WTM/KMA/IVD/134/09/2009

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: DR. K. M. ABRAHAM, WHOLE TIME MEMBER

ORDER

DIRECTIONS UNDER SECTION 11D OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 IN RESPECT OF TEMPTATION FOODS LIMITED AND ITS MANAGING DIRECTOR MR. VINIT KUMAR IN THE MATTER OF KOHINOOR FOODS LIMITED

Date of hearing: March 25, 2009

Appearance:

For Temptation Foods Limited and its Chairman and Managing Director, Mr. Vinit Kumar }	Mr. Somasekhar Sundaresan, Advocate Mr. Ravichandra S. Hegde, Advocate Mr. Sukham Singh, Advocate Mr. Vinit Kumar Mr. Vipin Chandra, President, Temptation Foods Limited
For Securities and Exchange Board of India:	Mrs. Medha Sonparote, Deputy General Manager Mr. Vijayakrishnan G, Deputy Legal Adviser Mr. Amol Ramchandra Hogade, Assistant General Manager Mr. T. Vinay Rajneesh, Legal Officer

1. Securities and Exchange Board of India (hereinafter referred to as SEBI) had observed that Temptation Foods Limited (hereinafter referred to as TFL) was deliberately publishing and disseminating false and misleading information (claiming to hold 13.69% share capital along with persons acting in concert, when it actually held only 2.28% in its demat accounts) of its holding in Kohinoor Foods Limited (hereinafter referred to as KFL), to the public through news paper reports (The Times of India) and stock exchanges. In view of the same, SEBI, vide an ad interim ex-parte order dated February 16, 2009, under Section 11D of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as SEBI Act), for the reasons stated therein, directed TFL and its Managing Director, Mr. Vinit Kumar to cease and desist with

immediate effect, from publishing or causing to report or circulate or cause to circulate in any manner any false or misleading information relating to dealing in securities (as set out in the said order) or in any manner until further orders. Further, the order advised the aggrieved parties to file their objections, if any, within fifteen days.

2. Pursuant to the said interim order, TFL, vide letter dated February 26, 2009 filed its objections. TFL and its Managing Director, Mr. Vinit Kumar shall be collectively referred to as noticees. The contentions of the noticees in their aforesaid letter, in brief, are:

a) that the alleged findings are primarily arrived at based on the data provided by the stock exchanges, National Securities Depository Limited (hereinafter referred to as NSDL), Central Depository Services (India) Limited (hereinafter referred to as CDSL) and KFL, which had been viewed and considered out of context and without weighing it with regard to the truly factual position available with SEBI, and in disregard to the data provided by them.
b) that in some instances, the declarations were filed by way of abundant caution even when the percentages specified in the aforesaid regulations were not reached. The disclosures under Regulation 7 (1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeover**s**) Regulations, 1997 (hereinafter referred to as Takeover Regulations) and the Regulation 13 (1) and 13 (3) of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 (hereinafter referred to as Insider Trading Regulations) were made in respect of the shares sold by VBAL (sold 4,00,055 shares of KFL on January 1, 2009 and 53,500 shares on January 2, 2009) and the shares purchased by TFL (4,00,000 shares of KFL on January 01, 2009 and 53,500 shares on January 02, 2009). While MFSL made abundantly cautious disclosure under the Takeover Regulations, there was no declaration required to be filed under Regulation 13(3) of the Insider Trading

Regulations, which requires the declaration to be filed only when there is change in the quantum of ownership by 2% or more.

c) that the Register of Members is maintained by KFL and that, since all the shares were acquired by them in demat form, the information downloaded from the depository system would clearly evidence the same.

d) that the only reason why their holding could be mistaken by SEBI is the transfer of shares to the entities providing finance for acquisition of shares of KFL.

e) that SEBI has given an informal guidance to stock brokers clearly stating that the shares provided by a client towards margin cannot be used by it as its own shares. Therefore, the shares although technically not in the name of the client, have to be transferred to the 'financier' for margin purposes was *de facto* belonging to the client. In the instant case, they continue to be the legal and beneficial owners of their shares. The secured margin finance from their four financiers was as per the table below:

Sr. No.	Name of the Depository Participants	No. of Shares
1.	HDFC Bank	3,395
2.	Microsec Capital Limited	11,90,000
3.	Nirmal Bang Securities Private Limited	9,78,000
4.	Shriram Insight share brokers Limited	8,50,000
5.	SSJ Finance & Securities Private Limited	6,12,253
	Total	**36,34,148**

f) that the beneficial interest in the shares (of KFL) belonged to TFL and that the shares were provided as a security to the financiers towards margin finance.

g) that Microsec Financial Services Limited (MFSL) does not accept marking of a pledge of shares against the margin finance facility. Therefore, to meet the requirements in the internal policy of the financier, TFL and VBAL had transferred 11,90,000 and 4,53,468 shares respectively in the depository account of MFSL as security against the facility provided by them. Regardless of what MFSL has done with the shares, the beneficial ownership of those shares continues to vest with TFL and VBAL. SEBI has wrongly concluded that the beneficial ownership of shares had passed on MFSL, while ignoring the

averment of Clause 6.1 of the Agreement (dated June 17, 2008, between MFSL and TFL) for the facility.

h) that it was mandatory for TFL to maintain a margin for the facility provided and the same was to be maintained by transferring such quantity of securities for such value as may be determined by the stock broker from time to time.

i) that in the order, SEBI failed to recognise that the right in Clause 6.1 of the Agreement given to MFSL is limited only to the recovery of moneys due by it.

j) that it had executed a separate Power of Attorney in favour of the financier to *inter alia* create pledge over the shares of KFL. Besides, the financier had the liberty to pledge the said shares to a non banking financial company or any other financial institution. Therefore, if the beneficial ownership had been transferred to the financier, the Power of Attorney would not have been required for further 'delegation of shares'.

k) that after the ex parte order came to be passed, the shares which were transferred to MFSL and Nadi Finance and Investment Private Limited have been transferred back to their account and a pledge created in favour of the financiers.

l) that the statement dated February 18, 2009 by Nirmal Bang Securities Private Limited shows the closing balance of 9,78,500 shares which had been transferred to their depository account. Nirmal Bang Securities Private Limited had not marked any pledge on the shares but had taken documents for the creation of pledge. The statement dated February 18, 2009 from MFSL shows that the present holding of 7,37,838 shares of KFL are held in their name and pledged to MFSL. that none of the statements made by them were incorrect, misleading and artificial and that no representation was made by them which may cause rumours of impending takeover of KFL.

m) that it had requested Shriram Insight Share Brokers Limited (one of the financiers) to transfer the shares of KFL into its depository account to then create a pledge.

n) that there was no attempt to mislead the investors and create artificial market to induce investors in violation of Regulation 4(2)(f) and 4(2)(r) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade

Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as PFUTP Regulations).

3. TFL also submitted contract notes in respect of all the share purchased (and sold) and the statements of holding issued by the depository participants evidencing their holding along with the aforesaid reply.

4. Thereafter, an opportunity of hearing was granted to the noticees on March 25, 2009. Mr. Somasekhar Sundaresan, Advocate, appeared before me and made submissions on their behalf. Mr. Ravichandra S. Hegde, Mr. Sukham Singh (Advocates), Mr. Vinit Kumar (Chairman and Managing Director of TFL) and Mr. Vipin Chandra (President of TFL) were also present during the hearing. During the course of the hearing, the learned counsel submitted that, if TFL was heard before passing the ex parte interim order, the said order would not have been passed. The learned counsel made his submissions at length in the matter. The learned counsel, for the first time, informed that TFL had complained about the mismanagement in KFL to the Company Law Board (hereinafter referred to as CLB), under Section 398 of the Companies Act, 1956 and that one of the necessary requirements to make a complaint under the said provision was that the entity making such a complaint should hold 10% of the share capital in the company against whom the complaint is made, to have a *locus standi*. The learned counsel contended that only in order to frustrate the said complaint; KFL had alleged irregularities against TFL to make it appear that it did not have the necessary shares. It was further submitted that SEBI interim order was taken by KFL to CLB to 'thwart' the proceedings initiated under Sections 397 and 398 of the Companies Act, 1956. The learned counsel submitted that the real test was to see whether TFL actually held 13.69% of the shares on January 17, 2009. The learned counsel referred to Para 2.6 of the interim order which *inter alia* mentioned that the shares were transferred by TFL to MFSL as 'margin' and because of the said transfer, the shares came to be

perceived as belonging to MFSL and not of TFL. The learned counsel added that MFSL admitted that the shares were kept as margin and it was not the beneficial owner as it had sought the permission of TFL to deal with the said shares. The learned counsel's argument was that if the shares were not of his client (TFL), why MFSL required its (TFL's) permission to deal with them. According to the learned counsel, MFSL was a financier and TFL was a borrower. The Learned Counsel referred to various clauses in the agreement (entered into between MFSL and TFL) drawing special attention to Clauses 6.1, 6.4, 6.5, 6.6, 6.12 to prove his point that the shares were in fact in the control of TFL, though the beneficial ownership in them were transferred to MFSL. The learned counsel submitted that the shares transferred to MFSL were kept as margin and that if the same was not treated as that of TFL, it would result in market abuse as acquirers may be able to purchase shares and keep them as margin with any Non-Banking Financial Corporation (NBFC) and would be able to circumvent the provisions of the Takeover Regulations. The learned counsel while admitting that the pledge of shares had not been created in the manner specified, contented that the said agreement cannot be invalid because of the same. He further contended that the newspaper report (Times of India) was not wrong as TFL was in control of those shares. With regard to the allegation that TFL did not intimate its intention of taking over KFL as required under Clause 36(7)(ii) of the Listing Agreement, it was submitted that since there was no 'design to takeover as of now', the said clause in the listing agreement would not come to play. With respect to the finding in Para 3.4 of the ex parte interim order that TFL did not make necessary disclosures, it was submitted that MFSL had disclosed to KFL that it was holding around 17 lakh shares of KFL and the mode of such acquisition was shown as margin. It was further submitted that MFSL was clear in its mind that it was disclosing the shares by reason of it holding them as margin, under Regulation 7(1) of the Takeover Regulations. The learned counsel further contented that TFL was the true *defacto* owner of

13.69% of shares of KFL and that it did not publish or cause to publish any false news and that the newspaper reports were in fact true. The learned counsel brought to my notice, the adjudication order passed in the matter of Angel Broking Limited. The learned counsel submitted that, it had convinced some of its lenders to return the shares and had marked a pledge as required under the Depositories Act, 1996. The learned counsel further stated that the records from the depository which are available every Friday, do not capture all types of commercial interest and that they static in nature. On the basis of the aforesaid submissions, the learned counsel requested that the interim order passed by SEBI be withdrawn.

5. Pursuant to the personal hearing, TFL, vide its letter dated April 06, 2009 also filed its written submissions and paragraph-wise reply to the interim order dated February 16, 2009. The written submissions/ paragraph-wise reply so filed by TFL were on the lines of the submissions made by its Advocate during the personal hearing and its earlier reply.

6. I have considered the reply/written submissions dated February 26, 2009 and April 06, 2009, respectively, filed on behalf of the noticees and the oral submissions made by Mr. Somasekhar Sundaresan, the learned counsel, on their behalf. The issue to be considered in the matter would be whether TFL was holding 36,34,296 shares (13.69%) of KFL along with VBAL (person acting in concert) when TFL disclosed to the stock exchanges of its holding and when the news paper report (The Times of India dated December 22, 2008) were published or caused to be published.

7. TFL has contended that, it along with VBAL was holding 13.69% of the share capital of KFL during the relevant period. In its written submissions and during the personal hearing, TFL had submitted that KFL was indulging in

making complaints against TFL to SEBI, National Stock Exchange of India Limited (NSE) and Bombay Stock Exchange Limited (BSE) only to frustrate the proceedings initiated by it against KFL before CLB,**.** It would be pertinent to note that KFL had alleged that the disclosures made by TFL under Regulation 7(1) of the Takeover Regulations were incorrect and misleading and further alleged that TFL was using fictitious demat account(s) in contravention of the provisions of Section 68A of the Companies Act, 1956. The argument that proving that TFL held less than 10% of the share capital of KFL would render the proceedings against KFL infructuous as it would lose its *locus* to proceed further is conceivably true. But that is not what is directly relevant to this proceeding. The issue here is to merely find out whether TFL was actually holding 13.69% share capital of KFL, when it published or cause to be published the news of its holding in KFL through news paper reports and stock exchanges.

8. I note that the shareholding of TFL in KFL as per the statement issued by Skyline Financial Services Private Limited (share transfer agent of KFL and a SEBI registered intermediary) is as follows:

S. No.	Holding as on week ending	Total Shareholding (TFL & VBAL)	Percentage
1	28/11/2008	2309296	8.56%
2	05/12/2008	1069296	3.96%
3	12/12/2008	1154296	4.28%
4	19/12/2008	1069296	3.96%
5	26/12/2008	615648	2.28
6	31/12/2008	615648	2.28
7	09/01/2009	615648	2.28
8	16/01/2009	615648	2.28
9	23/01/2009	615648	2.28
10	30/01/2009	615648	2.28
11	06/02/2009	615648	2.28
12	13/02/2009	615648	2.18*****
13	20/02/2009	1453486	5.16
14	27/02/2009	1353486	4.80
15	06/03/2009	1274915	4.52

***** As mentioned in the statement

As can be seen from the above, TFL along with VBAL does not appear to have held more than 10% of the share capital of KFL, between November 28, 2008 and March 06, 2009. It is also observed that TFL made disclosures (as per the table below) for the period between June 18, 2008 and December 12, 2008 in terms of Regulation 7(1) of the Takeover Regulations, immediately on the date of acquisitions even though the shares acquired were not actually received in its demat accounts. It was noticed that the shares so purchased by TFL were not received in all instances in its demat accounts.

Details as per disclosure given under Regulation 7 (1) by TFL			Shareholding of TFL as per its demat accounts	
Date of acquisition	No of shares acquired	Shareholding after acquisition	holding as on date of acquisition	Holding a week after the date of acquisition (Date)
18-Jun-08	1000000	1000000	0	1000000 (25-Jun-2008)
13-Aug-08	190000	1190000	650000	840000 (20-Aug-2008)
4-Sep-08	95416	1285416	840000	840000 (11-Sep-2008)
5-Sep-08	270011	15555427	840000	840000 (12-Sep-2008)
9-Sep-08	228826	1784253	840000	840000 (16-Sep-2008)
10-Sep-08	100000	1884253	840000	840000 (17-Sep-2008)
26-Sep-08	200000	2084253	1315253	1883253 (03-Oct-2008)
24-Oct-08	500000	2584253	1730648	1730648 (31-Oct-2008)
24-Nov-08	199725	2130373	18855648	740648 (03-Dec-2008)
25-Nov-08	50275	2180648	18855648	615648 (04-Dec-2008)
4-Dec-08	270000	2450648	615648	615648 (11-Dec-2008)
10-Dec-08	300000	2750648	615648	615648 (17-Dec-2008)
12-Dec-08	120000	2630648	700648	615648 (19-Dec-2008)

I also note that as per the data made available by NSDL and CDSL, VBAL had transferred 4,53,648 shares of KFL to Microsec Capital Limited on December 23, 2008, the same being admitted by TFL. There were credits and debits of shares of KFL in the demat accounts of TFL between December 08, 2008 and

January 06, 2009 to Nirmal Bang Securities Private Limited. Further, it is an admitted fact that TFL had transferred 11,90,000 shares of KFL to Microsec Capital Limited and that the same has been acknowledged by MFSL (in terms of the agreement dated June 17, 2008) on December 22, 2008. MFSL is the financier and Microsec Capital Limited is one of the stock broker's of TFL and VBAL**.** It is pertinent to note here that on the same day, TFL had informed the stock exchanges that it had acquired 31,80,648 shares (constituting 11.98% of the share capital of KFL) and that VBAL had acquired 4,53,548 shares (constituting 1.71%), which together aggregated to 36,34,296 shares (constituting 13.69% of the share capital of KFL). Further, TFL has admitted that it had transferred its holding in KFL to four financiers for availing finance. Thus, even as per TFL, it is very clear that as on the dates when the disclosures were made to the stock exchanges and newspaper reports, TFL along with VBAL were not holding 13.69% of the share capital in KFL as claimed by it, in their beneficiary depository accounts.

9. TFL had claimed that, it had transferred its shares as a security for availing margin finance from four financiers. Though it had transferred shares, it contended that the beneficial interest in the said shares belonged to it. TFL had submitted that, since MFSL did not accept marking of a pledge of shares against the loan advanced/or to be advanced, it had to abide by the internal policy of MFSL and accordingly, transferred 11,90,000 shares to the demat account of MFSL. Similarly, VBAL had also transferred 4,53,468 shares to MFSL. It further submitted that, regardless of the transfer of shares to MFSL, the beneficial ownership of those shares vested in and continued to vest with it and VBAL, respectively. I note that in terms of Section 10 of the Depositories Act, 1996, the beneficial owner is the person whose name is recorded as such with a depository and is entitled to all the rights and benefits and also subjected to all liabilities in respect of its/his securities held by a depository. As per

Section 41 (3) of the Companies Act, 1956, *"Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company"*. Further, as per Section 152A of the said Act, the register and index of beneficial owners maintained by a depository under Section 11 of the Depositories Act, 1996, shall be deemed to be an index of members and register and index of debenture holders, as the case may be. Therefore, the presence of shares in a depository account is a *sine quo non* for any individual/entity to declare that he is a shareholder of the company. Further, any transfer of securities from the beneficial owner account would be construed as change in ownership in respect of those securities which have been transferred to another beneficiary depository account.

10. In this case, I have perused the agreement dated June 17, 2008 entered into between MFSL and TFL. Clause 4(a) of the said agreement provides that the borrower (TFL) shall transfer or cause the 'said stock broker' to transfer to the depository account of the financier (MFSL) such value as may be determined by the financier from time to time. Further, as per clause 6.3 of the agreement, the borrower unconditionally and irrevocably authorized the financier to sell, transfer and dispose off the shares/securities transferred by the stock broker for the purpose of recovering the amount due to the financier from the borrower and/or in the event the borrower fails to discharge the obligation with reference to the maintenance of margin required to be maintained by the borrower. Thus, it can be seen that the securities have been transferred by TFL to MFSL for the finance availed or to be availed by it from MFSL. The plea of TFL that the said shares were pledged to MFSL by way of the aforesaid agreement could have been justified had those shares been pledged in accordance with the provisions of the Depositories Act, 1996, Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996

(hereinafter referred to as D&P Regulations) and the Bye-laws and business rules of the depositories. ‘Pledge’ or ‘hypothecation’ under the depository system does not involve any transfer of shares from the pledger to the pledgee as only an entry is recorded in respect of the securities so pledged or hypothecated, which would evidence the creation of a pledge. Further, pledge or hypothecation of securities held in a depository shall be made as per the method and manner prescribed under the provisions of the Depositories Act, 1996, D&P Regulations and the Bye laws of the depositories. Section 12 of the Depositories Act, 1996 provides for pledge or hypothecation of securities held in a depository, which is reproduced herein below:

“Pledge or hypothecation of securities held in a depository-

12. (1) Subject to such regulations and bye-laws, as may be made in this behalf, a beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository.

(2) Every beneficial owner shall give intimation of such pledge or hypothecation to the depository and such depository shall thereupon make entries in its records accordingly.

(3) Any entry in the records of a depository under sub-section (2) shall be evidence of a pledge or hypothecation.”

Further, Regulation 58 of the D&P Regulations provides for the manner of creating pledge or hypothecation, the same is reproduced herein below for reference:

“Manner of creating pledge or hypothecation -

58.[(1) If a beneficial owner intends to create a pledge on a security owned by him he shall make an application to the depository through the participant who has his account in respect of such securities.

(2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.

(3) The depository after confirmation from the pledgee that the securities are available for pledge with the pledger shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the participants of the pledger and the pledgee.

(4) On receipt of the intimation under sub-regulation (3) the participants of both the pledger and the pledgee shall inform the pledger and the pledgee respectively of the entry of creation of the pledge.

(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.

(6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if pledger or the pledgee makes an application to the depository through its participant:

***Provided** that no entry of pledge shall be cancelled by the depository without prior concurrence of the pledgee.*

(7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledger.

(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.

(9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledger and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledger and pledgee respectively.

(10)(a) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).

(b) The provisions of sub-regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation:

***Provided** that the depository before registering the hypothecatee as a beneficial owner shall obtain the prior concurrence of the hypothecator.*

(11) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a participant without the concurrence of the pledgee or the hypothecatee, as the case may be.]"

NSDL (in Bye law 9.9) and CDSL (in Bye law 14) have prescribed the procedures to be followed while creating a pledge on the securities held in their depositories. A depository creates and records the pledge only after receiving a confirmation from the depository participant of the pledgee. Thus, for creating a pledge on the securities held by a depository, the aforesaid legal provisions have to be followed necessarily. In the present case, TFL had transferred 11,90,000 shares to MFSL by way of an agreement, when the said shares were in dematerialised mode and held by the depositories. In this context, TFL had submitted that the procedure for creation of pledge as provided for in Section 12 of Depositories Act, 1996 may only be one of the modes for creation of pledge and that the financing agreement between MFSL and TFL provided for another manner of creation of security in favour of MFSL by transfer of the shares to its demat account. According to them, the principle reason for doing so was to enable MFSL to obtain refinance against the said shares. Though, TFL contends so, it failed to comply with the legal requirements, prescribed for pledge of shares in the depository system. Therefore, pledge of dematerialised securities shall be created as per the provisions of the Depositories Act, 1996, D&P Regulations and the bye laws of the depositories. In this connection, I place reliance in the decision of the Hon'ble Supreme Court of India in **Kunwar Pal Singh vs. State of U.P. [(2007) 5 Supreme Court Cases 85]**, wherein it was observed as under:

> *"…….The principle is well settled that <u>where any statutory provision provides a particular manner for doing a particular act, then, that thing or act must be done in accordance with the manner prescribed therefore in the Act</u>."* [Emphasis supplied]

In a recent decision, the Hon'ble Supreme Court of India vide its order dated April 21, 2009 in Civil Appeal No. 3696 of 2005 (**SEBI Vs Saikala Associates Limited**) *inter alia* observed *"……When something is to be done statutorily in a particular way, it can only be done that way."* The noticees have failed to act as per the requirements of the relevant statutes. I further find that Section 12(3) of Depositories Act, 1996 mentions that any entry in the records of a depository shall be evidence of a pledge or hypothecation. The reason for creating a pledge in the manner as specified under Section 12 of the Depositories Act, 1996 read with Regulation 58 of the D&P Regulations is to have proper record of securities held in a particular beneficiary account. The said requirement is also utilised for the purposes of computing the shareholding of any individual/entity in a particular company for the purposes of the Takeover Regulations and the Insider Trading Regulations, as only depository records are used for proving the title of the shares. As submitted by TFL, *6,12,253* shares of KFL acquired through funding provided by SSJ Finance and Securities Private Limited were pledged with SSJ Finance and Securities Private Limited and a pledge marked in its depository account. The said shares constituted part of 2.28% of the share capital of KFL, which were accounted for, as the pledge was created in accordance with the provisions of the Depositories Act, 1996 and the D&P Regulations. When TFL was able to mark the shares pledged with SSJ Finance and Securities Private Limited in the manner specified, nothing prevented it from doing the same in respect of the other shares which were pledged with other financiers through an agreement. Had TFL created pledge in respect of the 11,90,000 shares (with MFSL) and the shares pledged (by TFL/VBAL) with the other financiers, in accordance with the provisions of the Depositories Act, 1996, D&P Regulations and the bye laws of the depositories, the same would have been reflected in the beneficial owner account of TFL and VBAL and its claim may have been justifiable. TFL had submitted that after the

ex-parte interim order dated February 16, 2009 came to be passed, the shares which were transferred to MFSL and Nadi Finance and Investment Private Limited have been transferred back to their (TFL/VBAL) account and that it had subsequently created pledge in favour of the financiers in accordance with the statutory requirements. It also submitted that, it had requested Shriram Insight Share Brokers Limited (one of the financiers) to transfer the shares of KFL into its depository account and would then create a pledge. If such measures were followed at the beginning, the ex-parte interim order may have not been passed by SEBI. As, it is an admitted position that TFL and VBAL have not created 'pledge' in the manner specified, the transfer of shares in the described manner cannot be recognised as a pledge in the demat system, as the same was not done in accordance with the relevant provisions. Thus, by transferring shares to MFSL, TFL has indulged in an irregular manner in creating a pledge.

11. I note that even as per the agreement (Clause 6.9) between MFSL and TFL, provides for the recording/creation of pledge under the Depositories Act, 1996 and the regulations framed by SEBI and/or the byelaws of the concerned Depository and to do everything required to create an effective pledge of the pledged securities in favour of the Lender (financier). The said clause is reproduced herein, "*In consideration and as security for repayment of the Loan / facilities together with interest, charges, dues, fees thereon or otherwise due to the Lender under this Agreement, the Borrower agrees to create an exclusive pledge in favour of the lender of fully paid up marketable securities (the "Pledged Securities") belonging to the Borrower including but not limited to securities held in the designated Demat Account free from any third party charge, lien or other encumbrances and shall do all such acts, deeds and things and execute all such documents, declarations and forms as may be required to record/create the pledge under the depository system as per the provisions of the Depositories Act, 1996 and the regulations framed by the Securities and*

Exchange Board of India (SEBI) and/or the byelaws of the concerned Depository and to do everything required to create an effective pledge of the Pledged Securities in favour of the Lender". As per the said clause, the Borrower (TFL) agreed to create an exclusive pledge in favour of the lender (MFSL) of fully paid up marketable securities belonging to the Borrower including but not limited to securities held in the designated demat account free from any third party charge, lien or other encumbrances. As already stated above, no pledge was marked in the depository account of TFL in respect of those securities which were pledged or were to be pledged, for the purposes of securing the loan from MFSL. Therefore, the submission of TFL that MFSL does not accept marking of a pledge of shares, is against the very agreement between TFL and MFSL. I also note that by creating a pledge or hypothecation in accordance with the relevant provisions of the Depositories Act, 1996 and D&P Regulations, the pledgee's interest is adequately protected, as Regulation 58 (11) of the D&P Regulations provides that no transfer of security in respect of which a notice or entry of pledge or hypothecation is in force, shall be effected by a participant without the concurrence of the pledgee or hypothecatee. Thus, even in the absence of transfer of shares to the account of MFSL, the security interest of the lender/pledge is adequately protected as mentioned above.

12. MFSL, vide its letter dated December 30, 2008 addressed to KFL had made its disclosure in terms of Regulation 7(1) of the Takeover Regulations. As per the same, MFSL had indicated that it had acquired 4,53,648 shares of KFL on December 22, 2008 and the mode of acquisition was shown as *'margin'*. In terms of Regulation 7(1) of the Takeover Regulations, any acquirer, who acquires shares or voting rights which (taken together with shares or voting rights, if any, held by him) would entitle him to more than five per cent or ten per cent or fourteen per cent or fifty four per cent or seventy four per cent shares or

voting rights in a company, in any manner whatsoever, shall disclose at every stage the aggregate of his shareholding or voting rights in that company to the company and to the stock exchanges where shares of the target company are listed. The *Explanation* to said Regulation prescribes that for the purposes of sub-regulations (1) and (1A) [of Regulation 7], the term '*acquirer*' shall include a pledgee, other than a bank or a financial institution and such pledgee shall make disclosure to the target company and the stock exchange within two days of creation of pledge. TFL has contended that the disclosure under Regulation 7(1) of the Takeover Regulations have been fully complied with by MFSL making it clear that the nominal holding in its name was only because KFL shares represent "margin" towards finance provided for acquisition of shares. The said contention would not be acceptable as the term 'margin' refers to those shares and money kept/maintained with stock brokers in respect of sales and purchases made by a client. If MFSL was a pledgee, it ought to have shown the mode of acquisition of shares of KFL as *'pledgee'* and not as *'margin'*. It is not improbable that the disclosure by MFSL was intended to ward off any possible ill effects that might accompany a failure to disclose an acquisition.

13. The learned counsel for the noticees brought to my notice, the adjudication order (dated February 19, 2009) passed in the matter of Angel Broking Limited, to support his contention that there was no change in the beneficial ownership when the shares moved from TFL to the financier. In the said case, the Adjudicating Officer had held that the stock broker (Angel Broking Limited) did not fall within the ambit of the term 'acquirer' as defined in Regulation 2 (1) (b) of the Takeover Regulations, for the shares purchased on behalf of its clients and retained by it. This case may not be applicable here, as in the present case; shares have been transferred to the financier for availing finance, whereas in the cited case, the shares purchased by the stock broker on

behalf of its clients were retained by it on a temporary basis. In the present case, the agreement dated June 17, 2008, used the term '*margin*' to refer to those shares transferred to the financier to avail finance. Therefore, considering the facts and circumstances of the case, in my view, the cited case would not be an appropriate reference for the present case. Further, the contention of TFL that informal guidance of SEBI to stock brokers should apply to its case of loan against shares or margin finance is not established since it can apply only to the dealing of stock brokers with their clients, in accordance with law. If shares were maintained in the demat account of the stock broker and not that of the financier, the case of the latter producing a disclosure under Regulation 7(1) of the Takeover Regulations is *non-sequitor*.

14. In view of the foregoing, it is established that TFL had transferred shares of KFL for availing finance from the financier (MFSL). Though, the noticees contend that the said shares were in nature of a pledge, it failed to follow the necessary statutory requirements mentioned under the Depositories Act, 1996, the D&P Regulations and the relevant bye laws of the depositories, which prescribe the method and manner in which a pledge of dematerialised shares have to be created. The noticees have submitted that immediately after the ex-parte interim order, they had called back the shares from the financiers for the purposes of creating pledge in respect of those securities, as per the legal provisions. It was also submitted that they had created pledge in accordance with the statutory provisions, in respect of shares of KFL for availing finance from certain entities. In view of their rectification, the noticees submitted that the '*cease and desist*' order be revoked. The noticees further submitted that there was no deliberate attempt on their part to mislead the investors/public. From the facts and circumstances of the case and also the submissions made by the noticees, I find that the information disseminated to the public by TFL regarding its shareholding in KFL may be a misconception on its part assuming that it was

the owner of those shares even though it had transferred the same for availing loan from MFSL, as per the agreement executed between TFL and MFSL. The noticees have also highlighted various provisions in the financing agreement, to show that shares were in fact in the control of TFL, even though they had been transferred. However, it is found that TFL had failed to follow the necessary statutory requirements mentioned under the Depositories Act, 1996, the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 and the relevant bye laws of the depositories, while creating pledge in respect of the dematerialised securities. The ex-parte interim order was passed in February 2009. Considering the case in its totality, I am of the view that the directions passed in ex-parte order against the noticees for having violated the provisions of Regulation 4(2)(f) and 4(2)(r) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003, need not continue.

15. Therefore, in exercise of powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992, hereby dispose of the proceedings initiated under Section 11D of the Securities and Exchange Board of India Act, 1992, against Temptation Foods Limited and its Managing Director, Mr. Vinit Kumar, without any further directions. However, they are advised not to report or publish information regarding their shareholding without strictly adhering to the provisions of law which govern the method and manner of creation of a pledge in the depository system.

DR. K. M. ABRAHAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai
Date: September 11, 2009