BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. EAD-12/ AO/SM/156-160 /2017-18]

UNDER SECTION 19H OF THE DEPOSITORIES ACT, 1996 READ WITH RULE 5 OF THE DEPOSITORIES (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES BY ADJUDICATING OFFICER) RULES, 2005

In respect of:

Kotak Mahindra Prime Ltd.
Sharad Shah
Sharad Shah HUF
Trupti Sharad Shah
Astral Securities

In the matter of Tata Coffee Limited

FACTS OF THE CASE IN BRIEF

1. Securities and Exchange Board of India (hereinafter referred to as 'SEBI'), pursuant to examination of the scrip of Tata Coffee Limited (hereinafter referred to as "TCL/ company") had observed that Kotak Mahindra Prime Limited (hereinafter referred to as "Noticee 1"), Sharad Shah (hereinafter referred to as "Noticee 2"), Sharad Shah HUF (hereinafter referred to as "Noticee 3"), Trupti Sharad Shah (hereinafter referred to as "Noticee 4") and Astral Securities (hereinafter referred to as "Noticee 5") have violated section 12 of Depositories Act, 1996 (hereinafter referred to as "Depositories Act") and regulation 58 of SEBI (Depositories and Participants) Regulations, 1996 (hereinafter referred to as "DP Regulations").

2. It was alleged that In order to leverage their holdings in TCL, Noticees 2 to 5 pledged their holdings to Noticee 1 as margin for loans. However, they failed to get the previous approval of the depository creating the pledge and also all the Noticees failed to bring the pledge of shares to the notice of the depository and thereby they failed to comply with the manner of creating pledge as per law.

APPOINTMENT OF ADJUDICATING OFFICER

3. Vide an order of the Competent Authority, SEBI, dated March 23, 2016, Mr. D Sura Reddy was appointed as the Adjudicating Officer under section 19 of the SEBI Act read with section 19H of the Depositories Act and rule 5 of the Depositories (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 2005 (hereinafter referred to as 'Rules') to inquire into and adjudge the alleged violations of provisions of Depositories Act and DP Regulations. Pursuant to the transfer of the case, the undersigned has been appointed as the Adjudicating Officer in the matter.

SHOW CAUSE NOTICE, REPLY AND HEARING

4. Based on the findings by SEBI, Show Cause Notice/s dated June 21, 2016 (hereinafter referred to as 'SCN') was issued to the Noticees under Rule 4(1) of Rules to show cause as to why an inquiry should not be held and penalty should not be imposed on them under Section 19G of the Depositories Act for the alleged violations.

5. The charges in the SCN broadly are as follows:
   a. Noticees 2, 3, 4 and Noticee 5 (wherein Noticees 2 and 3 are directors), had availed a loan facility against shares ("LAS") of TCL. The Clients had provided Noticee 1 collaterals in the form of securities and property.
   b. As part of the collateral for the LAS, the clients had pledged about 10,00,000 shares of TCL as margin. These shares of TCL constituted about 85% of the total margin towards the LAS ("Margin").
   c. Noticee 1 sold more than 8,00,000 shares of TCL i.e. more than 5% of TCL's shareholding on June 13, 2013. Noticee 2 sold approximately 3.75 lakh shares of TCL while Noticee 4 sold about 32,000 share of TCL on June 12, 2013. The trading by Noticee 1 in the scrip of TCL was investigated and Noticee 1 had provided SEBI with the reasons for executing the trades.

d. The Clients are alleged to have failed to get the previous approval of the depository creating the pledge.

e. Therefore all the Noticees failed to bring the pledge of shares to the notice of the depository.

f. The Noticees are alleged to have failed to comply with the manner of creating pledge as per law.

6. Noticee 1, vide letter dated December 7, 2017 gave the following reply:

a. A record of pledge in the books of the depository is not a mandatory requirement under the DP Act or the Regulations made therein.

b. Section I2 and Regulation 58A only contains a mechanism and guideline to be followed by the pledger (the Clients in the present case) and not by the lender or pledgee.

c. Should the beneficial owner, being the pledger decides to record the pledge in the register of the depository the mandatory requirements of Section 12 and Regulation 58A shall be attracted and there is no other manner of creation of pledge under the Depositories Act. The words "may" in Section 12 (I) clarifies this position as contrasted with the word "shall" in Section 12(2) of the Act.

d. Regulation 58 (II) makes it mandatory on the part of the depository to not effect the sale of shares which are recorded as pledged shares by the pledger without the consent of the pledgee . This clarifies that the intent of following the mechanism under Regulation 58 is to ensure protection to the pledgee.

e. Regulation 58 (8) makes it clear that the mode of invocation of pledge too could be made subject to the pledge document and does not override the arrangement between the parties which are recorded in the pledge document.

f As envisaged in Section 28 of the Depositories Act, the provisions of the Act shall not be in derogation of any other law in India relating to holding and transfer of securities. Accordingly, the provisions of the Contract Act, 1872 governing the pledge of securities is equally applicable in the present case and there cannot be any exclusivity over the pledge arrangement by the Depositories Act.

g. There is no mandatory requirement provided under law where the borrower is required to compulsorily record the creation of interest on security under the Depositories Act and that is not even the case of SEBI as seen from the Show Cause Notice.

h. While Regulation 58 only provides for a mechanism of creating the pledge, should the beneficial owner decided to opt for such, the provision singularly fails to make it mandatory on the part of the beneficial owner to follow Regulation 58 except for using the same as an evidence of creation of pledge.

i. We have made the required disclosures that the shares were held in our name as margin and there was no reason for us to not follow the guidelines in Regulation 58.

j. The Loan Documents contained various security measures and even without the pledge of shares, the securities of the Clients could have been easily sold by us. The Agreements contained several protective provisions which provided appropriate protection to us in terms of recovery of loss from the Clients which we could have done without any intimation to anyone. Therefore there cannot be any insinuation attributed to us merely because the Clients as beneficial owner did not comply with the non-mandatory provisions of the Depositories Act.

k The security interest was created in compliance with the conditions stipulated in the loan agreement and also with the bonafide intention to protect the interest of the lender. There was no conscious or malafide intention to not follow any provisions/ procedure in the Act or the Regulations.

l Finally in a recent identical situation (Balarshi's Case), another adjudicating officer of SEBI has not levied any penalty assigning the reason that the violation of procedure to create Pledge and DePledge of shares as laid down in the Depositories Act and DP Regulations are technical in nature.

7. Noticees 2, 3, 4 and 5, vide letter/s dated December 21, 2016 made similar submissions, stating, inter alia, the following:

- *We are investors and we have been trading in the securities market in various scrips through various brokers in the ordinary course for a considerable period of time. Till date we have never defaulted in meeting our payment or delivery obligations on any occasion. For the purpose of trading, we have been dealing through various stock brokers including KSL.*
- *During the course of our trading, sometime in August 2009 we had decided to raise loan from KMPL - an NBFC and sister concern of KSL. Accordingly, during the course of discussions with KMPL with regard to loan, various terms and conditions were set by them which inter alia included:*
  - *i. That KMPL shall provide a financial facility package to us for which requisite documents as per the norms and standards of KMPL were executed.*
  - *ii. That we shall provide collateral securities as security margin for the financial facility so availed.*
  - *iii. That KMPL should be provided with POA inter alia for the purporse of transfer of securities etc.*
- *Post the discussions with KMPL, we had executed following agreements/documents with KMPL as per their requirement viz. Master Loan Agreement, Pledge Agreement & Power of Attorney.*
- *The execution of various documents viz. Master Loan Agreement, Pledge Agreement, Power of Attorney for the demat account was followed as per the advise/instructions of KMPL and we merely entered into such an arrangement in good faith. We submit that the whole transaction as entered into with KMPL was bonafide with no ulterior motives.*
- *From the bare perusal of the arrangement, it can noticed that that the said arrangement provided execution of various documents as KMPL envisaged a financial facility package wherein KMPL had various options/choices in order to secure its loan and ensure repayment in case of default in whatever manner deemed fit.*
- *Post the said loan arrangement in 2009, we have never defaulted in any monthly*

instalment payments due towards the borrowing from KMPL. The margin was also diligently maintained between 30% and 15%, as advised by KMPL.

- *On June 12, 2013, despite the fact that the requisite margins were adequately maintained, KMPL sold the shares at a very low price so as to ensure that they recover the full margin levels. KMPL did not wait and sold our shares, resulting in further selling pressure in the stock and reducing the value of shares , leading to a cascading effect of the margin being eroded due to falling of the share price. It is submitted that we have no role whatsoever in these scheme of events from June 11-13, 2013. Here, we are the victim of the said transactions, wherein KMPL mercilessly liquidated our shares, without giving us sufficient time to restore the levels of margin, to our utter detriment and financial loss.*
- *It may be noted that though the pledge agreement was executed between the parties, but the same was never acted upon by the Lender i.e. KMPL. At no point of time KMPL insisted on us to create pledge in its favour or KMPL itself, on the strenght of POA, created pledge in its favour. Instead, KMPL resorted to the option to transfer the securities to its own name and account as enshrined in Clause 3.4 (b) of the Master Loan Agreement (reproduced before) . The aforesaid has also been confirmed by KMPL to SEBI vide its letter dated October 9, 2013 {at Para 3(xv) of the letter}, which has been made available to us by SEBI during the inspection.*
- *It may be noted that, taking the shares by way of margin by a Lender and transferring the shares to a separate dedicated account maintained by the Lender for the purpose, is a well recognised and accepted market practice. Such transfer creates encumbrance in favour of the Lender, but not pledge. Merely because, the Pledge Agreement was entered into between the parties, which was never acted upon by the Lender, the transfer of securities from borrowers account to the lenders account cannot be termed as p l e d g e . Further, since the Lender chose to exercise the other option (i.e. of transferring the securities to its own name and account), it cannot be alleged that parties have failed to create pledge in consonance with the applicable provisions. Furthermore, the parties cannot be forced to act upon the Pledge Agreement when KMPL, as Lender, had many options at its disposal, which it exercised.*
- *We state that, it is only when the pledge is created, the requisite formalities under the Depositories Act and DP Regulations are required to be followed .Since in the matter under reference, the Pledge Agreement executed between the parties was not acted upon and thus no pledge was created, the issue of violating the provisions of the Depositories Act and DP Regulations cannot and does not arise.*
- *It may also be appreciated that at no point we have portrayed or projected or disclosed to anybody (including shareholders, investors, stock exchanges etc) that the said transactions (involving transfer of shares to KMPL) were in the nature of pledge transactions. Further, it is not our case that the transactions under reference were pledge transactions. Therefore, if the transact ions under reference were not pledge transactions, then we cannot be saddled with the liability of creating a pledge and meeting the concomitant requirements for creating a pledge. We reiterate that the Lender had, in terms of various documents executed between the parties for the purpose of loan, multiple options in order to secure its loan. The Lender in the instant case has chosen to exercise the option (which was other than the option of pledge creation in its favour) for securing the loan i.e. by*

taking margin by transferring the securities to its own name and account. Surely, choice option to be exercised, in a given case, cannot be thrusted on the Lender by anybody including the Borrower. It is solely the Lenders prerogative.

- *Since the occasion for actual enforcing of Pledge Agreement (though executed) did not arise in the instant case, as the Lender chose other option available at his disposal, the pledge was never created. As a borrower, we had no control as to which option the lender would take recourse to within the parameters of the agreements. It is reiterated that the pledge was never created in the first place. Therefore, we cannot be alleged to have violated the provisions of Regulation 58 of DP Regulations or Section 12 of the Depositories Act, pertaining to creation of pledge and the process to be followed thereof.*

8. In order to comply with the principles of natural justice an opportunity of personal hearing was given to the Noticees on December 13, 2017 vide notice dated November 21, 2017. The authorised representative appeared on behalf of Noticee 2, 3, 4 and 5 appeared and reiterated the submissions already made. The authorised representative of Noticee 1 appeared and made further submissions vide letter dated December 28, 2017.

    - *The shares in question were taken as margin for disbursal of a loan against shares by KMPL. There was a disclosure made in this regard to the stock exchanges by KMPL which was tendered at the hearing and a copy of which is annexed as Annexure 1 hereto. It is submitted therefore that there was no mala fide intention on part of KMPL in the transaction in question and the same was to the knowledge of the market in general. Further it was done in the normal course of business and as per the prevalent market practice. This only demonstrates the bonafides of the Noticee in complying with all the required obligations on the part of the Noticee.*
    - *The shares in question were therefore taken into the demat account ofKMPL as security against the loan granted to the Clients. This was as per the loan facility agreements, copies of which were provided at the time of the hearing. Such an arrangement is not in violation of any provision of law as there is no provision that does not allow such a contractual arrangement. In any event, SEBI's circular dated August 17, 2010 ("SEBI Circular") also provided that:*

"...Section 12 of the Depositories Act and Regulation 58 of the SEBI (Depositories and Participants) Regulations, 1996 along with the relevant Bye Laws of the Depositories clearly enumerate the manner of creating pledge. It is felt that there is need to communicate to the BOs that any procedure followed other than as specified under the aforesaid provisions of law shall not be treated as pledge.

- *The provisions of Section 12 and Regulation 58 require making of a pledge in the event that the shares lie in the account of the pledgor to earmark the same for the*

purpose of the pledge. In the event that such procedure is not followed, the pledgee cannot enforce its contractual right to have the shares transferred in the event that the pledge is invoked. Even the language of the provisions are clear in this regard where separate connotations of "may" and "shall" are used as explained in detail in the Reply.

- *The SEBI Circular too only clarifies the position which is mentioned under Section 12 and Regulation 58. This allows the depositories system to ensure transfer of shares at the time of invocation. The depositories system is also made aware of the encumbrance of the shares in such a case. The SEBI Circular states that in such an event, not following the procedure under Section 12 and Regulation 58 would mean that the transaction would not be treated as a pledge. In case of an arrangement such as the present, in case the shares are transferred to the account of the lender, the same cannot mean that the process under Section 12 and Regulation 58 is required to be followed. The arrangement carried out in the present case is only an alternative method of taking margin which does not require the marking of a pledge in the depositories system. The decision of the Hon'ble ITAT in Mukesh Ambani's Case also supports this position.*
- *In other words, the facility of invocation available to the pledgee would not be available in the event that this process is not followed. This does not mean that the marking of the pledge is the only manner of creating a security interest or encumbrance in the shares. There were similar cases before the Hon'ble Securities Appellate Tribunal whereby even in the absence of the procedure under Section 12, the pledge arrangement was recognized and the Hon'ble Tribunal permitted the sale of shares by the lender to recover the funds paid to the borrower who was the beneficial owner of the shares at the time of sale. It cannot be anybody's case that pledge is the only mar111er in which the security interest can be created. If that is the position SEBI wishes to take, then it would be deviating from the practice followed and recognized by SEBI under extant rules/regulations/circulars/FAQ.*
- *In any event, assuming whilst denying that the arrangement was not a pledge, it is submitted that it was not possible for marking a pledge in the depositories system. The shares in question were lying in KMPL's account pursuant to a valid contractual arrangement. There was no question of marking a pledge thereon as the depositories system requires the marking of a pledge only in the event that the shares are in the account of the pledgor and such an option is on the beneficial owner. In no way could the Noticee initiated the creation of pledge, even if the Noticee had intention to create the pledge. The Noticee was covered with the security interest and such commercial decision cannot be subject matter of a regulatory intervention by SEBI, which the learned Officer is requested to take note of.*

CONSIDERATION OF ISSUES AND EVIDENCE

9. I have carefully perused the charges levelled against the Noticees in the SCN, their replies and the material / documents available on record. In the instant matter, the following issues arise for consideration and determination:-

   (a) Whether the Noticees 1 and 2 have violated section 12 of the Depositories Act and regulation 58 of DP Regulations?
   (b) Do the violations, if any, on the part of the Noticees attract monetary penalty under section 19G of the Depositories Act for the alleged violation?; and,
   (c) If so, what would be the quantum of monetary penalty that can be imposed on the Noticee after taking into consideration the factors mentioned in section 19I of the Depositories Act?

10. Before proceeding further, I would like to refer to the relevant provisions of the DP Regulations and the Depositories Act:

Relevant provisions of DP Regulations:

58 - Manner of creating pledge or hypothecation..

(1). If a beneficial owner intends to create a pledge on a security owned by him he shall make an application to the depository through the participant who has his account in respect of such securities.

(2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.

(3) The depository after confirmation from the pledgee that the securities are available for pledge with the pledger shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the participants of the pledger and the pledgee.

(4) On receipt of the intimation under sub-regulation (3) the participants of both the pledger and the pledgee shall inform the pledger and the pledgee respectively of the entry of creation of the pledge.

(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.

(6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if pledger or the pledgee makes an application to the depository through its participant: Provided that no entry of pledge shall be cancelled by the depository without prior concurrence of the pledgee.

(7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledger.

(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.

(9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledger and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledger and pledgee respectively.

(10)(a) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).

(b) The provisions of sub-regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation: Provided that the depository before registering the hypothecatee as a beneficial owner shall obtain the prior concurrence of the hypothecator.

(11) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a participant without the concurrence of the pledgee or the hypothecatee, as the case may be.

Relevant provisions of the Depositories Act:

12 ***- Pledge or hypothecation of securities held in a depository-***

(1) Subject to such regulations and bye-laws, as may be made in this behalf, a beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository.

(2) Every beneficial owner shall give intimation of such pledge or hypothecation to the depository and such depository shall thereupon make entries in its records accordingly.

(3) Any entry in the records of a depository under sub-section (2) shall be evidence of a pledge or hypothecation.

19G. Penalty for contravention where no separate penalty has been provided-

Whoever fails to comply with any provision of this Act, the rules or the regulations or bye-laws made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

11. I note from the documents on record that Noticees 2 to 5 had transferred 10,00,000 shares of TCL as margin to Noticee 1 and availed a loan from it. All the Noticees have submitted that the shares which were provided to Noticee 1 was in the form of Loan against Shares (LAS) and not pledge. Noticees 2 to 5 have further submitted that Noticee 1 resorted to the option to transfer the securities to its own name account as enshrined in clause 3.4(b) of the Master Loan Agreement which reads as follows:

"The Lender may, at its discretion, hold the security in its own name and account or in the name and account of the security provider and may whenever it deems necessary require the security provider to transfer the securities in the name and account. The lender shall, at any time during the tenure of the agreement, be entitled to transfer the security in its own name and account."

12. In the present case, the shares in question were transferred to the DP account of the lender, i.e. Noticee 1. Taking the shares by way of margin by a lender and transferring the shares to separate dedicated account maintained by the lender for the purpose is apparently a well-recognized and accepted market practice. Such transfer creates encumbrance in favour of the lender but not pledge. This also gets validated by the Circular of RBI (RBI/2014-15/186 dated August 21, 2014) which clearly states that Non-Banking Financial Companies (NBFCs) can lend against shares either by way of pledge of shares in their favour, transfer of shares or by obtaining a power of attorney on the demat accounts of borrowers. The circumstances in the present case clearly signifies that there was a transfer of shares and no pledge was created.

13. I also note that in regulation 29(4) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter referred to as "SAST, 2011") it is clarified that shares taken by way of encumbrance shall be treated as acquisition, shares given upon release of encumbrance shall be treated as disposal and disclosure shall be made by such person accordingly in such form as may be specified. Therefore in compliance of said Regulation, Notice 1 has considered shares transferred by other Noticees to it as acquisition of shares and resultantly made disclosure as per SAST, 2011.

14. I also note that SEBI vide its Circular dated August 05, 2015 (while enumerating the formats for the reports/disclosures to be filed under the SAST 2011 Regulations) has recognised Non Disposable Undertaking (NDU) as a type of encumbrance and directed promoters of the companies to include NDU as an encumbrance and mandated disclosure as per Regulation 31 of SAST, 2011. The above action of SEBI denotes that SEBI acknowledges that there are various ways of creating encumbrance on shares.

15. I also note that SEBI vide its letter dated August 17, 2010 to Depositories (subsequently included in the Master Circular dated Dec 15,2016) has inter alia clarified that

    a. Any procedure followed other than as specified under the provision of law shall not be treated as pledge.
    b. An off market transfer of shares leads to change in ownership and cannot be treated as pledge.

16. From the above clarification, I understand that there is a clear demarcation between giving shares for loan purpose by way of transfer of shares and by way of pledging of shares.

17. Moreover, on a plain reading of section 12(1) of the Depositories Act, "…a beneficial owner **may** with the previous approval of the depository…" and regulation 58(1) of the DP Regulations "If a beneficial owner **intends to create a pledge** on a security owned by him…", it can be construed that the requirement to create a pledge is optional upon the pledger but not a mandatory requirement. The wordings of the Depositories Act and DP Regulations indicate that there is no compulsion to create interest on the security in the manner prescribed.

18. Hence, the Noticees were not under any obligation to comply with the procedure laid down in the Depositories Act and DP Regulations.

ORDER

19. Having considered the facts and circumstances of the case, the material available on record, the submissions made by the Noticees, I, in exercise of the powers conferred upon me under section 19H of the Depositories Act read with Rule 5 of the Rules, hereby dispose of the SCN.

20. In terms of the provisions of Rule 6 of the Securities and Exchange Board of India (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules 1995, a copy of this order is being sent to the Noticees.

Date : January 23, 2018 **SAHIL MALIK**
Place : Mumbai **ADJUDICATING OFFICER**