BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. BM/AO- 124/2011]

UNDER SECTION 15-I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES BY ADJUDICATING OFFICER) RULES, 1995.

In respect of

MTZ Industries Limited

(PAN: AAACM7504Q)

In the matter of MTZ Polyfilms Limited

FACTS OF THE CASE

1. Securities and Exchange Board of India (hereinafter referred to as **'SEBI'**) conducted investigation in trading in the scrip of MTZ Polyfilms Limited (hereinafter referred to as **'the company'**) during the period between July 2009 and September 2010 as huge off-market transfers were observed during this period. The shares of the company are listed at Bombay Stock Exchange (hereinafter referred to as **'BSE'**). The paid-up capital of the company during July 2009 to September 2010 was 89,355,760 shares.

2. It was observed that that during the period between quarter ending June 2009 and September 2009 MTZ Industries Limited (erstwhile MTZ (India) Limited and hereinafter referred to as the **'Noticee'**), a BSE listed company and belonging to the promoter group entity of the company, had transferred 56,25,000 shares of the company on 10.07.2009, 04.08.2009 and 17.09.2009 in off-market to Mr. Sanjay Bajranglal Sharma(hereinafter referred to as Mr. Bajranglal Sharma). It was further

observed that Mr. Bajranglal Sharma then transferred 56,25,000 shares off-market to the Noticee on 13.07.2010, 13.08.2010, 08.09.2010, 14.09.2010. It was observed that due to such transfers the Noticee crossed 10% and 14% of the total shareholding in company and there was more than 2% change in the holding of the Noticee. Such changes required disclosures to the exchange under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as **'SAST Regulations'**) and SEBI (Prohibition of Insider Trading) Regulations, 1992 (hereinafter referred to as **'PIT Regulations'**). It was alleged that the Noticee did not make the necessary disclosures under 7(1) & (2) of SAST Regulation and 13(3) & (5) of PIT Regulation.

3. In view of the above it was alleged that the Noticee failed to comply with the provisions of 7(1) & (2) of SAST Regulation and 13(3) & (5) of PIT Regulation. Consequently the Noticee was liable for penalty under Section 15A (b) of SEBI Act.

APPOINTMENT OF ADJUDICATING OFFICER

4. The undersigned was appointed as Adjudicating Officer vide order dated December 2, 2010 under Section 15 I of SEBI Act read with rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995 (hereinafter referred to as '**Rules'**) to inquire into and adjudge the alleged violations of SAST Regulations and PIT Regulations.

SHOW CAUSE NOTICE, HEARING AND REPLY

5. Show Cause Notice No. EAD-6/BM/VRS/14662/2011 dated May 6, 2011 (hereinafter referred to as **'SCN'**) was issued to the Noticee under rule 4 of the Rules to show cause as to why an inquiry should not be held and penalty be not imposed under Section 15A (b) of SEBI Act for the alleged violation specified in

the said SCN. The said SCN was delivered and acknowledged by the Noticee. Noticee vide letter dated August 28, 2011 submitted as follows:

a. *That there were no transactions of Sale and /or Purchase of shares of the Company between MTZ Industries Limited and Mr. Sanjay B Sharma as alleged attracting the provisions of Regulation 7 and 13 of SAST and PIT Regulations respectively.*
b. *That the transactions referred to in the Notice is the outcome of a Loan transaction. The said Mr. Sanjay Sharma has advanced loan to the Company (MTZ Polyfilms Limited) which was guaranteed by the Noticee by providing 56,25,000 shares of the said Company own and held by it as Collateral Security to secure the said Loan transaction.*
c. *From the said Loan Agreement it can be observed that the transaction was of Loan and Pledge and the Noticee has pledged the captioned shares on the terms and conditions mentioned in the said Agreement more particularly clause 6.1 and 8.1 . The shares being in demat form the instructions were accordingly issued.*
d. *That in contravention of the provisions of the said Loan Agreement the Lender opted for transfer of said shares in his name instead of keeping the demat instructions with him without serving notice as required under clause 6.1 and 8.1 of the Loan Agreement and furnishing required declaration under the Companies Act, 1956 and other applicable regulations including SAST.*
e. *As the shares were transferred in the name of the Lender, (in contravention of the agreement as the Lender has no authority to transfer the shares in his own name), the Noticee had protested and has taken the matter with him to transfer back the shares as unless there is a default in the repayment of Loan, the Lender under the agreement was not entitled to en-cash and or invoke the security that too without giving notice as required under the agreement as well as in the common law.*
f. *Thus it can be observed that though the shares were transferred and shares were registered in the name of the Lender, the Right, Title and Interest in the shares were not transferred and the Noticee continued to be the owner of the said*

shares by reason of action taken without complying the provisions of agreement more particularly provision of clause 6.1 and 8.1 of the agreement.

g. *From the Loan Agreement it is clear that the basic or the actual nature of the transaction under reference was that of the Lending which was secured by collateral security in the form of pledge of equity shares held by the Noticee and not of Sale and/or Purchase of shares as alleged.*

h. *Without prejudice to what is stated hereinabove, we state that in our humble opinion provisions of Regulation 7 and 13 of SAST and PIT respectively need not be invoked or made applicable in the instant case because:*

   (i) *It has been observed by the investigation officer that at the end of the transaction, the status quo is maintained and shares are restored back.*

   (ii) *On the perusal of the Loan Agreement it can be noticed that the Lender has transferred the Shares in his own name in contravention of the agreed terms. The Clause 6.1 and 8.1 clearly provides that in the event of default , the lender can transfer the shares to third party (and not to himself) that too after giving due notice and offering first right of purchase. Since the Lender has transferred the shares in breach of agreement, the same was not recognized by the Noticee.*

   (iii) *It is pertinent to note that as per the Loan Agreement, the Lender in the event of default and for the purpose of recovering dues can sell to the third party only after giving notice to the Borrower and/or Guarantor. Thus it can be seen that the Lender has no right to transfer the shares in his name as stipulated in clause 6.1 r/w 8.1 of the Loan Agreement.*

   (iv) *From the perusal of the Loan Agreement, it can also be seen that the transaction was essentially of Loan and the shares were offered as Security by way of Pledge.*

   (v) *Further being a Pledge transaction, it involves a deposit of shares to the Lender to secure repayment of Loan given to the Company. The pledge is a form of possessory security, and accordingly, the assets which are being pledged need to be physically delivered to the beneficiary of the pledge. Thus*

aa. A Pledge involves only a transfer of possession or custody, not of ownership. Once the purpose of the Pledge has been completed, the Pledgee usually must return the property to the Pledgor, or account for it, depending upon the terms of the contract.

bb. In the case of pledge, the pledgee acquires a special property in the goods pledged whereby he gets possession coupled with the power of sale, on default. (the pledgee can sell the goods after due notice to Pledgor)

i. The Pledge is not the same as a sale, which is an intentional transfer of ownership of personal property in exchange for something of value. Inference of Sale cannot be drawn merely because the shares were transferred in the de-mat account of the Lender as by very nature of transaction, delivery (of course with the remarks (Loan taken), was given to the Lender.

j. 'Sale of share' in the instant case can be inferred only if,

(i) The buyer (i.e Lender in this case) get absolute Right title and interest in the Shares as against conditional or contingent, which is not the case as no Notice of invocation was served neither Right of First Purchase was offered as required under clause 6.1 and 8.1 of the Loan Agreement.

(ii) Delivery is lawfully given, which is not the case as the Lender has transferred the shares in his de-mat account in breach of Loan agreement and in violation of clause 6.1 and 8.1 thereof.

(iii) Consideration or payment has been made, which is not the case as there is nothing to show that the Rights of the Lender under the Loan agreement are subrogated or vested in Guarantor (MTZ Industries Limited), on the contrary the repayment of loan was made directly to the Lender.

(iv) Documents to show that transaction is in the nature of Sale, which is not the case. As it is also not the case that the Seller has booked the transaction as Sale in its Books of Accounts and accordingly in the Tax Return.

k. *It is a settled law of subrogation that in the event of invoking or en-cashing the guarantee all the rights title and interest of the creditors get vested in Guarantor. In the instant case no such subrogation happened nor the Lender has issued notice to the Guarantor or the Borrower to make good for deficient / short amount or has refunded the excess amount. Further the Borrower had re-paid money directly to the Lender. Thus it cannot be said that there was actual sale transaction or Pledge invocation that has taken place at any stage attracting disclosure under Regulation 7 of SAST or 13 of PIT Regulations.*

l. *Assuming without admitting that the conduct resulted in the Sale and Purchase transaction then more actions are required such as booking the sale transaction in the Books of the Noticee as well as reflecting the same in the Income Tax return. It is not the case of the Investigation officer that the Noticee has booked the transaction in his books as sale transaction and has accordingly shown Gain or Loss in its Return of Income.*

m. *Thus by no stretch of imagination the transaction can be held as that of Sale and Purchase and by holding the transaction superfluously as Sale and Purchase transactions, the Noticee will be erroneously burdened.*

n. *That the definition of "dealing in securities" in the SEBI Insider Trading Regulations is quite specific and exhaustive though a bit clumsy. It says that "dealing in securities" means "an act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person either as a principal or an agent". Pledging of shares is not subscribing or buying or selling of securities, nor is it agreeing to do so.*

o. *The definition has some clumsiness in terms of being circumlocutory when it uses the word "deal" again in the latter part of the definition but that is not sufficient to cover bonafide pledge of shares. Thus bonafide pledge of shares should be treated differently and need not held to be Insider Trading apparently by taking an extended meaning of "dealing" in "securities".*

p. *The intention of the Regulations prohibiting Insider Trading is obviously to restrict insiders from dealing ahead of material disclosures, at a time when the price is*

significantly different from what may be if these disclosures were made. When a person pledges shares, he keeps the risks and rewards in the shares with himself. When the lender sells the shares on default or margin calls, he sells at a time when the prices may have already fallen but then it is the borrower who has to bear such fall. He would be credited obviously only to the extent of the amount realized by sale. If the borrower bears the risk of such fall, then this goes against the very concept of Insider Trading where the dealer profits from a fall in price that may be the result of adverse information published later.

q. *The definition of "Acquirer" in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 means any person who, directly or indirectly, acquires or agrees to acquire shares or voting rights in the target company, or acquires or agrees to acquire control over the target company, either by himself or with any person acting in concert with the acquirer. Acquisitions mean purchase or possess something which was not previously owned and possessed.*

r. *In the instant case, the possession of shares was parted conditionally on account of Pledge to provide security for a Loan. When the shares were transferred by the Lender in his name in violation of Loan Agreement the action cannot be held as Pledge Invocation because he has not followed the due procedure prescribed in this regard in the Agreement and under the common Law. In view thereof the action of the Lender was unauthorized and hence the shares were always beneficially owned by the Noticee.*

s. *On repayment of loan when the shares were re-transferred, it cannot be construed as "Acquired" - especially when the Pledge was never invoked during the currency of the agreement and no opportunity was given to our clients for Purchase of Shares as required under clause 8.1 of the Loan Agreement entitling the Lender to transfer the shares (to third party, which is also not the case).*

t. *Further the Acquisition as meant in the SAST necessarily result in either increasing or decreasing the shareholding by a threshold percentage- which is not the case here as the shareholding remains the same before and on the conclusion of the Loan transaction.*

u. *In our humble opinion, unauthorized transfer of shares in violation of Loan Agreement by the Lender to himself should not be construed as pledge invocation thereby casting burden on the Noticee for disclosure in terms of Regulation 7 and 13 of SAST and PIT respectively.*

v. *The alleged transaction is bonafide Pledge Transaction and violation, if any, is related to non disclosure of pledge transactions attracting provisions of Regulation 8A.*

w. *It can thus be observed that the issue arose due to unauthorized and wrongful action on the part of the Lender of transferring shares in his own name in violation of Loan Agreement without giving any formal intimation as required under the Loan Agreement, concerned Regulations and the Companies Act as result the said action of Lender has to be contested by the Noticee and the Borrower. It should be appreciated that in the event of Noticees recognizing the unauthorized action of the Lender, it would have gone against the interest of the Noticees.*

x. *In any case on repayment of Loan the same shares were returned back to us and the position was thus neutralized and restored.*

y. *In view of the forgoing you will observe that the transactions were not of a sale and purchase or invocation of Pledge and therefore we shall be obliged if the same are interpreted accordingly.*

z. *Further while transferring the shares, the Lender has given no declaration or intimation to the Noticee or the Company and therefore the Company or the Noticee could do nothing in this regard.*

6. In the interest of natural justice an opportunity of hearing was provided to the Noticee on July 20, 2011 vide hearing notice dated July 04, 2011. Noticee vide letter dated July 19, 2011 sought for an adjournment. Vide hearing notice dated August 11, 2011 another opportunity of personal hearing was provided on August 30, 2011. Mr. Haresh Sanghvi, Authorized Representative appeared on behalf of the Noticee and reiterated the submissions given in the reply to the

SCN. During the personal hearing, Noticee was asked to submit the documents showing the lien which they claimed to have created on the shares and were pledged against the loan. Noticee vide letter dated September 5, 2011 submitted only copies of inter depository delivery instructions given to the Bank of Baroda (Depositary Participant).

CONSIDERATION OF ISSUES AND FINDINGS

7. I have carefully examined the documents available on record. The allegations against the Noticee are as follows:

   i. Noticee did not disclose to the company and to the stock exchange when its shareholding in the company crossed ten percent and fourteen percent as required under Regulation 7(1) read with 7(2) of SAST Regulations.
   ii. Noticee did not disclose to the company of change in its shareholding amounting to more than two percent in the company as stipulated under Regulation 13(3) read with 13(5) of PIT Regulations.

8. In view of the above it was alleged that the Noticee violated the provisions of Regulation 7(1) read with 7(2) of SAST Regulations and Regulation 13(3) read with 13(5) of PIT Regulations.

9. Before moving forward, it will be appropriate to refer to the relevant provisions of Regulation 7(1) read with 7(2) of SAST Regulations and Regulation 13(3) read with 13(5) of PIT Regulations, which reads as under:

The continual disclosure requirement under Regulation 7 of SAST Regulations:

1) 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.

(2) The disclosures mentioned in sub-regulations (1) and (1A) shall be made within two days of,—

(a) the receipt of intimation of allotment of shares; or

(b) the acquisition of shares or voting rights, as the case may be.

The continual disclosure requirement under Regulation 13 of PIT Regulations:

(3) Any person who holds more than 5% shares for voting rights in any listed company shall disclose to the company [in Form C] the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below 5%, if there has been change in such holdings from the last disclosure made under sub-regulation (1) or under this sub-regulation; and such change exceeds 2% of total shareholding or voting rights in the company.

(5) the disclosure mentioned in sub-regulations (3) and (4) shall be made within 2 working days of:

(a) the receipt of intimidation of allotment of shares, or

(b) the acquisition or sale of shares or voting rights, as the case may be.

10. The issues that arise for consideration in the present case are:

i. Whether Noticee acquired shares more than 5% of the paid capital of the company and violated Regulation 7(1) read with 7(2) of SAST Regulations?
ii. Whether Noticee has violated Regulation 13(3) read with 13(5) of PIT Regulations?
iii. Does the violation, if any, on the part of the Noticee attract monetary penalty under Section 15A (b) of SEBI Act?
iv. If so, what would be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of the SEBI Act?

FINDINGS:

11. I now proceed with the alleged violations of SAST and PIT Regulations.

i. I observe that the shareholding of the Noticee as per disclosures made by the company for the quarters June and September 2009 was as under:

Quarter ending	Total Shares of MTZ Polyfilms Limited	Shares held by MTZ Industries Limited	% shareholding of MTZ Industries Limited
June 2009	89,355,760	16,801,618	18.80%
September 2009	89,355,760	15,385,391	17.22%

ii. I note from the SEBI data of the NSDL for holding more than 1%, that as on 17.09.2009 that Noticee was holding 97,60,391 shares representing 10.92% of shareholding of the company. The paid-up capital of the company during July 2009 to September 2010 was 89,355,760 shares. Thus the Noticee was holding more than 5% of the paid up capital of the company.

iii. During the period between quarter ending June 2009 and September 2009, Noticee transferred 56,25,000 shares representing 6.3% of shareholding of the company on 10.07.2009, 04.08.2009 and 17.09.2009 in off-market transfers to Mr. Bajranglal Sharma. The details of the off-market transfer between the two entities for various dates during July 2009 till September 2009 is as under:

Execution Date	Quantity	Sell BO Name	Buy BO Name
10/7/2009	1250000	MTZ(India) Limited	Sanjay Bajranglal Sharma
4/8/2009	2500000	MTZ(India) Limited	Sanjay Bajranglal Sharma
17/9/2009	1875000	MTZ(India) Limited	Sanjay Bajranglal Sharma
Total	**5625000**		

iv. It is observed that Mr. Bajranaglal Sharma then transferred 56,25,000 shares off-market to the Noticee on 13.07.2010, 13.08.2010, 08.09.2010, 14.09.2010. The

details of the off-market transfer between the two entities for various dates during July 2010 till September 2010 is as under:

Execution Date	Quantity	Sell BO Name	Buy BO Name
13/7/2010	180000	Sanjay Bajranglal Sharma	MTZ(India) Limited
13/8/2010	180000	Sanjay Bajranglal Sharma	MTZ(India) Limited
8/9/2010	3225000	Sanjay Bajranglal Sharma	MTZ(India) Limited
14/9/2010	2040000	Sanjay Bajranglal Sharma	MTZ(India) Limited
Total	**5625000**		

v. The allegation against the Noticee is that it acquired shares which crossed more than 10% and 14% of the paid up capital of the company further the transfers also resulted in change in holding of more than 2% but the required disclosures were not made under SAST and PIT. The details of change of shareholding on various dates was as under:

- Shares transferred to Mr. Bajranglal Sharma

Date of Transaction	No. of shares Transferred	Shareholding in the MTZ Polyfilm Ltd.	% Change in shareholding	Total % of shareholding
9/7/2009	0	16801618	0	18.80
10/7/2009	1250000	15551618	1.4	17.40
4/8/2009	2500000	11635391	2.8	13.02
17/9/2009	1875000	9760391	2.1	10.92

- Shares acquired from Mr. Bajranglal Sharma

Date of Transaction	No. of shares Acquired	Shareholding in the MTZ Polyfilm Ltd.	% Change in shareholding	Total % of shareholding
13/7/2010*	(180000)	8900239	0.2	9.96
13/8/2010*	(180000)	9080239	0.2	10.16
8/9/2010*	(3225000)	12305239	3.6	13.77
14/9/2010*	(2040000)	14345239	2.3	16.05

vi. From the above table I note that on 04.08.2009, 17.09.2009, 08.09.2010 and on 04.09.2010 there was change in the holdings of the Noticee of more than 2%. Hence the Noticee was required to make disclosure to the company under

Regulation 13 (3) within 2 working days as required under Regulation 13(5) of PIT as under:

Date of Transaction	No. of shares Transferred/ (Acquired)	Shareholding in the MTZ Polyfilm Ltd.	% Change in shareholding	Date of making disclosure*
4/8/2009	2500000	11635391	2.8	6/8/2009
17/9/2009	1875000	9760391	2.1	19/9/2009
8/9/2010	(3225000)	12305239	3.6	10/9/2010
14/9/2010	(2040000)	14345239	2.3	16/9/2010

* Dates when disclosures were required to be made

Further I observe from the table that on 13.08.2010 the holding of the Noticee crossed 10% and on 14.09.2010 its holding crossed 14% for acquiring shares from Mr. Bajranglal Sharma. Hence the Noticee was required to make disclosures to the company and the exchange as required under Regulation 7(1) of SAST within 2 working days of the respective date of acquisition as required under Regulation 7(2) of SAST Regulations.

vii. Noticee in its reply has claimed that the above transactions were not of a sale and purchase but of a pledge of shares and therefore the Noticee has not violated the provisions of SEBI PIT and SAST Regulations. In support of the claim Noticee has submitted the Loan Agreement wherein Mr. Bajranglal Sharma had advanced loan to the company which was guaranteed by the Noticee by offering 56,25,000 shares of the company as collateral security to secure the said loan. Noticee further submitted that though the shares were transferred and registered in the name of lender i.e. Mr. Bajranglal Sharma; the right, title and interest in the shares were not transferred and the Noticee continued to be the owner of the said shares by reason of action taken for not complying with clause 6.1 and 8.1 of the said agreement.

viii. From the documents before me I observe that the shares were recorded in the name of Mr. Bajranglal Sharma when those shres were transferred to

him in 2009 for availing finance. 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. From the Demat Instructions submitted by the Noticee I find that the nature of transaction of the Noticee and Mr. Bajranglal Sharma was an off-market transfers of shares where the beneficiary ownership had transferred to the transferee.

ix. I have perused the agreement dated July 09, 2009 entered into between the Noticee and Mr. Sanjay Bajranglal Sharma. Clause 6.1 provides that in the event of default in repayment of the outstanding amount by the Noticee to lender, the lender shall be required to give 15 days notice to the company to set right the default, before dealing/parting (and or selling/disposing off the said shares to the third person at the prevailing market price). Further, as per clause 8.1 of the agreement, the lender in the event of default and after giving notice as per clause 6.1 shall in all cases give the borrower the first right to purchase the said shares. Thus, it can be seen that the securities

have been transferred by the Noticee to Mr. Bajranglal Sharma for the purpose of finance availed or to be availed by it and there was change in beneficial ownership of the shares. The plea of the Noticee that the said shares were pledged to Mr. Sanjay Bajranglal Sharma 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 DP 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, DP 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 DP 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 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.

x. 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, Noticee had transferred 56,25,000 shares to Mr. Sanjay Bajranglal Sharma by way of an agreement, when the said shares were in dematerialised mode and held by the depositories. In this context, Noticee submitted that the transactions entered between the entities by way of agreement was that of lending which was secured by collateral security in form of pledge of equity shares held by the Noticee. According to the Noticee, the principle reason for doing so was to enable Mr. Bajranglal Sharma to obtain finance against the said shares. Though, Noticee contends so, it failed to produce the documents for pledging of the shares and 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, DP 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 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." [Emphasis supplied]*

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."*

xi. The Noticee has 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 DP 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 SAST Regulations and the PIT Regulations, as only depository records are used for proving the title of the shares.

xii. I note that even as per the agreement (Clause 7.1) between Noticee and Mr. Bajranglal Sharma, provides for the recording/creation of pledge which is reproduced herein, "The Borrower shall pledge the 12.50 lakhs equity shares of the MTZ Polyfilms Limited with the lender in demat mode within 7 days for the date of the agreement". As per the said clause, the Borrower (MTZ Polyfilms

Limited) agreed to create an exclusive pledge in favour of the lender (Mr. Bajranglal Sharma) of 12.50 lakhs equity shares of the company. As already stated above, no pledge was marked in the depository account of the Noticee in respect of those securities which were pledged or were to be pledged, for the purposes of securing the loan from Mr. Bajranglal Sharma. The Noticee produced only 'Inter Depository Delivery Instruction' given to their Depository Participant, Bank of Baroda. Therefore, the submission of Noticee that the transfers were not sale or purchase but only pledge of shares is not acceptable. I note that by creating a pledge or hypothecation in accordance with the relevant provisions of the Depositories Act, 1996 and DP Regulations, the pledgee's interest is adequately protected, as Regulation 58 (11) of the DP 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 Mr. Bajranglal Sharma, the security interest of the lender/pledge is adequately protected as mentioned above.

xiii. I also note from the clause 9.9.2 of Bye Laws of NSDL that "the pledgor and the pledgee must have an account in the Depository to create a pledge" and as per clause 2.1.6 Depository means "National Securities Depository Limited". I further note from clause 8.5.1 of the Operating Instructions of CDSL that "the pledgor and the pledgee must have accounts in CDSL to create a pledge". The aforesaid pre-requisite are mandatory for creating a valid pledge on a security. In the present matter I note that NSDL is the depository of the Noticee and CDSL is the depository of Mr. Bajranglal Sharma. Hence, inter-depository creation of pledge is restricted by the depositories.

xiv. Noticee claimed that the said transaction does not amount to acquiring of shares under SAST Regulations since on repayment of loan, the shares were

re-transferred and the pledge was never invoked during the currency of the agreement. Though the Noticee contend that the said shares were in nature of pledge, it failed to follow the necessary statutory requirement mentioned under Depositories Act, 1996, DP Regulations and the various bye laws of the depositories which prescribe the method and manner in which a pledge of dematerialised shares have to be created. Further, I find nothing available in 'Demat Instruction' showing that any form of pledge or hypothecation was created over the shares. Thus the submissions made by the Noticee are not acceptable.

xv. As stated in para 11 (vi) the Noticee was required to make disclosures under Regulation 13(3) read with (5) of PIT and Regulation 7(1) read with (2) of the SAST Regulations. From the information given by BSE and the submission of the Noticee it is observed that the Noticee did not make the required disclosures. In view of the above I hold that the Noticee violated the provisions of Regulation 7(1) read with (2) of the SAST and Regulation 13(3) read with (5) of PIT Regulations.

12. The object of the SAST and PIT Regulation mandating disclosure of acquisitions beyond certain quantity is to give equal treatment and opportunity to all shareholders and protect their interests. To translate this objective into reality, measures have been taken by SEBI to bring about transparency in the transactions and it is for this purpose that dissemination of such information is required. In this regard I would like to rely upon the findings of Hon'ble SAT in the matter of *Milan Mahendra Securities Pvt. Ltd Vs. SEBI* (Appeal No. 66 of 2003 and Order dated November 15, 2006) regarding the importance of disclosure in which SAT has observed that:

"the purpose of these disclosures is to bring about transparency in the transactions and assist Regulator to effectively monitor the transactions in the market".

Failure to make disclosure within the stipulated time period provided in the regulation cannot be considered as trivial or of no consequence to be overlooked. After taking all the facts into consideration, it is established that the Noticee has violated the provisions of Regulation 7(1) read with (2) of the SAST and Regulation 13(3) read with (5) of PIT Regulations.

13. The next issue for consideration as to whether the failure on the part of the Noticee to comply with the provisions of Regulation 7(1) read with (2) of the SAST and Regulation 13(3) read with (5) of PIT attracts monetary penalty under section 15A(b) of SEBI Act, and if so what would be the monetary penalty that can be imposed on the Noticee. The Hon'ble Supreme Court of India in the matter of *SEBI Vs. Shri Ram Mutual Fund* [2006] 68 SCL 216(SC) held that

> *"In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant…".*

14. In view of the foregoing, I am convinced that it is a fit case to impose monetary penalty under section 15A(b) of the SEBI Act, which reads as under:

15A(b). <u>Penalty for failure to furnish information, return, etc.-</u>

To file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.

15. While determining the quantum of penalty under Section 15A (b) of SEBI Act, it is important to consider the factors stipulated in section 15J of SEBI Act, which reads as under:

"15J - Factors to be taken into account by the adjudicating officer

While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:-

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default."

16. In view of the charges as established, and the facts and circumstances of the case, and the various judgments referred to and mentioned hereinabove, the quantum of penalty would depend on the seriousness of the violation. The SAST and PIT Regulation have been framed in order to bring about the transparency in the market and timely disclosure to the investors. Correct and timely disclosures are an essential part of the proper functioning of the securities market and by failure to do so results in preventing investors from taking well-informed decisions. The Noticee, had responsibility in ensuring the compliance of disclosure norms. The timely disclosure was of importance from the point of view of outside shareholders/other investors as such disclosure would have prompted them to buy or sell shares of the target company. It is an admitted fact that the Noticee had not made the disclosure as required and hence there was no dissemination of information to the general investor. By virtue of the failure on the part of the Noticee to make the necessary disclosure, the fact remains that the shareholders/investors were deprived of the information. Under these circumstances, the compliance with the disclosure requirements under SAST and PIT Regulation assumes significance and the Noticee's failure to do so needs to be viewed seriously and an appropriate view is being taken with regard to imposition of monetary penalty in the matter.

17. In the instant case, it is noted that no quantifiable figures are available to assess the disproportionate gain or unfair advantage made as a result of such default by

the Noticee. Further from the material available on record, it may not be possible to ascertain the exact monetary loss to the investors on account of default by the Noticee. I find from the records the default not repetitive.

ORDER

18. After taking into consideration all the facts and circumstances of the case, I impose a penalty of ₹ 3,00,000 (Rupees Three lakh only) under Section 15A (b) of SEBI Act, on the Noticee which will be commensurate with the violations committed by it.

19. The Noticee shall pay the said amount of penalty by way of demand draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, within 45 days of receipt of this order. The said demand draft should be forwarded to Mr. Shashi Kumar, Deputy General Manager, Investigations Department, SEBI Bhavan, Plot No. C – 4 A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051.

20. In terms of rule 6 of the Rules, copies of this order are sent to the Noticee and also to the Securities and Exchange Board of India.

Date: **September 21, 2011** **BARNALI MUJHERJEE**

Place: **Mumbai** **ADJUDICATING OFFICER**