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SAT REVERSES SEBI ORDER AGAINST ENAM

INTRODUCTION

The Securities Appellate Tribunal (“**SAT**”) in its recent ruling in the matter of Enam Securities Private Limited¹ v. the Securities and Exchange Board of India (“**SEBI**”) has set aside² the order dated December 31, 2010 passed by the Adjudicating Officer of SEBI (“**SEBI Order**”)³ vide which a penalty of INR 2.5 million was imposed on Enam Securities Private Limited (“**Enam**”) for violation of Regulation 13 of SEBI (Merchant Bankers) Regulations, 1992 read alongwith relevant provisions of the erstwhile SEBI (Disclosure and Investor Protection) Guidelines, 2000 (“**DIP Guidelines**”).

FACTS

An appeal challenging the SEBI Order was filed before the SAT, by Enam and consequently the following observations made under the SEBI Order were examined by and challenged before the SAT:

1. That Enam had failed to exercise due diligence while making certain disclosures in relation to Rabobank International Holding B.V. (“**Rabobank**”), and failure to mention Rabobank as a promoter of Yes Bank Limited (“**Yes Bank**”) in the prospectus for the Initial Public Offer (“**IPO**”) of Yes Bank.
2. That Enam had failed to make disclosures pertaining to the allocation of shares to qualified institutional buyers (“**QIB**”) and preferential treatment was conferred to certain foreign institutional investors.
3. That Enam had failed to suitably monitor the flow of applications and other matters connected to the closure of the public issue of Yes Bank.

After considering the contentions raised on behalf of both the parties and the specific roles and responsibilities of a merchant banker as stipulated under the SEBI (Merchant Bankers) Regulations, 1992, SAT decided to set aside the SEBI Order on the following grounds.

1. Rabobank not a Promoter of Yes Bank

It was observed by SEBI that in order to meet the minimum promoters’ contribution, around 20% share capital held by Rabobank was taken into account and the same was locked in for a period of 5 years. However, Rabobank was not specifically classified as a promoter elsewhere in the prospectus, which was filed on behalf of Yes Bank.

On the contrary, the counsel on behalf of Enam contended that Rabobank was not a promoter of Yes Bank and it was merely named as a co-promoter in the application made to RBI for the purpose of procuring a banking license. Necessary disclosures in this regard and also with respect to the fact that Rabobank holds a minimum of 20% shares of Yes Bank had been made in the prospectus filed with SEBI, which was sufficient information for the investors to make an informed investment decision. Further, upon being brought to the notice that Rabobank was never named as a promoter in any of the financial statements/ draft red herring prospectus filed with the stock exchanges/ SEBI, SAT failed to appreciate the fact that SEBI did not object to this omission while clearing the draft red herring prospectus.

Relying on the definition of the term ‘Promoter’ as provided under the DIP Guidelines and marrying the same with the circumstantial evidence at hand (i.e; Rabobank could nominate only two out of twelve directors of Yes Bank and was not instrumental in the formation of plan or programme pursuant to which securities are offered to the public and Rabobank has not represented itself as the promoter of Yes Bank) SAT conceded with Enam that Rabobank could not be classified as a promoter of Yes Bank.

In view of the aforesaid submissions, SAT held that Enam cannot be made liable for making inadequate disclosures in the prospectus or for making misrepresentations or false statements thereunder.

2. Discretion exercised in allotment of shares is not arbitrary

SEBI contended that while allotting the shares under the QIB category, Enam did not exercise its discretion judiciously and consequently majority of shares under the QIB category were allotted to foreign institutional investors and the banks/ mutual funds received negligible shares.

While placing on record the criteria followed by Yes Bank in allotment of shares under the discretionary quota, the counsel on behalf of Enam contended that in the absence of any prescribed guideline to be followed while exercising discretion in the allotment under the QIB category, Enam advised Yes Bank on the best possible allocation to QIBs. However, since allotment of equity shares in a public issue is a purely commercial decision, the final decision with regard to this was taken by the Board of directors of Yes Bank.

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After considering the contentions on behalf of both parties, SAT held that the parameters laid down by Yes Bank for the exercise of the aforementioned discretionary powers are indeed questionable, however since Enam has placed on record the criteria followed by Yes Bank in allotment of shares, Enam could not be held responsible for such acts of non-compliance.

3. **Enam has not failed to discharge its duties in relation to redressing investor grievances and other matters pursuant to closure of the public issues**

There were certain inconsistencies in the Yes Bank IPO, which were brought to light by SEBI and which included allotment of shares to certain applicants having non-existing DP-IDs, having the same address and same name but different DP IDs. It is pertinent to note that SEBI alleged that though the registrar and share transfer agent to the issue failed to identify these inconsistencies, it was the primary responsibility of Enam to manage the flow of applications and the post issue activities (including the allotment of shares).

Enam, on the other hand submitted that it is not obligated to play the registrar and share transfer agent role. However, while pursuing its duty to supervise the registrar and share transfer agent, it had appointed duly qualified officers post closure of the offer for the purpose of proper scrutiny and verification of applications and it was vehemently contended by Enam that at the time of such scrutiny, there was no irregularity that was brought to the notice of such deputed officials, which in the mind of Enam was required to be reported to SEBI.

In view of the aforesaid, SAT absolved Enam of any penalty for contravention/ non-compliance of the provisions of the DIP Guidelines.

ANALYSIS

SAT by way of this order has reiterated the statutory duties and obligations of a merchant banker which require a merchant banker to maintain high standards of integrity, dignity and fairness in the conduct of its business and promptly notify SEBI in case of any non-compliance of the regulatory framework that comes to its notice. Due consideration was given to the activities and conduct of Enam before giving a reasoned judgement on the subject.

SAT by overruling the SEBI Order has established the fact that though the merchant bankers are expected to exercise due care and diligence in the management of public issues (and allied activities), SEBI is vested with the responsibility to closely monitor the functioning of other nodal agencies involved in the process (including the registrar and share transfer agents) so as to ensure that there is smooth co-ordination of activities between the various agencies involved in the IPO process. Further, the SAT order has also clarified that going forward SEBI is expected to be slightly more cautious while scrutinizing draft red herring prospectus of the issuer companies such that the discrepancies (if any) be communicated to the issuer companies well within the stipulated time period, which would also allow the companies sufficient window to rectify the discrepancies.

– Harshita Srivastava, Anil Choudhary & Vyapak Desai
You can direct your queries or comments to the authors

¹ M/s/ Enam Securities Pvt. Ltd. is a merchant banker registered with SEBI and is engaged in the business of providing merchant banking services.
² Appeal No. 39 of 2011
³ SEBI Adjudication Order No. ESPL/AO/DRK/AS/EAD-3/231/09 -134/2010 dated December 31, 2010.
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