

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

IN THE MATTER OF M/S. VLS FINANCE LTD.

M/s. VLS Finance Ltd. (hereinafter referred to as the "company") is a public limited company and stated to be engaged in the business of financing projects, leasing and investments. In terms of its prospectus dated November 14, 1994 the company is stated to be listed at the stock exchanges at Mumbai, Delhi, Madras, Ahmedabad, Calcutta and the Uttar Pradesh Stock Exchange at Kanpur (hereinafter referred to as the BSE, DSE, MSE, ASE, CSE and UPSE respectively).

The Company vide the prospectus dated November 14, 1994, offered by way of a public issue, 36,66,600 equity shares of Rs. 10/- each at a premium of Rs. 390/- per share aggregating to Rs. 146,66,40,000/ which opened for subscription on December 15, 1994. SBI Capital Markets Limited was the lead manager to the public issue.

In the prospectus, the following disclosure have been made :

Year	Stage	Number of shares held by promoters	Equity Capital	% Holding
	Capital Existing before the issue	2343048	3333400	70.29%
	Present issue	2343048	7000000	33.47%
1996-97	After conversion of 10% OCNTs.	3343048	8000000	41.79%
1997-98	After conversion of 30% OCNTs	6343048	11000000	57.66%
1998-99	After conversion of 30% OCNTs	9343048	14000000	66.74%
1999-00	After conversion of Balance OCNTs	12343048	17000000	72.61%

Point No. 7 in notes under Capital Structure, the prospectus states as under :-

"7. The promoters have been issued 10 lakh optionally convertible non-transferrable warrants (OCNT), each convertible into 10 equity shares at their option which shall be exercised not earlier than 12 months and not later than 60 months from the date of allotment of the warrants. This OCNT warrants issue was approved by the shareholders in their meeting held on 2.8.94 and allotted to the promoters in the Board meeting held on the same day. The promoters have given an undertaking to the Company that they shall opt for conversion at Rs. 400/- per share. They have also undertaken that the conversion shall be opted in phases so that the growth rate in the Earnings Per Share (EPS) is maintained every year. **At each stage of conversion of the OCNT warrants with the promoters, it would be ensured that promoters' holding does not fall below 25% of the expanded capital. At each stage of conversion of the OCNT warrants 25% of the shares arising out of such conversion would be locked in for a period of 5 years from the date of allotment of such shares. "**

Pursuant to the AGM held on August 2, 1994, the shareholders of the company had consented, under section 81(1A) of the Companies Act, 1956, to issue to the promoters 10,00,000 optionally convertible non transferable warrants (for brevity's sake referred to as OCNTW), each warrant convertible into 10 equity shares, at their option, which shall be exercised not earlier than 12 months and not later than 60 months from the date of allotment of the warrants.....(i.e between 1-5 years). The prospectus further stated that the promoters would undertake to opt for conversion @ Rs. 400 per share and that the conversion would be opted in phases so as to maintain the growth rate in the earnings per share every year.

However, on the basis of the information submitted by the company to the DSE, the DSE vide their letter dated November 20, 1998 informed SEBI that the promoters of the company did not opt for conversion of the OCNTW in 96-97 and 97-98 and in 1998, the company at their meeting held on May 07, 1998 allotted 1 lac equity shares of Rs 10/- each against 1 lac warrants. The DSE vide its letter dated 20.11.98 stated that it was the contention of the company that as these warrants are optionally convertible, the promoters had the right to opt for conversion of these warrants into equity shares into any number of equity shares between 0 to 10. Accordingly, the company had opted for conversion of each warrant into only one equity share instead of 10 equity shares. The DSE submitted that the stand adopted by the company was at variance with the terms of the prospectus, according to which the conversion ratio was 10 equity shares of Rs. 40 each for each OCNT. It further stated that promoters now opting for one share per warrant is contrary to statements made in prospectus both in letter and spirit.

In view of the same, SEBI vide its letter dated January 28, 1999, addressed to Mr. Somesh Mehrotra, called upon the promoter of the company viz. Mr. M. P. Mehrotra, to honour his commitment relating to the conversion of warrants as undertaken in the prospectus since, his failure to honour his commitment amounted to his acting at variance with the terms of the offer and the undertaking made by him and resulted in fraudulently inducing the investors to subscribe to the shares of the company. The promoter was also advised to submit a compliance report in this regard.

In reply to the same, the promoters vide their letter dated February 01, 1999, reiterated the stand that had been taken with the DSE and further stated that all disclosures had been made to the shareholders in the EGM dated 04.06.98. It was further stated that no investor would have applied for the shares of the company and be influenced only by the OCNT warrants to be taken up by the promoters. They would in fact be influenced by the fact that the shares of the company were being traded in the range of Rs. 400-600 per share and the fact that the capital market was booming and the economy was vibrant.

In the meantime, SEBI also received complaints from several investors/ shareholders against the stand undertaken by the company. Hence, after taking into consideration the contentions of the promoters of the company and that of their lead manager, M/s SBI Capital Markets Ltd., SEBI vide its letter dated October 3, 2001, rejected the contention of the company and that of the lead manager, M/s SBI Capital Markets Ltd., as unsatisfactory and advised the promoters of the company to honour their commitment relating to the conversion of the warrants as undertaken and represented by them in the prospectus failing which, appropriate orders would be passed under section 11B of the SEBI Act, 1992. SEBI further stated that the failure on the part of the promoters to act as per the undertaking given in the prospectus to the effect that they shall be investing more funds in the company over the years,

amounted to making misleading statements in the prospectus in order to induce the public to invest money in the company's shares. It was stated that such an undertaking made by the promoters' of the company indicated their sincere commitment towards the company and the said disclosures may have weighed in the minds of the public while deciding on investing in the company's shares. Accordingly, the company was advised to submit their reply to the notice issued by SEBI within 15 days from the date of the letter, failing which it would be presumed that they had nothing further to submit and that SEBI would be constrained to initiate any action as it deemed fit.

Thereafter, the company made several representations seeking extension of time for filing their reply. Finally vide their letter dated November 15, 2001, the promoters inter alia stated that they had exercised their option to convert a part of their OCNTW into equity shares at the price of Rs 400 per share for an aggregate sum of Rs 400 lacs, even though the market price of the company's shares at that point of time was in the range of Rs 40/- - 45/-. They contended that the term 'option' meant a choice, discretion, free decision, right to choose etc. The term "option" in the case of derivatives had been defined as a contract which gives the buyer (holder) the right but not the obligation to buy or sell specified quantity of the underlying assets at a specific (strike) price on or before a specified time (expiration date). It was stated that an option is a contract which gave the buyer a right but not the obligation to buy or sell shares of the underlying security at a specific price on or before a specific date. Further, the table in the offer document of the company indicating the capital structure upon conversion of OCNTW was only illustrative in nature, and meant to convey the impact of the promoters' holding, in case the promoters opted for conversion of OCNTW equity shares at their option.

The promoters further mentioned that the company was involved in the process of recovering money due to it from various companies that had defaulted and towards the same, they had filed cases in appropriate courts of laws against the various firms. The management of one such defaulting firm namely Shri S.P Gupta of Sunair Hotels Ltd. had indulged in fraudulent and illegal activities in Sunair Hotels Ltd and was now involved in the effort to defame the company for ulterior motives. It was stated that in fact a number of enquiries had been initiated against them on the basis of reports and complaints of investor forums which, on subsequent investigation by the Government agencies, had been found to be bogus investor firms. It was stated that the persons acting as conveners in these firms were neither shareholders nor had any stake in the company but were instead acting on the behest of Mr Gupta. The promoters stated that these facts had been brought to the notice of SEBI on several occasions.

Thereafter, a personal hearing was granted to the promoters of the company on January 23, 2002 before the then Chairman. The hearing was attended by Mr B.M. Oza and Mr Somesh Mehrotra, directors, who during the course of their submissions, requested to be allowed to submit a legal opinion in support of their contentions. Thereafter, vide their letter dated January 28, 2002, they also enclosed a legal opinion in support of their contentions.

On perusal of the same, it was noted that the opinion reiterated the submissions and issues that had been raised earlier by the company in response to all the letters of SEBI and which had been examined by SEBI several times. It was inter-alia contended that the resolution passed in the AGM dated August 02, 1994 was an "enabling" resolution and there was no compulsion for the promoters to necessarily opt for 10 shares for each warrant. In view of the same, the action of the promoters was not at variance with the undertaking. It was further contended that the people had invested in the company on account of various factors such as 100% increase in profits for the last 5 years, highest EPS amongst the listed finance companies, booming primary market etc. Moreover, as the warrants were "optionally" convertible, no investor could be induced by "options" available to the promoters. The disclosures regarding these instruments were made only to fulfill the requirement of the SEBI Guidelines. It was reiterated that it was not compulsory for the promoters to opt for conversion of the OCNT warrants into equity shares, since the warrants were optionally convertible.

On examination of the contentions raised in the legal opinion, the same were found to be unsatisfactory. Further as the company appeared to have failed to honour their commitment relating to the conversion of warrants as undertaken and represented by them in the prospectus, SEBI called upon the company to show cause vide notice dated April 3, 2002, as to why appropriate orders should not be passed against them under section 11B of the SEBI Act, 1992, and advised them to indicate whether they desired an opportunity of personal hearing.

In reply to the same, the company vide their letter dated April, 17, 2002 stated that they had not violated any provisions of Section 11 of the SEBI Act, 1992, and that they were unaware of the sub-section of Section 11B under which SEBI proposed to proceed against the company. It was further contended that Section 11B of the SEBI Act, 1992 was not applicable to their case. It was also submitted that although the promoters had given an undertaking to positively or compulsorily exercise the option of conversion, it was not obligatory for them to exercise the option in only one way i.e. to convert the OCNTW positively. If that was the meaning attached to the term 'option', then it lost its character entirely and became an obligation. It was clarified that the undertaking was only with respect to the price at the time of exercise of option which was to be paid by the promoter group if the conversion took place. Hence, merely on the basis of the undertaking, the OCNTW would not become compulsorily convertible by the promoters. The matter on the whole had to be looked into both on facts and laws and the correct interpretation was to be given in the matter of the issue of these warrants, failing which the whole edifice of the word 'optional' would fall through. If the Lead manager to the issue wanted to make these warrants compulsorily convertible, the Board would have been advised to pass another resolution for this matter. Instead the promoters were advised to give only an undertaking that the warrants would be converted at Rs 400/- per warrant at any time when the option was exercised by them. Hence, in order to protect the interest of the general public and the investors, the lead managers insisted that that as and when the promoters exercised the option to convert these warrants, the price shall be fixed at Rs 400 only and not less than Rs 400/-. Hence, the time frame for exercising the option was fixed in the undertaking. The Board resolution had given the time for exercise of this option anytime between the 12th month and the 60th month. Although the promoters had the right to exercise the option in the 60th month, by means of the undertaking made by them, the same had been curtailed.

Thereafter, SEBI vide their letter dated May 6, 2002 informed the promoters of the company that all the issues raised by them regarding the conversion of OCNTS issued by the company and the defense of the interpretation taken by the promoters in this regard, had been examined by SEBI and found to be unsatisfactory. The promoters of the company were also informed that no further extension of time would be granted to them for the personal hearing with the Chairman, SEBI and during the course of which they were advised to make their submissions as regards the proposed action against the company in terms of Section 11B of the SEBI Act, 1992.

Subsequently, vide letter dated June 7, 2002, SEBI informed the promoters of the company that by failing to exercise the option to convert the OCNTW, they had prima facie violated sections 62 and 63 read with 65 and 68 of the Companies Act, 1956 and also acted in a manner prejudicial to the interest of the investors and orderly development of the securities market thereby inviting action under sections 11 and 11B of the SEBI Act, 1992. Further as regards the applicability of the section 11B of the SEBI Act, it was clarified that though the prospectus was dated before the insertion of sections 11A and 11B of the SEBI Act, the obligation to exercise the option to convert the options fell at points of time, subsequent to their enactment and thus they were applicable to this case. Further the proposed action if any would be initiated under sections 11 and 11B, since the promoters had prima facie acted in manner prejudicial to the interest of investors in securities and the orderly development of the securities market. In view of the same, the promoters were called upon to show cause vide the notice dated June 7, 2002, as to why they should not be debarred from accessing the capital market directly or indirectly for a period of five years and hence were informed that a personal hearing would be granted to them before me on July 12, 2002 wherein they could present their case.

On 12.7.2002, Mr. M. P. Mehrotra, Vice Chairman, Mr. A. Gowdia, Vice President, Mr. Gramopadhy, General Manager, Mr. M. G. Diwan, Director appeared on behalf of the company and once again reiterated the submissions made by them earlier. They also requested for additional time to submit their written submissions. Thereafter vide their written submissions dated July 25, 2002, while referring to certain case laws to substantiate their claim, the promoters inter-alia made the following submissions : -

Although the word 'shall' has been used, it has to be read as 'may' and will not in any way interpreted or forced to become 'will'. Hence as regards the nature of the OCNTW and the other terms of allotment given in the board resolution dated August 02, 1994, it cannot be construed that the word "shall" used in the undertaking is "will" i.e. the promoters had surrendered their option completely and have, with respect to the price, surrendered only partially their option i.e. instead of any price not exceeding Rs 400/- the price was fixed at Rs 400/-.

The right of option (at the sole discretion of the promoters) could never be taken away from the promoters on the basis of the undertaking which is an undertaking about the price at conversion and not about the number of OCNTW to be converted. The number of OCNTW has not been stated anywhere. The Board resolution dated 02.08.1994 gave the full term of allotment for the OCNTW and they remained valid for all purposes except that on the basis of the undertaking, the conversion shall be at Rs 400 per share.

The undertaking did not make it imperative and mandatory on the part of the promoters to convert all the 10 lakh OCNTW at Rs 400 per share.

These OCNTW were made as per the special resolution passed in the general meeting and resolution passed in the Board Meeting on 02.08.94 which are two legal and important documents. These documents could only be amended by the shareholders and/or Board of Directors, as the case may be. The mere undertaking, which was given with the sole object to determine the price of OCNTW by the promoters would, in no way change them from optionally convertible into compulsorily convertible warrants.

The Lead Manager to the issue was SBI Capital Markets Ltd. who, while drafting the prospectus had taken all precautions to disclose this fact in the prospectus. The same was filed with the SEBI for scrutiny and approval, and SEBI had given their consent to the same before the prospectus was issued. Thus all the material facts relating to the issue of these OCNTW was duly disclosed in the prospectus. The fact of OCNTW was taken as one of the risk factors in the prospectus and duly explained under the heading "Management Perception" on the cover page of the prospectus.

Notwithstanding the same, the issue was subscribed more than five times, Hence, the inference by SEBI that the investors were induced and influenced to subscribe to the issue, was out of context and unwarranted. The investors were provided all details as regards the highlights of the issue and these OCNTW and after a full understanding of the same, had applied for the shares.

The promoters had complied with their undertaking as far as the price is concerned and had taken one lakh shares at Rs 400 per share that were allotted to them on May, 07.1998. The share price at the relevant time was only about Rs 45/- per share.

The Board had passed another resolution on January 01, 1998 whereby certain terms and conditions of their resolution dated August 02.1994 were changed by the Board, particularly to the effect that on conversion, instead of 10 shares for one OCNTW, only one share per OCNTW would be allotted on conversion. Hence, the allegation by SEBI that the promoters had not followed the given undertaking was totally incorrect and based on surmises and conjectures and was contrary to facts, law and principles of natural justice. In fact, the promoters had acted honestly with due commercial prudence.

SEBI should not penalise the company for no fault on its part, more particularly when the matter was post-issue and out of the jurisdiction of SEBI. Not only that, the provisions of section 11 and 11 B of the SEBI Act, came into force much later than the date of prospectus dated December 14, 1994, and hence had no bearing nor any relevance to the prospectus.

Section 11 A was introduced in the Securities and Exchange Board of India Act, 1992 by the Securities Laws (Amendment) Act, 1995 w.e.f. January 25, 1995. Hence if at all, any direction was to be issued under section 11B(b) of the SEBI Act, 1992, to any company in respect of matters suggested in the main section 11A, the same would also not be applicable since the prospectus was issued much earlier than the introduction of section 11A of the SEBI Act, 1992.

As regards the allegation of non compliance of sections 62 & 63, read with sections 65 & 68 of the Companies Act, 1956, it was submitted that the allegation was fully misconceived and erroneous. All material facts, matters, necessary information and legal issues were fully disclosed. The prospectus was a complete legal document, accepted by the Registrar of Companies. Each and every fact about the OCNTW and undertaking of the promoters in respect thereof was fully disclosed, including a note under Risk Factors and Management Perception thereof. The prospectus was duly registered with the Registrar of Companies, Delhi. All the necessary documents and consent letters of experts were filed with the prospectus. The SBI Capital Markets Ltd. an expert body of Merchant Bankers had taken full care and exercised due diligence of all matters. Hence there was no contravention of provisions of any relevant sections under the Companies Act.

As far as the provisions of section 62 of the Companies Act was concerned, the same was not attracted in the instant case, in as much as there was no mis-statement whatsoever, or any misleading statement or ambiguous statement in the prospectus for which any liability could be fixed under section 62 of the Companies Act. All statements given in the prospectus are true and should not be

even misread. Section 62 relates to civil liability. Furthermore, no complaint or claim for compensation had been made by any shareholder either with the company or with any other authorised body till date. Similarly the provisions of section 63 of the Companies Act, which deals with criminal liability, was also not applicable in the instant case. No untrue statement was made in the prospectus to mislead the investors. The issue was over-subscribed by five times. The prospectus does not contain any matter which is untrue in the form and context in which it is included. Full disclosures about OCNTW as well as the undertaking given by the promoters about the fixing of price at Rs 400 per share on conversion had been made.

On the basis of the submissions summarized above, the promoters requested that the no action should be initiated against them.

Consideration of issue

I have taken into consideration the oral and documentary evidence on record, the submissions put forth on behalf of the company and the facts and circumstances of the case including the material papers available on record. On consideration of the same, it is noted that the primary point of contention in the present case is whether or not the company has exercised the option of conversion of OCNTW in terms of the undertaking given by them which is disclosed in the prospectus and whether the promoter by giving undertaking in the prospectus to subscribe OCNTW has induced the investors to subscribe in public issue and whether the promoters has committed breach of fulfillment of undertaking referred to in the prospectus.

The allegation as against the promoters is that the promoters had been allotted 10 lakh warrants, each convertible into 10 equity shares at their option, and had in the prospectus dated November 14, 1994 given an undertaking to the company that they shall opt for conversion of Rs. 400/- per share, and that the conversion shall be opted in phases so that the growth rate in the earnings per share (EPS) is maintained every year. At each stage of conversion of the OCNTW with the promoters, it would be ensured that promoters' holding does not fall below 25% of the expanded capital. At each stage of conversion of the OCNTW, 25% of the shares arising out of such conversion would be locked-in for a period of 5 years from the date of allotment of such shares. The disclosure in respect of conversion of OCNTW of Rs. 400/- per share and undertaking of promoters to exercise option, has to be seen in the context of premium of Rs.390/- for shares of Rs. 10/- offered to the public for subscription.

Thus, as per the prospectus, the proposed conversion was to take place as per the following details.

Year	Stage	Number of shares held by promoters	Equity Capital	% Holding
	Capital Existing before the issue	2343048	3333400	70.29%
	Present issue	2343048	7000000	33.47%
1996-97	After conversion of 10% OCNTs.	3343048	8000000	41.79%
1997-98	After conversion of 30% OCNTs	6343048	11000000	57.66%
1998-99	After conversion of 30% OCNTs	9343048	14000000	66.74%
1999-00	After conversion of Balance OCNTs	12343048	17000000	72.61%

However, it is noted that contrary to the said undertaking, the promoters had opted for conversion of these OCNTW by converting one equity share per warrant instead of one warrant into 10 equity shares on the premise that the term "optionally" means the option to choose the number of shares the warrant can be converted into as opposed to the understanding that the term "optionally" means the option to convert the warrant into 10 equity shares which shall be optionally exercised either between one year or 5 years.

The promoters have contended that the term option means choice, discretion, free decision, right to choose etc. They have referred to the term "option" as defined in the case of derivatives as a contract which gives the buyer (holder) the right but not the obligation to buy or sell specified quantity of the underlying assets at a specific (strike) price on or before a specified time (expiration date). On that basis they have contended that an option is a contract which gives the buyer a right but not the obligation to buy or sell shares of the underlined security at a specific price on or before a specific date.

In this context, it would seem relevant to refer to those portions of the prospectus where the undertaking has been reproduced.

At page 10 of the prospectus, under the head "CAPITAL STRUCTURE" at points F & G, the details of "PAID UP CAPITAL AFTER THE PUBLIC ISSUE " and "PAID UP CAPITAL IN 1999-2000 AFTER FULL CONVERSION OF OCNTW" has been mentioned. Further on the same page, immediately after the "capital structure", the details of "PROMOTERS HOLDING IN EXPANDED CAPITAL AT EACH STAGE OF CONVERSION OF OCNTW " has been given and the same has been reproduced at "B" above at page 16.

From the above, it is clear that the prospectus does not state "assuming" full conversion/the promoters holding "assuming" the conversion as proposed at each stage. Rather it gives definite figures after such conversion. The term option has to be construed in the context of the terms used in the prospectus for issue of OCNTW and not with reference to secondary market trading of derivative contract. Therefore reliance of the noticees on definition of option as defined in the context of derivative contract is misplaced.

The term "options" is to be read with respect to the statement made in prospectus, with reference to :-

- a. the capital structure;
 - b. the details of the promoters' holding in expanded capital at each stage of conversion of OCNTW incorporated at page 10 of the prospectus and reproduced at "B" above at page 16 and also
 - c. the undertaking dated September 6, ` 1994 given by Shri Somesh Mehrotra, Director/promoter (the holder of warrants and representative of the promoters) on Rs 10/- non judicial stamp paper to that effect – "we hereby confirm and undertake that :-
1. we shall convert the OCNTW and take the resultant shares at the price of Rs 400/-
 2. ..we shall opt for conversion in phases ..the tentative period for conversion of OCNTW is as under:-
- a. 1996-97 10% of the total number of OCNTW

- b. 1997-98 30% of the total number of OCNTW
- c. 1998-99 30% of the total number of OCNTW
- d. 1999-2000 30% of the total number of OCNTW

- 1.
- 2. The terms of the issue of the OCNTW is fully agreeable to us.."

Thus, it can be reasonably concluded that the promoters had undertaken to exercise the option granted to them as per the terms and conditions and in the phased manner as specified and as detailed in the prospectus. More relevantly it is to be noted that the word "shall" and not "may" has been used by the promoters in the prospectus....."..."the option shall be exercised "..."the promoters shall opt for conversion at Rs. 400/- per share..." It should not be lost sight of the fact that the public issue price of VLS Finance was at a premium of Rs. 390/- for a share of Rs. 10/-. The undertaking in the prospectus to exercise the option of Rs. 400/- by the promoters and conversion to be opted in phases to ensure that promoters holding does not fall below 25% was inter alia to induce the investors to subscribe the issue of the company at premium of Rs. 390/-. The market price of the scrip of the company is now below par, i.e. Rs. 8.50/-. Therefore the promoters are now dragging their feet to exercise the option at price of Rs. 400/- and seeking to give such interpretation to wriggle out from the undertaking given to the public / investors at the time of public issue to subscribe at premium of Rs. 390/-.

Thus the promoters are obliged to fulfill the undertaking made by them in the prospectus as regards their commitment to take the shares at specified stages as disclosed under the head "Capital Structure".

It would seem that the preferential issue under which the warrants were allotted to the promoters was approved at the General meeting held on August 2, 1994, prior to the public issue which came out during December 1994. However, it has been contended by the promoters that the terms of the offer document were modified vide Board resolution dated January 14, 1998 by giving the promoters the option to opt for one equity share for each OCNTW as against the earlier option of 10 equity shares to be exercised for each OCNTW. If that were so, then it would be necessary to examine as to whether the said subsequent modification after the public has subscribed at premium of Rs. 390/- in the public issue based as the disclosure made in the prospectus is permissible or took place in accordance with the relevant laws. Section 61 of the Companies Act, 1956, inter alia requires that any change in the terms of the prospectus can be made only with the approval of the general meeting. Even if it is assumed that it is possible to vary such terms of the prospectus on the strength in which the public has subscribed, the same can be done by the company only with the authority given in the general meeting. Therefore the promoters or directors has no authority to vary the terms without the approval or authority given in the general meeting. Even if the general body gives such authority to the company, the promoters or the Board of the which consists of interested directors cannot vary such terms in view of section 300 of the Companies Act. It is noted that the provision of these sections have not been complied with. In view of the same, the modification that took place was void and the contention of the promoters that the resolution passed in the AGM dated August 2, 1994 was an enabling resolution and that there was no compulsion on their part to opt for 10 shares for each warrant and that their action was not in variance with the undertaking, is under these circumstances, not tenable.

It is to be noted that at page 10 of the prospectus, the table showing promoters' holding in expanded capital at each stage of conversion of OCNT warrant indicates that each of the said warrants would be converted into 10 equity shares in four stages. In addition, the undertaking by the promoters on page 11 states that the conversion will be at Rs. 400 per share. Further the undertaking given by the promoters refers to both the price at which the conversion shall take place as well as the manner in which the conversion will take place, the exact figures for which have been provided in the table on page 10. Hence, there is no scope for any ambiguity on this issue. The promoters were obliged to convert the warrants into shares as per the schedule mentioned on page 10 at the price given in their undertaking.

The promoters contend that the market price of the company's share at the time of the public issue was in the range of Rs 600-800 which was the prime inducement for the investors to invest in the shares of the company.

Interestingly enough I have noted that during January 1994, the share price of the company was hovering around Rs 100 in the stock market. In July 1994, it was quoting at Rs 250/- and suddenly shot up to Rs 850/- at the time the company came up with the public issue with the premium of Rs 390 per share. Now the price of the scrip is quoting below par i.e. Rs. 8.50/-.

I find it difficult to accept the contention that as the warrants were optionally convertible, no investor can be induced by the options available to the promoters. It cannot be ignored that one of the prime concerns of any investor, while deciding on investment is the commitment of the promoters to the company to exercise option of Rs. 400/- for a period of 4 years. The fact that the promoters' shareholding would increase gradually to 72% over 4 years would carry weight in the minds of the investors. Moreover, the fact that the promoters were ready to pay Rs. 400/- per share even over a period of 4 years, thereby giving a level of confidence or inducement to the investor to invest at the issue price of Rs. 400/-.

The said disclosures definitely induced the investors to subscribe to the issue on the basis of this undertaking of the promoters which promised a huge funds commitment by the promoters. The present market value is approximately Rs 8.50/- as against the issue /conversion price of Rs 400/-. The issuer company has collected a sum of Rs 146.20 crores on the promise that the promoters would take one crore shares at Rs 400/- each on conversion of the warrants. This is reflected under the head "Capital Structure". Thus the undertaking of the promoters to pay Rs 400 crores for the One crore shares is a material feature in the prospectus. If the promoter wish to back out of their undertaking, it would be a clear case of making a promise without any intention of performing it and would amount to "fraud" as defined in the Indian Contract Act and also a violation of Sections 63 and 68 of the Companies Act.

The contention that the disclosure regarding these instruments were made only to fulfill the requirements of the SEBI guidelines is an indication of the casual attitude of the promoters towards their obligation to investors and comply with the provisions of law. Therefore the promoters who have made such statements and given such undertaking based on which the investors have invested at Rs. 400/- per share, cannot wriggle out from their promise. It is absolutely necessary that such promoters are sternly dealt with and that the interest of the investors is protected. If the promoters wriggle out on such pretext, it would erode the confidence of investors in the capital market and would be detrimental to the economy.

It has been mentioned that the present issue has basically arisen on account of the complaints of Shri SP Gupta of Sunair Hotels Ltd. who besides being a defaulter member of VLS Finance had indulged in fraudulent and illegal activities in Sunair Hotels Ltd and is now involved in the efforts to defame VLS for ulterior motives. Wherever there is such violation or the interest of the investors is involved, SEBI would take necessary action irrespective of the receipt of such complaints.

On the basis of the above, it could be concluded that the promoters had made a promise in the prospectus without any intention of performing it which amounts to a fraud. One can reasonably state that cases like these make investors lose their confidence in the capital markets. Such promoters should not be allowed to back out of their undertaking made in the prospectus, by taking recourse to interpretation of the undertaking given by them in the prospectus.

As regards the applicability of Section 11B of the SEBI Act, to the present case, the same was inserted to empower SEBI to make directions for the protection of interests of investors and the securities market. Hence while action cannot be taken under a particular statute on the basis of events which took place prior to its enactment, it is well settled that past conduct, even that occurring prior to the enactment of the statute can be considered for imposing a posterior disqualification. If the object of a statute is not to inflict punishment but to protect the public from the activities of undesirable persons who bear the stigma of misconduct on their character, the misconduct of such a person before the operation of the statute may be relied upon. This proposition derives support from the decision of the Supreme Court in *State of Bombay v. Vishnu Ramchandra*, AIR 1961 SC 307. Thus there is no infirmity in taking action under section 11B in the present case.

Further under Section 11, SEBI has been in no uncertain terms mandated to protect the interest of investors in securities by such measures as it thinks fit. Under Section 11, SEBI has framed guidelines for Disclosure and Investor Protection under which the public issue in question was made. Thus in view of Section 11 which was in the statute book since 1992, the promoters or the company cannot take shelter from those events that took place after the enactment of the SEBI Act containing Section 11. The Securities Appellate Tribunal in Appeal no. 7/2000 – @ Integrated Amusement Ltd. Vs. SEBI has held that Section 11 and 11B are interconnected and coextensive as both these sections are mainly focused on investor protection. Therefore, even if Section 11B was inserted subsequently, SEBI has powers under Section 11 to take action.

The proposed action against the company and its promoters is not penal but preventive so as to prevent them from causing further damage to the securities market. The promoters have accessed the capital market making a statement in the prospectus to the effect that they will subscribe OCNTW at Rs 400/-. Hence, and the investors who have subscribed to the issue based on such a commitment of the promoters, would certainly feel cheated, if the promoters fail to act upon their commitment. If such a company is once again allowed to access the capital market, the same would shatter the confidence of the investors in the securities market. Hence, such directions are preventive and not punitive.

During the course of considering the various issues raised in this case, I have had the opportunity to peruse the previous track account of the company in its dealings in various fields related to the capital market and have noted that the company has a rather dubious track record in the market, some of which are as under :-

1. VLS Fin acquired shares of Trackparts, in violation of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. They made an application for exemption, to the takeover panel. The panel rejected the case on 19.02.2002 and the matter was referred to adjudication for violation of Regulation 15H(ii) of the said Regulations.
2. Earlier, in the same case, a penalty of 5 lacs was imposed on the entity, for non-disclosures, which was reduced to Rs. 25000, which was paid by the entity.
3. As per the database of the investigation department of SEBI, an enquiry is under process against VLS Finance Ltd., for their role as merchant banker in the issue of M/s Bestavision Electronics Ltd.

On the basis of the facts and circumstances of the case and the various issues deliberated upon, it is clear that the action of the promoters of the company as elaborated above is detrimental to the orderly development of securities market and to the interest of investors. It is also noted that the Company does not have a good track record in complying with the rules / regulations. Hence necessary action is required to be taken by SEBI in order to ensure that the investors in the securities market do not in any way suffer any losses and are not put to any harm and that the safety and integrity of the market remain unimpaired.

Order

Hence, in exercise of the powers conferred upon me under section 4(3) of the SEBI Act, 1992, read with Sections 11 and 11B of the SEBI Act, 1992, I hereby direct that Mr. M.P. Mehrotra, promoter of the company and Mr Somesh Mehrotra, director of the company, honour their commitment relating to the conversion of warrants as undertaken or represented by them in the prospectus dated November 14, 1994 within a period of 30 days from the date of this order, failing which Mr. M.P. Mehrotra, Mr Somesh Mehrotra and the other companies, which they have promoted or in which they are holding or controlling a substantial interest, shall hereby be restrained, from accessing the capital market, directly or indirectly for a period of 5 years.

Date : September 20, 2002
Place: MUMBAI

G. N. BAJPAI
CHAIRMAN
SECURITIES AND EXCHANGE BOARD OF INDIA