

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER SECTIONS 11 AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH REGULATION 32 OF SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVERS) REGULATIONS, 2011 IN RESPECT OF KARVY FINANCIAL SERVICES LIMITED

IN THE MATTER OF ACQUISITION OF SHARES OF REGALIAA REALTY LTD.

Appearances for Karvy Financial Services Ltd.: Mr. P R Ramesh, Advocate
Mr. Muthuswamy Iyer
Mr. Vikram Dutt
Mr. KRCV Seshachalam, Advocate

1. Regaliaa Realty Ltd. (hereinafter referred to as “target company” / “RRL”) is a company having its registered office at block A, 2nd Floor, no. 138, Nungambakkam High Road, Chennai – 600034 and its securities are listed on the Bombay Stock Exchange Ltd. (“BSE”).
2. Karvy Financial Services Ltd. (“KFSL/Noticee”) and RRL entered into an agreement whereunder KFSL provided RRL a loan amount of ₹ 4,00,00,000/- (Rupees Four Crore only) under the Secured Business Loan, vide application No. 311040 and 100369 and agreed to be repaid in 12 Equated Monthly Installments.
3. According to RRL, its promoters executed a pledge in favor of KFSL in respect of 20,00,100 equity shares (constituting 55.56% of the paid up share capital of the company) for the loan provided by KFSL. RRL also submitted that they were facing some issue with the land owner during that period and KFSL without giving prior notice to RRL invoked the pledge forms and transferred the shares in the name of KFSL.
4. The following changes occurred in the shareholding of KFSL in the target company after the invocation of pledge.

Date of Acquisition	Pre-Acquisition Holding	Post-Acquisition Holding
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16-Feb-2012	0 (0%)	20,00,100 (55.56%)
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5. In response to a clarification sought from it, KFSL, vide letter dated October 8, 2014 stated that it is a RBI registered Non-Banking Financial Service (NBFC) and is engaged in the business of Micro & Small Enterprise Secured Business Loan, Loan Against Property, etc. It also stated that it had disbursed a loan facility of ₹7,00,00,000/- (Rupees Seven Crore only) to RRL, which RRL defaulted in repayment. Therefore on February 16, 2012, KFSL transferred the pledged equity shares (i.e. 20,00,100 shares) into its own demat account.

6. KFSL further submitted that it was exempt from making an open offer since the aforesaid transaction qualified under regulation 10(1)(b)(viii) of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred to as “the Takeover Regulations, 2011” which reads as:

"The following acquisitions shall be exempt from the obligation to make an open offer under regulation 3 and regulation 4 subject to fulfillment of the conditions stipulated.

(b) acquisition in the ordinary course of business by...

(viii) invocation of pledge by Scheduled Commercial Banks or Public Financial Institutions as a pledgee."

7. SEBI, vide letter dated July 29, 2015, asked KFSL to clarify whether it is restricted from carrying out business other than Micro & Small Enterprise Secured Business Loan, Loan Against Property/Gold, Loan Against Shares and Loan for small commercial vehicle, etc. as mentioned in their previous letter dated October 08, 2014. In response thereto, vide letter dated August 05, 2015, KFSL submitted the following:
 - a) KFSL has not acted as per provisions of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest, 2002 (54 of 2002) as KFSL has not yet been notified as Public Financial Institution.
 - b) Further, KFSL is a registered NBFC as notified by RBI vide registration certificate number N-13.02033 and is indeed restricted from carrying out any other business as specified in the said certificate. Moreover, KFSL is also restricted from acquiring control over the said company, which rights are available to notified financial institutions or banks under the provisions of Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest, 2002.

8. As a result of invocation of pledge by KFSL on February 16, 2012, KFSL’s shareholding in the target company increased from 0% to 55.56% and consequently, breached the threshold of 25% as stipulated in the regulation 3(1) of the Takeover Regulations, 2011. Thus, KFSL

was required to make a public announcement for an open offer in accordance with Takeover Regulations, 2011, which it failed to make.

9. Further, KFSL does not fall within the definition of a “Public Financial Institution” (PFI) provided under the Companies Act, 2013 and is thus not exempted from the obligation to make an open offer under regulation 10(1)(b)(viii) of Takeover Regulations, 2011. Therefore, KFSL was required to make public announcement for open offer on invocation of pledge for 55.56% share capital of RRL on February 16, 2012 under regulation 3(1) of Takeover Regulations, 2011. KFSL had the option to seek exemption from SEBI under regulation 11 of the Takeover Regulations, 2011 prior to invocation of pledge, which it failed to do.
10. In view of the above, vide show cause notice dated February 23, 2016 (hereinafter referred to as the “SCN”) KFSL was called upon to show cause as to why suitable directions under sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 (SEBI Act’) and regulation 32 of Takeover Regulations, 2011 should not be issued against it for the alleged violations.
11. KFSL filed its reply to the SCN vide letter dated March 17, 2016 and also requested for the inspection of documents relied upon by SEBI in arriving at the conclusions as captured in the SCN. The inspection of documents was provided to KFSL on April 29, 2016 when its authorized representatives inspected the documents.
12. KFSL was also granted an opportunity of personal hearing on May 17, 2016, which was adjourned at the request of KFSL. On the next date of hearing i.e. June 28, 2016, authorized representatives on behalf of KFSL appeared and requested for one month’s time to file detailed submissions in the matter. The request was acceded to and hearing was scheduled on August 2, 2016 which was further adjourned to August 11, 2016 at the request of KFSL. On August 11, 2016, the authorized representatives for KFSL appeared and submitted that KFSL has filed an exemption application in the matter before the concerned department of SEBI and is awaiting the response in that regard. In view thereof, it requested that hearing in the matter may be adjourned by two weeks. Thereafter, the hearing was fixed on August 30, 2016 when KFSL’s authorized representatives appeared and made submissions on its behalf. KFSL also filed its written submissions in the matter vide letter dated September 7, 2016. The replies/ written submissions of KFSL are, *inter alia*, as under:-
 - i. It neither acquired control of the target company nor did it have any directors on the Board of the target company.

- ii. It was never shown as Acquirer, or promoter or person in control in any of the reporting made by the target company, as factually it was holding the pledged shares as security only.
- iii. KFSL is a RBI registered NBFC established in the year 2009 and it is engaged in the business of Micro & Small Enterprise Secured Business Loan, Loan Against Property / Gold, Loan against Shares and Loan for Small Commercial Vehicles etc. In view of the lack of statutory powers, KFSL could never have acquired control or management of any of the borrower companies and the principle of 'impossibility of performance' should be read into any directions that may be issued to make an open offer.
- iv. During normal business transaction, KFSL had disbursed a loan facility of ₹7,00,00,000/- (Rupees Seven Crore Only) to M/s. Regaliaa Realty Limited (as a Principal Borrower) along with its directors, viz., Mr. D. Sudhakara Reddy, Ms. D. Usha Reddy, Ms. D. Deeptha Reddy (being Co-borrowers) against equitable mortgage of their property and also, pledge of shares. For the said purposes, the Borrowers along with the Co-Borrowers have executed the various loan documents such as Loan Agreement, Demand Promissory Note, Undertaking, Memorandum of Entry, Letter of Guarantee, Power of Attorney, Declaration, Authorization and Declaration, Memorandum of Deposits of Title Deeds etc., in favour of KFSL.
- v. In February 2012, Regaliaa Realty Limited and its co-borrowers have defaulted in repayment of loan amount and also, during the said period, there were certain contingency arisen about Regaliaa Realty Limited and also, possibility of various cases against it which could have resulted in encumbrances to the pledged shares, which would have been detrimental to KFSL's interest. Further the shares were infrequently traded and highly illiquid which prevented us from invoking the pledge and selling the same in tranches without touching the 25% limit under the Takeover Regulations. Therefore, on 16.02.2012, KFSL was constrained to invoke the pledge on 20,00,100 equity shares into its own Demat Account with the sole intention of eradicating the risk associated with the pledged security. By virtue of the pledge being invoked, KFSL shareholding in Regalia Realty Ltd was 55.56%.
- vi. The present proceedings have been initiated by SEBI purely based on a complaint filed by Regaliaa Realty Ltd. There has been no incident which have affected the interest of the public shareholding or affected the interest of investors in the securities market. By doing so, the complainant promoters are taking advantage of their own default.
- vii. As per provisions of Regulation 10(1)(b)(viii) of the Takeover Regulations 2011 the invocation of Pledge of shares by the Lender is exempted from the obligation to make

an open public offer as outlined in Regulation 3 & 4 of the Takeover Regulations, 2011. In no manner it can be construed that, KFSL was interested or involved in the acquisition of shares or voting rights for the purpose of exercising/ gaining control over Regaliaa Realty Limited. Under the circumstances, it is only as a risk mitigating measure that KFSL has invoked the pledge resulting in transfer of shares to its demat account and there has been no intention whatsoever to acquire shares or gain control of the company.

- viii. Invoking of pledge has not been prejudicial to the interest of the shareholders as even after the transfer of shares in the name of KFSL has been affected, the shares held by the public remained intact and the public shareholding continued to remain more than 25% as stipulated in the Listing agreement.
- ix. The transfer of shares from the demat account of the pledger to the demat account of the Pledgee should not be treated as an 'acquisition' of shares under the SEBI SAST Regulations, for the following reasons;
- The Takeover Regulations envisage such possibility by giving automatic exemption to the public financial institution. Karvy may not be a Public financial institution but it is a 'financial institution under Section 45 I of the Reserve Bank of India Act. It is submitted that SEBI ought to consider the 'substance' of the Regulations by looking at the transaction. It is very clear that Karvy continues to be 'pledgee' and not 'an acquirer' as the information to public is also that the karvy is a public shareholder and not an 'acquirer'.
 - Karvy never acquired control or management of the Borrower, and the shares were transferred to the Demat account of Karvy only as a security. When a pledge is created, the systems in the Depository mark a 'lien' in the demat account of the Borrower. There is no system to mark the 'lien' in the demat account of the Lender. The mere transfer of shares from the demat account of the Borrower to the demat account of lender as 'pledgee' is not a transaction of 'acquisition' under the SEBI SAST Regulations. In this regard, the provisions of Section 172 of the Indian Contract Act, 1872, which read as under are applicable.
- x. "The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The bailor is in this case called the 'pawnor'. The bailee is called 'pawnee'. The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'.
- xi. It is submitted that the provisions of the SEBI Act, 1992 and the SEBI Regulations as well as the Depositories Act 1996 are in addition to and not in derogation of other laws. In a pledge the 'goods' as per the provisions of Section 172 of the Indian

Contract Act, are kept in the physical possession of the 'pledgee'. However since the goods in this case are the 'shares', they are held in the physical control in the demat account of Karvy as 'pledgee' and not as 'acquirer'.

13. I have considered the SCN, replies and submissions made by KFSL and other material available on record.
14. In terms of regulation 3(1) of Takeover Regulations, 2011, no acquirer himself or with persons acting in concert with him can acquire shares or voting rights in a target company which entitle him to exercise 25% or more voting rights in the target company unless such acquirer makes a public announcement to acquire shares of such company in accordance with Takeover Regulations, 2011. In the present case, it is an undisputed fact that due to the invocation of pledge by KFSL on February 16, 2012, KFSL's shareholding in the target company had increased from 0% to 55.56%. Consequently, KFSL breached the threshold of 25% as stipulated in regulation 3(1) and thus, KFSL was under an obligation to make a public announcement of an open offer in accordance with Takeover Regulations, 2011.
15. Regulation 10(1)(b)(viii) of the Takeover Regulations, 2011 exempts Scheduled Commercial Banks and Public Financial Institutions from open offer requirements in case of acquisition of shares through invocation of pledge. In the instant case, KFSL is a RBI registered NBFC and was not exempt from the obligation to make an open offer by virtue of regulation 10(1)(b)(viii). However, KFSL had the option to seek exemption from SEBI under regulation 11 of the Takeover Regulations, 2011 *prior to invocation of pledge* but it failed to do.
16. It is noted that while the proceedings pursuant to the issuance of SCN were in progress, KFSL filed an application before SEBI seeking exemption under regulation 11(1) of the Takeover Regulations, 2011 for the transaction forming subject matter of the SCN. In response thereto, vide letter dated September 6, 2016, SEBI informed KFSL as under:

“ ...

3. Regulation 11(3) of the SEBI (SAST) Regulations, 2011 provides that exemption application under regulation 11 may be filed for a proposed transaction whereas in the instant case, the application was made post facto i.e. after the acquisition was made by Karvy.

4. In view of the above, it is informed that your application is returned as regulation 11 of the Takeover Regulations, 2011 considers only cases of proposed acquisition.”

17. KFSL has submitted that it is a RBI registered NBFC and during normal business transactions, it had disbursed a loan facility of ₹7,00,00,000/- to the target company (as a Principal Borrower) along with its directors (being Co- borrowers) against equitable mortgage of their property and also, pledge of shares. In February 2012, target company and its co-borrowers defaulted in repayment of loan amount and also, during the said period, there were circumstances whereunder non-invocation of pledge could have been detrimental to the KFSL's interests. KFSL further submitted that the shares of target company were infrequently traded and highly illiquid which prevented it from invoking the pledge and selling the same in tranches without touching the 25% limit under the Takeover Regulations. Thus, as per KFSL, on February 16, 2012, KFSL was constrained to invoke the pledge on 20,00,100 equity shares with the sole intention of eradicating the risk associated with the pledged security. In this regard, it is clear from KFSL's submissions that it was well aware of the fact that invocation of pledge would have resulted in breach of the 25% threshold stipulated under regulation 3(1) of the Takeover Regulations, 2011. There is no dispute as to the fact that KFSL is not a scheduled commercial bank or a public financial institution and is not covered under the exemption provided under regulation 10(1)(b)(viii) of Takeover Regulations, 2011. Being aware of these facts, before invocation of the pledge, KFSL could have filed an application seeking exemption from making a public announcement for an open offer. Had such an application been filed by KFSL, the facts such as KFSL being an NBFC, shares being pledged as security, circumstances under which the pledge was invoked, reasons for invocation of pledge, illiquidity of the shares of target company, etc. would have been relevant for the purpose of consideration of the exemption application. However, the fact remains that no application under regulation 11 was filed by KFSL. In so far as the present proceedings are concerned, the only relevant fact is that as a result of invocation of pledge by KFSL, its shareholding in the target company increased from 0% to 55.56% thereby breaching the threshold of 25% stipulated under regulation 3(1) of the Takeover Regulations, 2011. Consequent to the said breach of the threshold of 25%, KFSL was under a mandatory obligation to make a public announcement for an open offer in accordance with the Takeover Regulations, 2011. In my view, the intention and motive behind an acquisition are not relevant for the purposes of application of regulation 3(1). In view of the above, I am unable to agree with the submissions of KFSL in this regard.

18. KFSL has also submitted that it never acquired control over the management of the target company and was never shown as a promoter or person in control over the target company in the filings made by the target company. In this regard, I note that the allegation against KFSL in the present case is that it has violated the provisions of regulation 3(1) under which

no person shall acquire shares or voting rights in the target company which taken together with the persons acting in concert with him, entitle him to exercise 25% or more of the voting rights of the target company. The fact whether the voting rights in excess of 25% have been exercised or not by the acquirer is not relevant for the purpose of the obligation stipulated under regulation 3(1). The language of regulation 3(1) envisages a mandatory obligation to make a public announcement of an open offer in case of acquisition of shares beyond 25% in a target company. In the instant case, undisputedly, KFSL acquired 55.56% shares of the target company (consequent to invocation of the pledge) which entitled it to exercise more than 25% voting rights in the target company. Further, there is no allegation in the SCN that KFSL has acquired control over the target company. In view of the above, I do not find any merit in the submissions of KFSL in this regard.

19. I note that regulation 32 of the Takeover Regulations, 2011 which provides for consequences of breach, as found in this case, gives flexibility to SEBI to enforce regulation 3(1) by way of several directions including - (a) disinvestment of shares acquired in breach of regulations; (b) transfer of any proceeds or securities to the investors protection fund; (c) making open offer for acquiring shares of the target company, etc.

20. I note that in the context of enforcement of regulation 10, 11 and 12 of the Takeover Regulations, 1997 which is *pari materia* the provisions of regulations 3(1), 3(2) and 4 of the Takeover Regulations, 2011, the Hon'ble Securities Appellate Tribunal ("SAT"), vide order dated September 08, 2011 in the matter of *Nirvana Holdings Private Limited vs. SEBI* (Appeal no. 31/2011) observed as follows:

"The primary object of the takeover code is to provide an exit route to the public shareholders when there is substantial acquisition of shares or a takeover. This right to exit is an invaluable right and the shareholders cannot be deprived of this right lightly. It is only when larger interest of investor protection or that of the securities market demands that this right could be taken away. Therefore, as a normal rule, a direction to make a public announcement to acquire shares of the target company should issue to an acquirer who fails to do that. The Board need not give reasons as to why such a direction is being issued because that is the mandate of Regulations 10, 11 and 12."

21. I note that the object and purpose of Takeover Regulations, 1997 and Takeover Regulations, 2011 is common i.e. to provide equality of treatment of all shareholders, to provide an exit opportunity to the shareholders in the case of a substantial acquisition of shares or takeover and to ensure that a person does not make a substantial acquisition in or acquire control over the target company in a clandestine manner and to the detriment of other shareholders. I further note that the guiding principle for the directions under regulation 32 is the protection of

interests of the investors and securities market. I, therefore, am of the view that the above mentioned principles laid down by the Hon'ble SAT shall apply in the present case also.

22. In the present case, the obligation of the acquirer to make the open offer has been triggered on account of breach of provisions of regulation 3(1) of the Takeover Regulations, 2011 as KFSL acquired 55.56% equity shares in the target company. Had the acquirer made the public announcement on February 16, 2012 in accordance with the Takeover Regulations, 2011 and complied with all related activities within the timelines specified therein, all formalities with respect to the public announcement and the open offer would have been completed within 57 working days from February 16, 2012.
23. I find that the KFSL has deprived the shareholders from the exit opportunity in respect of infrequently traded shares of the target company. In the facts and circumstances of the present case, I do not find any reason to deviate from the normal rule to make a public announcement to acquire shares of the target company in accordance with the provisions of Takeover Regulations, 2011, and issue any other direction as envisaged in regulation 32. I also find it important to mention that the shares of the target company are infrequently traded and therefore a direction to KFSL to make a public announcement for an open offer will be in the interest of shareholders of the target company.
24. I am also of the view that since the public announcement now would provide a delayed exit opportunity to the shareholders of the target company, KFSL should pay interest on the consideration amount to the shareholders who tender their shares in the open offer and who are eligible for interest as per law.
25. I, therefore, in exercise of powers conferred upon me under sections 11, 11B read with section 19 of the SEBI Act, 1992 and regulation 32 of the Takeover Regulations, 2011, hereby issue the following directions:
 - a) KFSL shall make a public announcement to acquire shares of the target company in accordance with the provisions of the Takeover Regulations, 2011, within a period of 45 days from the date of this order;
 - b) KFSL shall alongwith the consideration amount, pay interest at the rate of 10% per annum from 58th working day from February 16, 2012 to the date of payment of consideration to the shareholders who were holding shares in the target company on the date of violation and whose shares are accepted in the open offer, after adjustment of dividend paid, if any.

26. This order shall come into force with immediate effect.

27. A copy of this order shall be served upon the Noticee, stock exchanges and depositories for ensuring compliance with the above directions.

Sd/-

DATE: October 27th, 2016

PLACE: MUMBAI

**RAJEEV KUMAR AGARWAL
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**