

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA**CORAM: Dr. T.C.NAIR, WHOLE TIME MEMBER
IN THE MATTER HFCL INFOTEL LIMITED**

Date of hearing: November 27, 2006

Appearances

For Noticees : Shri Someshekar Sundaresan, Advocate

Shri Vinay Chauhan, Advocate

Shri Surendra Lunia, Chief Executive Officer, HFCL Infotel Limited
Shri Vikash Agrawal, Head Corporate Finance, HFCL Infotel Limited

For SEBI : Shri P.K. Nagpal, Chief General Manager

Shri Praveen Trivedi, Deputy Legal Advisor

Shri Ansuman Dev Pradhan, Manager

Ms. Kshama Chavan, Legal Officer

ORDER**UNDER SECTION 11A OF THE SEBI ACT, 1992****1.0 Background**

- 1.1 HFCL Infotel Limited (hereinafter referred to as "HIL") is promoted by Himachal Futuristic Communications Limited (hereinafter referred to as "HFCL"). During the financial year 2002-2003, pursuant to a scheme of amalgamation approved by the Hon'ble Court of Punjab and Haryana at Chandigarh and the Hon'ble Court of the Judicature at Madras, HFCL Infotel Limited, an unlisted company, had amalgamated with Investment Trust of India Limited (hereinafter referred to as "ITIL"), a company listed on the Bombay Stock Exchange Limited (hereinafter referred to as "BSE"), Madras Stock Exchange (hereinafter referred to as "MSE") and Calcutta Stock Exchange (hereinafter referred to as "CSE"). ITIL thereafter had changed its name to HFCL Infotel Limited and continued the business of the erstwhile HIL.
- 1.2 The Securities and Exchange Board of India (hereinafter referred to as "SEBI") had conducted investigations into the buying selling and dealing in the shares of HFCL for the period from October 01, 1999 to March 31, 2001. Investigations inter alia revealed that during the said period, HFCL, promoters and subsidiaries of HFCL Group had provided funds and HFCL shares to the entities connected with Shri Ketan Parekh (hereinafter referred to as KP entities) and thereby aided and abetted the KP entities in price manipulation in the scrip of HFCL thereby violating the provisions of Regulation 4 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 (hereinafter referred to as "PFUTP Regulations"). In view of the findings of the investigations, a show cause notice dated August 30, 2004 under section 11 B of the SEBI Act, 1992 was issued to the promoters / associates of HFCL including HIL asking them to show cause as to why suitable directions under Regulation 11 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 read with section 11 (4) (b) & 11B of SEBI Act and including a direction restraining them from accessing the capital market / buying selling or dealing in securities for a particular duration should not be passed.
- 1.3 During the pendency of the 11B proceedings, HIL filed a draft Offer for Sale document with SEBI through its lead manager, KJMC Global Market (India) Limited on December 23, 2005. SEBI, vide letter dated June 13, 2006, informed HIL that the draft Offer for Sale document shall be examined in the light of the investigation conducted by SEBI into the alleged violation of PFUTP Regulations by the promoters, associates and subsidiaries of HFCL, including HIL.
- 1.4 Pursuant to the show cause notice under section 11B of the SEBI Act, 1992, HIL appeared for personal hearing before the Whole Time Member on September 11, 2006 and filed its reply dated September 29, 2006 to the aforesaid show cause

notice.

- 1.5 In the meanwhile, HFCL filed a writ petition before the Hon'ble High Court of Delhi questioning the jurisdiction of SEBI in the proceedings initiated against them under section 11B of the SEBI Act.

2.0 Show Cause Notice

- 2.1 SEBI issued a show cause notice dated February 20, 2007 to HIL in terms of the General Order no. 1 of 2006, viz., SEBI (Issuing Observations on Draft Offer Documents Pending Regulatory Actions) Order, 2006, dated December 8, 2006 under Section 11A of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the "SEBI Act, 1992"), advising HIL to show cause within 7 days from the date of the notice as to why an order withholding communication of observations of SEBI on their draft offer document till March 28, 2007 or any further date or till the matter is disposed of by the Hon'ble Court should not be passed.

3.0 Personal Hearing and Reply

- 3.1 An opportunity of personal hearing was granted to HIL on February 27, 2007, in terms of the General Order No. 1 of 2006, wherein the persons mentioned on the first page of this Order appeared before me and made submissions.
- 3.2 HIL inter alia made written submissions to SEBI vide letter dated March 1, 2007 as under :
- (i) HIL's case is a standalone case and it cannot be linked with other Notices. The allegations against HIL can easily be severed from the allegations leveled against other Noticees. The transaction of loan of Rs.65 crore given by it to Goldfish Computers Pvt. Limited can be severed from the transactions of other Noticees and an independent view can be taken based on HIL's reply dated September 11, 2006 and written submissions dated September 29, 2006. HIL further stated that the said transaction pertains to loan given by HIL to Goldfish for acquisition of stake in DSQ Software Limited (DSQ) and for no other purpose. Based on the feedback received from Ernst & Young, not to invest in the shares of DSQ, HIL received the money back within three weeks with interest from Goldfish.*
- (ii) Further HIL submitted that the proposed offer for sale is not aimed at tapping the funds from the market. The same is being made pursuant to and in compliance with the directions of BSE so as to increase the non – promoter holding in HIL, to get the shares listed.*

4.0 Consideration of issues

- 4.1 I have carefully considered the show cause notices dated August 30, 2004 and February 20, 2007 and replies of HIL. My findings are as under:
- 4.2 I have noted that SEBI had conducted an investigation into the buying, selling and dealing in the shares of HFCL for the period from October 01, 1999 to March 31, 2001 (relevant period) during which price of the scrip opened at Rs.250.35 on October 1, 1999 and rose at a level of Rs.2415 on March 7, 2000 and registered a sharp decline on March 13, 2001 touching a low of Rs.230.75.
- 4.3 It is alleged in the show cause notice dated August 30, 2004 that during the relevant period, promoters and subsidiaries of HFCL had provided funds as well as shares of HFCL to entities connected with Shri Ketan Parekh (hereinafter referred to as "KP entities"). Such transfer of funds and shares of HFCL had taken place during the period when price of HFCL was on a declining trend.
- 4.4 Further HFCL and its promoters / subsidiary viz., HFCL Infotel Ltd and Burlington Finance Ltd had given an amount of Rs.736.28 crore to various Ketan Parekh entities (KP entities, viz., Classic Credit Limited, Panther Fincap & Management Services Limited, Chitrakut Computers Pvt. Ltd. Goldfish Computers Pvt. Ltd. Triumph International Finance India Limited and Nakshatra Software Pvt. Limited.) during the period March 23, 2000 to March 29 2001. Out of Rs.736.28 crores, Ketan

Parekh returned Rs.288 crore to HFCL thereby resulting in funding of a net amount of Rs.448.28 crore by HFCL group to Ketan Parekh entities. HFCL Infotel gave Rs.65 crore to Goldfish computers, a KP entity in July 2000 and received back the same in August 2000.

- 4.5 It is further alleged that KP entities had cornered a substantial quantity of stock of HFCL and created large concentrated position through a number of brokers across the exchanges. The funds received by KP entities from the HFCL group were ultimately utilised:
- (a) to meet the settlement obligations of broking entities controlled and managed by Shri Ketan Parekh;
 - (b) to make payments to various stock brokers with whom KP entities had maintained client accounts; and
 - (c) to make payments to banks.
- 4.6 Not only the funds, it is alleged that the promoters of HFCL had provided 82 lakh HFCL shares with a market value of Rs.931 crore to KP entities viz., Classic Credit Limited and Panther Fincap & Management Services Ltd. during the period January 27, 2000 to January 15, 2001 without any collateral. This was stated to be done for placement of shares to strategic investors at price not less than Rs.1650/- per share.
- 4.7 In this regard, I also note that the shares given by promoters of HFCL to Ketan Parekh entities were utilized for creation of artificial markets/manipulation in the scrip of HFCL and for raising finance which were in abuse of settlement mechanism of the exchange.
- 4.8 I further note that Promoter entities were also found to have sold a net of 20.88 lakh shares of HFCL (purchase of 2.48 lakh shares and sale of 23.36 shares with a net consideration of 271 crore) in the market during the period July 2000 to March 2001 when the promoters were transferring funds and shares to KP. This prima facie shows that they were interested in holding the prices of HFCL from declining with a view to maximizing their realization from the sale of stake in HFCL.
- 4.9 I have noted the submission made by HIL that the allegations against HIL can easily be severed from the allegations leveled against other Noticees mentioned in the show cause notice dated August 30, 2004 issued under Section 11B of the SEBI Act, 1992. I find that HFCL is the promoter of HIL, having a stake of 61.98% as per the shareholding pattern as on December 2006. Further, there are common directors namely Shri Vinay Maloo, Chairman and Shri Mahendra Nahata, Whole Time Director amongst HFCL and HIL. I am of the view that the "offer for sale" proposed to be made by HIL is essentially an offer for sale of shares held by the promoter of HIL, viz., HFCL. As may be determined from the major stake of HFCL in HIL, the proposed off loading of stake of promoter holding in HIL will be directly beneficial to HFCL. On the other hand, none of the issue proceeds will be received by HIL.
- 4.10 Taking into account the facts and circumstances of the case and the proceedings pending under Section 11B of the SEBI Act, 1992 against several entities of the HFCL Group including HIL for alleged violation of PFUTP Regulations for having aided and assisted KP entities in creating artificial market and thereby indulging in market manipulations, I am of the view that it may not be possible to sever the case of HIL from that of HFCL Group and deal with it separately. I am of the view that the ultimate beneficiary for this proposed offer for sale of 80 lac shares of HFCL will be the promoter of HIL i.e. HFCL. I find that any directions subsequent to the proceedings under 11B of the SEBI Act including a direction restraining HFCL / promoters and subsidiaries including HIL from accessing capital market will affect the interest of the investors who will be subscribing to the proposed offer for sale by HIL. In the interest of investors, I find that it may not be proper to issue observations on the draft offer for sale document of HIL, till the proceedings under section 11B are disposed of.
- 4.11 I further note that pursuant to the show cause notices dated August 30, 2004 and September 17, 2004 issued to directors, promoters and associates of HFCL, several opportunities of personal hearing were granted to HFCL before me. However HFCL has been raising the question of jurisdiction of SEBI in the proceedings initiated under section 11B and have approached division bench of the Hon'ble High Court of Delhi. As per the oral observations of the Division bench of the Hon'ble High Court hearing the matter, further hearing in the matter of HFCL by SEBI has been kept in abeyance till the completion of the High Court proceedings.

- 4.12 I note that though HIL is not a party before the Hon'ble Delhi High Court. However, in view of the complex and intermingled facts of the case which led to the issuance of the common show cause notices to all the group entities of HFCL including those who have approached the Hon'ble Delhi High Court and during the pendency of the matter in the Hon'ble Court, it is not appropriate to pass an order under 11B only in case of HIL while keeping the proceedings in other inter related matters in abeyance in terms of the Hon'ble Court directions.

5.0 Order

- 5.1 In view of the above and in exercise of the powers conferred upon me under Sections 19, read with 11A of the Securities and Exchange Board of India Act, 1992, I do hereby direct that communication of observations on the draft offer for sale document filed by HFCL Infotel Limited be withheld till the proceedings under Section 11 B of the SEBI Act are disposed of.
- 5.2 It is clarified that this order is passed for a limited purpose of dealing with the offer for sale document filed by HFCL Infotel Limited and the same shall not in any way influence the proceedings pending under Section 11B of the SEBI Act, 1992.
- 5.3 This order shall come into force with immediate effect.

Place: Mumbai
Date: 7.03.2007

T.C. Nair
Whole Time Member
Securities and Exchange Board of India