

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 READ WITH REGULATION 24(6) OF SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 1997 IN THE CASE OF HSBC SECURITIES AND CAPITAL MARKET (INDIA) PVT. LTD AS A MERCHANT BANKER

WTMO/14/CFD/12/03

BACKGROUND

- 1.1 HSBC Securities and Capital Market (India) Pvt Ltd [hereinafter referred to as 'HSBC Securities'] is registered with SEBI inter alia as a Category I Merchant Banker bearing Registration No.INM0000010353.
- 1.2 HSBC Securities acted as a Merchant Banker for the open offer made by Mr. V K Modi, Dr. B K Modi, Mod Fashions and Securities Pvt Ltd and Modikem Ltd in concert with Witta International Inc., and Sidh International Ltd (hereinafter referred to as 'the acquirers') under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as 'Takeover Regulations'), to the shareholders of Modi Rubber Ltd (hereinafter referred to as 'target company') to acquire upto 87, 64,186 fully paid up shares of the target company representing 35% of the paid up capital of the target company.
- 1.3 The offer opened on 4th June, 2001 and was to be closed on 3rd July, 2001. The Acquirers were to complete all the formalities by 2nd August, 2001 i.e. acceptance/rejection of the shares offered by the share holders and corresponding payment for the acquired shares/ return the share certificates for the rejected shares. The shares tendered in the offer were 108,06,760 including 27,04,205 shares by LIC. On 21st July,2001, LIC, one of the share holder of MRL which had lodged 27,04,205 shares in response to the offer, wrote to HSBC Securities (Merchant Banker) and Karvy (Registrar to the Issue) to return the shares tendered by it on the ground that (a) the said shares had been tendered in an unauthorised manner and (b) their act of lodgement of the shares was the "offer" and not an "acceptance" of the offer. On 23rd July,2001 HSBC Securities replied to LIC that shares once tendered cannot be returned. Offer closed on 23rd July, 2001.

- 1.4 LIC has filed a suit being Suit No.2497 of 2001 in the Hon'ble Bombay High Court – LIC v/s MRL and others and took a notice of motion No.1704 of 2001 praying for interim relief. The Hon'ble High Court issued orders dated 24 July,2001 and 1st August,2001 ordering maintenance of status quo in the matter.
- 1.5 In the said open offer, SEBI did not allow Modipon and Modi Spinning and Weaving Mills considered as the promoters of MRL to participate in the Open offer. Modipon and Modi Spinning and Weaving Mills filed two appeals before Hon'ble Securities Appellate Tribunal (hereinafter referred to as 'SAT') against SEBI's order, bearing Appeal Nos. 34/2001 and 43/2001 respectively. SAT, vide its Order dated 31st July, 2001 allowed Modipon to participate in the offer.
- 1.6 Pursuant to the above, a revised public announcement dated 1st August, 2001 was issued by HSBC Securities to shareholders of the target company, stating that payment of consideration could be made by 22nd August,2001 subject to the final orders of the Hon'ble High Court. On 6th August 2001, HSBC Securities (being defendant) filed an affidavit before the Hon'ble High Court in Notice of Motion no.1704 of 2001 in Suit No.2497 of 2001 in Life Insurance Corporation of India Ltd vs Modi Rubber Ltd & Ors and inter alia prayed for passing appropriate Orders with regard to acceptability or otherwise of the shares tendered by LIC. The Hon'ble High Court vide its interim order dated 24th August, 2001 observed to the effect that, if interim injunction was not granted LIC would permanently lose about 20 lakh shares, based on proportional acceptance by the acquirers. While granting injunction, the Hon'ble High Court directed that in case the suit is finally dismissed, then LIC would submit about 20 lakh shares to the Acquirers for purchase in accordance with the public offer and in case the Acquirers for any reason do not want to purchase the said shares, LIC shall not insist on the Acquirers to purchase the said shares. In other words, as per the order, while LIC would be under an obligation to tender the shares the Acquirers shall be under no obligation to purchase the same if they do not want to do so.
- 1.7 The Hon'ble High Court also stipulated that LIC shall not, without Court's approval, transfer or encumber the said 20 lakh shares during the pendency of the suit. The Hon'ble High Court took note of the fact that considering the number of shares received in response to the public offer, in case the shares tendered by LIC were excluded, the balance would be less than 35% of paid up capital of the company and, therefore, the acquirer would have to purchase all the shares offered (by

the public other than LIC). And the acquirer, subject to the court's decision on the Suit, could do this.

- 1.8 On 30th August, 2001, HSBC Securities indicated that it is proceeding with proportionate allotment and specifically sought confirmation from SEBI with regard to the acceptance of the shares tendered by Modi Spinning and Weaving Mills Ltd. Further, on 3rd September 2001, HSBC Securities wrote to the acquirer that the shares tendered by Modi Spinning and Weaving Mills would be accepted on Pro-rata basis. SEBI vide letter dated 6th September 2001 advised HSBC Securities to await the decision of SAT and be guided accordingly. HSBC Securities informed SEBI and the acquirers on 17th September 2001 that the shares tendered by Modi Spinning and Weaving Mills Ltd would be accepted on pro-rata basis in case SAT order is in favour of Modi Spinning and Weaving Mills Ltd. SAT vide its interim order dated September 20, 2001, restrained HSBC Securities and others from finalising the public offer without taking into account the shares lodged by the Modi Spinning and Weaving Mills Ltd till 25th October, 2001 and vide final order dated November 9, 2001 SAT allowed Modi Spinning and Weaving Mills Ltd to participate in the public offer made by the Acquirers.
- 1.9 On 27th September, 2001, HSBC Securities filed a 45 days report to SEBI pursuant to Regulation 24(7) of Takeover Regulations and informed that after transferring Rs.4,76,28,547/- from the Escrow Account to special account for payment to shareholders(other than Modipon and Modi Spinning and Weaving Mills Ltd.), a sum of Rs.13,13,80,380/- had been earmarked for Modipon and Modi Spinning and Weaving Mills Ltd and the balance Rs.2,09,91,073/- would be transferred to the acquirers on completion of the formalities.
- 1.10 HSBC Securities had released the balance amount of Rs 2,09,91,073 to the Acquirers on 18th October, 2001.
- 1.11 SEBI vide letter dated 25th January 2002 sought details from HSBC Securities regarding the amount in escrow account for meeting the liability towards LIC/ public shareholders as the case may be and the extent of compliance with relevant provisions of Takeover Regulations.
- 1.12 On examining the material available on record, SEBI vide letter dated May 27, 2002 sought for the explanation of HSBC Securities as to why action under sub-regulation (4) of Regulation 45 of the Takeover Regulation should not be initiated against it for violating Regulation 24(6) and Regulation 28 of the Takeover Regulations for having released the balance amount from the escrow account to the acquirer prior to the completion of all the obligations with respect to the open offer.

- 1.13 HSBC Securities vide letter dated 18.6.2002 furnished its reply to the aforesaid letter inter alia stating that it has fully carried out the requirements of the Regulations.

ENQUIRY :

- 2.1 On considering the reply of HSBC Securities, SEBI appointed, vide order dated 12th September, 2002, an Enquiry Officer to enquire into the alleged contravention of Regulation 24(6) by HSBC Securities. The Enquiry Officer conducted the enquiry in accordance with the procedure laid down in SEBI (Procedure for Holding Enquiry by Enquiry Officer and imposing penalty) Regulations, 2002 (hereinafter referred to as 'Enquiry Procedure Regulations') and submitted his report on 30th May, 2003.

FINDINGS OF THE ENQUIRY :

The Enquiry Officer in his report observed to the following effect:

- 3.1 The contention of HSBC Securities that the public announcement was for acquisition of 87,64,186 shares constituting 35% of the equity capital of the target company and that there was no obligation on the acquirers to acquire exactly 35% of the paid up capital is untenable. When the acquirer makes a public announcement to acquire shares from the public at large for the purchase of upto a definite number of shares, constituting a certain percentage of the equity share capital, he is under an obligation to acquire the shares upto the specified number.
- 3.2 Offer given by the acquirer was not a "conditional offer" and therefore the contention of HSBC Securities that the acquirer is not under obligation to acquire 87, 64,186 shares representing 35% of the paid up capital of the target company is not tenable.
- 3.3 The Hon'ble Mumbai High court had observed that if the shares tendered by LIC are excluded, the number of shares offered by public would be 32% i.e. less than 35% of equity capital of the company, and all the shares tendered by public would therefore have to be accepted. The acquirers could have accepted all the shares tendered by the public (32.36%) and depending on final outcome of the suit, they could have purchased the remaining 2.64% from LIC.
- 3.4 The balance shares of 15,31,452 tendered by the public should have been retained and the balance in the escrow account should not have been released by the merchant banker. The obligation in respect of other shareholders for 15, 31,451 shares were not informed to the court.

- 3.5 HSBC Securities has acted negligently and caused the release of the balance amount from the escrow account to the acquirers without ensuring that the acquirer has complied with all the provisions of Takeover Regulations.
- 3.6 HSBC Securities as Merchant Banker has violated the provisions of Regulation 24(6) of Takeover Regulations and recommended major penalty of suspension of the certificate of registration granted the Merchant Banker for a period of 6 months.

SHOW CAUSE NOTICE AND HEARING

- 4.1 Pursuant to the enquiry-report, a show cause notice dated 1st August, 2003, was issued in terms of Regulation 13(2) of the Enquiry Procedure Regulations, to HSBC Securities forwarding a copy of the Enquiry Report. HSBC Securities vide its letter dated 20th August, 2003 furnished its reply to the said show cause notice. Thereafter, an opportunity was granted to HSBC Securities for being heard and the date of hearing was slated for September 25, 2003. HSBC Securities sought adjournment of the said hearing on the ground of non-availability of its Counsel on the said date. Accordingly, the hearing was adjourned to October 9, 2003. The opportunity was availed by HSBC Securities. Shri K Balakrishnan, Director, Ms. Jasmine Batliwala, Director of HSBC Securities along with their counsels Viz S/Shri Virag Tulzapurkar and S. Saikrishna. Shri S.N.Talwar, Senior Partner, Shri S. Balakrishnan Senior Associate and Shri Suneet Barve from Crawford Bayley & CO., attended the hearing and Shri Virag Tulzapurkar made the submissions on behalf of HSBC Securities.

SUBMISSIONS OF HSBC SECURITIES :

HSBC Securities contended that :

- 5.1 *As per Regulations 21(6) of Takeover Regulations where the number of shares offered for sale by the shareholders are more than the shares agreed to be acquired by the acquirer, the acquirer shall accept the offer on proportional basis. It has been accepted by all parties including SEBI and also by the Hon'ble High Court that the provisions of Regulation 21(6) of the Takeover Regulations were attracted.*
- 5.2 *It was not open to the acquirer or HSBC to ignore the shares offered by LIC for determining the basis of allotment. SEBI's stand, in its letter dated 24th July 2001 addressed to LIC, also was that LIC's shares could not be withdrawn and could not be excluded from consideration.*

Even the Order passed by the High Court on 24th August 2001 does not provide that the LIC shares ought not to be considered or ought not to have been considered by the acquirers/HSBC in calculating the total number of shares pursuant to the offer. In fact, by accepting the position that Regulation 21(6) of the Takeover Regulations did become applicable, the Court necessarily accepted the position that the LIC shares had to be taken into consideration which the acquirer and HSBC had done.

5.3 The show cause notice issued to HSBC does not allege that the LIC shares ought to have been ignored or kept aside and that the basis of acceptance ought to have been determined dehors the LIC shares or that HSBC wrongly took the LIC shares into consideration.

5.4 Since the total number of shares offered exceeded the shares agreed to be acquired by the acquirers, necessarily Regulation 21(6) of the Takeover Regulations became applicable. Thereupon, it was not and is not permissible for the acquirer to accept all the shares offered by the public and to restrict acceptance of the LIC shares only to 2.64%. Regulation 21(6) made it binding on the acquirer to accept the shares offered on a proportional basis and therefore, there was and is no question of the Enquiry Officer holding that the acquirers could have accepted all the shares tendered by the public (32.36%) and, depending on the outcome of the Suit, could have purchased the remaining 3% (actually 2.64%) from the LIC shares. This would have been contrary to Regulation 21(6) which was admittedly attracted to the case.

5.5 In its affidavit HSBC had drawn attention to the interest of the general body of small shareholders (the public shareholders) who had tendered shares in response to the offer who were likely to find themselves in a situation where they had neither their shares nor the offer price.

5.6 *HSBC had placed all relevant facts and material before the High Court and specifically drawn attention to the public shareholders' position (a) that the shares offered by the public shareholders were likely to be blocked till the decision of the Suit (which would take a long time) (b) the public shareholders would not even receive the offer price till the decision of the Suit. This position would result in the public shareholders suffering by depriving them of the right to dispose of their shares without receiving the offer price for the said shares.*

5.7 *High Court, while passing the Order inter alia, provided for both eventualities(a)where the Suit was decreed resulting in all the LIC shares being excluded from the offer - in which event, the acquirers would have to purchase all the shares offered by the public and which could be done by the acquirers subject to the decision of the Suit. This meant that while decreeing the Suit, the High Court would if it deemed fit, pass necessary orders and directions as to what was to be done by the acquirers in respect of the public shares. It was envisaged that at the stage of final disposal, the Court would, if it deemed fit, pass necessary orders directing the acquirers to purchase the other shares from the public and also provide for the necessary mechanism in that behalf (b) the second eventuality was that if the Suit was dismissed, the LIC shares would be made available by LIC for purchase by the acquirers, with the Court making appropriate order in that regard. This position is clear from paragraphs 13 and 14 of the High Court order. Another fact clear from paragraphs 13 and 14 of the Order is that only the proportional numbers of shares of LIC were required to be protected for the benefit of the acquirers in the event of LIC not getting relief in the Suit at its final hearing. This is clear from the Order requiring "about 20 lac shares" being made subject to LIC's undertaking. This figure of "about 20 lacs" is on the proportional basis only. This also makes it clear that Regulation 21(6) of the Takeover Regulations had become applicable; the Court had accepted that it had*

become applicable. Therefore, it was not open to the acquirer/HSBC to ignore the LIC shares from consideration. That the acceptance of shares offered was not to be on or ought not to have been on a proportional basis in terms of Regulation 21(6) of Takeover Regulations.

5.8 It would be for the Court to pass appropriate orders at the final decision of the Suit, depending upon the result of the Suit so as to direct in what manner the total number of shares to be acquired by the acquirers were to be taken by the acquirers and from whom. This does not and cannot mean that at that stage the Acquirers / HSBC Securities could or were required or found to proceed on the basis that all the shares offered by the public were required to be taken by the acquirers.

5.9 As per the Takeover Regulations the Offer had closed and it was necessary for the acquirers/HSBC to do various acts including finalizing the number of shares to be acquired by the acquirers and the proportional basis of acquisition as well as making payment for the shares acquired. There are specific periods provided for in the Takeover Regulations for doing these acts. There is no provision for extension. It was and is not expected that this entire exercise would be kept open indefinitely till the disposal of the Suit. (Which could take more than 10 years)? This would also not have been in the interest of any of the shareholders including the public shareholders. Keeping the position open indefinitely, till the decision of the Suit, would have resulted in:

- (i) all the shares offered by the public being frozen, thereby removing them from the control of the public shareholders, so that they could not exercise any right of sale or transfer of those shares, till the decision of the Suit; and*

(ii) *Even while losing control over the said shares, the public shareholders would not have received any consideration or offer price towards those shares till the decision of the Suit. This would certainly be against the interest of the public shareholders and it is impossible to say that this course of action ought to have been followed by HSBC.*

5.10 *HSBC acted bona fide and in good faith and in the interest of the shareholders at all times while considering the proportional basis of acceptance of the total shares offered, in returning the rejected shares to the public, in returning the LIC shares to LIC, in allowing the balance in the Escrow Account to be released and in filing the report with SEBI under Regulation 24(7). At all stages, SEBI was kept duly and timorously informed by HSBC, by forwarding to SEBI the correspondence addressed by HSBC to the acquirers.*

5.11 *HSBC further submits that in the Appeal filed against the High Court's Order dated 24th August, 2001, HSBC made an application to the Appellate Court by means of Notice of Motion No.1491 of 2002, specifically seeking confirmation that HSBC, having duly complied with its obligations in law in respect of the open offer, could return the LIC shares to LIC. The Appellate Court duly considered HSBC's said Notice of Motion and confirmed that HSBC had complied with all its obligations in law and also directed that it could return the LIC shares to LIC.*

5.12 *HSBC has at all times, acted bona fide in good faith, in the best interests of the shareholders (particularly the public shareholder), and in due compliance with all regulations. Had HSBC blocked the public shares while at the same time retaining the entire amount in the Escrow Account (without making payment for any of the public shares) this would have been adverse to the interest of the public shareholders. HSBC has acted pursuant to Orders passed by competent Courts and HSBC cannot be faulted for doing so. HSBC has kept SEBI timeously*

informed of the proportionate acceptance under Regulation 21(6) of the return of the balance shares to the public and all other relevant factors. SEBI has not at the relevant time found fault with HSBC for any of its acts, till long after the Offer had been closed, all parties had acted in the manner they did and the final report submitted by HSBC to SEBI on 27th September 2001.

- 5.13 *The Enquiry Officer holds that the balance public shares (which were rejected and returned) should have been retained till disposal of the Suit and the Escrow Account in respect of LIC's shares should also have been maintained in respect of them. HSBC submits that firstly, there was no requirement in law to do so at all. Secondly, had this been done, it would have worked gravely adversely to the public shareholders whose shares would have been blocked and put out of their control, without the shareholders being paid the offer price in respect thereof. It was not in the interest of the public shareholders to do so.*
- 5.14 *The Enquiry Officer erred in holding that if the acquirers opted not to accept the LIC shares on a dismissal of LIC's Suit, the acquirers were then obliged to acquire those many shares from the public shareholders. HSBC respectfully submits that the acquirer/HSBC could not be required to keep the position open to the detriment of the public shareholders till the disposal of the Suit. Having regard to the specific periods provided for in the Regulations for doing various acts, HSBC/acquirer had to complete the entire process in a timely manner, which they proceeded to do without any breach or default whatsoever. If LIC's Suit was dismissed and if, thereupon the acquirers refused to take the LIC shares (event that was/is uncertain as the acquirers may well opt to take the LIC shares), it was for the High Court at this stage to pass appropriate orders and directions as to what the acquirers should do in respect of the shares to be acquired by them and the High Court would have passed necessary orders in that behalf at that stage.*

However, the entire matter was complete in September 2001, warranting the filing of the final report by HSBC with SEBI, which HSBC duly did after having duly and properly returned the balance of the public shares and having stated that the balance amount in the Escrow Account would be returned which was not required to be retained therein. The balance amount in respect of the LIC shares was returned in October 2001.

- 5.15 The Enquiry Officer erred in holding that HSBC acted negligently by releasing the balance money from the Escrow Account without considering the claims in respect of the balance public shares. There were no claims of the balance public shares to be considered at that stage, particularly having regard to peculiar and exceptional supervening events caused by LIC's Suit and the High Court's Order dated 24th August 2001. In any event, there were no outstanding obligations of the acquirers under the Takeover Regulations and HSBC's act in releasing the balance in the Escrow Account was not negligent or without the fulfillment of the acquirers' obligations under the Takeover Regulations.*
- 5.16 Alleged obligation in respect of the balance public shares was not informed to the Court is not correct. The entire material was before the Court in the form of HSBC's Affidavits dated 6th August 2001 and 2nd May 2002.*
- 5.17 HSBC submits that the High Court itself while disposing of the Suit finally would have passed appropriate orders, if LIC's Suit was dismissed, and the acquirers opted not to take the LIC shares, as to what was to be done by the acquirers. The Court would have passed appropriate Orders at that stage taking into consideration all the relevant facts and material.*

- 5.18 *The Enquiry Officer erred in holding that the obligations of the acquirers were not fulfilled, without setting out which obligation of the acquirers had remained outstanding and still to be performed. HSBC verily believes that no action has been taken against the acquirers for any failure to perform any of the acquirers' obligations under the Regulations. This shows that SEBI accepts the position that the acquirers had duly fulfilled all their obligations without any remaining outstanding. In these circumstances, it is impossible to hold that HSBC acted negligently without ensuring that the acquirers had fulfilled their obligations.*
- 5.19 *It may be noted that by an order dated 28th November 2002 the Securities Appellate Tribunal in the matter of Grasim Industries Ltd and another v/s. SEBI issued an order, while restraining the acquirers from proceeding with the public offer, held that the acquirers be allowed to withdraw monies from the escrow account as maintaining it would have a bearing on the acquirer's finance and the monies would be unnecessarily blocked, since the appellants have been asked not to proceed with the public offer, it is but fair to allow the appellants to withdraw money from the escrow account, if they so desire and they will redeposit the required amount as ad when the public offer is allowed to be made.*
- 5.20 *Without prejudice to the above, HSBC respectfully submits that unless conditions set out in Regulation 13(6) (in relation to major penalty) are present, there is authority to impose any major penalty as recommended by the enquiry officer.*

ISSUE

- 6.1 The issue that arises for consideration is:
Whether in the light of facts and circumstances of the case, HSBC Securities, as Merchant Banker, has acted in a negligent manner and released the balance amount

in the Escrow Account without ensuring that the acquirer has complied with all the provisions of the SEBI (SAST) Regulations, 1997 and thereby violated the provisions of Regulation 24(6) of the Regulations and whether the major penalty of suspension of the certificate of registration granted to HSBC Securities as merchant bankers for a period of 6 months recommended by the Enquiry Officer is warranted?

CONSIDERATION OF THE ISSUE

- 7.1 I have carefully considered the facts and circumstances of the case, the findings of the Enquiry Officer, the written submissions of HSBC Securities - vide its letter dated August 20, 2003, and also the oral submissions made during hearing held on October 9, 2003. Following are the provisions relevant for consideration of the issue:

Regulation 21(6):

“where the number of shares offered for sale by the shareholders are more than the shares agreed to be acquired by the person making the offer, such person shall, accept the offers received from the shareholders on a proportional basis, in consultation with the merchant banker, taking care to ensure that the basis of acceptance is decided in a fair and equitable manner and does not result in non-marketable lots.

Provided that acquisition of shares from a shareholder shall not be less than the minimum marketable lot or the entire holding if it is less than the marketable lot”.

Regulation 24(1)

- 1) “Before the public announcement of offer is made, the merchant banker shall ensure that –
 - a. The acquirer is able to implement the offer
 - b. The provision relating to escrow account referred to in regulation 28 has been made
 - c. Firm arrangements for funds and or money for payment through verifiable means to fulfil the obligations under the offer are in place;
 - d. The public announcement of offer is made in terms of the regulations”

Regulation 24(5):

“The merchant banker shall ensure compliance of the regulations and any other laws as may be applicable in this regard.”

Regulation 24(6):

“Upon fulfilment of all obligations by the acquirers under the Regulations, the merchant banker shall cause the bank with whom the escrow account has been deposited to release the balance amount to the acquirers.”

Regulation 24(7):

“The merchant banker shall send a final report to the Board within 45 days from the date of closure of the offer”

- 7.1 It is noted from the quoted regulations that it is the responsibility of the merchant banker mandatorily appointed by the acquirers to manage the public offer, to ensure compliance of the relevant regulations in regard to the offer and also to see that the balance in the Escrow Account is not released to the acquirers until all obligations of the acquirers under the Takeover Regulations are fulfilled. In the instant case, HSBC Securities, the merchant banker has caused the release of the balance amount in the escrow account to the acquirers. The question that arises, therefore, is whether the acquirer's all obligations had been fulfilled before release of the balance in the Escrow Account and if not, whether the merchant banker has acted negligently in this regard.
- 7.2 The question needs to be examined in the context of the relevant facts and circumstances of the case. As per the announcement of the public offer the acquirers had agreed to purchase upto 87,64,186 fully paid up equity shares, representing 35% of the equity share (and voting) capital of Modi Rubber Ltd at an offer price of Rs.81.50 (later revised, in stages, to Rs.90/-) per share. The offer, which had opened on June 4, 2001 and was to be closed on July 3, 2001, actually closed on July 25, 2001, the closing date having been extended by direction of court orders pursuant to certain legal disputes. The total number of shares received in response to the public offer, at 1,08,06,760 – including the shares tendered by Modipon Ltd (11,33,333) and MSWM (6,66,667) as well as LIC (27,04,305) – was in excess of the quantum of shares intended to be acquired (87,64,186). The shares tendered by Modipon and MSWM have been reckoned for proportional acquisition, since SEBI's order declaring Modipon and MSWM as ineligible to participate in the offer was set aside by SAT. The shares lodged by LIC were sought to be withdrawn on the ground that these had been tendered in an unauthorized manner and the suit filed by LIC in this regard is pending

before the Honorable High Court of Mumbai. The substantive issue viz. whether the lodgement of shares by LIC in response to the public offer for acquisition was an “offer” or “acceptance” of an offer or, in other words, whether LIC was entitled to withdraw the shares tendered before their acceptance by the acquirers is still sub-judice. However, based on the notice of motion (no.1704 of 2001) taken by LIC praying for interim relief, the Court has granted injunction against acceptance of these shares. *The order states that in case the shares of Plaintiff are excluded from consideration, the number of shares would be less than 35% of the equity share capital. Therefore, the acquirers would have to purchase all the shares offered. This can be done by the acquirer subject to the decision of the suit and in case ultimately the suit is dismissed, the shares of the plaintiff can be made available for processing in accordance with the Regulations by making appropriate order in that regard at this stage itself.* Envisaging the eventuality of dismissal of the suit filed by LIC, the court order adds that “... in case this suit is dismissed for any reason, subject to any order that the court may make while dismissing this suit, the plaintiff within a period of four weeks from the date of dismissal of the suit, submit 20 lakh shares of the defendant no.1 company to the acquirer for purchase in accordance with the public offer and that, in that event, in case the acquirer for any reason does not want to purchase the shares, the plaintiff shall not insist on the acquirer to purchase the share” Against this background, all the shares tendered (1,08,06,760) in response to the public offer has been reckoned to decide on proportional acquisition and, the acquisition has been made, on such proportional basis, to the extent of 65,71,103 shares and the balance unaccepted shares have been returned to all concerned including LIC. The consideration for the shares acquired has also been paid. In the circumstances, HSBC securities has allowed the release of the balance in the Escrow Account to the acquirers.

- 7.3 It is seen that the acquirers have acquired only 65,71,103 shares as against 87,64,186 shares agreed to be purchased in terms of the public offer. But for the legal issue pending in regard to the shares tendered by LIC, the acquirers would have acquired 21,93,083 shares out of 27,04,205 shares tendered by LIC on proportional basis. Thus, the actual acquisition has fallen short of number of shares agreed to be acquired, despite excessive response from the public. A question that arises, therefore, is: whether all the obligations of the acquirers pursuant to the said public offer can be deemed to have been fulfilled, till the pending LIC’s suit is finally decided upon.
- 7.4 The interim order of the court, has stated that in the event of ultimate dismissal of the suit, while LIC shall submit to the acquirers such number of shares as would have been accepted but for the suit, the acquirers would be under no obligation to accept them. Assuming, that the final order would be largely in consonance with the interim

order, the acquirers will have no obligation to acquire the shares from LIC, irrespective of the decision on the suit. In that scenario, a volley of questions arise:

- ? Whether, in the aforesaid odd circumstances, the acquirers should have acquired all the shares tendered by the shareholders other than LIC i.e. ignoring the shares lodged by LIC altogether.
- ? Whether the acceptance/ acquisition process should have been kept open till the final decision of the court on LIC's suit.
- ? Whether the balance in the Escrow Account should have been retained till disposal of the said suit, so as to meet the eventual contingency of the acquirer being required to buy any part of the shares returned to the public including LIC.

7.5 As the number of shares offered for sale by the shareholders was more than the number of shares agreed to be acquired, the Regulation 21(6) of the Takeover Regulations dictates proportional acquisition. If all the shares tendered by the shareholders other than LIC were to be accepted, the shares tendered by LIC would have been totally ignored for computation of the total number of shares as denominator to decide on proportional acquisition. This would not have been in order in view of pendency of the suit filed by LIC; for, the final decision of the Honorable High Court cannot be anticipated.

7.6 It is argued that as per the Takeover Regulations, the offer had closed and it was incumbent upon the acquirers and the merchant banker to complete the process within the prescribed time frame and that there is no provision for extension. The merchant banker's further argument is that the entire exercise cannot be expected to be kept open indefinitely till the disposal of the pending suit ("which could take more than 10 years"). It is stated that this would not have been in the interests of any of the shareholders including the public shareholders, for such a freeze of the shares would have deprived the shareholders of the benefit of receipt of consideration for the shares acquired and the right of their sale/transfer as well, for an indefinite period. There is some force in the argument. I agree that it would not have been fair to the shareholders, had the entire exercise of acquisition pursuant to the public offer been kept open for an indefinite period. Similarly, it would not have been fair if the unaccepted shares from the public had been retained indefinitely.

7.7 This leads to the question of the contingent obligation of the acquirers to buy the shares from LIC, on final disposal of the suit, if the suit is dismissed or from the public (other than LIC) to the extent of shares returned unaccepted. A corollary issue that pops up relate to need for retention of the balance in the Escrow Account to meet such a contingency. In this respect, a mix of arguments has been put forth. One is that there was no outstanding obligation on the part of the acquirers having regard to the facts and circumstances of the case and, particularly the order dated August 24, 2001 passed by the Honorable Bombay High Court which does not cast any obligation on the acquirers to buy the shares from LIC, if LIC were to submit the shares to the acquirers in the event of dismissal of the LIC's suit. This, for the nonce, ignores the eventuality of the acquirers' acquiring an obligation to buy the shares returned to the public (other than LIC). The Honorable High Court in the said interim order had recognized such an eventuality. The merchant banker too, envisaged such a lurking possibility and has argued that if LIC's suit was dismissed and, if thereupon the acquirers refused to take the LIC shares, it was for the High Court at that stage to pass appropriate orders and directions as to what the acquirers should do in respect of the shares to be acquired by them. Though the argument runs as if the eventuality was a thing of the past, it remains valid, even as the eventuality is yet to be encountered. In defense of its action, HSBC Securities has cited the SAT's order in the matter of Grasim Industries Ltd and another vs. SEBI, allowing the acquirers to withdraw the money in the Escrow account, as maintaining it would have a bearing on the acquirer's finances and monies would be unnecessarily blocked. According to SAT's order, "since the appellants have been asked not to proceed with the public offer it is but fair to allow the appellants to withdraw money from the (escrow) account, if they so desire and they will redeposit the requisite amount as and when the public offer is allowed to be made." Prima facie, the circumstances of the case of Grasim differs somewhat from the instant case. In the case of Grasim, the acquirer had not been allowed to proceed with the public offer itself, whereas in this case, the public offer has been proceeded with and closed. The difference, however, does not detract from the relevance of the underlying principle of the SAT's order to this case. The acquirer's obligations, if any, to buy further shares (over and above what they have already acquired) pursuant to the closed public offer, in this case, would depend on the nature and directions of the court while finally deciding on LIC's suit. Though it may not take 10 years or more as pessimistically apprehended by the merchant bankers, for disposal of the suit, it is noted that a period of 2 years and a half has already elapsed since the close of the public offer. Even assuming that the obligation on the part of acquirers would still arise to buy more shares from LIC or public in terms of the closed public offer, based on the court order to be passed on disposal of the pending LIC's suit, the proposition would throw up a number of practical issues to contend with, in view of changed

circumstances and market conditions and presumably these would be dealt with suitably in the court order. Therefore, it could virtually tantamount to a fresh offer as contended. In view of the above, I am inclined to agree that it was fair that the balance in the escrow account pertaining to the closed public offer was not retained indefinitely.

7.8 Finally the issue of any negligence on the part of the merchant banker: It is observed that, as has been averred, HSBC Securities has kept the Regulator (“timorously”) informed of significant developments in the case from time to time. It has submitted final report (45 days report) on September 27, 2001 to SEBI, in terms of Regulation 24(7) of the Takeover Regulations, wherein it had mentioned, under the item relating to Escrow account that “the balance amount of Rs.2,09,91,073 would be returned to the acquirers on completion of the formalities”. It is contended rightly that, at no stage, the merchant banker had been called upon to adopt a different approach in the matter. As a measure of abundant precaution, HSBC Securities has secured a confirmation from the court regarding its regulatory compliance. By order of June 14, 2002, the Honorable Court has confirmed that HSBC Securities had complied with all its obligations in law in respect of the public offer and that it could return the LIC shares to LIC.

7.9 There is no denying the fact that this is an exceptional case, riddled with complications of litigations. Based on totality of consideration of the given facts and peculiarity of circumstances of the case and the conduct of the merchant banker in navigating the public offer, it would be but reasonable to conclude that HSBC Securities, as merchant banker, has not acted negligently.

ORDER

8.1 In the light of the aforesaid findings I, in exercise of the powers conferred on me as Member of the Board, in terms of Section 19 of the SEBI Act 1992 read with Regulation 13(4) of the Enquiry Procedure Regulations, hereby hold that HSBC Securities and Capital Market (India) Pvt. Ltd., as merchant banker for the public offer made in June 2001 by Shri V.K. Modi and others to acquire shares representing 35% of Equity share capital of Modi Rubber Ltd. has not acted negligently warranting imposition of penalty.

Place : Mumbai
Date: December 9, 2003

T M NAGARAJAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANG BOARD OF INDIA