’ holding increased from 30.82% to 37.22% in the equity shares of the Target company and as a result of the aforesaid acquisition the provisions of regulation 11(1) have been triggered.

2.3 Therefore, a public announcement was required to be made by the

Acquirer in terms of regulation 14(1) of the Regulations within 4 working days from the date of 24.12.2002 in accordance with the Regulations. As the Acquirer acquired the said shares/voting rights and control of the company in the manner as stated above without making a public announcement, the Acquirer had, prima-facie, violated the provisions of regulations 11(1) read with regulation 14(1) of the Regulations and hence is liable for penal action under the Regulations and SEBI Act, 1992.

3.0 The Acquirer submitted its reply to the abovesaid show cause notice vide its letter dated 21.2.2003.

4.0 **PERSONAL HEARING**

4.1 Thereafter a personal hearing was granted to the Acquirer on 30.4.2003 wherein the authorised representative of the acquirer Ms. Rashida Aaenwala, Company Secretary appeared and made submissions on his behalf. Written submissions were also submitted on behalf of the acquirer after the conclusion of oral submissions.

5.0 **SUBMISSIONS OF THE ACQUIRER**

The oral and written submissions made on behalf of the acquirer during personal hearing dt. 30.04.05 are given hereunder :

5.1 The Target company was originally incorporated on 2.12.1993 as M/s. Golden Carpets Pvt. Ltd. The Target company was converted into a public limited company vide special resolution dated 21.12.1994 and fresh certificate of incorporation was issued on 1.1.1995.

5.2 The Target company was incorporated with the objective to carry on the business of manufacturers, retailers, distributors, stockists, agents, importers and exporters in all kinds of carpets made of polypropylene, wool, cotton, jute, or any kind of fibre by machine and manmade and was also carrying on the business of erectors, wholesalers, stockists, agents, importers and exporters of the machinery, accessories, and spares relating to the carpet industry.

5.3 The Target company came out with Initial Public Offer (IPO) in June 1996 for 49,25,000 equity shares of Rs.10/- each at par, aggregating to Rs.492.50 lacs which was subscribed to the extent of 97.98%.

5.4 At the time of IPO, the estimated cost of the project was Rs.1500 lacs out of which the Industrial Development Bank of India, Hyderabad had

financed to the extent of Rs.500 lacs.

- 5.5 In addition to under-subscription, there were dues on allotment money for which repeated reminders were sent to the concerned investors. However, as subscription money which was due from the investors to the company was not received, on failure to receive the allotment money, these shares were forfeited.
- 5.6 The Target company started its commercial production in the financial year in 1998-1999 and has been constantly incurring losses since then. Further, the Target company was originally registered as an 100% EOU and thereby it could not grab the domestic market due to regulatory restrictions. Considering the tremendous potential and also the high margins available in the domestic market viz a viz the international market, the management of the target company decided to debond the unit. Accordingly, the units were debonded in 2001 and for this the target company had to incur huge expenditure.
- 5.7 Due to under subscription, forfeiture of shares and various other reasons stated above, the Target Company was constantly facing severe liquidity crisis. This added in undue delay in commencement of the commercial production. In order that the operations of the target company be started, IDBI further granted an additional working capital facility to it, which required the promoter director, Mr.Shrikrishna Naik to pump in funds at regular intervals. Accordingly, to save the Target company and the small investors the Chief promoter, Mr.Srikrishna Naik brought in cash aggregating to Rs.61,00,000 at regular intervals to meet the stipulations of IDBI for sanction / enhancement of the credit limits.
- 5.8 The cash brought in by the Acquirer were reflected in the books of accounts to the extent of Rs.45,00,000 under Share Application Deposit and the balance of Rs.16,00,000 under Current liabilities.
- 5.9 Further, as per the terms and conditions of finance granted by IDBI, the cash brought in by the Acquirer was required to be converted into equity capital. However, the number of shares to be issued in lieu of that amount nor the price of shares was contemplated.
- 5.10 Accordingly, the target company had made a preferential allotment of 6,10,000 equity shares of Rs.10/- each at par out of the forfeited shares representing 9.26% of the voting capital to the Acquirer in order to comply with stipulations of IDBI.
- 5.11 The acquirer is the promoter of the Target company. After the proposed

preferential allotment, the shareholding of the acquirer has increased from 30.82% to 37.22% shares in the Target company.

5.12 The Acquirer is already in control in the Target company. The proposed acquisition would amount to consolidation of shareholding. The shareholding pattern of the Target company is as under :

Sr. No.	Shareholders Category	Pre Allotment in terms of shares		Post Allotment in terms of shares	
		No.	%	No.	%
1	Indian Promoter	22,23,340	37.17	28,33,340	42.99
2	Foreign Promoter	27,06,160	45.25	27,06,160	41.06
3	Private Corporate Bodies	1,00,000	1.67	6,08,600	1.52
4	Indian Public	6,08,600	10.18	6,08,600	10.18
5	NRI/OCBs	3,42,800	5.73	3,42,800	5.20
	Grand Total	59,80,900	100.00	65,90,900	100.00

5.13 As a result of the above preferential allotment there has been no change in the management or control of the Target company.

5.14 The acquirer made the investment when the acquisition of shares on preferential basis was exempt under Regulation 3 (1) (c) of the Regulations i.e. prior of 09.09.02 and therefore the acquirer be granted exemption on acquisition from making public announcement for the acquisition of 9.26% of the shares on preferential basis.

6.0 **ISSUES**

6.1 I have taken into consideration the facts of the case, the submissions written as well as oral made on behalf of the Acquirer during the hearing and also the documents submitted in support of the submissions.

6.2 The acquirer acquired 6.40% (post acquisition – 37.22% and pre-acquisition 30.82%) through preferential allotment on 24.12.02. Pursuant to the amendment made on 9.9.02, acquisition through preferential allotment beyond the percentages specified under the Regulations is not eligible for exemption.

6.3 In the instant case, as the acquisition of 6.40% is more than the creeping acquisition limit of 5% and the same was made without complying with the requirement of making a public announcement / open offer, whether the acquisition is in violation of Regulations 11(1) and 14(1) of the Regulations.

7.0 **CONSIDERATION OF ISSUES**

7.1 In this regard it will be pertinent to refer to regulations 11(1) and 14(1) which are reproduced hereunder:

Regulation 11(1) (Consolidation of Holdings)

“No acquirer, who together with persons acting in concert with him has acquired, in accordance with the provisions of law, (15% or more but less than 75%) of the shares or voting rights in a company, shall acquire either by himself or through persons acting in concert with him any additional shares or voting rights entitling him to exercise more than (5%) of the voting rights, unless such acquirer makes a public announcement to acquire shares in accordance with the regulations.”

Regulation 14 (Timing of the public announcement of offer)

Regulation 14(1) :

“The public announcement referred to in Regulation 10 or Regulation 11 shall be made by the merchant banker not later than four working days of entering into an agreement for acquisition of shares or voting rights or deciding to acquire shares or voting rights exceeding the respective percentage specified therein”.

7.2 From the reading of the above regulations, it is clear that in a case where and also orally and vide letter submitted on behalf of the acquirer during Acquirer is holding more than 15% shares but less than 75% of the Target company then it cannot acquire additional shares or voting rights which entitle him to exercise more than 5% of the voting rights unless the acquirer makes a public announcement to acquire such shares / voting rights in accordance with the Regulations. Further, the aforesaid public announcement has to be made by the Acquirer not later than four working days of entering into an agreement for acquisition of such additional shares or voting rights or deciding to acquire such additional shares or voting rights.

7.3 In this context it is observed that the requirement of the regulation 11 (1) is very clear that if an acquirer is already holding more than 15% shares, as in the case of the acquirer herein, and he wants to acquire additional shares, he has to make public announcement for acquiring such additional shares in accordance with the Regulations.

7.4 In the instant case, I find that the Acquirer was already holding 30.82% shares. On 24.12.02, the Acquirer acquired additional 6.40% shares /

voting rights of the Target company without making the public announcement in accordance with the Regulations. I do not find merit in this submission of the Acquirer that the Acquirer brought in funds to the tune of Rs.61,00,000/- to meet the stipulations of IDBI for sanction / enhancement of the credit limit which it offered to the Target company. The requirements of law have to be complied with without any exception. Further, preferential allotment was made on 24.12.02 i.e. after 09.09.02 when the Regulations were amended to take away the exemption in respect of preferential allotment of shares.

7.5 In this regard it is pertinent to refer to the observations made in the order dt. 25.01.01 by the Hon'ble Securities Appellate Tribunal (SAT), Mumbai in Appeal no. 24/2000- M/s. Cabot International Capital Corporation vs SEBI & Others in Appeal. In this case also it was contended by the acquirers/appellants that though the allotment alleged to have taken place after the notification of the 1997 Regulations i.e. on 20.02.97, the meeting of the Board of Directors of the company approving preferential allotment was held on 24.12.1996 i.e. prior to the notification of the 1997 Regulations and hence, the preferential allotment made to them did not come under the purview of the 1997 Regulations. On this issue, Hon'ble SAT had held inter alia that:

"..... As the reference is to "the allotment made in pursuance of a resolution passed", there is hardly any scope to view that the allotment of share is complete by passing the resolution itself. Allotment is a distinct event post the resolution referred in section 81 (1A). It is ultimately that date on which the board of directors validly allotted the shares, which in the present case is after the notification of the 1997 Regulations. Compliance of the provisions of regulation 3 (4) is a post acquisition requirement. Therefore, I have no hesitation to hold that the preferential allotment made to the Appellant comes under the purview of the 1997 Regulations and thereby regulation 3 (4) is attracted."

7.6 In light of the aforesaid observation of SAT, I do not find any merit in the submission of the Acquirer that though allotment was made on 24.12.02 i.e. subsequent to the date of notification of the amendment in Regulations, the board of directors of the target company had decided to convene the general meeting to consider the preferential allotment of shares to the acquirers on 16.08.02 and therefore, the preferential allotment would fall under exemption category under Regulation 3(1) (c) as it existed prior to the Amendment dt. 09.09.02.

7.7 In light of the aforesaid legal position, I find that as required under the aforesaid regulations, no public announcement has been made by the Acquirers and therefore the acquirer has violated regulation 14 (1) of the said Regulations.

7.8 In the instant case, I have also noted the contentions made by the Acquirer during the course of the hearing that they were aware of the implications of the amendments made to the captioned Regulations. Therefore, the Acquirer had the option of making an application in terms of Regulation 3(1)(l) read with Regulation 4(2), before acquiring the shares through preferential allotment. However, according to the Acquirer, based on the abovementioned reasons, it was felt by them that they would be eligible for exemption and the allotment would not attract the provisions of amended Takeover Regulations. It is indicative of the fact that prima facie, there was a willful default on the part of the Acquirer in complying with the Regulations.

7.9 I find no merit in the submission of the Acquirer that the requirement of making a public announcement through merchant banker will be financially unaffordable for the Acquirer.

7.10 In light of the aforesaid, I am of the view that there was an obligation on the part of the Acquirer to make the public announcement within 4 working days from the date of acquisition of shares, i.e. 24.12.2002. As the Acquirer has failed to make the public announcement, he has contravened the provisions of regulation 14(1) of the Regulations.

7.11 I also find that the shares of the target company are infrequently traded and in fact there was no trading either on the date of General Meeting i.e. 30.09.02 or on the date of acquisition i.e. 24.12.02. The acquisition was made at Rs. 10/- per share. One of the parameters to determine the offer price in terms of Regulation 20(5) is the price at which the acquirers acquired the shares. Thus, I am of the view that if an open offer is made, the offer price cannot be less than Rs.10/- per share, which would be in the interest of the shareholders of the Target Company.

8.0 CONCLUSION

8.1 In view of the aforesaid, I find that the Acquirer has violated regulation 11(1) r/w regulation 14(1) of the Regulations, as he has acquired 6.40% shares/voting rights in the Target company, without making public announcement to acquire shares/voting rights of the Target company in accordance with the Regulations.

9.0 ORDER

9.1 Having regard to the above, and in exercise of the powers conferred upon me under sub-section (3) of Section 4 read with Section 11B of SEBI

Act 1992 further read with Regulations 44 and 45 of the Regulations, I hereby direct the Acquirer to make public announcement as required under Chapter III of the said Regulations in terms of regulations 11(1) taking 16.8.2002, the date of first Board Resolution for convening the general meeting to consider the preferential allotment of shares to the acquirer, as the reference date for calculation of offer price in terms of explanation (ii) to regulation 20(11) of the Regulations. The public announcement shall be made within 45 days of passing of this order.

9.2 Further, in terms of Sub-Regulation (12) of Regulation 22, the payment of consideration to the shareholders of the Target Company has to be paid within 30 days of the closure of the offer. The maximum time period provided in the said Regulations for completing the offer formalities in respect of an open offer, is 120 days from the date of public announcement. The public announcement in the instant case ought to have been made on or before 31.12.2002 and thus the entire offer process would have been completed latest by 30.4.2003. Since no public announcement for acquisition of shares of the Target Company has been made, which has adversely affected interest of shareholders of Target Company, it would be just and equitable to direct the Acquirer to pay interest @ 10% per annum on the offer price. The Acquirer is hereby accordingly directed to pay interest @ 10% per annum to the shareholders for the loss of interest caused to the shareholders from 1.5.03 till the date of actual payment of consideration.

9.3 This order shall come into force with immediate effect.

G.N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai

Date: June 23, 2003