CO/152/ISD/02/2005

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002, AGAINST JM MORGAN STANLEY PRIVATE LIMITED, CATEGORY- I MERCHANT BANKER WITH SEBI REGN. NO. INM 000010361 IN THE MATTER OF PUBLIC ANNOUNCEMENT OF OFFER TO ACQUIRE SHARES OF LARSEN & TOUBRO LIMITED ON BEHALF OF M/s GRASIM INDUSTRIES LIMITED AND ANOTHER.

BACKGROUND:

1) JM Morgan Stanley Private Limited (hereinafter referred to as "JMM") is a Category-I, Merchant Banker, with SEBI Regn. No. INM 000010361 registered with Securities and Exchange Board of India (hereinafter referred to as 'SEBI'). An Enquiry Officer was appointed vide order dated 27/2/2003 to inquire under Regulation 45(4) and (5) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997(hereinafter referred to as "SAST Regulations"), the alleged contravention of Regulation 24(1)(d), (4) & (5) read with Regulation 16(ix) and (xix) of the SAST Regulations by JMM in the matter of public announcement of offer to acquire shares of Larsen & Toubro Ltd on behalf of M/s Grasim Industries Limited and another.

ENQUIRY REPORT AND RECOMMENDATION:

2) The Enquiry Officer, after conducting the enquiry as per the prescribed procedure, submitted a report dated 22/1/2004. The enquiry officer recommended that the certificate of registration of JMM be suspended for a period of four months.

SHOW-CAUSE NOTICE:

3) Pursuant to the above, a show cause notice dated 9/2/2004 was issued to JMM along with a copy of the enquiry report. JMM submitted reply vide letter dated 24/3/2004. In the interest of natural justice, an opportunity of personal hearing was granted to JMM before me on 6/5/2004. The representatives of JMM appeared before me and made oral submissions and they were advised to submit written submissions within a week's time. Thereafter, JMM submitted a letter 13/5/2004 along with three files containing documents, case laws etc. I shall proceed to examine the allegations and also the submissions of JMM as under:

ISSUES FOR CONSIDERATION:

ALLEGATIONS:

4) It is alleged that the public announcement dated 13/10/2002 made by the acquirer i.e. Grasim and others for the acquisition of 4,97,32,070 shares of Larsen & Toubro Ltd. constituting 20% of its equity at Rs.190/- per share for which the merchant banker was acting on behalf of the acquirer as required under SEBI(SAST) Regulations, 1997 did not contain the following disclosures:

1 Object and purpose of the acquisition of shares of L&T as per Regulation 16(ix) of the said Regulations.

2 Reasons for the price paid by the acquirers to Reliance Industries for acquisition of shares of L&T of Rs. 306.60 per share over the then prevailing market price of Rs.208/- , i.e., a premium of Rs. 98.60 per share.

3 Vide a share sale/purchase agreement, dated 18 November 2001, with Reliance Industries Ltd. (RIL), the acquirers purchased 2.5 crore shares of L&T constituting 10.05% of its equity, at Rs.306.60 per share. The following important covenants of the said agreement were not disclosed:

3.1 The seller (RIL) confirms that upon the sale of the shares as aforesaid, it does not hold either by itself or through its affiliates or associates any shares of L&T; or any instrument that would confer or will provide a right to acquire any equity shares or any other instruments that provides or will provide voting rights.

3.2 The seller undertakes that upon execution of this agreement, the seller and its subsidiaries, affiliates or associates will not acquire any equity shares of L&T or any other instrument that would confer a right to acquire any equity shares of

L&T. The seller further undertakes not to deal in shares of L&T and/or any other instrument that would confer a right to acquire any equity shares of L&T or any other instrument that provides voting rights. The seller makes this covenant so as to bind themselves, the affiliates, associates or any person acting at their behalf.

3.3 The seller acknowledges that the obligations as mentioned in point no 3.1 & 3.2 above shall be of an enduring nature and in any event the seller shall be obliged to comply with the same for a minimum period of 5 years from the date hereof.

3.4 Following the sale of shares as aforesaid, the seller and/or representatives will in good faith, arrange to convene a Board meeting(s) of L&T as soon as possible to inter-alia transact the following business and approve the same:

- Informing the Board of Directors of L&T about the shares acquired by the purchaser from the seller under spot delivery contract.
- Submission of letter of resignation by the Representatives of the seller to the Board of Directors of L&T.

JMM'S SUBMISSIONS:

5) JMM vide its letter dated 13/5/2004 had, inter-alia, made the following preliminary submissions:

1. At the outset, the Noticee submits that the present Show Cause Notice has been issued by the General Manager, Integrated Surveillance Department, SEBI. However, under the SEBI (Procedure for Holding Enquiry by Enquiry Officer) Regulation, 2002 ("Enquiry Regulation, 2002"), a Show Cause Notice can only be issued by the Chairman or the Member of the Board. Regulation 13(2) does not confer the power to issue a Show Cause Notice on any other person. Nor, do the Enquiry Regulation, 2002 provide for the delegation of this power to any other officer. The present Show Cause Notice is, therefore, ultra vires the provisions of the Enquiry Regulation, 2002 and is not maintainable.

2. The present Show Cause Notice adopts in its entirety the enquiry report dated 22nd January, 2004. The enquiry report however makes several allegations which were not made in the show cause notice dated 12th March, 2003. Whereas the Show Cause Notice dated 12th March, 2003 alleges that the Noticee failed to make adequate disclosures in the Public Announcement dated 13th October, 2002, the enquiry report goes on to allege that the Noticee in fact failed to satisfy itself whether the acquirer "was in a position to influence the management" or "indeed acquired control" or "intends to acquire control" of the target company. The enquiry report goes even further in alleging that the Noticee was required to, and failed to, satisfy itself regarding the objects and purpose of the acquisition of shares of L&T made by the acquirer from a former shareholder (RIL) as far back as 18th November, 2001, and to determine the reasons for the premium paid in the light of the restrictive covenants contained in the Share Sale/Purchase Agreement, and that it ought to have made such disclosures in the Public Announcement dated 13th October, 2002. The enquiry report makes various allegations against the Noticee. The Noticee, therefore, submits that the enquiry report travels beyond the Show Cause Notice dated 12th March, 2003 and is in breach of the principles of natural justice. The Noticee submits that the enquiry report and present show cause notice (to the extent that it travels beyond the original Show Cause Notice dated 12th March, 2003) must be quashed and/or set aside.

It is well settled that findings in investigation cannot travel beyond the Show Cause Notice and any finding which travels beyond the Show Cause Notice is in breach of the principles of natural justice. (Wimco Ltd V. UOI 1980 ELT 293, Collector V. ITC 1995 2 SCC 38).

3. The Noticee submits that SEBI had by its letter dated 25th February, 2003 addressed to Grasim, the acquirer, made allegations against Grasim which were the same as those contained in the enquiry report. Further, to these allegations, SEBI had by its letter dated 8th November, 2002 to the Noticee restrained Grasim from proceeding with the public offer. However, after a detailed investigation in relation to Grasim's acquisition of 10.05% shares of L&T from RIL and upon Grasim agreeing to make further disclosures in its subsequent public announcements, SEBI by its letter dated 22nd April, 2003 to the Noticee, allowed the public offer to proceed. It is submitted that by allowing Grasim to proceed with the public offer, SEBI is deemed to have waived these charges against Grasim. Having done so, SEBI is now estopped from proceeding against the Noticee in respect of the same allegations which were earlier made against Grasim.

4. In any event, it is submitted that the shareholders of L&T have not acted upon the public announcement dated 13th October, 2002. The public offer was in fact restrained by SEBI's letter dated 8th November, 2002, and by public announcement dated 20th November, 2002, notice of this fact was given to the shareholders of L&T, and to all investors. No complaint from the shareholders of L&T or any other investors has been received by any of the concerned parties. Even after all the disclosures suggested by SEBI had been made by the public announcements dated 6th March, 2003 and 23rd April, 2003, no such complaints have been received. None of the shareholders who participated in the public offer have sought to be compensated for any loss caused to them. Therefore, the Noticee submits that neither the shareholders of L&T nor any investors have suffered any loss or injury as a result of the public announcement dated 13th October, 2002. The SAST Regulations, being for the protection of investors, no penalty is therefore justified and/or can be imposed.

5. **Allegations relating to control in the Enquiry report:**

The enquiry report proceeds upon the misplaced and erroneous assumption that the allegations contained in the Show Cause Notice dated 12th March, 2003 are "related to the question of control". The Noticee submits that:

i. This is not the charge in the initial show cause notice dated 12th March, 2003.

ii. Under regulations 3 read with 6 read with 13(2) of the Enquiry Regulations, 2003, the enquiry officer cannot travel beyond the show cause notice issued under regulation 6(1) of the SAST Regulations.

iii. The charges in the enquiry report are deliberately vague, and liable to be struck down.

iv. This was the very charge against Grasim (SEBI's letter dated 25th February, 2003). SEBI having allowed the public offer to proceed, the same is deemed to have been waived, and/or in any event SEBI is estopped from proceeding with the same charges against the Noticee.

v. The Noticee did exercise its independent professional judgement. Grasim categorically informed it that it had no intention to acquire control by the present acquisition. Grasim's Board had, based on the presentation made to it, clearly accepted that the objective of the acquisition was to average out the cost of acquisition of L&T shares by GIL and to augment its holding above 15%. The Noticee had absolutely no reason or basis to doubt any of this. The Noticee was also convinced that the acquisition was NOT for control by the fact that the premium that was offered was very meager. The insignificant premium was itself strong indication that the object of the acquisition could not be and was not, for gaining control of L&T. It is only after being so satisfied that the Noticee made the public announcement dated 13th October, 2002.

vi. The premium offered in the public offer was approximately 10% over the market price. It is a well established practice that a public offer only has a chance of achieving full subscription if a substantial premium over the market price is offered. Such a premium would be offered where the acquirer in fact desires to acquire control. The fact that Grasim offered a premium of 10% to the previous days closing price (1% to the minimum price as per SAST Regulations) itself was clearly indicative that Grasim, as stated by it, was interested in and intended to augment its shareholding in L&T and not in acquiring control of L&T.

vii. The Noticee's conclusion is also justified by the public announcement dated 20th November, 2002, 29th November, 2002, 6th March, 2003 and 23rd April, 2003 and the Letter of Offer dated 28th April, 2003, which corroborates that Grasim did not intend to acquire control of L&T.

viii. It may be noted that the letter of offer which also contains a statement that Grasim was not intending to acquire control was issued only after the same was vetted by SEBI.

ix. Since, the enquiry report and the subsequent Show Cause Notice dated 9th February, 2004 overlook these admitted facts, it is submitted that the Notice suffers from non-application of mind and should be quashed.

x. The fact that Grasim acquired 10.05% from RIL pursuant to the agreement dated 18th November, 2001 only for the purpose of strategic investment and not to acquire control over L&T is also borne out by the statements made to this effect by Grasim itself to its shareholders and by RIL itself to its shareholders in the Annual Reports of RIL and Grasim.

xi. These Annual Reports were widely circulated and filed with relevant Stock Exchanges as required by Law.

Press Releases dated 18th November, 2001 of Grasim, Grasim's announcement to BSE and NSE dated 19th November, 2001, RIL's press release dated 18th November, 2001, RIL's intimation to BSE and NSE dated 19th November, 2001, L&T's intimation to BSE dated 23rd November, 2001, Extract of Annual Report of Grasim for year 2001-2002, Extracts of RIL's Annual Report for year 2001-2002, press releases given above, corroborate the Exercise of independent professional judgement by the Noticee. The Noticee submits that a presentation made to the Board of Grasim (in the preparation of which the noticee was advising Grasim) in fact expressly stated that the objective of the proposed transaction was inter-alia to average the cost of acquisition of shares by Grasim and to augment its holding beyond 15%.

In the light of the above documents / understanding / information there is no rational basis or justification whatsoever for the enquiry officer to conclude that the Noticee failed to exercise its independent professional judgement to "ascertain whether the acquirer was in a position to influence the management or indeed acquired control or intends to acquire control of the target company".

6. As explained earlier the reference to the control aspect has been referred to by the enquiry officer in relation to the exercise of due diligence by the noticee in the issue of the public announcement. The importance of this information is brought out by clause 16 (ix) of the SAST regulations and the same was also likely to influence the decision of the investors in this regard. Also, vetting of the public announcement by SEBI does not in anyway absolve the noticee from their responsibility of ensuring appropriate disclosures in the announcement as the merchant banker has the responsibility to ensure that the contents of the public announcement of offer as well as the letter of offer are true, fair and adequate and based on reliable sources, according to regulation 24(4) of the SAST regulations.

The submissions of JMM in response to the allegations in the show cause notice are as follows:

Allegation 1:

Object and purpose of the acquisition of shares of L&T were not disclosed as per Regulation 16(ix) of the SAST Regulations:

a) The public announcement dated 13th October, 2002 in fact makes all necessary disclosures. C1 1.3 expressly states that the object & purpose was to augment Grasim's shareholding in L&T beyond 15%. C1 1.4 expressly states that the public offer is made under regulation 10, and intentionally makes no reference to regulation 12.

b) The disclosure of the relevant regulation under which the acquisition is made to clarify the object and purpose of the acquisition is a practice known to and accepted by SEBI.

c) The enquiry officer erred in attempting to distinguish the case of Kapil Kotex, which he was in fact bound to follow.

d) Clauses 2.1 and 2.3 stated the rationale for Grasim's public offer & future plans for L&T.

e) Had Grasim intended to acquire control, the Noticee would have stated the public offer was under regulation 12 SAST Regulations.

f) The enquiry officer failed to appreciate that the draft Letter of Offer was also in the form applicable to acquisition of shares without control. Viz under Regulation 10.

Allegation 2:

Reasons for premium paid by Grasim to RIL were not disclosed in the Public Announcement in violation of Regulation 16(xix) of the Regulations:

a) The disclosure of reasons for payment of such premium is not "essential" under Regulation 16(xix) of the SAST Regulations. Had it been, it would have been specifically stated in one or other of the clauses in Regulation 16 itself.

b) The agreement of 18th November, 2001 was an entirely independent transaction and had not triggered the open offer under the Regulations.

c) The Noticee did not consider it 'essential' in its independent professional judgement. SEBI cannot sit in judgement over the merchant banker's bona fide judgement.

It is well settled that the exercise of discretion on part of a merchant banker whether to include certain information or not in the interest of the investors is akin to the exercise of discretion which a Board of Directors exercises in the interest of all its shareholders. It is well settled law that when a Board acts bonafide and not arbitrarily and not for any collateral motive, the exercise of discretion of the Board is to be tested as the opinion of fair and sensible men in the interest of the Company (Bajaj Auto Ltd. V. Firodia 1971 41 Co. Cases).

d) The SAST Regulations do not require disclosure of the reasons for the premium paid for a past purchase.

e) The agreement of 18th November, 2001 was almost a year prior to the public announcement dated 13th October, 2002. Under the SAST Regulations, only the price of the shares 6 months prior to the date of the public announcement is relevant for the purpose of determining the minimum price under the SAST Regulations. Even within this 6 month period, only the price of the shares is relevant and not the premium paid.

f) To place an additional requirement upon the Noticee to disclose reasons for the payment of premium paid almost a year prior to the date of the public announcement and penalize the Noticee for not doing so would be read into the SAST Regulation, provisions which do not exist. It is well settled that a statute which creates an offence or imposes a penalty must be construed strictly in favour of the subject (State of WB & Ors V. Swapan Kumar Guha & Ors (1982) 1 SCC 561))

g) It is an accepted practice that only the premium paid (not the reasons for such premium) are disclosed in the public announcement and that SEBI is aware of this practice. The Noticee has not come across a single case where an Acquirer has, in a Public Announcement, given reasons for premium paid, even though the premium has been substantial. The Noticee will rely on numerous such instances where no reasons were at all given for premium paid and in none of these cases has SEBI taken any action or objected on this score.

h) The Noticee has a legitimate expectation that SEBI would not act contrary to such an accepted practice.

Allegation 3:

That the Agreement contained restrictive covenants which if disclosed, would have had a significant bearing on the response to the open offer, and that accordingly JMMS failed to exercise its independent professional judgement and the due diligence required by not disclosing the restrictive covenants in violation of Regulation 16(xix) of the SAST Regulation.

a) The agreement of 18th November, 2001 was almost 1 year prior to the public announcement dated 13th October, 2002. As such it was not relevant.

b) Clause 3.1 of the agreement was a mere statement of fact.

c) Clause 3.1 of the agreement was even otherwise not relevant or essential for the shareholders to make an informed decision. In any event the contents were disclosed in the Letter of Offer dated 28th April, 2003 to the shareholders of L&T. The disclosure had not appreciable effect upon the shareholders participation in the public offer and the response was only 2% of the offer size i.e. 0.4% of the total paid up share capital of L&T.

d) The contents of Clauses 3.2 and 3.3 of the agreement viz., the fact that RIL had exited from L&T and that Grasim had acquired all its shares was generally well known from their Annual Reports and the intimations to the Stock exchanges.

e) Clause 3.4 of the agreement had been acted upon, which fact was in the public domain. The obligations under Clause 3.4 were intimated by Grasim, RIL and L&T to the stock exchanges.

f) In any event these provisions were subsequently disclosed.

g) The Noticee did exercise due diligence, proper care and in its independent professional judgement concluded that disclosure was not essential.

h) The enquiry officer failed to appreciate that the test under regulation 16(xix) is whether the information is "essential". Not whether it would "weigh in the minds of the shareholders of L&T" or "would certainly have made a difference".

i) The enquiry officer without justification questioned the independence of the Noticee making the following allegations, each of which are belied by the following facts:

i. **That the Noticee ought to have clarified from Grasim whether it was a condition precedent for the acquisition of 10.05% shares that RIL's representatives should step down.**

Neither RIL nor Grasim have ever been in control of L&T. Therefore whether RIL's nominees stepping down from the board of L&T was made a condition precedent or not is irrelevant.

ii. **The Noticee ought to have questioned why Grasim should made it a condition that RIL's directors step down from the board of L&T in favour of Grasim, if the acquisition was for strategic investment:**

RIL itself never having been in control of L&T, it could never have caused Grasim's nominees to be co-opted on the board of L&T.

iii. **The Noticee ought to have questioned how it was possible for RIL to convene a board meeting if they were not in control of L&T or in a position to influence the management of L&T.**

Article 121 of the Articles of association of L&T expressly provides that any Director may call for a board meeting.

iv. **The allegation that, the reasons for payment of premium, in light of the restrictive covenants were not stated.**

The agreement itself does not state that the consideration paid by the buyer is split into price for the shares and premium. Consideration is indivisible and **when** the parties have themselves not attributed any part of the consideration to a particular obligation it cannot be so attributed (1957 ITR 299, 305). The purchase price of Rs.306.6 per share paid by Grasim cannot be divided up into premium and the price of the share.

v. Neither GIL nor RIL have in their Annual Reports to their shareholders, after the agreement of 18th November, 2001, advised them of the restrictive covenants therein. This, too, establishes that RIL and GIL also considered this to be non-essential. Had it been essential then it would have constituted price sensitive information which, under their Listing Agreements, they would have been mandatorily obliged to notify to the Stock Exchanges.

j) The enquiry officer's insinuations are premised on the fact that the object & purpose of the present acquisition was to acquire control, which is not the case.

Allegation 4:

That the aforesaid acts of JMMS resulted in breach of Regulation 4(d) of the Merchant Bankers Rules read with clauses 1, 2, 7(a) and 9 of the code of conduct read with Regulation 13 of the Merchant Bankers Regulations:

i. These allegations are premised on the alleged breaches by the Noticee under Regulations 16(ix), (xix) & 24(1) (d) (4) & (5) of the SAST Regulations. The latter allegations being themselves unsubstantiated and unjustified (for reasons stated above), the former cannot be sustained.

ii. The public announcement dated 13th October, 2002 complies with regulation 16(ix) & (xix). Therefore the Noticee is not in breach of regulation 4 (d) of the Merchant Bankers Rules.

iii. The Noticee has observed the highest standards of integrity and fairness. Therefore, it is not in breach of Clause 1 of the Code of Conduct.

iv. Due diligence and proper care mean the usual, ordinary and reasonable efforts. The Noticee has acted accordingly. Further, the Noticee has bona fide exercised its independent professional judgement, and concluded that the public announcement dated 13th October, 2002 complied with all relevant laws. Having done so, SEBI cannot penalize the Noticee merely because another view is possible.

The term "due diligence" and "proper care" has not been defined in the SEBI Merchant Bankers Regulations. It is abundantly clear that the law does not require any unusual or extraordinary efforts. When a person is required to exercise due diligence the only requirement is that usual ordinary and reasonable efforts be exercised having regard to the facts and circumstances of the case. The dictionary meaning of the said words as defined in the Law Lexicon, 2nd Edn. on pages 552 and 598 supports this view. We reproduce below the dictionary meaning as stated in the Law Lexicon for convenience of reference.

> "**Diligence ...** is the care and prudence as is usually by persons of common or average care and prudence." The law does not require any unusual or extraordinary efforts but only that which is usual ordinary and reasonable. "Due care … just proper and sufficient care, so far as the circumstances demand…"

v) The Noticee has provided true and adequate information. Therefore it is not in breach of Clause 7(a) of the Code of Conduct.

vi) The Noticee has complied with all relevant laws. It is not in breach of regulation 13 of the Merchant Bankers Rules and / or Clause 9 of the Code of Conduct.

Further submissions by JMM:

1. It has also been submitted by the noticee that the very charge was sought to be raised against Grasim vide letter dated 25th February, 2003. As further stated hereinabove, SEBI vide their letter dated 22nd April, 2003 permitted Grasim to proceed

with the offer, withdrawing the earlier ban on the offer. In light of the fact that SEBI, after conducting an investigation against Grasim, in respect of these very matters, did not proceed any further is in contradistinction to the finding of a prima-facie case against JMM.

2. The non-disclosure in the initial public announcement on the aspect of control would not have had any impact on shareholders decision since there was never any intention to acquire control, as clearly borne out by the disclosures in the subsequent public announcements and by the disclosures in the final letter of offer duly approved by SEBI. Also none of the shareholders of L&T acted upon the said public announcement and there was no loss caused to them. The fact that the shareholders have acted upon the subsequent announcements etc., negates the question of any person making any disproportionate gains or unfair advantage.

Submission on the quantum of penalty:

a) The Noticee has not committed any breach. Therefore no penalty can be imposed upon it.

b) The Noticee submits it has acted bona fide and in the belief that it is entitled to act accordingly. The breach, if any, is therefore at most merely a technical / venial breach. The enquiry officer must therefore exercise his discretion not to impose any penalty. The Noticee submits that it is well established that this principle applies in the case of civil, criminal and quasi criminal penalties (SEBI V. Cabot International Capital, App 7 of 2001, in SAT Appeal No.24 of 2000).

c) Without prejudice to what is stated in (b) above, the Noticee submits that the enquiry officer failed to appreciate that mens rea is a necessary ingredient of any offence under the SAST Regulations. The Enquiry Officer failed to appreciate that the show cause notice makes no finding on mens rea, therefore no penalty can be imposed (Akbar Badrudin Jiwani v. Collector Air 1990 SC 1579, Hindustan Steel V. State of Orissa AIR 1970 SC 253)).

d) The Noticee submits that none of the shareholders of L&T acted upon the public announcement dated 13th October, 2002. The shareholders have in fact only acted upon the subsequent public announcements and corrigenda. Therefore no loss has been caused to them by the public announcement dated 13th October, 2002. The SAST Regulations being a measure of investor protection, no penalty can therefore be imposed.

e) The Noticee submits that regulation 13(6) is an exhaustive list of circumstances in which major penalties can be imposed. Since none of the circumstances mentioned therein apply to the Noticee case, no major penalty can be imposed upon the Noticee.

FINDINGS OF THE ENQUIRY OFFICER:

6) I have perused the enquiry report dated 22/1/2004 and observe that the findings of the enquiry officer are as under:

1. "The allegation against the merchant banker is regarding non disclosure of certain important material facts in the Public Announcement made on 13th October 2002 on behalf of the acquirers for the acquisition of shares of L&T Ltd relating to objects and purpose of acquisition, reasons for the high premium paid by the acquirer to RIL. The restrictive covenants in the sale / purchase agreement 18th November 2001. These also relate to the question of 'control' over the target company.

   It was contended on behalf of the merchant banker that the object and purpose of acquisition of shares as required under Regulation 16(ix) is contained in para 1.3, 1.4, 2.1 and 2.2 of the public announcement dated 13/10/2002. It was also contended that in similar situations the market practice was also to disclose on similar lines and also filed the public announcement of offer and offer document of Kapil Kotex Ltd.

   Para 1.3 of the P.A states that the Board of Grasim has thought it fit to augment its holding in L&T beyond 15% and accordingly the P.A. was being made.

   As per para 1.4 of the PA., the offer was being made pursuant to Regulation 10 <u>and other provisions of Chapter III</u>…..

   Under the heading "rationale for the offer and future plan" at para 2.1 of the P.A., it was stated that the offer was being made pursuant to Regulation 10 <u>and other provisions of Chapter III</u> of and in compliance with the Regulations for the purpose of substantial acquisition of shares.

At para 2.2 of P.A. it was stated as under:

"The Aditya Birla Group, an Indian Multinational has identified inter-alia. Cement and Knowledge-intensive business, with a strong service orientation as signification growth opportunities, Grasim, with a major presence in Cement, finds synergies with L&T's cement business. In addition, L&T is recognized as a premier Indian enterprise with major investments in Cement, IT and other Knowledge-intensive service oriented businesses. Their Engineering & Construction business is a leading provider of solutions to the Infrastructure Sector, both in India and abroad. Grasim's offer to augment its equity stake in L&T is expected to yield the following benefits to both Grasim and L&T:

This will enable the two companies to better compete in the rapidly expanding cement market in India, against foreign multinationals, who have the benefit of scale on their world wide operations. In the process, the two companies will be in a position to derive multi-functional synergies, on an arms length basis, yielding potential cost reduction and product/service innovation.

Enhance financial flexibility, and the ability to access both domestic and international capital at competitive costs, to support future growth opportunities.

Strengthening the intellectual talent within the two companies, with their diversity of skills, expertise and capabilities to pursue growth opportunities that are likely to emerge in the future."

The offer document and PA of Kapil Kotex Ltd filed by the merchant banker in support of his contention is examined. Although in that PA it is stated that the offer was pursuant to Regulation 10 and other provisions Chapter III of SEBI (SAST) Regulations, 1997, the letter of offer clearly states that the offer was being made in terms of Regulation 10 &12 of the said Regulations. Therefore, the control aspect has been dealt with unambiguously in the letter of offer. Whereas in the instant case the control aspect had been dealt with unambiguously only after the intervention of the regulator, which compelled further disclosures. Therefore, the two cases are not comparable.

2. The contention of the noticee that the information contained in the previous para sufficiently discloses the object and purpose of the acquisition to enable the shareholders of L&T to understand and intelligently appraise the offer is not correct. According to the Enquiry officer, the information is sketchy and slipshod. It does not state anything about the intention of the acquirer on the control aspect. It was only at the intervention of SEBI that a subsequent disclosure was made vide P.A dated 6th March, 2003. In such announcement alone there was a disclosure that the offer was being made pursuant to Regulation 10 read with Regulation 14(1) of the Regulations for the purpose of Substantial Acquisition of Shares without change in control.

The acquirers were progressively increasing their stake after acquiring 10.05% shares from RIL in terms of an agreement dated 18th November 2001 and further acquired 11,121,540 shares thereby increasing their stake to 14.53% of L&T's paid up capital, which is close to the 15% mark that triggers the open offer. The acquirers also made an open offer to acquire 20% shares of the target company with a view to consolidating their shareholding. As per the agreement between the acquirers and sellers, two nominees of the acquirers were to be inducted into the Board of the target company in the vacancies caused by the exit of two nominees of the seller. Further, the seller undertook that they would not be acquiring any shares in the target company atleast for the next 5 years, and that they will arrange to convene a board meeting of the target company. In view of all this as also steep premium that was being paid, the merchant banker should have sought further clarifications and exercised independent professional judgement to ascertain whether the acquirer was in a position to influence the management or indeed acquire control or intends to acquire control of the target company and disclose the relevant information in this regard for the benefit of shareholders of L&T, thereby enabling them to make informed decision with regard to the open offer.

That RIL has no intentions to acquire the shares of L&T for the next 5 years would definitely be a factor that would weigh in the minds of the shareholders of L&T on whether or not to tender the shares in the open offer. The sale agreement is by and between the parties and the contents of the same are not made known to the shareholders of the target company, much less the restrictive covenants as aforesaid. It would have certainly made a difference to the

shareholder's decision on whether or not to participate in the open offer if only they were made aware of the aforesaid important clauses in the said agreement.

The information about exit of the nominees of RIL from the Board of the target company with a further undertaking that neither RIL nor any of its affiliates would acquire any shares in the target company atleast for a period of 5 years would have certainly made a difference to the decision of the shareholders of L&T and their perception with regard to the entry of the acquirers in the place of the sellers and the complete exit of the sellers from the target company.

The merchant banker should have sought further clarification from the acquirers as to whether it was a condition precedent for the acquisition of 10.05% shares by the acquirer that the Reliance's representatives should step down, and that if the acquisition is for strategic investment, why should the acquirers make it a condition that the Reliance Directors should step down in their favour from the target company's Board? How is it possible for the sellers to arrange for convening the Board meeting if they were not in control of the target company or in a position to influence the management? After obtaining these clarifications, the merchant banker should have satisfied himself regarding the objects and purpose of acquisition, and determine the reasons for the premium paid in light of the restrictive covenants in the sale/purchase agreement and made the necessary disclosures in the public announcement.

3. It was contended by the merchant banker that the acquirer is not obliged to disclose the reasons for the premium paid in terms of the said Regulations and it is sufficient if the price at which the shares were acquired by the acquirers in the previous 12 months were disclosed. It was argued that, when it is disclosed in the PA that the acquirers had acquired shares at a price of Rs.306.60 per share from RIL vide agreement dated 18/11/2001, almost a year prior to the public announcement, the Regulatory requirement has been complied with. It was also argued that there was no market practice to disclose the reasons for payment of premium. It was further submitted that block sale of share would always attract a premium than the prevailing market price. It was also pleaded that when the acquirer had acquired shares of L&T from RIL at Rs.306.60 as against the then prevailing market price of Rs.208, the market price was in the public domain and reported in the media. While it may be true that the information about the price was available but what was not disclosed is the reasons for the payment of such high premium, which is material to decision making.

It is difficult to accept the contention that the reasons for the premium paid and the bilateral covenant need not be disclosed. When the sale agreement between the parties contained important provisions as discussed earlier, the merchant banker should have disclosed the restrictive covenants and the reasons as to why a high premium was paid by exercising independent professional judgement in terms of Regulations. More so, when the other shareholders of the target company were being offered a price of only Rs. 190/- which is much less than the price of Rs.306.60/- that the acquirer had paid to acquire the shares from RIL.

It may be significant to note that in the subsequent disclosure made by the acquirer at the instance of SEBI several important reasons were disclosed under the head " Reasons for payment of premium", which are as under :

- The purchase of block equity shares is invariably at a premium to the prevailing market price. In this case, the transaction was for a block purchase of a sizeable equity stake in L&T.
- The negotiated price represented the <u>fair value</u> on the basis of sum of the parts of valuation of the businesses of L&T.
- The sale consideration represented the value for the entire stake of 25,000,000 shares held by seller, which made Grasim the single largest shareholder in L&T next only to the Financial Institutions. This transaction embodies in it the exit of seller as shareholder of L&T.
- The share price prevailing on the stock exchanges at that time, given the depressed market conditions, did not reflect the intrinsic value of the businesses of L&T.
- L&T is the largest cement producer in India besides having leadership position in knowledge intensive Businesses.
- L&T is India' s premier infrastructure Company and is poised to grow as industrial/infrastructure development accelerates in India.

The Noticee had also failed to examine and disclose whether the premium that is being paid is for acquisition of control or not in the light of the restrictive covenants and other factors as discussed earlier.

4. The subsequent disclosures were necessitated in view of the sketchy and slip shod disclosures made by the merchant bankers earlier. It is, therefore, established that non disclosure of material information as discussed above in the PA is in violation of 24(1)(d) and (4) & (5) Regulation r/w Regulation 16(ix) and (xix) of SEBI (SAT) Regulations, 1997. It is also in violation of Rule 4(d) of SEBI (Merchant Banker) Rules 1992 r/w Clauses 1, 2 of the Code of Conduct for the Merchant Bankers, specified in Schedule III r/w Regulation 13 of SEBI (Merchant Regulations) 1992".

FINDINGS:

7) I have carefully analysed the findings of the enquiry officer and the submissions made by JMM in response to the show cause and at the time of hearings before me. I find merit in the findings of the enquiry officer that the merchant banker had not made proper disclosures regarding the objects of the issue in the public announcement dated 13/10/2002. This led to the issue of the subsequent public announcement dated 06/03/2003, that too after the intervention of SEBI, in this regard. The said announcement had come out with a clear disclosure under Regulation 10 read with Regulation 14(1) of the Regulation for the purpose of shares without change in control.

8) It is observed from the show cause notice dated 12th March, 2003 that one of the allegations against the Noticee is that the object and purpose of the acquisition of shares of L&T were not disclosed as per the relevant regulations. The enquiry officer had discussed the responsibility of the merchant banker with regard to the sufficiency or otherwise of the information disclosed according to the said regulation. The fact that the object of the acquisition of shares by Grasim was not for the purpose of acquiring control but only to augment their holdings in L&T, was disclosed only based on the direction from SEBI and not earlier, by the Noticee, which should not have been the situation. For this purpose the Noticee should have exercised due skill considering whether the acquirer was in a position to influence the management or indeed acquired control or intends to acquire control of the target company, which was not done by them. Thus the enquiry officer has not traveled beyond the scope of the show cause notice issued for this purpose and has only explored the role of the Noticee in relation to the disclosure requirement.

9) I also find a submission that since the public announcement was allowed to be made subsequently with changes as suggested, SEBI was estopped from taking any action against the Noticee for non-disclosures in the original announcement. The fact that SEBI had allowed the public announcement to be made with suitable modifications suggested by it does not in any absolve the noticee from the defects that had crept in the original public announcement. The primary consideration is the investors' protection for which purpose the public announcement was required to be made with suitable modifications. This in no way means that the noticee has not committed any violation due to the alleged non-disclosures in the initial public announcement for which they are liable for action.

10) I am in agreement with the finding of the enquiry officer with regard to the disclosure of the reasons for the premium paid in this matter. The information contained in the bi-partite agreement had a bearing on the decision of the shareholders and the general investors. Hence it was insisted by SEBI that the contents of the agreement relating to the premium paid to sellers be published by way of a public announcement dated 06/03/2003. Also, there was lack of clarity regarding the purpose for which the premium was being paid, whether for the purpose of acquiring control or not in the light of the restrictive covenants and other factors contained in the agreement.

11) Also it is noted that there were investor complaints filed regarding the specified open offer based on which an investigation was initiated by SEBI. By a communication dated 08/11/2002, SEBI had prohibited the Acquirer from proceeding further with the open offer formalities pursuant to the public announcement made on 13/10/2002. This communication was challenged before the Securities Appellate Tribunal (hereinafter referred to as SAT) (Appeal No. 109/2002) for being stayed and SAT had observed that:

> "In my view granting an interim order as sought for by the Appellants, in the light of the facts of the case would tantamount to staying an investor protection measure put in operation by the Respondent.
>
> For the reasons stated above I am not inclined to grant interim relief as prayed for by the Appellants."

Further, the defect, if any in the public announcement dated 13/10/2002 was, however rectified according to the directions of SEBI vide revised public announcements issued on 06/03/2003, which was considered and acted upon by the shareholders of the target company. In view of the subsequent public announcement making requisite disclosures, there has been no loss caused to the shareholders or the investors due to the non-disclosure of the specified information in the public announcement dated 13/10/2002. Nonetheless, the merchant banker cannot be fully absolved of its omission in ensuring the requisite disclosures in the public announcement dated 13/10/2002.

12) For the purpose of taking a final view in the matter of awarding penalty, I have also taken note of the case of Chona Financial Services Pvt. Ltd. Vs SEBI – Appeal No. 95/2003 where the penalty of four months suspension was reduced to a warning. In this case, the intermediary was found guilty of delaying payments to clients, dealing with unregistered sub-brokers, delay in issue of contract notes, duplicate contract notes not bearing clients acknowledgement, stamp duty not fixed as per requirement and non-segregation of client and own funds. While deciding the case, the Hon'ble SAT had observed as follows:

"After hearing both the parties, we have to decide on three issues namely whether there were irregularities and if there were irregularities, whether they were merely of technical nature or were serious irregularities. Thirdly, what is the nature of penalty to be imposed. As regards the irregularities, it cannot be treated as a very serious irregularity. Moreover, this was done for the first time. It cannot also be said that the nature of punishment should be harsh that the appellant would have to cease working for a period of four months. The consequences are far reaching not only to the appellant but also to his clients and the employees."

"Taking into account more or less similar cases, where SEBI rightly issued a warning rather than close the business, we feel it appropriate to modify the penalty from four months to a warning to the appellant. In that view of the matter the impugned order is modified accordingly. No order as to costs."

13) In Appeal No. 52/2002 – SATCO Securities and Financial Services Ltd. Vs SEBI, the Securities Appellate Tribunal had set aside the order of SEBI suspending the certificate of registration of the Appellant for a period of seven days. In this case, the Enquiry Officer had in his report observed as under:

"Satco has taken the prescribed client registration application form and also executed member client agreement with Shri Rahul Bajaj. However, it has been observed from the client registration form that the details at columns pertaining to annual income and market value of portfolio have not been indicated by the client. Satco should have insisted for the said details, otherwise client registration becomes only a formality rather than an exercise of due skill and care in introducing a client to the market."

In response to the above, the SAT has observed as follows:

"In the circumstances of the case, in my view omission to fill up few columns in the client registration form remains a pure technical lapse and it cannot be considered as a major failure to exercise due skill and care to warrant penalty of suspension of certificate of registration."

14) Also, an appeal (No. 39/2002) was filed against the Adjudication order passed by SEBI imposing a penalty of Rs. 4,75,000 on Reliance Industries Limited (RIL) for non-disclosure of acquisition in excess of 5% prescribed under the Takeover Regulations, prior to the sale of shares to Grasim Industries Limited (GIL) under the agreement as discussed earlier. SAT has set aside the adjudication order and observed as follows:

"The appellant can, at best, be held to have made a technical lapse. In such circumstances, the role of a regulator is to rehabilitate and bring to an end litigation, which may not cast a stigma on the appellant, who otherwise, admittedly, has maintained a good track record. The High Court in Cabot's case has pronounced that if a breach was merely technical and unintentional, it does not merit penal consequence. It ultimately depends on the facts of each case. In this case, the breach was *bona fide* and the appellant was under the impression since it had already made a disclosure earlier it was not necessary to make a fresh disclosure once again. This, in our view, is an error of judgment and, at best, an error of understanding the law. Ignorance of law is no excuse but an erroneous interpretation is a mitigating factor especially if such interpretation is honest and *bona fide* to the knowledge of the appellant. Following the judgment in Cabot International and for the reasons stated herein, we hold that the breach cannot be called as deliberate and the non-disclosure was due to lack of understanding of the law. In that view of the matter, the impugned order is set aside."

15) In the present case, non-disclosure in the public announcement is merely in the nature of a technical lapse as the investors interest has been protected by subsequent announcement which provided them an opportunity to take an informed decision about the proposed offer.

16) In view of the fact that no loss has been caused to the shareholders or investors and that the acquirers in the related proceedings pertaining to the present matter have not been found guilty on any count, I think it would not be prudent to levy a major penalty of four months on the merchant banker, as recommended by the enquiry officer in his report. This penalty, if levied, in no way would advance the twin objects of investor protection and promotion and development of the securities market as envisaged by the SEBI Act.

ORDER:

17) Accordingly, in view of the facts and circumstances of the case, I have thought it fit to reduce the penalty as proposed by the enquiry officer and accordingly, I find that a censure would be adequate.

18) Therefore, in exercise of the powers conferred upon me by virtue of section 4(3) of the Securities and Exchange Board of India Act, 1992 read with regulation 13(4) of the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby censure M/s JM Morgan Stanley Private Limited.

G. N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA

Place : Mumbai

Date : 18/2/2005