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"Electrosteel Casting Limited vs SEBI"

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Order Reserved On: 23.10.2019, Date of Decision: 14.11.2019
Misc. Application No. 381 of 2016 and Appeal No. 223 of 2016

Electrosteel Steels Ltd (Appellant)
Versus
Securities and Exchange Board of India (Respondent)

CORAM: **Justice Tarun Agarwala, Presiding Officer**
Dr. C.K.G. Nair, Member
Justice M. T. Joshi, Judicial Member

Brief facts:

Electrosteel Castings Ltd ("**ECL**") is the parent company of Electrosteel Steels Ltd. ("**ESL**") which deals with manufacturing of cast iron pipes. Iron ore is a core raw material in their manufacturing process and therefore for their overall business. For the business ECL needs various statutory clearances for obtaining iron ore. ECL and the Government of Jharkhand had signed an Memorandum of Understanding ("**MoU**") for setting up a steel manufacturing plant in Jharkhand for which the company needed the clearance for diversion of forest land at Kodolibad for mining from the forest department, government of Jharkhand. The company had put in an application for the same on 20th January, 2007 which was "rejected" by the Ministry of Environment and Forests ("**MoEF**") on 19th January, 2009. This decision of the MoEF could be appealed but the appeal should've been made within 3 months of the decision being taken. On 10th July, 2009 the government of Jharkhand appealed to MoEF to sanction the clearance which was done consecutively by the MoEF on 4th February, 2010. Meanwhile, ECL filed a Red Herring Prospectus ("**RHP**") with Securities Exchange Board of India ("**SEBI**") on September 11, 2010 which was opened on 21st September and closed on 24th September; 2010.The Prospectus filed however did not mention the rejection of clearance by MoEF which was appealed and sanctioned eventually after the offer was complete. On September 20, 2013 a show cause notice was issued to the appellants stating that rejection of forest clearance ought to have been disclosed in the Prospectus as well as to the Stock Exchanges by ESL and ECL respectively. Thereafter SEBI imposed a penalty of 1 crore on M/s Electrosteel Limited further penalty of 1 crore had been imposed jointly and severally on the three Merchant Bankers under 64(1) of Issue of Capital and Disclosure Requirements,

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Regulation, 2009 ("**ICDR**"); and a penalty of Rs.50 Lakhs each has been imposed on Electrosteel Castings Limited under various SEBI regulations by order dated 31st March, 2016. The same order has been challenged before the Securities Appellate Tribunal in this matter

Issue:

1. Whether Non-disclosure of "rejection" of the forest Clearance by ministry of Environment and Forests on an application for iron ore mining filed by ECL was material to an Initial Public Offer ("**IPO**") made by ESL and for disclosure under Clause 36 of the Listing Agreement for ECL and;
2. Whether the penalty imposed was "too harsh "

Ratio:

The bench repeatedly specified that the "rejection" of the forest clearance by the MoEF is a material event that must be mentioned in the prospectus by ESL and under clause 36 of the Listing Agreement by ECL, under ICDR regulations by ESL and under SEBI (Merchant bankers) Regulations by the 3 BRLMs collectively, and that given the core role the project would play in the future performance, profitability and even viability of the business even if it was considered only an "initial rejection" it was a material information to be disclosed irrespective of whether finally the project got clearance or not. The emphasis is on disclosure; not otherwise, which means disclose even when the issuer doubts whether there is any materiality. In other words, it would imply that only facts/ events which the issuer is undoubtedly sure of having no relevance to the issuer or to the issue can be excluded from disclosure. SAT upheld SEBIs' findings but reduced the penalty imposed from 1 crore to 50 lakhs on ESL; from 1 crore to 50 Lakhs collectively on the Book Running Lead Merchants ("**BRLMs**"); and upheld the 50 lakhs penalty imposed on ESL and clarified the penalty imposed by SEBI in this matter isn't excessive or too harsh

Analysis:

The counsel for ESL argued that there was no rejection of the clearance to be obtained and the letter received by them on 23/25th September, 2008 by the FAC was merely an opinion and the said opinion was not final decision by the MoEF as that could have been appealed by the government of Jharkhand and the appellants within 3 months as per the guidelines. Simultaneously the counsel also goes on to say that the appeal to the letter had eventually been made and accepted by the MoEF and the clearance had been obtained by them. Therefore at no stage were they required/ obligated to make any disclosure related to this clearance in their prospectus according to the regulations. He further stated that making such a disclosure would have been factually incorrect and they would be reprimanded by SEBI for the same.

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The counsel for the ESL also stated that they were aware that all disclosures must be made with the SEBI while filing the prospectus and therefore they had mentioned various scenarios in the prospectus under the heading "risk factors". Special attention was drawn to “risk factor” No. 3, 10 and 12 which explain scenarios relating to failure to obtain or renew a number of approvals/ sanctions/ licenses/ registration and permits to develop and operate the mines and consequent impact on their business. They also mentioned in the prospectus that certain mining leases in the Kodolibad project were pending and the project would commence only after obtaining such permissions and nowhere did the Appellant take guarantee that all approvals would be given by the government assuredly. The counsel for the Appellant (ESL) further contended that no fine can be imposed on the Appellant Company as the appellant company has gone under Corporate Insolvency Resolution Process (“**CIRP**”) under the Insolvency and Bankruptcy Code, 2016 and the National Company Law Appellate Tribunal has approved the plan and the company is now taken over by Vedanta ltd who was the successful bidder in the CIRP. Furthermore the company has been delisted after giving all its public shareholders the exit opportunity therefore as per approved resolution plan all penalties/ a fines etc. against the appellant stand written off in full and permanently extinguished.

The counsel ECL agreed to arguments made by the counsel of ESL and further added that he submits that the alleged violation in respect of the appellant is non-disclosure under Clause 36 of the Listing Agreement as the said ‘rejection’ of forest clearance for the proposed mining project was not disclosed to the Stock Exchanges. Therefore, penalty is imposed under two Sections of the Securities (Contract) Regulations Act, 1956 (“**SCRA**”); Section 23A (a) and 23E and contended that two penalties for the same violation is not sustainable under law. Further, it was also contended that while the show cause notice alleged that the impugned information was material for profitability, the impugned order holds that it was a price sensitive information therefore, what is held in the impugned order is not what was show caused and hence it is a misdirected enquiry and, therefore, violation of the Wednesbury principles. It was contended by the learned counsel that Section 23E of SCRA is applicable only to mutual funds or Collective Investment Schemes not to the appellant company and hence the penalty imposed under that Section is unsustainable. The counsel for ECL contended that rejection by Forest Advisory Committee (“**FAC**”) isn't Rejection by MoEF therefore it wouldn't constitute rejection of the clearance and the clearance was always under consideration and eventually approved by MoEF.

It was further contended that at the relevant time several clearances had been already obtained and the stage of each clearance, either obtained or pending, has been categorically stated in a tabular format at Page 110 of the prospectus. In the said table against Environmental Clearances what is recorded is that the Approving Authority is MoEF. It was also contended by the learned counsel for the appellant that Adjudicating Authority (“**AO**”) of SEBI did a ‘roving inquiry’ at the back of the appellants and obtained information from the MoEF and used that information while passing the impugned order without sharing that

information with the appellant and, therefore, has violated principles of natural justice. The counsel further contended, on the one side, the impugned order is interpreting the approval process under those laws and concluding that the application for the proposed project was rejected by MoEF but simultaneously taking the position that AO cannot go into interpreting those legal provisions.

Therefore, the impugned order is contradictory in nature. The learned counsel for the appellants also relied on the order of the Supreme Court of the United States in **TSC Industries, INC., vs. Northway, INC**[1]. which provided guidance for determining the standard of the requirement to provide material information. Stating that disclosure of information of dubious significance may accomplish more harm than good, it was also urged that the allegation of suppression of information was raised for the first time only in the impugned order and that point was not raised either in the show cause notice or in any of the subsequent proceedings lasting for 2.5 years. In any case, the learned senior counsel submits that the penalty of ` 1 crore imposed on the appellants, who are just the Merchant Bankers, at the maximum amount of penalty imposable under Section 15HB of the SEBI Act is too harsh even if it is held that there was a technical violation. It is not a fit case for imposition of heavy penalty and far from the maximum amount of penalty, it was argued. The learned counsel relied on the judgements passed by this Tribunal in the matters of **Kotak Mahindra Capital Company Limited & Ors. vs. SEBI**[2] **, M/s. Keynote Corporate Services Ltd. vs. SEBI**[3] **and M/s New Delhi Television Limited vs. SEBI**[4] and reiterated the grounds for no penalty or at most a very nominal amount of penalty.

The Appellate Tribunal took into consideration the argument made by the counsel that FAC isn't a Competent authority to reject the clearance and therefore the clearance was never really rejected. The Appellate Tribunal produced certain regulations, rules, guidelines etc. such as regulation 57(1), 57(2)(a)(ii) of the ICDR regulations; Section 21 of the SCRA; Rule 7 & 8 of Forest (Conservation) rules,2003:Guideline 14.4 of the Forest (Conversation) act, 2003. The Appellate Tribunal clarified that the ICDR is Voluminous and emphasis is on disclosure; not otherwise, which means disclose even when the issuer doubts whether there is any materiality. In other words, it would imply that only facts/ events which the issuer is undoubtedly sure of having no relevance to the issuer or to the issue can be excluded from disclosure. The required permissions for the mining project is an important component of the statutory approvals. The Appellate Tribunal further held it is undoubtedly and abundantly clear that the` 700 crore plus investment in the newly promoted company ESL by ECL and an MoU between them were critical events which were disclosed and therefore any event which would lead to a disruption, delay or even a temporary halt which would affect the time schedule, cost, production etc. in the said project was undoubtedly a material event for both ESL and ECL.

[1] INC. 1976 SCC Online US SC 119
[2] SAT Appeal No.: 63/2015
[3] SAT Appeal No: 84/2012
[4] SAT Appeal No: 385/2015

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Therefore, the Appellate Tribunal finds no reason to interfere with the findings in the impugned order that the rejection letter communicating either the view of the Forest Clearance Division and/ or the decision of the MoEF regarding rejection of Environmental Clearance because of rejection of forest clearance were material information to be disclosed in the IPO Prospectus under ICDR by ESL and under Clause 36 of the Listing Agreement by ECL. The contention of the appellants that they were strictly following guideline 4.14(ii) under Forest Conservation Act, 1980 which stipulates a three months deadline for reconsideration application, is contrary to the facts on record. In any case, the question is not whether the application itself was finally rejected or whether reconsideration application was submitted or even whether there was provision of reconsideration etc.

The question is only whether a communication of the rejection of Forest Clearance / Environmental Clearance for the mining project in question was a material event to be disclosed in the prospectus by ESL and under Clause 36 of the Listing Agreement by ECL given the importance of the project for ESL and ECL. The answer to these questions, in the courts considered view, is strongly in the affirmative. Given the core role the project would play in the future performance, profitability and even viability of the business even if it was considered only an "initial rejection" it was a material information to be disclosed irrespective of whether finally the project got clearance or not. The Appellate Tribunal is of the opinion that they are constrained to state that all the counsel for the appellants made only a feeble/passive reference to the January 16, 2009 letter which categorically rejected (even assuming that it was for the time being) Environmental Clearance for the project proposed by ECL on the basis of the rejection by FAC. The Appellate Tribunal placed reliance on the table mentioned on page 110 of the prospectus and stated that In the row relating to Environmental Clearance what is indicated in the above table is that the approving authority for both in respect of coking coal mining and iron ore mining is the MoEF; approval in respect of coking coal mining has been received and approval in respect of iron ore has been received, but applicable once forest clearance is received. When this statement was published as part of the prospectus the 04.10/11.2008 rejection letter of the FAC as well as the rejection letter dated January 16, 2009 of the MoEF and the subsequent efforts made by the appellants for reconsideration were all in the knowledge of the appellants. Therefore, great effort has been made to put such facts in a compact statement like "received, but applicable once forest clearance is received"; a clear case of not only partial/ inadequate disclosure but also to the effect of concealment. Instead of disclosing a rejection everything else has been disclosed. This is what the order of **TSC Industries (**Supra) categorically cautions against. Therefore, reliance of the appellant on this order not only does not help the appellants but rather does more harm to them.

The Appellate Tribunal does not propose to deal with the contention of the learned senior counsel for ESL that ESL has undergone a CIRP and all claims relating to penalties etc. have been permanently extinguished and so on under the approved Resolution Plan. We would just state that those issues would be addressed by the appropriate authorities under applicable

laws. However, in the interest of justice the Appellate Tribunal tends to agree with the submissions of the appellants in Appeal No. 202 of 2016 and in 223 of 2016 that non-disclosure of the initial round rejection of the mining project proposal in the Prospectus is not in the category where maximum penalty is imposable. Accordingly we would reduce the amount of penalty of ` 1 crore each imposed on ESL under Section 15HB of the SEBI Act to ` 50 lakhs. A similar penalty of ` 50 lakh on the three Merchant Bankers jointly is sufficient to meet the ends of justice in Appeal No. 202 of 2016. However, as far as the appeal of ECL is concerned, the penalty imposable under the provisions of 23A(a) and 23E of the SCRA is a maximum of ` 1 crore and ` 25 crore respectively. Therefore, the penalty of ` 50 lakh each imposed under the said provisions cannot be termed as excessive or harsh. Therefore, no interference is needed. The contention of the appellant ECL that sub-section 23E of SCRA, 1956 is not applicable to the appellant-company since it is applicable only to persons managing CIS or mutual funds is an incorrect reading of the sub-section. A correct reading of the above sub-section would make it abundantly clear that a company failing to comply with listing conditions or delisting conditions etc. shall be liable to a penalty not exceeding ` 25 crores. Such listing/delisting conditions are relevant to a company rather than persons managing CIS or mutual funds.

In conclusion, we pass the following order:

a) Appeal No. 202 of 2016 and 223 of 2016 are partly allowed by reducing the penalty amount from ` 1 crore each to ` 50 lakh each. The penalty of ` 50 lakhs imposed on the appellants in Appeal No. 202 of 2016 shall be paid jointly and severally by the appellants.
b) Appeal No. 224 of 2016 is dismissed.
c) Appellants are directed to pay the penalty amount within 30 days from the date of this order.

Conclusion:

The order given by the Securities Appellate tribunal is two-fold : Firstly that the “rejection” by the FAC of the MoEF although eventually approved forms a part of material information to be disclosed in the prospectus as that would affect the choice of the investor as that clearance formed a major part of the profitability and viability of the project to set up a steel manufacturing plant undertaken by the company, thus making it essential for the company that is ESL and the parent company ECL to disclose the same in their prospectus and it also falls under the due diligence activity undertaken by the Merchant bankers prior to the IPO. Secondly the Appellate tribunal upheld the penalty imposed by SEBI but also reduced the same in view of the arguments made by the Appellant. The Appellate Tribunal however did not reduce the penalty imposed on ECL. In summary the Appellate tribunal has become more stringent in deciding cases of material non – disclosure and has penalised the offenders under law. The Appellate Tribunal has also lowered the amount of discretion given to the company as to what constitutes “material” or “relevant” information and has urged that all information however minute should be mentioned in the prospectus unless it holds absolutely no bearing to the company and its fresh issue for allotment of shares.