

Sebi Vs. Consortex Karl Doelitzsch

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Court : SEBI Securities and Exchange Board of India or Securities Appellate Tribunal SAT

Decided On : Feb-07-2006

Judge : Madhukar

Appellant : Sebi

Respondent : Consortex Karl Doelitzsch

Judgement :

Andhra Pradesh Power Tools Limited (hereinafter to be referred to as APPTL) was registered as a public Limited company. The company identified Consortex Karl Doelitzsch GmbH from Germany as the foreign collaborator and entered into technical and financial collaboration agreement for importing the technology. APPTL changed its name from Andhra Pradesh Power Tools Limited to Consortex Karl Doelitzsch (India) Limited (herinafter to be referred as Consortex) effective from April 14,1998. Consortex came out with a public issue of 1,68,80,500 equity shares of Rs. 10 each for cash at par aggregating to Rs. 1668.05 Lakhs.

The public issue of the Consortex opened on 22.1.96 and closed on February 1, 1996. Volkscas Mercantile Ltd (herinafter to be referred as VML) is a company promoted by Shri V. P Rao and Shri K K P Pillai. Investigation conducted by SEBI revealed manipulation in the public offer.

2. Show cause Notice and reply : A Show cause notice dated February 5, 2004 was issued to Shri.V.P.Rao and Consortex advising them to show cause as to why

appropriate action under Regulation 11 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market), 2003 (hereinafter to be referred to as FUTP Regulations, 2003) and SEBI (Disclosure & Investor Protection) Guidelines, 1992 read with Section 11B of SEBI Act, 1992, including restraining Consortex from accessing the capital market for a certain period and prohibiting Shri V P Rao from buying, selling or dealing in securities in any manner whatsoever for a particular period, should not be initiated.

3. Shri.V.P. Rao submitted his reply vide letter dated 15.03.2004 along with enclosures. Consortex also filed its reply dated 15.03.2004. The reply of consortex was on the same lines of the reply submitted by Shri.V.P.Rao. Both the entities requested for an opportunity of personal hearing.

4. Personal Hearing: Consortex and Shri V.P.Rao were given an opportunity to attend personal hearing on 17.1.2006. Consortex vide its letter dated January, 27 2006 requested SEBI to take on record its submissions made on 15.3.2004 and also submitted that they did not have any further information to be furnished before the Whole Time Member.

Shri.V.P.Rao also sent another reply dated 17th January 2006 requesting SEBI to drop further proceedings.

5. Consideration of Issues and observations: I have considered the facts of the case and replies filed by both the entities and the related enclosures and documents on record. I proceed to examine the allegations and my observations thereof are as follows.

6. Allegation 1: It is alleged that a group of nine applicants had applied through stock invests for 10 lakh shares each amounting to 90 lakh shares with the application amount of Rs. 50 lakh each totaling Rs. 4.50 crores respectively in order to manipulatively attain 90% minimum subscription.. The funds for the same were supplied by Consortex through VML. Thereby Shri V. P. Rao and Consortex have violated the provisions of Regulation 6(a) read with Regulation 2(c) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market), Regulations 1995.

7. Observations: I observe that the nine applicants viz., Jyoti Vora, Bharat Kanakia, Shilpa Timbadia, Yogesh Parekh, Kina Kanakia, Nitin Vora, Chetna Valia, Trupti Parkeh, Sonal Kanakia had entered into Memorandum of Understanding (hereinafter to be referred as MoU) with VML , a company promoted by Shri V. P Rao and Shri K K P Pillai for making applications and agreeing to hand over the certificates on allotment and receiving the money back. By reading the MOU, it is very clear that MOU was entered into before the opening of the public issue.

further observe that VML received a credit of Rs. 4.5 cr from Consortex's A/c no. 12051 held with Bank of Madura Ltd., Matunga branch, Mumbai (now ICICI Bank Ltd.) vide cheques no 554301 & 554302 dated 7.6.96 signed by Shri V P Rao on behalf of Consortex as authorized signatory. Subsequently, the amounts were paid to all the nine applicants by cheques issued to the 9 applicants which were signed by Shri Rao on behalf of VML as Director.

8. I further observe that if these 9 applications were to be excluded, the issue would have been subscribed only to the extent of 47% and the issue would have failed. Hence it is clear that out of total subscription of Rs. 7,43,34,000, an amount of Rs. 7,24,70,000 was collected through Stock Invests which means that nearly 97.5% of subscription was met through Stock Invests. Shri V.P.Rao himself stated vide his reply that the consortex utilized the public issue funds by issuing two cheques bearing numbers 554301 and 554302 of Rs. 4,00,00,000/- and Rs. 50,00,000/-respectively on bank of Madhura favouring VML after the public issue was listed. VML had a long association with the consortex having running account, inter alia, for capital contracts executed for the company. The Board of Directors of the Consortex had authorized V.P.Rao to sign cheques for and on behalf of the consortex pursuant to which Shri. V.P.Rao signed the aforesaid cheques favouring VML. A copy of the Board resolution dated 1.3.1996 adopted in this behalf was also enclosed. I observe that these documents only prove the manipulative intention of Consortex and Shri.

V.P.Rao. Consortex forwarded these two cheques to VML and debited its account in the books. This clearly shows that funds came from Consortex through VML to

reach the nine applicants. At this juncture I reproduce Regulation 2(c) and 6(a) of FUTP Regulations, 1995.

Fraud includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter to the contract; - (1) the suggestion, as to a fact, of that which is not true by one who does not believe to be true; (2) the active concealment of a fact by one having knowledge or belief of the fact; (5) any such act or omission as a law specifically declares to be fraudulent.

a. In the course of his business, knowingly engage in any act, or practice which would operate as a fraud upon any person in connection with the purchase or sale of, or any other dealing in, any securities; 9. I am convinced that the conduct of Shri VP Rao is falling under the definition of 2(c) of FUTP Regulations, 1995. I also hold that the above act of funding by Shri. V.P. Rao and acceptance of stock Invests for the purpose of manipulatively attaining the minimum subscription by the company is violative of the provisions of 6(a) of FUTP Regulations, 1995, the provisions of SEBI (Disclosure & Investor Protection) guidelines, 1992 and also violative of terms and conditions of the prospectus issued by Consortex in as much as the above acts were intended to defraud the investors by manipulating minimum subscription.

10. Allegation 2: It was also alleged that the money to be invested by the foreign collaborator Consortex Karl Doelitzsch GmbH, Germany which should have come before the opening of public issue was never invested in the company by the promoter. Thus the promoters contribution was never brought in by the foreign promoter viz Consortex Karl Doelitzsch GmbH, and instead VML invested the amount on its behalf. It was further alleged that this information was not disclosed in the prospectus.

11. Observations: I observe from the prospectus that foreign collaborator was supposed to subscribe to the shares at a premium of Rs. 5 per share whereas the offer to public was at par and this was highlighted on the front page of the offer document. I observe that the disclosure made in the offer document about foreign promoter's contribution at a premium is considered as mis-statement made by the

company in the offer document, since no money was contributed by the promoter thereby violating the provisions of Section C SEBI Guidelines for Disclosure and Investor Protection(Annexure to Clarification II dated July 16,1992 and also the terms and conditions of the prospectus issued by Consortex 12. I further observe that Shri V.P.Rao himself admitted in his reply that it is factually true that the foreign promoter could not invest in the public issue for diverse reasons and Consortex had to make alternate arrangement for this shortfall. VML at the request of consortex applied on 22.01.1996, for the shares in good faith so that the void created by inability of the foreign promoter is fulfilled and the public issue survives.

13. Hence it is clear that the Consortex is responsible for making misstatement in the offer document as this was important information for the investor for taking well informed investment decision.

14. I reproduce the Section L Clause b of the SEBI Guidelines for Disclosure and Investor Protection which reads as follows: b) This promoter's contribution shall not be diluted for a period of 5 years from the date of commencement of the production or date of allotment whichever is later. Promoters must bring in their full subscription to issues in advance before public issue.

15. I observe that, since no amount of promoter contribution was brought in by the foreign promoter these acts are in violation of minimum subscription clause (Section c) and Promoter's Contribution clause (Section L Clause b) as contained in SEBI Guidelines for Disclosure and Investor Protection.

16. Allegation 3: It was alleged that the fact of the public issue proceeds being attached by Court Order dated 23.1.1996, on the suit filed by Fairgrowth, was not brought to the notice of SEBI and investors.

17. Observations: I observe that Shri V.P.Rao stated in his reply that the company had taken a bridge loan of Rs. 50 lakhs against public issue from Fairgrowth Financial Services Ltd., in the month of March 1992. Consortex requested Mrs. Devamani, V.P.Rao's wife to give security of her property / shares as a collateral for the aforesaid loan availed by the company. Ultimately, consortex could not repay the loan to Fairgrowth Financial Services Ltd. Consortex claimed that on

page 1 & page 31 of the prospectus disclosed as risk factor about Fairgrowth Financial Services Ltd's case filed in the Special Court in respect of their claim of the aforesaid loan and interest thereon.

18. It is clear that in Offer document, it was stated that company had availed a loan of Rs. 50 lakhs from Fairgrowth Financial Services Ltd. and it had filed a suit on 17.2.95 for its dues amounting to Rs. 84 lakhs app. plus interest. I observe tht the date of prospectus is 17th November 1995 and the date of the attachment order is 23.1.1996. This fact of attachment was subsequent to the date of prospectus. Hence on this score I hold that no misrepresentation has been committed by Consortex.

19. The entities have further contended that the company filed an appeal against the order of Hyderabad Stock Exchange, the Regional Stock Exchange refusing to list its shares under Section 22 of the Securities Contracts (Regulation) Act, 1956(SCR Act) before the Appellate Authority, SEBI. It was contended that SEBI after considering the matter including the nine applications for 10 lakh shares each that were applied through stock invest instruments approved the listing of public issue subject to certain conditions for listing. The public issue shares were eventually listed on the stock exchanges. Thus SEBI's order dated 26.4.1996 under Section 22 of SCR Act which considered the post public issue aspects and the developments in its entirety. Hence, it was contented that SEBI is estopped from raising the same point and falling upon the same cause of action which was adjudicated through the statutory proceedings under Section 22 of SCR Act culminating in the aforesaid order dated 26.4.1996. The copy of the order was enclosed along with the reply.

20. The above contention cannot be accepted. Since, the order passed by SEBI dated April 26,1996 was conditional that the 9 applicants shall be given 21 clear days time to exercise the option of withdrawing from the issue and it clearly laid down that after the withdrawal requests if any, the subscription level does not fall below the stipulated 90% limit, the public issue can be considered successful. On the one hand the company has not produced any letter written to the 9 applicants informing them the option to withdraw from the issue. On the other hand the act of

funding by Shri V.P. Rao from the resources of Consortex came to light only after the Investigation which was launched based on the complaints received from NSE. Since the SEBI order dated April 26, 1996 proceeded not on the basis of funding by V.P Rao, the issue of fraudulently manipulating the public issue was not discussed in the earlier order. Hence the contention of Shri V.P.Rao that SEBI is adjudicating for the same cause action is not correct.

21. The contention of Shri. V.P Rao that he was not a director at the time of aforesaid public issue is also not relevant since he has transferred funds from Consortex to VML which ultimately went to the 9 applicants thereby he has violated the provisions of Regulation 6(a) read with Regulation 2(c) of FUTP Regulations 1995 . I am, therefore, convinced that it is a fit case to pass an order under Section 11 and 11B of SEBI Act, 1992 read with Regulation 11 and 13 of the FUTP Regulations, 2003 against Consortex Karl Doelitzsch (India) Ltd. and Shri.V.P.Rao.

23. I also note that SEBI vide its interim order dated February 1, 2006 has confirmed its earlier ad interim order dated September 29, 2005 directing Corsortex Karl Doelitzsch (India) Ltd., and its directors not to issue any further shares or alter its share capital in any manner till further directions. The company and its directors viz., Shri M.Sudhakar Rao, Shri V.Manohar, Shri K.Satyanarayan, Shri S.Surya Prakasa Rao and Shri G.Krishna Mohan were further prohibited from accessing capital market or dealing in securities, in any manner, directly or indirectly, till further orders.

24. Therefore, in exercise of powers conferred upon me in terms of Section 19, 11 and 11B of the SEBI Act, 1992 read with Regulation 11 and 13 of the FUTP Regulations, 2003, I hereby restrain Consortex Karl Doelitzsch (India) Ltd from accessing the securities market and restrain Shri.V.P.Rao from buying, selling or dealing in securities in any manner for a period of one year.

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