

INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT

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A CASE STUDY OF SAHARA INDIA PARIWAR SCANDAL (WITH REFERENCE TO ETHICAL AND GOVERNANCE ISSUES INVOLVED)

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ABSTRACT

The paper studies the Sahara India Pariwar scam. The two companies of Sahara group naming Sahara Group Companies Sahara India Real Estate Corporation limited (SIRECL) and Sahara Housing Investment Corporation (SHIC) were raising thousands of crores from the public without informing SEBI. The paper discusses how these two companies could raise so much of money without following the prescribed rules and regulations and how did SEBI come to know about the wrongdoings of these two companies. I have also studied what action was taken by Supreme Court in this particular case. Most importantly the paper studies the corporate governance issues in the group which lead to such big scam

KEYWORDS

Sahara Group, SIRECL, SHIC, Corporate Governance.

INTRODUCTION

 Sahara India Pariwar which is an Indian conglomerate having its headquarters in Lucknow, India was founded by Subroto Roy in 1968 with a capital of Rs 2000 with one small office having a table and two chairs, one Lambretta scooter and a staff having one clerk and a runner boy. Sahara India Pariwar started its journey with 42 depositors in all and a single establishment but today there are 6.1 crore depositors associated with the group through 1707 establishments all over the nation and Sahara group is now considered as one of the fastest growing business groups in the country. The group has wider interests in Finance, Infrastructure & Housing, Media & Entertainment, Tourism & Hospitality, Consumables, Manufacturing and Services & Trading. The company follows a unique profit sharing pattern which is 35% of profit goes towards Company's Net owned fund, 25% goes towards Social Development activities and 40% is meant for the welfare of Kartavyayogi workers because the company believes in collective sharing and caring.

WHAT ACTUALLY HAPPENED?

In 2010, two Sahara Group Companies Sahara India Real Estate Corporation (SIRECL) which was originally incorporated as public limited company under the Companies Act named Sahara India "C" 3 Junxion Corporation Limited on 28.10.2005 and its name was changed name to SIRECL on 7.3.2008 and Sahara Housing Investment Corporation (SHIC) were raising funds by issuing unsecured OFCDs by way of private placement without giving any advertisement to general public. The amount which was raised by issue of unsecured through private placement was 25,781.37 crore. It is unfortunate and shocking to hear that both of these companies were raising thousands of crores from the public but SEBI was not fully aware of why they were doing so or what they were doing with the collected money. Before going for such an issue the company is expected to file a request with SEBI, get it approved and then start the collection of public money. However, it wasn't the case with these two companies of Sahara.

It was a sudden incident, when Mr. Abraham who was the Director of SEBI until July 2011 was reviewing the Draft Red Herring Prospectus (DRHP) to raise equity for real estate company Sahara Prime City Ltd through an initial public offering (IPO) through which he came to know that these two companies were raising huge amounts of money from the public through optionally fully convertible debentures. Then SEBI started finding out what actually was cooking in Sahara India.

TIMELINE OF EVENTS

- **On January 4, 2010:** A note written in Hindi was sent to National Housing Bank by Roshan Lal, a resident of Indore, in which he requested the bank to look into the housing bonds issued by two companies naming Sahara India Real Estate Corporation and Sahara Housing Investment Corporation which the companies of Sahara India. Being a chartered accountant, he wrote in the note that the bonds issued by these two companies to large number of investors were not issued according to the rules. As the National Housing Bank did not have the authority to investigate the allegation, so the letter was forwarded to regulator of capital markets i.e Securities and Exchange Board of India, or Sebi.
- **November 24, 2010:** The promoters and directors of two Sahara group companies naming Sahara India Real Estate Corporation and Sahara Housing Investment Corporation were restricted by SEBI from raising any capital through the issue of securities: either equity shares, convertible debentures or any other securities.
- **December 13, 2010:** Sahara India challenged the order of SEBI before the Lucknow bench of the Allahabad High Court where SEBI was ordered not to take action until an order would be passed by the court.
- **4 January 2011:** SEBI filed a petition in Supreme Court to stop two firms from raising the capital from investors but it was rejected. But SC empowered SEBI to ask for information from Sahara and issue advertisements to inform investors that the issue is under investigation.
- **7 January 2011:** A public notice was issued by SEBI on OFCDs
- **10 January 2011:** SEBI published an advertisement warning the investors that it will not be able to redress the grievances of the investors on OFCDs. Sahara India Real Estate sends a legal notice to Sebi.
- **18 January 2011:** The Reserve Bank of India also warned the investors against putting money in Sahara group companies' deposits and cautioned citizens to verify the name of the company before investing in it. RBI also warned that it does not guarantee the repayment of deposits accepted by SIFCL or any other company in that group.
- **7 April 2011:** Allahabad High Court vacated the stay and wherein Sahara decided to move to. Supreme Court. Sahara Group filed a petition in the Supreme Court for challenging the order of Allahabad High Court, and the court asked Sahara to give full details of investors who participated in its fundraising exercise with SEBI. Sahara also accused SEBI of defaming it.
- **May 2011:** SEBI was directed by Supreme Court to SC to proceed with its investigation into financial instruments used by two Sahara group companies to raise money from the public.
- **23 June 2011:** The two Sahara companies - Sahara India Real Estate Corp and Sahara Housing Investment Corporation were directed SEBI to refund Rs 24,000 crore to investors.
- **15 July 2011:** Later Sahara appealed in Supreme Court saying that SEBI has no jurisdiction. SC directed Sahara to approach SAT against SEBI's order on OFCDs

- **18 Oct 2011:** SEBI's order against Sahara entities was upheld by SAT.
- **4 November 2011:** Sahara moved to Supreme Court against SAT order.
- **9 January 2012:** SAT order was stayed by Supreme Court directing two companies to refund around Rs 17,400 crore to their investors and asked the two companies to give the details of their assets and liabilities.
- **January 2012:** Sahara group companies were given three weeks' by supreme court to either choose between two courses to secure the investments made by the public in the OFCD scheme where it asked the companies to either give sufficient bank guarantee or attach properties worth the amount for which a review petition was filed by Sahara.
- **May 2012:** Supreme court is informed by Senior counsel Fali Nariman (appearing for Sahara India Real Estate Corp) informed supreme court that since there was no complaint from any investor, SEBI could not have taken up this issue of Sahara Group of companies raising funds through OFCD.
- **June 2012:** Supreme Court was informed by SEBI that real estate division of Sahara India Pariwar without complying with the norms of Market regulator had no right to mobilise Rs.27,000 crore from investors through optionally fully convertible debentures i.e OFCD .
- **August 2012:** Sahara India Real Estate Corporation Ltd. (SIRECL) and the Sahara Housing Investment Corporation Ltd. (SHICL) were directed by Supreme Court to refund over Rs. 24,400 crore
- **5 October 2012:** For the seeking the review of verdict given by supreme court on 31 august where Sahara was directed to return to investors Rs.17,400 crore with 15 percent interest that it had mopped up through Optionally Fully Convertible Debentures (OFCDs) in 2008 and 2009 the Sahara group moved the Supreme Court.
- **19 October:** A petition was filed by SEBI with Supreme Court for non compliance by Sahara.
- **27 November:** Sahara moved to SAT against SEBI for non acceptance of documents.
- **29 November:** SAT rejected the plea.
- **30 November:** Sahara appealed supreme court for SAT's order
- **31 November:** SAT order was upheld by Supreme Court.
- **December 5, 2012:** The Sahara Group got a temporary reprieve from the SC. The Supreme Sahara group was asked by the apex court to refund Rs 24,000 crore to its three crore investors in nine weeks time. The Supreme Court asked market regulator SEBI to accept their pay order of Rs.5,120 crore as part payment of the investors' money they had collected through optionally fully-convertible debentures (OFCD) and rest of the remaining amount would be deposited in two instalments. The court told that Sahara sum of Rs.10, 000 crore would be deposited by Sahara in the first week of January next year and the balance amount in the first week of February.
- **8 January 2013:** Sahara missed the repayment deadline which was set up by SC. The company failed to deposit the second instalment amount with market regulator. It was required to submit Rs 10,000 crore by January first week. The Supreme Court also dismissed the Sahara group's plea for a review of its verdict directing two Sahara firms to refund around Rs 24,000 crore to their investors with 15 per cent interest.
- **6 February 2013:** An order was issued by SEBI for attaching the bank accounts and other properties of the group after companies failed to pay remaining two instalments and later summons were issued for personal appearance of Sahara chief Subroto Roy and other three directors before it.
- **6 March 2013:** Sahara approached special appellate tribunal against SEBI move to attach properties. SEBI sort for the arrest of the Sahara Chief Subroto Roy. SEBI also said that most of records provided by Sahara were untraceable, implying several accounts were fictitious.
- **12 March:** SAT denies interim relief to Subroto Roy.
- **July 2013:** SEBI filed a contempt petition against Sahara in SC. Says Company flouting SC direction to make refund.
- **November 2013:** Subroto Roy was barred by Supreme Court from leaving country.
- **April 2013:** The Lucknow bench of the Allahabad High Court sort a response from Sahara India and its chairman Subroto Roy on a PIL filed by them against SEBI for denigrating them. Sahara Chief Subroto Roy however responded to this and said that his group had repaid Rs 20,000 crore to its investors and it was the market regulator which was delaying repayments. He also added that the Securities and Exchange Board of India (SEBI) should refund the balance Rs 5,000 crore already deposited with it to remaining investors.
- **October 2013:** The Supreme Court directed the Sahara Group to give SEBI the original title deeds of its assets worth Rs.20,000 crore as a guarantee towards the payment of investors money.
- **February 26 2014:** A non-bailable warrant was issued by the supreme court against Sahara group chief Subroto Roy for failing to appear before it in person as directed at the last hearing of the court. Roy was also given the time till March 4 to comply with the court's order. On the warrant of Supreme Court the Uttar Pradesh police arrested him on 28 February 2014, in a dispute with Market Regulator - SEBI.
- **March 2014:** On Mar 25, a fresh proposal was submitted by the Sahara to the supreme court in which it offered to pay group to pay Rs. 20,000 crore in five instalments to SEBI for the refunds to investors. In its previous proposal Sahara said that the company would pay 2,500 crore within three days from the day on which the proposal would be accepted by the apex court and rest in form of three instalments of Rs.3,500 crore each by 30 June, 31 September (an apparent typographical error made by the company) and 31 December, and the remaining amount of Rs.7,000 crore by 31 March of next year. SC said Sahara group Chief Subroto Roy could free himself out of Tihar Jail on bail only after paying Rs 10,000 crore. But Subrata Roy's lawyer on Mar 27, 2014 told the Supreme Court that the amount is very high which is why the company could not deposit the Rs 10,000 crore as surety for bail. This meant that Subroto Roy would have to stay in jail till his next hearing.

LEGAL ASPECTS OF SAHARA-SEBI'S CASE

Sahara and SEBI's point of view:

1. *Sahara* claimed that OFCD's which they issued were **hybrids** i.e., neither shares nor debentures i.e OFCD's are neither shares nor debentures but are convertible debentures which doesn't come within the purview of SCR Act as well as SEBI Act.
SEBI's judgment was that although OFCD's are hybrids i.e., neither shares nor debentures but hybrids are securities. OFCD's are debentures by name, nature and description. Definition of debenture under section 2(12) of the Companies Act, 1956 includes 'other securities'. 'Securities' as defined in section 2(45AA) of the Companies Act, 1956 includes hybrids. Therefore hybrids fall within the definition of debentures and provisions of sections 67 and 73 of the Companies Act would apply.
2. *Sahara* India said that as per the the Unlisted Public Companies (Preferential Allotment) Rules 2003 unlisted private companies can make preferential allotment through private placement by passing a special resolution without any restriction on the number as per the section 67(3) of the Companies Act and without requiring listing of such OFCDs on a recognized stock exchange. The company argued that OFCD's were issued only to select persons (in contra distinction to the general public) and therefore, it was not a public issue irrespective of the number.
SEBI's judgment was that even if special resolution was passed for any further issue of capital to person other than shareholders, it can only be subjected to the provisions of Section 67 of the Company Act, that is if the offer is made to fifty persons or more, then it will have to be treated as public issue and not a private placement. In the case of these two companies issue of OFCD's was a public issue and not a private placement as the offer was made to more than 50 persons i.e to more than 3 Crore people through more than 10 Lakhs agents and more than 2900 branches. Moreover documents produced by the company do not show any relationship Sahara Group had with the investors.
3. *Sahara* argued that section 73 of companies act is not mandatory for a company and it applies to only those companies who intend to list itself no company can be forced to get listed on a stock exchange.

But *Supreme Court* made the judgment any issue of securities which is made to more than 49 persons as per Sec 67(3) of the Companies Act, the intention of the companies to get listed does not matter at all and Sec 73 (1) is a mandatory provision of law which companies are required to comply with. Section 73(1) of the Act casts an obligation on every company intending to offer shares or debentures to the public to apply on a stock exchange for listing them. Such companies

have no option but to list their securities on a recognized stock exchange since once they invite subscription from over 49 persons the legal obligation of listing follows.

4. The *Sahara* companies contended that they were not listed with any stock exchanges and were not subjected to any rule / regulation / guideline / notification / directions of SEBI. Further, the companies did not intend to get the OFCD's listed on any stock exchange in India and therefore would not fall under sections 55A(a) or 55A(b) of the Companies Act, 1956. Therefore, the issuance of these OFCD's was not to be administered by SEBI but by the Central Government or ROC.

The *Supreme Court* held the judgement that although the intention of the companies was to make the issue of OFCDs look like a private placement, but it become a public issue instead of a private placement when such securities are offered to more than 50 persons. Section 67(3) clearly states that when any security is offered to and subscribed by more than 50 persons it will be deemed to be a Public Offer and therefore SEBI will have jurisdiction in the matter and the issuer will have to comply with the various provisions of the legal framework for a public issue.

CORPORATE GOVERNANCE ISSUES INVOLVED IN THE CASE

1. MONEY LAUNDERING: In 2008, the two companies of Sahara group naming Sahara India Real Estate Corporation Limited (SIRECL) and Sahara Housing Investment Corporation Limited (SHICL) started raising funds by issue of Optionally Fully Convertible Debentures (OFCD's) to 'friends, associates, group companies, workers/employees and other individuals associated/affiliated or connected in any manner with Sahara Group of Companies' by way of private placement, for which these two companies didn't give any advertisement to general public. The OFCD's were of varying tenures - 48 months, 60 months and 120 months. Between April 2008 and April 2011, Rs. 40,000 Crores was collected by both the companies from about 3 Crores of investors through more than 10 Lakhs agents and more than 2900 branches. This was biggest IPO ever in Indian markets as compared to that of Coal India in whose size was about Rs.15,000 Crores and the next biggest public offer subsequently was that of Bharti Infratel of about Rs.4,500 Crores in December 2012. In the form of a "Private Placement" the amount was collected from about 30 million investors without complying with the requirements applicable to the public offerings of securities.

2. ILLEGAL ISSUE OF SHARES: The funds were raised by these two companies through OFCDs after filing RHPs (Red Herring Prospectus) with the Registrar of Companies, although as per the rules they were required to take permission from SEBI as the issue of securities was made to more than 50 investors. 'The securities were issued to more than 3 crore investors without getting it sanctioned from SEBI between 25 April 2008 and 13 April 2011. And neither had they filed their RHP with SEBI.

3. FAKE INVESTORS: Sahara group companies didn't have proper records of the identity of the investors from whom they collected crore of rupees. The two companies, Abraham alleged, intended to rotate money between group companies. Though the OFCD instruments were issued in the name of the two companies, cheques were sought in the name of Sahara India. It was also found by SEBI that out of 20,000 sample depositors to whom SEBI asked for applying the refund of the money which they invested in the two companies, only 68 investors out of so many investors reverted back i.e less than 1%. Moreover no formal record or description of the scheme was found by SEBI.

4. FAKE ADDRESSES: Many of the addresses of the investors which were given to SEBI were fictitious and could not be located. Justification which was given to SEBI by the Sahara group regarding the fake addresses was that the companies' small and poor investors had to change their address frequently due to exigencies of work and poverty. Sahara India Real Estate Corporation Ltd (SIRECL) was asked by the Supreme Court to prove the "genuineness" of all its investors. The list of the names of the investors which was submitted by the two companies had the name 'Kalawati' 5,984 times on the list, similar names appeared against different locations. 'Jaipur, Nagpur, Maharashtra' and 'Aurangabad Lucknow UP' mentioned as addresses instead of giving the full address. Moreover SIRECL gave the list of investors to the Securities and Exchange Board of India (SEBI) in a CD protected with high-level security encryption. It felt that the company was preventing the market watchdog from doing any analysis or sorting of data

5. DUBIOUS ROLE OF REGISTRAR OF COMPANIES: The role of ROC in the entire episode was critical because without raising the basic questions it cleared the proposal. The net worth of both the companies was negligible. Equity capital of SIREC was only Rs 10 lakh and had a negative net worth at the time of issue of securities while the net worth of SHIC was around Rs 10 lakh. Even then both the companies thought of raising Rs 20,000 crore each. Its like applying for a bank loan of Rs 20,000 crore with only Rs 10 lakh as contribution. No bank would accept such a proposal, but unfortunately ROC allowed the Sahara Group companies to raise such a huge amount. Moreover ROC didn't the draft RHP given by two companies to SEBI as it was a public issue and hence violated Circular dated 1.3.1991 issued by the Department of Company Affairs, Government of India.

6. LACK OF TRANSPARENCY: The two companies of Sahara group naming Sahara Housing Investment Corporation (SHIC) & Sahara India Real Estate Corporation (SIREC) had floated OFCDs to raise about ₹24000 crores between March 2008 and September 2009. On 24th November 2010, the two Sahara companies were barred by SEBI from raising money from the public through OFCDs (Optionally Fully Convertible Debentures), as they were raising huge amount without complying with the norms public issue laid down by SEBI. Both the companies didn't follow any measures for investor protection neither they made the necessary disclosures. According to SEBI, it was a lack of transparency on the part of both the companies as these two companies deliberately did not give the information relating to the issues.

7. POLITICAL LINKS OF SUBROTO Roy: It can also be said that Subroto Roy has friends from the political spectrum and he was also close to Mulayam Singh Yadav and his Samajwadi Party. But before Mulayam, there was close to Vir Bahadur Singh, an author-politician from the Congress stable, who was also from Gorakhpur. So his strong contacts may have helped him to commit such a big fraud.

8. INFLATED VALUE OF LAND: on 4 January 2012, Sahara group companies, Sahara India Real Estate Corporation (SIREC) and Sahara Housing Investment Corporation (SHIC), filed an affidavit Supreme Court in which they disclosed market values of some of these real estate assets by saying that they had enough underlying assets to pay back investors. But it was found during investigation that the value of the property purchased was shown from Rs 62 crore to Rs 1,436 crore on its books i.e they showed the inflated value. The Sahara group grossly overvalued some of its real assets in order to show that it could meet its Rs 24,000 crore liabilities.

9. VIOLATION OF GUIDELINES: SEBI found that the two companies of the Sahara group violated DIP Guidelines and the ICDR Regulations as discussed as below:

- Failure to file the draft offer document with SEBI;
- Failure to mention the risk factors and provide the adequate disclosures that is stipulated, to enable the investors to take a well informed decision.
- Denied the exit opportunity to the investors.
- Failure to lock-in the minimum promoters contribution.
- Failure to grade their issue.
- Failure to open and close the issue within the stipulated time limit.
- Failure to obtain the credit rating from the recognized credit rating agency for their instruments.
- Failure to appoint a debenture trustee
- Failure to create a charge on the assets of the company.
- Failure to create debenture redemption reserve, etc."

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