BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Date of Hearing : 17.12.2021
Date of Decision : 21.03.2022

Appeal No. 475 of 2020

Brickwork Ratings India Pvt. Ltd.
No. 29/3 & 32/2, 3rd Floor,
Raj Alkaa Park, Kalena Agrahara,
Bannerghatta Road, Bangalore – 560076. ….. Appellant

Versus

Securities & Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. … Respondent

Mr. Somshekar Sunderasan, Advocate with Mr. Abhishek Venkatraman, Ms. Savani Gupte, Mr. Ajay Kumar, Advocates i/b M/s Samvad Partners for the Appellant.

Mr. Gaurav Joshi, Senior Advocate with Mr. Manish Chhangani, Mr. Ravi Shekar Pandey, Ms. Samreen Fatima, Advocates i/b The Law Point for the Respondent.

CORAM : Justice Tarun Agarwala, Presiding Officer
Justice M. T. Joshi, Judicial Member

Per : Justice M. T. Joshi, Judicial Member

1. Aggrieved by the order of the learned Adjudicating Officer (hereinafter referred to as 'AO') of the respondent Securities and Exchange Board of India (hereinafter referred to as 'SEBI') dated September 29, 2020 imposing a penalty of Rs. 1 crore under Section 15HB of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as 'SEBI Act'), the present appeal is preferred.

2. The appellant is a credit rating agency (hereinafter referred to as 'CRA') registered with the respondent SEBI under Securities and Exchange Board of India (Credit Rating Agencies) Regulations, 1999 (hereinafter referred to as 'CRA Regulations'). A joint inspection of the appellant was conducted by SEBI as well as the Reserve Bank of India (RBI) in the month of November 2018. The inspection period was from April 1, 2017 to September 30, 2018. During the inspection, *inter-alia*, it was found that the appellant violated the provisions of Code of Conduct for CRA's, SEBI Circulars dated June 30, 2017, dated November 1, 2016, dated June 6, 2018, and March 1, 2012. Various deficiencies / lacunae were found as detailed in the

order. After issuing show cause notice, the adjudication proceeding was initiated in which the impugned order is passed.

3. We have heard Mr. Somasekhar Sundaresan, the learned counsel with Mr. Abhishek Venkatraman, Ms. Savani Gupte, Mr. Ajay Kumar, the learned counsel for the appellant and Mr. Gaurav Joshi, the learned senior counsel with Mr. Manish Chhangani, Mr. Ravi Shekar Pandey, Ms. Samreen Fatima, the learned counsel for the respondent.

The details of the alleged violations and our findings qua each of them are as under :-

A. Lack of surveillance mechanism

4. During inspection, it was allegedly found that the appellant had no proper alert mechanism for tracking the interest / principle repayment schedule of issuers of securities or other material events that may impact the creditworthiness of the issuer to yield timely and accurate rating. According to the respondent SEBI though the appellant claimed that it had a technology platform through which it gets data from NSDL website regularly, during inspection, it failed to provide demonstration of such system. Therefore, respondent SEBI

alleged that the appellant was not maintaining the proper surveillance system for tracking the above details and has, therefore, violated Clause 8 of the Code of Conduct for CRAs read with Regulation 13 of CRA Regulations and Clause 1 of SEBI circular dated June 30, 2017. The appellant replied that the technology platform downloaded from NSDL website was deployed just before the inspection. The absence of a fully functioning and voluntarily adopted technology platform, does not and cannot mean that the noticee had no mechanism at all to the repayment schedule.

5. It is an admitted fact that none of the rules or regulations or circulars required that the technology platform is required for carrying activities as detailed above. The learned AO, however, extensively emphasized that the intention of making provisions will have to be taken into consideration. The regulations as well as the provisions of the SEBI Act which are aimed at social or economic development apart from investor protection required beneficial interpretation of these provisions. The learned AO further reasoned that SEBI circular dated June 30, 2017 came into existence very much before the inspection of the noticee in November 2018.

Despite this timeline, the appellant was not able to show the surveillance mechanism.

6. The circular dated June 30, 2017 provided that CRAs to develop efficient and responsive systems to keep track of all important changes relating to the client companies as required under clause 8 of Code of Conduct of the CRA Regulations. The appellant, therefore, submitted that this surveillance system can be manual and / or technical one. There is no provision that such surveillance measure would be in the form of technology platform only but still the appellant was in the process of development of the technology platform and, therefore, for want of any specific provisions making technology platform mandatory the appellant cannot be found fault for the same.

7. Having heard both the sides, in our view, the order of the learned AO, in this regard cannot be sustained. During the relevant period, there was no mandate that the surveillance system should be in the form of technology platform. It appears that during the inspection the appellant simply claimed to have such a technology platform but failed to demonstrate the same. In view of the same the order as regard this default cannot be sustained.

B. Delay in recognition of default of Non-Convertible Debentures (NCDs) of Diamond Power Infrastructure Ltd. (DPIL)

8. The appellant had rated Non-Convertible Debentures (hereinafter referred to as 'NCDs') of Diamond Power Infrastructure Ltd. (hereinafter referred to as 'DPIL') aggregating to Rs. 2752.94 crores. The allegations are that in the month of April 2016, the appellant had delayed the recognition of default of these NCDs.

The appellant in April 2016, rated the NCDs as "BWR BB-". This rating would indicate that there was a moderate risk of default. However, shortly thereafter, on June 30, 2016, DPIL had disclosed that its lenders had invoked Strategic Debt Restructuring (SDR). Just before NCDs became due for repayment this disclosure was made. The next annual review of the rating of NCDs of DPIL was due on April 20, 2017. Between December 2016 to April 2017, the SDR package was sought to be implemented under which a part of NCDs were converted into equity.

9. The appellant held a board meeting on April 20, 2017 and sought information from DPIL on April 21, 2017 and April 26, 2017.

DPIL, however, did not send any reply and, therefore, the appellant sought information from debenture trustee of these NCDs on May 17, 2017. The said debenture trustee also did not reply the email. Later, on May 11, 2017, the appellant received an intimation that the account was classified as NPA from one of the banker of DPIL, namely, Bank of Baroda. Thereafter, on May 29, 2017, the appellant published its report assigning "D" rating while disclosing that DPIL was not co-operating. Respondent SEBI therefore alleged that the appellant failed to exercise due diligence in timely recognition of the default. As the appellant had earlier rated "BWR BB-" indicating the moderate risk of default, according to SEBI, it should have been vigilant enough to be constantly in touch with DPIL seeking information. Further, efforts were made by the appellant as late as on April 20, 2017 only when the review of the rating of NCDs was due. When the reply was not forthcoming from DPIL and debenture trustee, the appellant remained silent. Moreover, even when it received information from Bank of Baroda regarding the default, it remained silent and after waiting for two weeks for responses from DPIL, the rating was downgraded to "D" on May 29, 2017.

10. The appellant submitted that a default rating could not have been awarded without the implementation of SDR. It could have sent wrong message to the market. Therefore, the appellant sought clarity from DPIL and the debenture trustee. Further while Bank of Baroda classified the account of DPIL as NPA and intimated the same to it, another bank - Exim Bank orally informed that the account of DPIL was “standard” and thereafter the appellant assigned its rating to the NCDs. No prejudice was caused to any investors by this alleged delay as the NCDs were privately placed and the market was aware of DPIL’s financial trouble.

11. Upon hearing both the sides, however in our opinion, the appellant did not remain vigilant in this regard. Not only, the appellant remained silent when SDR came into existence, but DPIL as well as the Debenture Trustee did not response to the email of the appellant but also Bank of Baroda, one of the DPIL’s banker specifically intimated the appellant that account of DPIL classified as NPA. Still the appellant remained unmoved and relied on some oral alleged information from the Exim Bank that the account of the DPIL was “standard”. The event of defaults are required to be recognized instantly; due diligence is required to be shown according

to the CRA Regulations. Non-cooperation from the issuer and the Debenture Trustee should have immediately made the appellant alert of the situation. Above all when one of the banker of DPIL has cautiously in writing informed the appellant about the default, still the appellant did not move allegedly on the basis of certain oral responses from another bank.

12. The learned senior counsel for the respondent SEBI submitted that as per the RBI circular dated August 30, 2018, the bank is required to report NPA to RBI and it cannot be a case where one bank declared an entity's account as NPA, another bank still declares the entity as its account "standard". Be that as it may, the very fact that Bank of Baroda alerted the appellant but it still continued with the earlier rating would lead us to believe that the appellant did not act diligently much less with due diligence. The order of the learned AO in this regard therefore, requires no interference.

C. Failure to review rating and withdrawal of rating of NCDs of Great Eastern Energy Corporation Limited (hereinafter referred to as 'GEECL')

13. Respondent SEBI had alleged that on March 18, 2017 appellant granted rating of “BB” to the NCDs of GEECL. Thereafter another rating agency, namely, CRA downgraded these NCDs to “C” on April 21, 2017 with remark “delays in debt servicing of bank facilities on account of tightening of liquidity.” Thereafter, Care upgraded the rating to “BB+” in December 2017. The respondent however maintained the rating at “BB” already assigned by it earlier. Subsequently, it withdrew the rating on June 29, 2018 vide a press release dated June 29, 2018. It was therefore alleged that the appellant failed to review the rating of NCDs between the above period, despite the information on delay in payment of other obligations by the issuer company, which resulted in downgrade of rating of such instruments by other credit rating agency, namely, Care ratings.

14. The appellant however pointed out that, in fact, this other rating agencies had not downgraded NCDs to “C” on April 21, 2017 as alleged. It continued with the same “C’ rating that was granted earlier by adding the remarks as detailed in the show cause notice. Thus, it reaffirmed it’s previous rating of the “C”. On the other hand, the appellant vide a press release dated March 18, 2017 i.e. before

Care rating reaffirmed its rating as “C’ to “BWR A – Negative” to “BWR BB” (Outlook : Negative).

15. In view of this mistake of fact pointed by the appellant committed by respondent SEBI in show cause notice, the learned AO accepted that Care Rating had not downgraded the rating but reaffirmed the same. However, still it was remarked by the learned AO that the noticee should have taken the Care Rating’s remarks seriously and rating should have been reviewed. It was further observed that only on March 12, 2018, the appellant sought information from the issuer and thereafter published a press release maintaining the rating “BB” with “issuer not co-operating” dated March 14, 2018. The learned AO, therefore, concluded that the appellant should have carried out the review much earlier and, thus, violated the provisions of Regulations 15(1) and 24(7) of the CRA Regulations and clause 1.B of the SEBI circular dated June 30, 2017.

16. Regulations 15(1) and 24(7) of the CRA Regulations provides as under :-

> *“15(1). Every credit rating agency shall, during the lifetime of securities rated by it continuously monitor the rating of such securities, unless the rating is*

withdrawn, subject to the provisions of Regulation 16(3).”

“24(2)(7). Every credit rating agency shall, in all cases, follow a proper rating process.

(7) Every credit rating agency, shall, while rating a security, exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate.”

17. Upon hearing both the sides, in our view, the finding of the learned AO cannot be upheld. The facts on record would show that while the appellant had already downgraded the NCDs to negative much before Care Rating had maintained its rating “C” with a negative remark. Respondent SEBI was in error of fact stating in the show cause notice that the Care Rating had downgraded the rating. Further, on March 14, 2018 the appellant had maintained it’s already downgraded rating with remark that “issuer was not co-operating”. The appropriateness of the rating carried out by rating agencies cannot be questioned by SEBI. What is to be looked into is as to whether the rating agency had carried due diligence while rating the securities. Here, in the present instance, the appellant had in fact downgraded the NCDs and after about one month another rating agency maintained it’s earlier rating with certain remarks. In the

circumstances, there was no occasion for the appellant to take into consideration those remarks and again downgrade the rating. We, therefore, do not find any merit in the finding of the learned AO on this ground.

18. In the same episode of NCDs of GEECL**,** it was alleged that the said NCDs duration was from January 21, 2014 to March 31, 2020 i.e. for around six years. The appellant withdrew its exercise of rating of these NCDs on June 29, 2018 at the request of the company and as per the no objection certificate from the debenture holder. The show cause notice questioned this exercise being against SEBI circular dated June 6, 2018. This circular provides that a rating agency may withdraw rating subject to the said agency having rated the instrument continuously for five years or 50% of the tenure of the instrument, whichever is higher. Further, an undertaking is required from the issuer that the rating is available on that instrument. The appellant however replied that the circular of June 6, 2018 would not be applicable as the NCDs were issued for a period from January 21, 2014 to March 31, 2020. The circular of June 6, 2018, according to it, would apply prospectively. The learned AO refused to accept the said contention and concluded that the circular was in force at the

time of withdrawing of the rating and was applicable for all outstanding obligations.

19. The learned counsel for the appellant submitted that when the circular of 2018 came into force, the NCDs had a tenure of just under two years. Therefore, the condition of requiring the continuous tenure of five years would have been impossible to meet. Therefore, the circular would not be applicable.

In our view, SEBI's circular of 2018 was not applicable to the NCDs whose life remained only less than two years at the time of issuing of the circular. Therefore, withdrawal of rating by the appellant of these instruments would not be violation of the said circular. The circular specifically had no retrospective operation and, therefore, no fault can be found in this regard. The charge in this regard therefore fails.

20. Another charge under the same episode was that the appellant had not rated the NCDs at the time of withdrawal. The learned counsel for the appellant submitted that it was a bonafide human error and immediate steps were taken by the noticee and the appellant amended the standard form of agreements to incorporate

such a condition as per guidelines issued by SEBI. The violation on this count therefore is an admitted fact,

D. Failure to recognize default in NCDs ratings of Essel Group entities (hereinafter referred to as "Essel")

21. Some promoters had pledged the equity shares of Zee Entertainment Enterprises Ltd. (hereinafter referred to as 'ZEEL') in issue of NCDs of Essel. However, around end of January 2019, there was a fall in the price of the shares of ZEEL. Various mutual funds agreed to reschedule the payment obligation of debt securities to a later date so that the pledge of shares need not be invoked. In the circumstances, on January 31, 2019, the appellant issued a press release whereunder it reaffirmed the rating at "AA- (SO)" alongwith remarks "credit watch with developing implication." Further, while intimating the standstill agreement between the Essel and its lender, the appellant also vide the same press release remarked that there will not be any event of default due to fall in price of the shares. The promoters holding of ZEEL was also published. thereafter on February 18, 2019, the appellant issued another press release declaring downgrading of the rating from "AA- (SO)" to "A+ (SO)" with remark that the rating was downgraded on account of increase

in pledge levels in promoters shareholding in ZEEL and also increase in volatility in share price thereby impacting the securities cover. It also took note of the position "financial flexibility of the group was impaired, and the promoter's ability to top-up, as required in terms, weakened on account of high percentage of pledge."

22. The respondent SEBI in the show cause notice, pointed out that the promoters of Essel were not able to bring additional money or shares to maintain the securities cover, as can be seen from publicly available data on BSE Ltd. (BSE) website. It was, therefore, observed in the show cause notice that this breach of covenant dealing with security cover would normally result in multi-notch downgrade or default. However, the appellant downgraded the ratings by only one notch. It was, therefore, alleged that the appellant failed to recognize the default in terms of Clause (3) read with Annexure A point 2.A.I.a of SEBI circular November 1, 2016 and Regulation 24(2), 24(7) of Code of Conduct for CRAs read with Regulation 13 of the CRA Regulations.

23. The learned AO further observed that the appellant was fully aware or should have itself made aware of the situation that the terms the security cover of the NCDs have been breached. Thus, even if

the lenders could have entered into a standstill agreement in their commercial interests or interests of investors, it was the appellant's duty to clearly make it public that there was a default. It was observed that it is the role of credit rating agency to identify risks and inform the stakeholders in a timely manner. However, by not reviewing the rating, the appellant failed to show the actual picture and, therefore, in terms of the above provisions the violation had occurred.

The appellant submitted that whether there should be a multi-notch or single multi downgrade is a matter left to the discretion of the rating agency since it renders an opinion and that cannot be assailed lightly merely because SEBI believed a different view is possible. Only if the rating is arbitrary and/or of a such a nature that no reasonable person would have arrived at the same, then and then only the rating agency can be blamed. In the present case, according to the appellant, because it took the decision bonafide not to treat the NCDs as a default for various factors like the satisfactory operation and financial performance of ZEEL; performance of the other companies of the Essel group; the promoters had the ability to monetize their stake in ZEEL for repaying the debt and neither the

lender nor the debenture trustee disclosed that there was a default. It was further reasoned that a lender's decision to reschedule the term of repayment cannot ipso-facto be called an attempt to avoid a default. It was argued that every breach cannot inexorably lead to calling of a default since that is the right of the lender. It is open for the lender to postpone or reschedule due date of payment to enable the borrower to repay its debts.

24. We have gone through the SEBI circular dated November 1, 2016, relevant portion of which is extracted in the show cause notice and the impugned order in this regard. The circular does not provide that there should be a multi-notch downgrade or default if a default occurs. SEBI's grievance is that the appellant downgraded rating only by one notch. It was the discretion of the rating agency to take a call. In the circumstances of the case the act, cannot be called arbitrary or unreasonable. The appellant while downgrading the rating to one notch had specifically added the remark as detailed (supra) that financial flexibility of the issuer was impaired and promoter's ability to pay the debt was weakened on account of high percentage of pledge of the shares. Thus, besides one notch downgrading in the rating, the appellant added an adverse remark.

Therefore a declaration that multi-notch downgrading was imperative, in our opinion, may amount to an interference in the discretion to be exercised by a rating agency. The only issue ought to have been as to whether the appellant had exercised due diligence in the matter. Admittedly due diligence was exercised by the appellant. In the circumstances, the finding of the learned AO on this issue cannot be upheld.

E. Violations as regards Structured Obligation (SO)

25. In the joint inspection report under the heading other observation in paragraph no. 26 onwards, the observations were as under :-

26. That the appellant was not independently assessing the enforceability, revocability and other important aspects of the underlying assurance while undertaking rating of the SO. The appellant was required to examine the documents independently though the lender may have taken care of the same. Further, SO ratings were assigned on the basis of pledging of shares by group entities of the rated entities in respect of 14 entities which may not be a prudent assessment. It was, therefore, opined that the appellant

might review it's rating methodology in respect of SO ratings and undertake appropriate course corrections. It was also pointed out that there was no clear internal stipulation or various assumptions like discount factor used to arrive at net present value, valuation of securities to be taken as collateral, etc. The inspection report had therefore recommended that the appellant may consider suitable policy stipulations in this regard.

In the show cause notice, it was alleged that the methodology furnished by noticee as regards SO rating was sketchy in nature and lacked clarity on the various critical parameters. The appellant allegedly did not independently assess the enforceability, revocability and other important aspects of the underlying assurance while undertaking rating of SO. Further, it was alleged that the appellant awarded the top rating grades in respect of 12 SOs though in some cases there was default in the own credit obligations of the support providers to bank at some point of time or the other during the preceeding two years of the inspection. It was, therefore, alleged that there was violation on the part of the appellant in evaluating the strength of the support providers in a diligent manner. Table of parameters not being examined was also provided. Further, it was

pointed out that the appellant assigned SO rating in 58 cases on the basis of Letter of Comfort despite the assessing from the documentation that the support extended was not irrevocable, unconditional and legally enforceable. It was, therefore, alleged that the appellant failed to comply with Clauses 3 and 4 of the SEBI circular dated March 1, 2012.

The appellant replied that while accusing the appellant that it's rating methodology was sketchy, respondent SEBI had ignored the fact that the appellant had internal guideline running into five pages which was made available during inspection. Further according to it there was no obligation to verify underlying documentation as it is the responsibility of the debenture trustee to examine that the documentation obtained is in accordance with the "Term Sheet". Further, Regulation 15(1) of the Securities and Exchange Board of India (Debenture Trustee) Regulations, 1993 (hereinafter referred to as 'Debenture Trustee Regulation') lists the duties of the debenture trustee which cast obligation to verify the underlined documentation. Further, banks' sanction letters also contain stipulations in this regard. The appellant therefore had taken a view with the bank have enforceable documentation. Nevertheless, in view of the observations

in the inspection report, the appellant had started to hire an in-house legal officer to vet the documents. It was also pointed out that the appellant was not aware of the documents on the basis of which SEBI alleged that the support provider who were stated to have defaulted in their own credit obligations to banks at some point of time or the other during the preceeding two years. Further, none of the credit rating agencies and the appellant had noted in the credit rating that there was default. List of these ratings between 2016 to 2018 available on public domain was annexed to the reply as annexure II.

27. The learned AO in the order repeated allegations regarding the rating of 12 SOs and further that in those cases the support provider had defaulted in their credit obligation at some point of time during last two years. Therefore, it was ruled that the appellant was not examining important parameters in this regard.

28. Upon hearing both sides, in our view, the findings of the learned AO in this regard are not correct. While in the inspection, it was noted that the appellant might take appropriate steps to correct it’s policy, the said default, if any, in the show cause notice and in the impugned order is held a violation. In the inspection report the

said violation is included in “other observations”. Not only this, the allegation in the show cause notice and the repetition of the same in the impugned order itself is vague. No provision showing necessity to verify the documentation was specified anywhere in the rules or circulars. Further, while the appellant had supplied the list of ratings by itself and other credit rating agencies showing that there was no mention of default, while rating that SO’s by various rating agencies, the learned AO did not deal with the same. Considering all these aspects, in our view, the finding in this regard cannot be sustained.

29. To conclude, we find that the finding of the learned AO as regards A, D and E cannot be sustained while as regards C cannot be partly sustained. In the circumstances, the imposition of penalty of Rs. 1 crore also cannot be sustained. In view of the fact that we have upheld the finding of the learned AO as regards B fully and as regards C partly only, the interference in the quantum of the penalty is also required. Taking into consideration all these facts, the following order :-

ORDER

30. The appeal is hereby partly allowed without any order as to costs. The order of the learned AO imposing a penalty of Rs. 1 crore

is hereby set aside instead the appellant is directed to pay a penalty of Rs. 10 lacs.

31. This order will be digitally signed by the Private Secretary on behalf of the bench and all concerned parties are directed to act on the digitally signed copy of this order. Certified copy of this order is also available from the Registry on payment of usual charges.

Justice Tarun Agarwala
Presiding Officer

Justice M. T. Joshi
Judicial Member

21.03.2022
PTM

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