BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Appeal No. 67 of 2008

Date of decision: 18.11.2008

1. M/s. Bellary Steels & Alloys Limited
2. Mr. S. Madhav
3. Ms. S. Parvathi ……. Appellants

Versus

1. Securities and Exchange Board of India
2. M/s. Karnataka State Financial Corporation. ……. Respondents

Mr. M.V.V. Ramana Advocate for Appellants.

Dr. Poornima Advani Advocate with Ms. Harshada Nagare Advocate for Respondent no.1.
Mr. N.D. Shetty Advocate for Respondent no.2.

CORAM : Justice N.K. Sodhi, Presiding Officer
Utpal Bhattacharya, Member

Per : Justice N.K. Sodhi, Presiding Officer (Oral)

This appeal is directed against the order dated March 28, 2008 passed by the wholetime member of the Securities and Exchange Board of India (for short the Board) restraining, among others, the appellants herein from accessing the securities market and prohibiting them from buying, selling or dealing in securities either directly or indirectly for a period of 5 years. Appellant no.1 has also been directed to take immediate steps in coordination with the Depository and its share transfer agent to rectify its register of members in accordance with the provisions of the Companies Act 1956 after cancelling the duplicate shares issued by it and lying in the demat account of M/s. Panchaloha Hotels Pvt. Ltd., (for short the Hotel). Facts giving arise to this appeal are these:

2. M/s. Bellary Steels & Alloys Ltd. is appellant no. 1 before us and it shall be referred to hereinafter as the Company. S. Madhav and S. Parvathi are its directors and

they are appellants no. 2 and 3. The Board received a complaint dated 17 January, 2006 from the Karnataka State Financial Corporation (for short the Corporation) against the Company alleging fraud by the latter and its share transfer agent M/s. Karvy Computershare Pvt. Ltd., (Karvy) in effecting transfer of 21,50,000 shares which were lying pledged with the Corporation in physical form. On receipt of the complaint, the Board collected some information/clarification from Karvy and other sources which raised doubts regarding the genuineness of the transferred share certificates. By an ex parte order dated 1.2.2006, the Board issued specific directions to the Company, its Directors, the Hotel and some others restraining them from accessing the capital market till further orders and simultaneously ordered investigations into the matter. Investigations revealed that the Corporation had subscribed Rs.150 lacs by way of redeemable non convertible debentures of the Company in May 1996, which were secured by 21,50,000 shares of the Company held by M/s. S. N. Finance Limited (15 lac shares), M/s. Kodiganti Investments Ltd. (5.5 lac shares) and Shrimati K. Meenakshi (1 lac shares). It appears that the Company failed to redeem the debentures and the amount due to the Corporation as on December 31, 2005 was Rs.5,64,38,971. Since the amount due to the Corporation was not paid, it filed a petition under sections 31 and 32 of the State Financial Corporation Act in the Court of Principal District Judge at Bellary in the State of Karnataka which is still pending. By order dated 7.6.2002 properties of the Company and its directors stand attached before judgement on conditions specified in that order. We are further informed that the Corporation has also filed a petition under section 439 read with sections 433 and 434 of the Companies Act for the winding up of the Company which is pending in the High Court of Karnataka. The Corporation has also filed a criminal complaint against the Company and its directors for the alleged fraud committed by them and that, too, is pending in the Court of Additional Chief Metropolitan Magistrate, Bangalore.

3. Investigations further revealed that when the Company failed to redeem the debentures, the Corporation approached Karvy for the transfer of shares in its favour. Karvy then informed the Corporation that the shares pledged with it had already been

transferred in the name of the Hotel. It transpired that the original shareholders who had pledged the shares had obtained duplicate share certificates from the Company and transferred them in the name of the Hotel while original shares are in the possession of the Corporation. The Hotel is then said to have lodged 21,50,000 shares for dematerialization through its depository participant and they were dematerialized in November 2005. In view of the ex parte order referred to above passed by the Board, the Hotel, the pledgors and some others had been debarred from dealing with these shares as a result whereof these could not be traded in the market.

4. A show cause notice dated March 11, 2008 was issued to several entities including the three appellants before us making the aforesaid allegations. The appellants were required to file their reply by March 19, 2008 and appear in person with all the material available with them in support of their case. The appellants did not file any reply but they appeared in person on the date fixed and filed their written submissions which have been considered by the Board. On a consideration of the material collected during the course of the investigations and taking note of the written submissions filed on behalf of the appellants, the wholetime member framed the following two issues which according to him arose from the stand taken by the appellants.

> "I have carefully perused the ad-interim ex-parte order dated 01.02.2006, the show cause notice dated 11.03.2008, written and oral submissions made by the parties concerned along with other material available on record. After going through the above said documents, I find that the following issues arise for my consideration in the instant case:
>
> a. Whether BSAL had issued counterfeit/fake share certificates in contravention of the provisions of Regulation of 3 and 4(2)(h) of the SEBI (Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003?
>
> b. Whether the S N Finance, Kodiganti, Meenakshi and Panchaloha had acted in connivance with BSAL in dealing in counterfeit/fake security in physical form thereby contravening the provisions of Regulation of 3 and 4(2)(h) of the SEBI (Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003?"

The wholetime member after considering the material on the record has answered both the issues against the appellants holdings them guilty of violating Regulations 3 and

4(2)(h) of the Securities and Exchange Board of India (Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations 2003 (for short the Regulations). He has also found that the three pledgors and the Hotel acted in collusion with the Company in issuing duplicate shares which act of theirs was also in contravention of the Regulations. Accordingly, by his order dated 28.3.2008 the appellants alongwith others have been restrained from accessing the securities market. Some other directions have also been issued to the appellants and others. Hence this appeal.

5. We have heard the learned counsel for the parties. The first contention of Shri M.V. Ramanna, Advocate appearing on behalf of the appellants is that after the Corporation had filed a petition under the State Financial Corporation Act seeking to recover the amount due to it and got the properties of the Company and its directors attached, it (Corporation) lost its rights over the pledged shares and, therefore, it could not hold the shares belonging to the pledgors. It is urged that the Corporation could not approach Karvy for getting the shares transferred in its name. The next argument of the learned counsel for the appellants is that since the Corporation approached Karvy in November 2005 to get the shares transferred, the period of limitation by that time was over and it had lost its rights to get the shares transferred. It was then urged that the provisions of the regulations were not applicable to the Company since it was not “dealing in securities” within the meaning of Regulation 2(1)(b) of the Regulations when it issued duplicate shares to the pledgors. The learned counsel for the appellants submitted that Regulations 3 and 4 of the Regulations were also not applicable.

6. We have considered the arguments advanced by the learned counsel for the appellant and find no merit in them. The conduct of the appellants is such which disentitles them to any relief. As already noticed, shares of the Company held by S.N. Finance Limited M/s. Kodiganti Investments Limited and K. Meenakshi had been pledged with the Corporation to secure the redeemable non convertible debentures issued by the Company to the Corporation. The shares were in physical form and while they were in possession of the Corporation, the Company prodded the pledgors to apply

for duplicate shares on the plea that they had been misplaced by them. On 10.3.2004 all the three pledgors wrote to the Company asking it to give back their shares which were lying pledged with the Corporation as they needed them urgently. This is what they wrote to the Company:

> "As required by you, these shares have been pledged to KSFC. We need our shares back very urgently and duly discharged. I therefore request you to release the pledged shares from KSFC by replacing your own securities."

On receipt of the aforesaid letters from the pledgors, the Company addressed letters dated 6.4.2004, 7.4.2004 and 8.4.2004 to the three pledgors prodding them to apply for duplicate shares stating that the originals had been lost by them. The letter dated 8th April, 2004 addressed to S.N. Finance Limited reads as under:

> "
> BSAL/MD/2004
> 8th April 2004
>
> To,
> S. N. Finance Limited,
> "Sri Lakshmi", # 4000, 100 Feet Road,
> Indira Nagar,
> Bangalore- 560 008
>
> Dear Sir/ Madam,
>
> Sub: Shares of BSAL- Execution of Indemnity thereof.
>
> This refers to the 1000000 shares bearing distinctive numbers from 12692201 to 13692200, and 500000 shares, bearing distinctive numbers from 14192201 to 14692200, of BSAL held by you, and various discussions regarding same.
>
> In this connection, you are requested to execute an Indemnity Bond, indemnifying the Company against any damages, to enable us to issue duplicate certificate against the shares said to have been lost or misplaced.
>
> Upon receipt of the Indemnity Bonds, the Company will initiate necessary steps to regularise the matter.
>
> Thanking You,
>
> Yours Faithfully,
>
> **For BELLARY STEELS AND ALLOYS LIMITED**
> Sd/-
> S.MADHAVA
> Managing Director"

What is really borne out from this correspondence is the fraudulent conduct of the Company. The pledgors were wanting the return of the shares and had specifically stated in their letters that those were lying pledged with the Corporation. Instead of taking steps to get the shares released, the Company writes back to the pledgors asking them to apply for duplicate shares after executing indemnity bonds. The suggestion that the shares had been misplaced came from the Company and not from the pledgors. What could be more fraudulent. After obtaining the indemnity bonds from the pledgors, the Company issued duplicate shares to them. Again, it is interesting to note that in the indemnity bonds executed on 28th April, 2004, the pledgors stated that the shares had been lost and that they had not deposited the original share certificates by way of security or otherwise nor transferred or sold the said shares to anyone. Only a few days before executing the indemnity bonds the pledgors told the Company that the shares were lying pledged with the Corporation. In view of this conduct of the parties, we have no hesitation in holding that the Company and the pledgors had connived in the issuance of the duplicate shares which were subsequently transferred in the name of the Hotel. The Hotel, in turn, got the shares dematerialized in November 2005 and this act clearly indicates its intention to trade those shares in the market. The directors of the Hotel are also the directors of the Company. They were all party to the fraud. Had the Board not passed the ex parte order on 1.2.2006, the shares would have been traded in the market. In this background, we are clearly of the view that the Company is not entitled to any relief. The argument that the Corporation lost its rights over the pledged shares when it obtained an order of attachment of properties from the court of Principle District Judge, Bellary is devoid of any merit and cannot be accepted. In any case, this is not an issue over which the Board could record any finding. As the market watchdog it passed the ex parte order and saved the lay investors from being duped. Again, the plea of limitation that is being raised by the learned counsel for the appellant could not be urged in the present proceedings and we cannot agree with the learned counsel that the regulations were not applicable to the issuance of duplicate shares. “Dealing in securities” as defined in Regulation 2(1)(b) of the Regulations is an inclusive definition and what is stated therein is an addition to what

the term actually means. The action of the Company in fraudulently issuing the duplicate shares only to enable the subsequent transferees from trading them in the market is an act squarely covered by the provisions of Regulations 3 and 4 of the Regulations. We have already held that the act was fraudulent. In this view of the matter, no fault can be found with the findings recorded in the impugned order.

7. Lastly, the learned counsel for the appellant pointed out that the provisions of sections 111 and 111A of the Companies Act could not be administered by the Board in view of the provisions of section 55A of the Companies Act and, therefore the direction issued in para 25(d) of the impugned order is without jurisdiction. The argument is that the Board could not direct the Company and the depository to act in a coordinated manner to rectify the register of members maintained under the Companies Act. Such a direction, according to the learned counsel, could be given only by the Company Law Board. May be he is right, but we shall not examine this contention and interfere with the directions issued in the impugned order keeping in view the fraudulent conduct of the company, the pledgors and the Hotel. We decline to interfere exercising our powers under Rule 21 of the Securities Appellate Tribunal (Procedure) Rules, 2000.

8. This brings us to the connected Appeal no.77 of 2008 filed by P.S. Murali. The appellant herein joined as Executive Director of S.N. Finance Limited on April 20, 2002 which is one of the pledgors. This Company is a non banking finance company which was registered with the Reserve Bank of India but its certificate was cancelled in April 2002. The shares of the Company held by S.N. Finance were pledged with the Corporation in June 1996, and the appellant was the Executive Director at the time when S.N. Finance had applied for duplicate shares and transferred them in the name of the Hotel. We have already held that this conduct of the Company and the pledgors including S.N. Finance was fraudulent. What is contended by Mr. D. Pavanesh, Advocate on behalf of the appellant is that even though P.S. Murali was the Executive Director of S.N. Finance, he had no knowledge of the fact that the shares were pledged with the Corporation or that duplicate shares were obtained by executing indemnity

bonds as observed hereinabove and, therefore, the Board was not justified in restraining the appellant from accessing the securities market. The argument of the learned counsel is that Shri S. Madhav who is the Managing Director of the Company was also the Managing Director of S.N. Finance but after his resignation as the Managing Director of S.N. Finance on 3.6.2000, he had no authority to sign the share transfer forms on behalf of that company in favour of the Hotel and that his acts were illegal and not binding on S.N. Finance Limited and its directors including the appellant (P.S. Murali). The argument is devoid of merit and cannot be accepted. S.N. Finance in its letter addressed to the Board (received by the Board on 20.2.2006) denied knowledge of the pledge of share certificates with the Corporation and subsequent transfer of the same to the Hotel. However, in a subsequent letter dated April 1, 2006 addressed to the Board S.N. Finance Limited retracted their earlier stand and stated that the records relating to the pledge of shares and subsequent requests made by it for issue of duplicate certificates had been traced out and that S.N. Finance Limited accepted the facts as stated in the Company's letter dated 14.2.2006 addressed to the Board. In this letter of 14.2.2006, the Company has reiterated the entire sequence of events starting with the pledge of the shares with the Corporation and subsequent issue of duplicate shares and their transfer in the name of the Hotel. It is, thus, clear that S.N. Finance Limited, far from distancing itself from the allegedly unauthorised actions of S. Madhav on behalf of S.N. Finance Limited actually acknowledged and endorsed the acts of S. Madhav. The appellant, who was admittedly the Executive Director of S.N. Finance Limited when the letter dated April 1, 2006 was written, cannot disown responsibility for the action of his company and the Board is justified in holding him responsible for the actions of his company, S.N. Finance. It makes no difference that the letter of S.N. Finance of April 1, 2006 had not been signed by the appellant P.S. Murali.

9. It was next urged on behalf of the appellant that principles of natural justice had been violated in as much as he had not been afforded a reasonable opportunity to put forth his defence. The case of the appellant is that he was served with a notice dated 11th March, 2008 for appearance before the wholetime member on 19th March, 2008 and that

he did not have sufficient time to collect the relevant documents. This argument cannot be accepted. Admittedly, the appellant sent a reply in which he did not ask for further time. The fact that he sent a reply goes to show that he was not prejudiced in any manner. Not having asked for further time he cannot now after the order has been passed against him turn around and say that the principles of natural justice were violated.

10. Learned counsel for the appellant then contended that the punishment imposed on the appellant was very harsh and disproportionate to the gravity of the charge established against him. This argument is being noticed only to be rejected. We have already found that the company and the pledgors whose director the appellant was, had connived with each other in fraudulently obtaining duplicate share certificates of the Company which were subsequently transferred in the name of the Hotel. This being the conduct of the pledgors, it cannot be said that the punishment is harsh.

11. No other point was raised.

In the result, both the appeals fail and they stand dismissed. In view of the fraudulent conduct of the Company, it shall pay costs to the respondents which are assessed at Rs.50,000 to be shared by them equally.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Utpal Bhattacharya
Member

18.11.2008
pmb & pw