



# DLF Limited – Role of Housewives & Subsidiaries

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## BACKGROUND & TIMELINESS

SEBI has passed an Order on 10<sup>th</sup> October, 2014 against DLF Limited, in respect of a complaint received by it against non-disclosure of certain facts in its prospectus. A lot has been written or spoken by Analysts, Media and security market participants on the subject. Opinion seems to be divided on the issues discussed in the Order and its maintainability. The present analysis does not aim to discuss the Order but focuses on the issues that have emanated from facts that have for the first time come into public domain.

### INITIAL PUBLIC OFFERING

- DLF Limited (“DLF”) filed a Draft Red Herring Prospectus (“DRHP”) dated May 11, 2006 (“First DRHP”), later on withdrawn by it.
- DLF again filed fresh DRHP (“Second DRHP”) on January 2, 2007.
- DLF came out with an Initial Public Offer (“IPO”) in the year 2007.
- Issued 17.50 crore equity shares of ₹ 2 each at a price of ₹525 aggregating to ₹9,187.50 crore.
- SEBI issued its observations on the second DRHP on May 7, 2007.
- DLF issued the Red Herring Prospectus (“RHP”) dated May 25, 2007.
- The issue opened on June 11, 2007 and closed on June 14, 2007.
- The Prospectus was filed with Registrar of Companies on June 18, 2007.
- Shares of DLF were listed on Bombay Stock Exchange Ltd. and National Stock Exchange of India Ltd. on July 5, 2007.

### THE COMPLAINT

Mr. Kimsuk Krishna Sinha (“Mr. Sinha”) filed two complaints with SEBI on June 4, 2007 and July 19, 2007. In his complaint dated June 4, 2007, Mr. Sinha stated that Sudipti Estates Private Limited (“*Sudipti*”) and certain other persons had duped him of ₹34 crore (approx.) in relation to a transaction between them for purchase of land, and he had registered an FIR No. 249/2007 dated April 26, 2007 at Police Station, Connaught Place, New Delhi against *Sudipti*, one Mr. Praveen Kumar and others in that regard. He also stated that *Sudipti* had only two shareholders namely, DLF Home Developers Ltd. (“DHDL”) and DLF Estate Developers Ltd. (“DEDL”) (both companies being the wholly owned subsidiaries of DLF) holding 5,000 equity shares each. He further stated that *Sudipti*, DHDL and DEDL are sister concerns and are inextricably linked and these companies are a part of the DLF group. In view of the said allegations, Mr. Sinha requested that considering the imperative of safeguarding the interests of general public, the listing of DLF pursuant to the IPO be disallowed and immediate action be taken in this regard. In his complaint dated July 19, 2007, Mr. Sinha had pointed out that DLF in its reply dated July 11, 2007 to him had denied its/ subsidiaries’ connection with *Sudipti* at that point of time. He further stated that DLF’s claim of not having any association with *Sudipti* was false. Mr. Sinha in the said complaint requested SEBI to address his first complaint and immediately act thereupon.



**SECURITIES AND EXCHANGE BOARD OF INDIA (“SEBI”) ORDER**

SEBI came to a conclusion that it was a case of non-disclosure and *Sudipti* was in fact a subsidiary of DLF at the relevant time. SEBI arrived at the above conclusion by using definition of “Control” in various legislations including Companies Act, 1956 and SEBI SAST Regulations. Based on its findings, vide its Order dated 8<sup>th</sup> October, 2014, SEBI restrained the Company (DLF), its named promoters, some directors and some key managerial person from accessing the securities market and prohibit them from buying, selling or otherwise dealing in securities, directly or indirectly, in any manner, whatsoever, for the period of three years.

**NEW FACTS**

Following facts have come to public domain for the first time through SEBI Order and SES feels that the same are material from governance perspective.

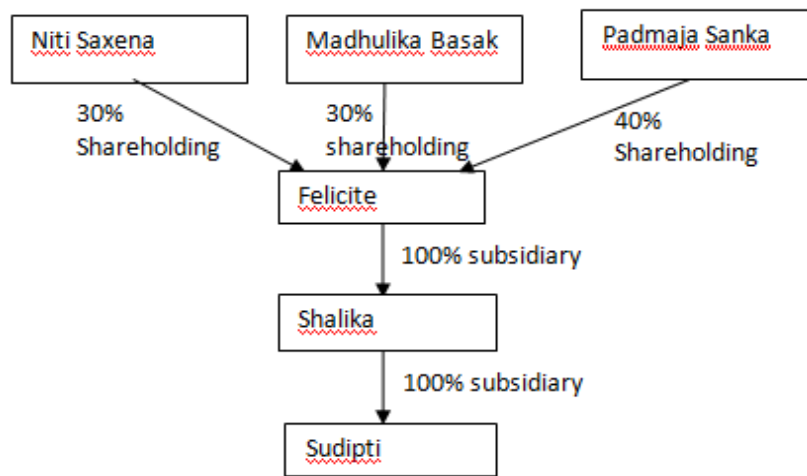
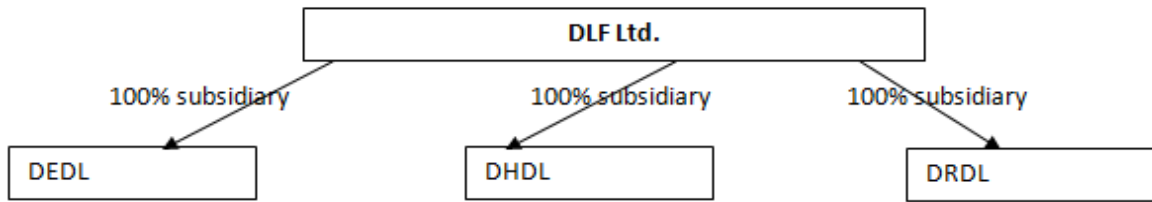
- DLF divested 355 subsidiaries (including *Sudipti*) in 2006-07, further, a total of 281 companies had become subsidiaries of Felicite Builder & Construction Pvt. Limited (“*Felicite*”).
- DEDL, DHDL and another company named DLF Retail Developers Ltd. (“DRDL”) were the subsidiaries of DLF.
- *Sudipti* and two other companies namely, Shalika Estate Developers Private Limited (“*Shalika*”) and *Felicite* were incorporated on March 26, 2006. DHDL and DEDL were subscribers to the Memorandum of Association of *Sudipti* and they together held entire equity shares in *Sudipti* (50% each). The entire shareholding of *Shalika*, was held by DHDL (30%), DEDL (30%) and DRDL (40%). Similarly DHDL, DEDL and DRDL were the only shareholders of *Felicite* and held 30%, 30% and 40% shares, respectively in it.
- On November 29, 2006, the entire shareholding in *Felicite* held by DHDL, DEDL and DRDL was sold to three persons namely, Mrs. Madhulika Basak, Mrs. Niti Saxena and Mrs. Padmaja Sanka. These three persons were wives of Mr. Surojit Basak, Mr. Joy Saxena and Mr. Ramesh Sanka respectively, who were the Key Managerial Personnels (“KMPs”) of DLF.
- On November 30, 2006, DHDL, DEDL and DRDL sold their entire shareholding in *Shalika* to *Felicite*. On the same date, DHDL and DEDL, sold their entire shareholding in *Sudipti* to *Shalika*.
- This way *Sudipti* was disassociated with DLF from being an indirect subsidiary to an independent company (as claimed).
- Structure of shareholding of *Sudipti*, *Shalika* and *Felicite* before and after the transfer of shares in these three companies is shown in the diagram below (Source: SEBI Order dated 10th October 2014).
- Even after the sale of entire shareholding in *Sudipti*, *Shalika* and *Felicite* by the wholly owned subsidiaries of DLF, there was no change in the composition of the Board of directors of these three companies. The directors in *Sudipti*, *Shalika* and *Felicite*, who were employees of DLF, continued to be the directors of these companies even after the aforesaid sale of shareholding.
- The three shareholders who, pursuant to purchase of shares of *Felicite* from DHDL, DEDL and DRDL on November 29, 2006, became 100% shareholders of *Felicite*, which in turn became 100% shareholder in *Shalika* and which in turn became 100% shareholder in *Sudipti*, were spouses of KMPs of DLF. These three shareholders were not regular investors/ traders in the securities market though they claimed that they purchased entire shares of *Felicite* for the purpose of investment in real estate sector. All the three transferees were “Housewives”.



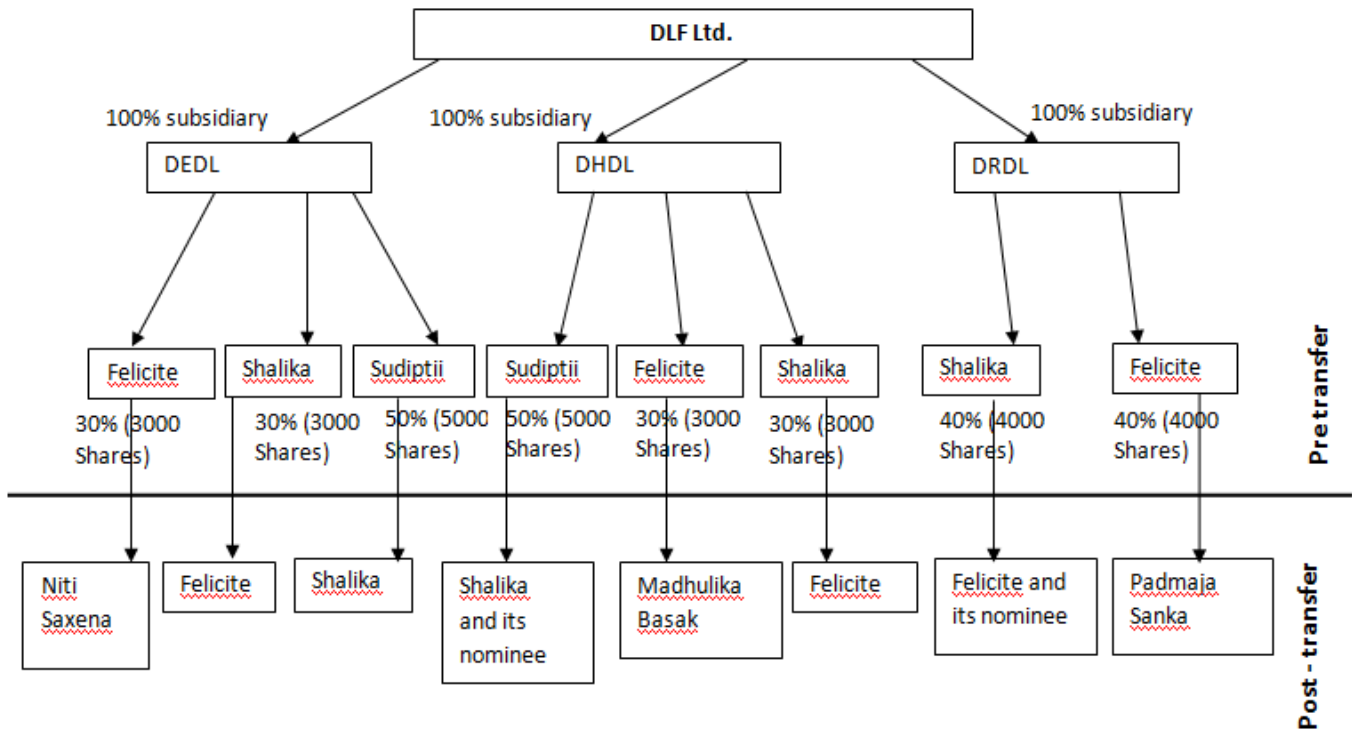
- Even after the sale of entire shareholding in *Sudipti*, *Shalika* and *Felicite* by the wholly owned subsidiaries of DLF, there was no change in any of the authorized signatories of the bank accounts of these three companies and Mr. Surojit Basak, husband of Mrs. Madhumita Basak and a KMP of DLF continued to be the common authorized signatory for the three companies. Further, there was no change in their registered office and Statutory Auditors.
- *Shalika* did not have any money of its own to purchase shares of *Sudipti* but the same was **funded by the sellers of those shares**.
- The said three “Housewives” continued to be the shareholders of *Felicite* as long as their respective husbands continued to be the KMPs of DLF and once they ceased to be the KMPs, shares were transferred to other KMPs' 'Housewives' /subsidiary company.
- Both *Sudipti* and *Shalika* did not account for any expenses on account of operations, cost of establishment/ personnel, rent, electricity, telephone, property tax or salary in their books of accounts during the financial year 2006-07 and 2007-08. It has been alleged that some other entity was incurring/ absorbing such costs.
- *Sudipti* had entered into a development agreement during the year 2006 with DLF Commercial Projects Corporation (“DCPC”) a partnership firm of DLF. Pursuant to the said agreement, DCPC had provided performance deposit amounting to ₹45 crore during the year 2006-07 to *Sudipti*. During the period September-October, 2006, *Sudipti* was funded by DLF’s subsidiaries/ associates through a series of transactions through an entity named Vikram Electric & Equipments Pvt. Ltd. (“Vikram”). These funds were used for purchase of land and creation of development rights on the land so acquired. As per the Annual Accounts of *Sudipti* for the year 2011-12, this amount is appearing as liability even after 6 years of claimed disassociation.



**PICTORIAL DEPICTION OF SHAREHOLDING POST TRANSFER OF SHARES**



**PICTORIAL DEPICTION OF SHAREHOLDING PRE TRANSFER OF SHARES**



**KEY ISSUES**

Stakeholders Empowerment Services (“SES”) believes that governance begins where the law ends. Following the law is just compliance. SES is not raising any issue which has been dealt by SEBI in its Order as Order has examined the matter purely from legal perspective. Nor the issue raised here in this Report are in any way connected with the maintainability of the SEBI Order at Hon’ble SAT or at Hon’ble Supreme Court. Whether it is finally held that *Sudipti* was a subsidiary or not, it will be a decision on technicalities and a victory of sort for the legal team of the winning side. Whatever may be the outcome, it is a fact that governance had been given a go-by by DLF and investors were treated unfairly or to put it straight, not thought worthy to receive vital information.

Whatever may be the final outcome, the following issues emanate for discussion:

- Duty of the Company to make full disclosure and transparency
- Right of shareholders to know and duty of the Company to inform Business Model of the Company
- Duty of the Company to place all facts before Merchant Bankers, Legal Advisors and Auditors
- Corresponding duty of Merchant Bankers, Legal Advisors and Auditors
- What is and who decides materiality?
- What is normal course of business?
- What is arms’ length and independent transaction?



## DUTY OF THE COMPANY TO MAKE FULL DISCLOSURE & TRANSPARENCY

While on one extreme the ultimate of transparency is seen in contracts of insurance where *Uberrima fides* “The duty of the utmost good faith” determines validity of contract of insurance. On the other extreme there is doctrine of *caveat emptor* (let the buyer beware).

Where does the transparency standard fit in between two extremes, in case of prospectus relating to an IPO?

Do we still live in an era of *caveat emptor*? SES feels certainly not.

While the duty cast upon issuer and all those associated with issue process is to disclose, in a meaningful manner, all that is required for an investor to take an informed decision relating to investment, a duty is also cast upon investor to take an informed decision and be aware that risks do not get eliminated from investments and investments continues to remain risky. Therefore, in limited manner doctrine of *caveat emptor* continues to be applicable. However, that doctrine cannot be applied to wish away the duties of issuer towards full disclosures.

SES finds that in the case of DLF IPO, the Company was not transparent in disclosures. As the facts that have been brought out in SEBI Order were apparently not disclosed. The Company’s argument throughout has been that they have disclosed all that was **required and expected**. Their argument is that the transactions referred above were normal business transactions and they were advised by legal advisors that the same need not be disclosed. Their contention is based mainly on legal position rather than materiality and governance aspect of the transactions. This raises hosts of other issues.

## WHAT IS ARMS’ LENGTH AND INDEPENDENT TRANSACTIONS?

While SEBI in its Order has described the transactions as ‘sham’, ‘camouflaged’ etc., SES finds that the transaction described above had no element embedded to classify the same as an independent and arm’s length transaction.

### DEFINITION OF 'ARM'S LENGTH TRANSACTION' (Source: Investopedia)

*A transaction in which the buyers and sellers of a product **act independently** and have **no relationship** to each other. The concept of an arm's length transaction is to ensure that both parties in the deal are **acting in their own self-interest** and are **not subject to any pressure or duress from the other party**.*

The fact that 281 subsidiaries were divested to 3 persons (housewives) who were relatives of KMP of DLF, each having no prior real estate business interest, continuation of same board, same bank signatories and DLF not recovering its advance even after 6 years and transfer of these subsidiaries to other housewives as soon as previous owners’ husbands ceased to be KMPs is too much of a coincidence. DLF could find only one set of buyers (3 housewives of its KMPs) for divesting 281 subsidiaries certainly indicates that fair price could not have been determined in the transaction as there was practically only one buyer and one seller.



## WHAT IS NORMAL COURSE OF BUSINESS?

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DLF has argued that these transactions (mentioned above) are in normal course of business. SES understands that “in normal course of business” an enterprise buys and sells something which is its main objective. DLF in its prospectus stated as under:

### **SUMMARY OF OUR BUSINESS, STRENGTHS AND STRATEGY**

#### **OVERVIEW**

*We are the largest real estate development company in India in terms of the area of our completed residential and commercial developments (Source: ACNielsen Report) and our primary business is the development of residential, commercial and retail properties. Our operations span all aspects of real estate development, from the identification and acquisition of land, the planning, execution and marketing of our projects, through to the maintenance and management of our completed developments. In our residential business line, we build and sell a wide range of properties including plots, houses, duplexes and apartments of varying sizes, with a focus on the higher end of the market. In our commercial business line, we build and sell or lease commercial office space, with a focus on properties attractive to large multinational tenants. Our retail business line develops, manages and mainly leases shopping malls, which in many cases include multiplex cinemas. We are also expanding our business by entering into the infrastructure, SEZ and hotel businesses.*

Where does hiving of 355 subsidiaries fit in within the above definition? SES is of the opinion that hiving off 355 subsidiaries in a year and transferring 281 out of the same to housewives of KMPs that too in the manner described above cannot be in the ordinary or normal course of business. And if one does believe that it is normal course of business, the entire business looks scary. If this is the way the Company really does business, the Company ought to have explained and disclosed a lot more details about its business.

## RIGHT OF SHAREHOLDERS TO KNOW & DUTY OF COMPANY TO INFORM BUSINESS MODEL

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Whether it was in normal course or not, the important question is: what is the objective of hiving off 355 subsidiaries in a year? Is creating and hiving subsidiaries a routine business or activity of DLF? How this activity fits in with the business model of the Company? If it is such an important part of business why it has never been explained to shareholders?

A company may have trade secrets which may not be disclosed, however, creating and hiving of subsidiaries certainly cannot fit in within the definition of business secrets. Shareholders ought to know and it is duty of the Company to inform the shareholders about the business model of the Company using subsidiaries. One may understand that a subsidiary might be created for a particular project and may not be required post completion of the project. Does this mean that the Company completed about 355 projects in 2006-07? This argument also cannot be accepted as *Sudipti's* land advance continued even after 6 years?

Is the Company not bothered about its receivables? Generally lenient attitude is adopted in case of associates/subsidiaries where one may be major interested party, however, what interest remained in *Sudipti* even after hiving off, so that DLF did not bother to recover money? Why it was hived off although it had interest in land parcel? All these questions are unanswered and shareholders are in dark.





## WHAT IS AND WHO DECIDES MATERIALITY?

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An argument is made by the Company that the disclosure was not made as it was not material and there was no intention to hide it.

What is material and what is not, who should decide this? The issuer? Certainly not. It amounts to arguing and deciding the case by same person. The obvious answer is that the decision is to be taken by an independent person who takes up the responsibility of guiding the issuer. Therefore in the case of an IPO, this duty is squarely cast upon Merchant Bankers, Legal Advisors and Auditors.

## ROLE OF MERCHANT BANKERS, LEGAL ADVISORS & AUDITORS

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While Merchant Bankers, Legal Advisors and Auditors have duty to ensure that proper disclosure in transparent manner is made, so that the document will enable the prospective investors to take informed decision. Having casted this duty on Merchant Bankers, Legal Advisors and Auditors, the question arises as to how they have to discharge their duty/ role?

Merchant Bankers, Legal Advisors and Auditors are not supposed to play a role of investigating agency in normal course. Nor they are forensic accountant or forensic auditor of the Company. They have to decide based on what material is placed before them by the issuer. Therefore, prime responsibility of placing correct facts rests with the issuer.

Merchant Bankers, Legal Advisors and Auditors can at best examine the material/ information placed before them and seek clarification if they feel that more information is required/ information is not in proper form or contradictory to other facts etc.

In addition to facts placed before them by the issuer, these three agencies are also expected to carry out proper due diligence against benchmark to ascertain correctness of the facts and more importantly to find out if any material information is not provided or disclosed to them so that they can decide and advise proper disclosures in the issue documents.

Legal advisors cannot and are not expected to advise the issuer to enter into sham transactions or to hide material facts. Same is the case with Merchant Bankers and Auditors.

## CONCLUSION

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DLF as an issuer owed responsibility to the prospective investors to place facts about its business in a transparent manner and make adequate disclosures to enable an investor to make an informed decision regarding his investment. As it turns out, DLF failed to do so.

Positive effect of this case will be that all issuers and intermediaries will strengthen their due diligence process, improve quality and transparency of disclosures, failing which a similar fate by way of SEBI action may come their way.



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