CHAPTER IV: MINISTRY OF COMMERCE AND INDUSTRY

The State Trading Corporation of India Limited

4.1 Imprudent financing decisions resulted in non-realisation of dues

STC signed (4 April 2005) a tripartite agreement with M/s. Global Steel Works International Inc. (GSWII) and GSHL (Umbrella Company of GSWII) for supply of raw material to steel plant of GSWII in Philippines. Non-adherence to trading guidelines of STC, fixing of exposure limit at an exorbitantly higher side, ignoring the defunct status of the plant, failure to exercise effective control through collateral management agency over the material lying in the plant of GSWII, failure to sell material on cash and carry basis (as approved by Board of Directors), avoidable conciliation agreement with the party, etc. resulted in blockage of funds amounting to ₹2,101.45 crore (including interest of ₹1,129.15 crore and additional trade margin of ₹220.99 crore as on 31 January 2017).

The State Trading Corporation of India Limited (STC) received a request (20 December 2003) from M/s Global Infrastructure Holdings Limited (GIHL)[1], now known as Global Steel Holdings Limited (GSHL), for participation in procurement of raw materials for their various units in Philippines and Bosnia, and subsequent sale on cash and carry basis. The proposal of GSHL envisaged that STC would procure raw material required for various plants of GIHL by opening letters of credit in favour of raw material suppliers. Thereafter, STC would have physical custody/collateral management of the material through a reputed Collateral Management Agency or any other agency nominated by STC. The material was to be released by STC to GSHL/its subsidiary in respective locations on "cash and carry basis". Subsidiary of GSHL in Philippines, namely, Global Steel Works International Inc (GSWII) operated two distinct and independent production systems (i) production of Cold Rolled (CR) Coils from Hot Rolled (HR) Coils and (ii) production of HR Coils/CR Coils from slabs.

STC obtained expert opinion from M/s Ernst & Young (E&Y), specialist in Corporate Advisory and Risk Management Services, on the risk perception of the proposed transaction considering its structure, securities offered, effect of price fluctuations etc. E&Y opined (January 2005) that STC did not face any perceptible risk as long as the net realisable value of the stock of raw material upon sale in the domestic/overseas market did not fall by more than 14 *per cent* of its Cost, Insurance and Freight (CIF) value at the time of its purchase.

The Committee of Management (COM) of STC deliberated the proposal at its 225 meeting held on 07 January, 2005 and recommended that proposal be placed before Board of Directors (BoD) of STC for approval since the same was beneficial to STC. BoD accorded in-principle approval (27 January 2005) to the third country transactions with GSHL and its subsidiary in Philippines, namely Global Steel Works International Inc. (GSWII).

[1] *The holding company of Ispat Group*

Accordingly, STC signed (4 April 2005) a tripartite sale and purchase agreement (Agreement) valid for one year with M/s. Global Steel Works International Inc. (GSWII, subsequently renamed as M/s Global Steel Philippines Inc. GSPI) and GSHL (Umbrella Company of GSWII). STC also signed (26 August 2005), a Collateral Management Agreement (CMA) for one year with Ace Audit Control and Expertise, Geneva (ACE) selected on nomination basis for collateral management of raw materials. The contract of ACE was extended further up to 30 June, 2007. Subsequently, STC appointed Central Warehousing Corporation (CWC) as CMA with effect from 01 July 2007. Trading margin of STC was 1.25 *per cent* of the value of Letter of Credit (LC) plus the expenses for opening of LC. This amount was to be paid by GSWII at the time of sale/lifting of material/expiry of usance period, whichever is earlier.

GSPI halted processing of raw material and sale of finished goods in September 2008 due to substantial fall in prices of raw materials and finished goods. STC received ₹1460.59 crore against the amount of ₹2135.91 crore financed till October 2008. The fall in prices resulted in a gap of about USD 37 million between the current value of stock and the amount funded by STC. When the Philippines plant started production again in May 2009, BoD of STC approved (May 2009) a proposal for supply of low price steel raw material to GSPI with the stipulation that GSPI would pay USD 50 per MT over and above the cost of raw material supplied to them by STC to clear the outstanding dues. To facilitate liquidation (sale) of stock of GSPI, STC also approved (July/September 2009) financing for another company M/s Topworth Steels and Power Private Limited, Mumbai[1], amounting to ₹300 crore for import of finished goods from GSPI only. STC further opened (May 2010) four LCs valuing USD 34.53 million (equivalent to ₹158.84 crore (approx.) @ ₹45.84 per USD) in favour of M/s Ispat Industries Ltd. (Ispat), a subsidiary of GSHL[2], to import the finished goods from GSPI. Due to irregular realisation of dues, the outstanding against GSPI increased to ₹903 crore (March 2010). GSPI finally closed its production plant around April –May 2010.

STC asked GSPI/GSHL to clear all the outstanding dues within a mutually agreed timeframe. GSPI committed (July 2010) to remit all outstanding dues in installments. However, Audit observed that the three cheques worth USD five million each given by GSPI were dishonored (15 November 2010). On occurrence of default, STC issued legal notices under section 138 of Negotiable Instrument Act against the Chairman, Directors and Principal Officers of GSHL. In March 2011, GSPI/GSHL informed STC that they had decided to induct a strategic investor and /or dilute its shareholding in GSPI with the plant having approximate value of USD 800 million and capacity of 2.4 million MT. As per proposed arrangement STC was to have unconditional first charge on the proceeds as a secured creditor to the extent of claims on GSHL/GSPI. GSPI/GSHL handed over 20 cheques by June 2011 for USD 168 million payable at Bank of India, Singapore and one cheque for USD 85 million drawn on Barclays Private Bank, London in lieu of the cheques returned unpaid, which could not be encashed because GSHL had requested STC to grant them more time for payments due to them. On the pretext of strategic sale of the plant GSHL/GSPI sought further time. STC rejected (14 July 2011) the request of GSHL/GSPI and asked them to make payment of entire amount outstanding to STC

[1] ***The original contract (August 2007) was for procurement of raw material for Topworth being actual user/consumer***

[2] ***Till 2010-11 as it was acquired subsequently by M/s JSW Ispat Steel Limited from M/s GSHL***

within five days. GSHL/GSPI offered (06 September 2011) to initiate conciliation process to determine the mode of payment, timeframe, schedule, quantification of the interest amount and the mode of securing the payment. STC agreed to the said offer and both the parties *i.e.*, STC and GSPI/GSHL nominated their respective Conciliators. Subsequently, Conciliation award / Settlement agreements entered on 15 November 2011, according to which GSHL agreed to pay total amount of USD 355.82 million in the following manner:

- USD 38 million within 90 days from the date of the settlement/agreement/award.
- Remaining balance of USD 317.82 million on or before 180 days from the date of the signing of the settlement/agreement/award.

It was also agreed that the settlement agreement would become enforceable and investments of GSHL would be executable immediately on expiry of 90 days, if first instalment was not paid by GSHL/GSPI, from the date of settlement agreement.

Chairman, GSHL/GSPI requested STC (26 April 2012) for further extension of time up to December 2012. Considering the inability to make the payment of the second instalment by the party, STC agreed to accept the request of GSHL/GSPI as a last and final opportunity to them. On 17 May 2012 'Further Settlement Agreement' with regard to the extension of time for payment of 2nd instalment of USD 317.82 million together with interest thereon, was entered into under the Settlement Agreement dated 15 November 2011 as under:

- GSHL/GSPI to pay USD 100 million within 90 days from 13 May 2012, *i.e.,* the date of payment of last instalment under the Settlement Agreement dated 15 November 2011.
- Remaining balance of USD 317.82 million for the extended period on or before 180 days from 13 May 2012.

It was further agreed that the settlement agreement would become enforceable and executable immediately on expiry of 90 days, if the first instalment was not paid by GSHL/GSPI, from the date of settlement agreement.

GSHL/ GSPI did not honour the 'Further Settlement Agreement' too. STC filed execution petition in August 2014 in the High Court of Delhi. The Court dismissed (9 March 2015) the petition on the ground of jurisdiction of the court with liberty to STC to approach the appropriate Court for enforcement of the Award. Eventually, STC moved to Supreme Court of India and their special leave petition No.14585/2015 is presently pending in Court. STC also filed a criminal complaint under the Indian Penal Code (6 June 2015) for dilution of their shares/ investments/assets by subsidiary/associates/affiliates of GSHL/GSPI. However, subsequent to ‘Settlement Agreement’ (15 November 2011) and ‘Further Settlement Agreement’ (17 May 2012), STC received cumulative payments of ₹821.13 crore (till 31 January 2017) from GSPI/GSHL. The total outstanding dues recoverable from GSPI/GSHL rose to ₹2,101.45 crore (including interest of ₹1,129.15 crore and additional trade margin of ₹220.99 crore as on 31 January 2017).

Audit observed that:

- STC allowed (September 2005) GSPI the facility of supply its finished products in lieu of the price of raw material released, in contravention of clause 1 of the Tripartite Agreement, to facilitate procurement of raw materials only. This exchange of raw material for finished products of GSPI resulted in accumulation of stock of ₹990.65 crore (March 2011) including finished goods.

- The Management failed to dispose of the stock under Clause 13 'Risk Sale' of tripartite agreement which stipulated that, in the eventuality of GSPI failing to take delivery within the prescribed period, STC shall have the right to dispose off the balance material, if any, to any other party at the risk and cost of GSPI after giving 15 days prior notice to GSPI. Instead of effecting the Risk Sale due to persistent defaults in payment, STC entered (15 November 2011 and 17 May 2012) conciliation agreements with GSHL/GSPI which were not honored by GSPI/GSHL.

- STC did not conduct the inspection of stock required to be carried out every 45 days and annual physical valuation of the stocks by third party in accordance with Trading Guidelines. No record of the status of the stock as on date (March 2016) was shown to audit.

- Despite the fact that Plant was under closure, STC increased its exposure from ₹25 crore (mentioned by GSHL in their proposal of December 2003), to ₹241.54 crore in October 2005 and then to ₹925.47 crore in February 2008, exposing STC to significant risk.

- STC opened LCs on behalf of GSPI/GSHL for 180 days usance period in violation of Clause 3.3 of the tripartite agreement for opening of LCs for 120 days basis.

- As against 20 *per cent* to 25 *per cent* of Earnest Money Deposit (EMD) rate stipulated in trading guidelines of STC, the Company fixed EMD at 10 *per cent* of value of LC opened on behalf of GSPI. Further, despite shortfall of ₹179.45 crore[1] in the value of stocks (October 2008 to May 2009) STC did not obtain additional EMD from GSPI to secure its financial interests.

- STC had established (May 2010) four LCs valuing USD 34.53 million, on behalf of Ispat for import of material from the plant of GSPI at Philippines. GSPI encashed all four LCs without effecting the supply of material to Ispat. GSPI informed (27 June 2011) STC that due to unavoidable circumstances the material could not be transferred / shifted to Ispat, hence the value of LCs negotiated by GSPI may be debited by STC to their account. GSPI acknowledged full responsibility and assured to pay the amount to STC along with all the charges and interest till the date of actual payment. STC objected the above action of GSPI

[1] ***USD 37 million @ ₹48.50 per dollar***

and informed (1 July 2011) GSPI that STC reserves its right to initiate appropriate legal action as deemed fit for the criminal conspiracy between GSPI and Ispat. While agreeing to the conciliation agreement (November 2011), STC admitted the request of GSPI. Audit however, did not find on record any legal action taken by STC in the matter.

- Despite the fact that GSPI/GSHL did not adhere to the first conciliation agreement (November 2011), Management entered into 'Further Settlement Agreement' (17 May 2012), instead of executing the assets of GSHL/GSPI under provisions of first Conciliation Agreement. STC filed execution petition No. 198662/2012 on 13 December 2012 which was withdrawn due to objections raised by the Registry. STC took 20 months' time to file amended execution petition in August 2014 which was disposed off (9 March 2015) by the High Court of Delhi.

- STC incurred an expenditure of ₹8.44 crore (March 2016) regarding legal expenses in these cases.

The Management replied (September 2015) that:

(a) Decision of the Management was not based solely on the opinion of E&Y which was only a preliminary paper, non-binding and hence not completely adopted by the Management.

(b) The change from cash & carry system to conversion system was covered by clauses 4.1.1. and 4.1.2 of the provisions of the tripartite agreement.

(c) Decision not to sell the material at the risk and cost of the party, although provided in the tripartite agreement, was on commercial considerations and also due to the legal implications involved.

(d) STC in no way has compromised the position of availability of stock by entering into conciliation proceedings with GSHL/GSPI, since the stock continue to be pledged with STC and the Company could always take recourse to sale of stock if debtor failed to pay the outstanding dues to STC as determined in conciliation proceedings.

(e) Physical verification of stocks could not be undertaken due to closure of plant and the same has been shown as unsecured in the books of account, on the advice of Statutory Auditors.

The reply was not acceptable in view of the following:

(a) The opinion given by E&Y was an important consideration submitted to the BoD for approval of this proposal. In this connection the BoD of STC had directed the Management in its 557th meeting held on 15 May 2009, to examine the reasons for not putting into practice the risk analysis carried out by E&Y. BoD had also expressed that prompt action should have been taken immediately upon the ceiling of 14 *per cent* being breached.

(b) Clause 4.1.1 and 4.1.2 of tripartite agreement referred in the reply stipulated release of material on cash and carry only and did not permit conversion basis.

(c) STC should have assessed the legal implications of not having its presence as a legal entity in Philippines, at the stage of approval of the business model itself. Failure to do so hampered capability of the Company to invoke 'Risk Sale' clause in the tripartite agreement.

(d) In the absence of physical verification of stock the pledge deed in favour of STC is of no use. The information on stock of raw material in the custody of GSPI was not furnished to Audit.

Thus, due to defective implementation of the terms of the agreement, STC could not realise its dues of ₹2,101.45 crore (as on 31 January 2017) including interest of ₹1,129.15 crore and additional trade margin of ₹220.99 crore from GSHL/GSPI.

The matter was reported to the Ministry in December 2016; their reply was awaited (January 2017).