

**IN THE SECURITIES APPELLATE TRIBUNAL
MUMBAI**

Appeal No. 55 of 2007

Date of decision: 17.07.2007

Alok Khetan

Appellant

Versus

Securities & Exchange Board of India

Respondent

Shri. P. N. Modi, Advocate alongwith Shri. Vinod Bhandana, Advocate for the appellant

Shri. Kumar Desai, Advocate for the respondent

CORAM

Justice N. K. Sodhi, Presiding Officer
Arun Bhargava, Member
Utpal Bhattacharya, Member

Per: Justice N. K. Sodhi, Presiding Officer

As a result of the investigations conducted by the Securities and Exchange Board of India (for short “the Board”) into the alleged price manipulation of the shares of Padmini Technologies Ltd. (hereinafter called “the company”) it transpired that as many as 73 entities including the appellant herein had allegedly indulged in unfair trade practices relating to the securities market and were charged with the violation of Regulation 3 and 6 (a) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 1995 (for short “the Regulations”) and section 16 read with section 2(i) of the Securities Contracts (Regulations) Act, 1956 (for short “SCRA”). All the entities including the appellant were served with separate notices calling upon them to show cause why directions under section 11B of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as “the Act”) be not issued debarring them from associating with the capital market related activities,

dealing in securities, accessing the capital market in any capacity whatsoever and associating with any of the intermediaries in the capital market for an appropriate period. The appellant filed his detailed reply to the show cause notice denying the allegations and also filed his written submissions at the time of the hearing. The other entities must also have filed their replies but since they are not in appeal before us we are not concerned with them in this order. After perusing the investigation report, the show cause notices sent to the entities, the replies received from them and other relevant material on record, the Board by its consolidated order dated March 31, 2007 found that the company had allotted 1.8 crore preferential shares to them who for the sake of convenience were broadly categorized as Kolkatta based allottees and Delhi based allottees. The appellant before us is a Kolkatta based allottee to whom 9,00,000 shares were allotted. It was also found that the allottees received the preferential shares without the payment of application/allotment money at the time of allotment. The Board further found that all the allottees sold the shares immediately thereafter to third parties including one Ketan Parekh and his entities to manipulate the market in the scrip of the company. It was also found that the transactions between the preferential allottees and the third parties were in violation of section 16 read with section 2(i) of SCRA and accordingly those transactions fell in the prohibited category, in as much as, the payment for the sale of scrips was received much beyond the time prescribed by law. Feeling aggrieved by this order, the appellant is in appeal before us. Since no other entity has come up in appeal, we shall only deal with the case of the appellant.

In the show cause notice issued to the appellant it was alleged that he had acted in nexus with the company and its promoters to enable them to make an irregular preferential allotment of shares and that 9,00,000 shares had been allotted to him on 20.06.1999 alongwith other Delhi and Kolkatta based entities for cash at par without actual receipt of money. Another charge leveled against the appellant was that he had sold his shares even before they had been listed in off market

transactions through one Sanjay Kumar and received payment for those shares after more than two months from the date of the transaction thereby violating the prohibitions imposed by the central government under section 16 read with section 2(i) of SCRA. Though it was mentioned in the how cause notice that large quantity of preferential shares were acquired by Ketan Parekh entities who were acting in nexus with the company in off market deals from Delhi based allottees and that those shares were off loaded by Ketan Parekh to the general investors at an artificially high price, it was nowhere alleged that the appellant had sold the shares either to Ketan Parekh or his entities with a view to enable them to manipulate the market in the scrip of the company. It is pertinent to mention here that the Board by its order dated 12.12.2003 had prohibited the aforesaid Ketan Parekh and his entities from buying, selling or dealing in securities in any manner directly or indirectly and from accessing the securities market for a period of 14 years and that order had been upheld by this Tribunal on 14.7.2006. The main charge against Ketan Parekh and his entities was that they had in a big way manipulated the market in several scrips

Let us now examine whether the two charges leveled against the appellant stand established. At the outset, it may be mentioned that the Board in the impugned order has recorded a finding that the aforesaid two charges stood established not only against the appellant but also against all the other entities. Since the case of the appellant was dealt along with the case of the other 72 entities, the Board after examining the stand taken before it by the different entities formulated the following two issues which, according to it, arose for its consideration “(a) Whether the Kolkatta and Delhi based allottees, Shri. Sanjay Kumar Gupta and other entities mentioned above either individually or acting in concert with other people had facilitated Ketan Parekh entities in manipulating the market in the share of Padmini in violation of the provisions of Regulations 3 and 6 (a) of the FUTP Regulations and (b) Whether the transactions by these allottees were in any way in violation to the provisions of Securities Contracts (Regulation) Act, 1956”. A perusal of the two issues as

formulated by the Board clearly indicates that in the case of the appellant the scope of enquiry had been expanded much beyond the charges leveled against him in the show cause notice. As already observed, the only two charges leveled against the appellant were that he had acquired preferential shares from the company irregularly and that those had been sold to third parties in contravention of the provisions of SCRA. It was never the case of the Board that the appellant had facilitated Ketan Parekh and his entities in manipulating the market in the scrip of the company. Having enlarged the scope of the enquiry the Board also recorded a firm finding against all the entities including the appellant in the following words in paragraph 2.12 of the impugned order:

“In the scheme of things as they transpired, the entire preferential allotment by Padmini to certain coterie of trustworthy entities without receiving allotment money was a well crafted design to flood the market with such preferentially allotted shares through KP entities for creating artificial volume in the market and the allottees in Delhi like VB Impex Pvt. Ltd. and JP Promoters Pvt. Ltd. were the necessary intermediary layers to impart a verisimilitude to the entire make-believe by making it appear that the process of allotment to the original allottees was genuine, at arm's length, so that Padmini would be distanced from KP entities while insinuating cleverly that the allottees in the intermediary layer sold the shares to KP entities directly or indirectly in the ordinary course of business. Thus in the process, the original allottees in the intermediary layer were necessary parties in facilitating the ultimate design of Padmini and to the extent, they were part of the manipulative assemblage.”

Again in paragraph 2.38 of the impugned order the Board held as under:-

“In the above context, I note that the preferential allotment of shares in Padmini was a ruse to manipulate the market with the help of a solid-phalanx of connected entities in a web of transfers by artificially creating volumes and price in the said shares. In the present matter, it is fairly established that the entities who acted as conduits in the scheme facilitated the KP entities to manipulate the shares of Padmini. In the process, interest of investors were affected.”

We put it to the learned counsel for the respondent Board as to how such sweeping findings could be recorded against the appellant when no such allegation or charge had been leveled in the show cause notice. He fairly conceded that these findings qua the appellant could not be supported. He was candid enough to submit that the show cause notice against the appellant levels only two charges against him namely (1) that he had irregularly acquired preferential shares from the company without actual payment of money (2) that those shares had been sold by him even before they were listed in contravention of the restrictions imposed by the central government under section 16 of SCRA. It is thus, clear that the findings recorded by the Board against the appellant regarding the flow of shares from him to Ketan Parekh and his entities for further manipulation in the market cannot be sustained. We are not basing our conclusion only on the concession made by the learned counsel for the respondent. The learned counsel for the appellant took us through the impugned order and also drew our attention to the relevant material on record and we find that there is not even an iota of evidence on the record which could indicate even remotely that the preferential shares in the hands of the appellant had gone to Ketan Parekh or his entities. As already observed, even the show cause notice does not make such an allegation. In the absence of any material, the findings of the Board in this regard qua the appellant have to be set aside. The Board has grossly erred in recording these findings because it dealt with the case of all the 73 entities together in the impugned order without separately dealing with the case of the appellant. It further appears to us

that without separately dealing with the case of the appellant. It further appears to us that without examining the case of the appellant he, too, has been painted alongwith others with the same brush. This, however, does not mean that the appellant will succeed.

Now coming to the first charge as leveled against the appellant in the show cause notice. It is alleged that he acquired the shares of the company in a preferential allotment in an irregular manner without actual payment of money. It is not in dispute that he is a share broker and also a director with substantial holding in Ishanika Securities Pvt. Ltd. which too is a broker. The appellant was summoned to appear before the Board during the course of the investigations and he stated that he had been introduced to the company during March/ April 1999 by his cousin brother Sunil Kishorepuria (SK) who was known to the company. His decision to acquire shares in the company was influenced by SK who told him that the working of the company had improved after the installation of its DVD plant and that it was expected to come out with good dividend. SK told him that he would be required to pay only Rs.2.50 initially against the allotment and when he told him that he did not have sufficient funds to take 9,00,000 shares, SK assured him that he (SK) would arrange the balance payment on his behalf. It is also the case of the appellant that he was never in touch with the company directly. SK also told the appellant that he was never in touch with the company directly. SK also told the appellant that the latter would be given sufficient time to make payment against the preferential allotment of shares. The appellant further stated that SK was in direct and close contact with the company and that he was managing his own investments as well as those of the appellant in the preferential allotment. According to the appellant, SK had an understanding with the company for making payment against allotment only after he sold his shares and received the sale consideration. The appellant tried to improve upon his statement during the course of the hearing before the Board but that is of no consequence. However, the learned counsel for the appellant accepted that the statement made by

the appellant during the course of the investigations is correct. In his written submission before the Board the appellant had stated as under:-

- “VI. Even before making an application for the said preferential allotment, I made it very clear to SK that I do not have sufficient funds and he has assured that he would arrange the balance payment of funds on my behalf, if the need arise as he was confident about the progress of the Company. I submit that I have no nexus or any connection with the management of the Company or the directors or the promoters and I am not a party to any misconduct or irregularities committed by the management in the said allotment or any other matter whatsoever.
- VII. As the share price of the scrip was below par even prior to the date of allotment, I have not kept any balance in my account and the cheque was not deposited by the Company for clearing.”

Going by the statement of the appellant as it is and taking the same to be correct, it is established on his own showing that that preferential allotment of shares was made to him without payment of money. This is also an allegation made in the show cause notice. It is, thus, clear that the allotment was irregular. It is quite intriguing that the appellant who had no contacts with the company at all was allotted preferential shares and given financial accommodation when he was assured by SK on behalf of the company that he will not have to make the payment. It is also an admitted fact that the appellant applied for preferential allotment and also issued a cheque dated 20.05.1999 in the name of the company in a sum of Rs.22,50,000/- which was the amount payable on application. It is again intriguing that the appellant had been assured that he would not be required to make the payment and yet he issued the cheque to the company which, of course, was not immediately encashed. The appellant had revalidated the cheque at least once, if not twice, and admittedly the same was encashed on 19.01.2000 after he had sold those shares and received the sale consideration on 12.01.2000. Counsel for both the parties were agreed that the preferential allotment from the very beginning was illegal and the shares had been allotted for some sinister purpose and admittedly, the company did not receive any

money on the allotment of these shares. Preferential allotment of shares is one of the modes recognized by the company law for increasing the subscribed capital of a company and amazingly when the allotment was made the company did not receive money and we are satisfied that the allotment was contrary to law and that the appellant was a party to the game plan. Preferential allotment of shares without actual receipt of money by the company is not only illegal but it also adversely affects the interest of investors in the securities market. It affects the rights of the existing shareholders of the company which was then a listed company. The preferential shares had not been listed till December 22, 1999 and, obviously, the game plan who to trade that tainted shares in the market as and when they got listed. This by itself is a serious market irregularity particularly when we find that the appellant was a person who was well conversant with the market as an intermediary. The first charge leveled against him, therefore, stands established.

We will now deal with the second charge as leveled in the show cause notice. This charge, in our opinion, also stands established on the appellant's own admission made during the course of the investigations. Section 16 of SCRA provides that if the central government is of the opinion that it is necessary to prevent undesirable speculation in specific securities in any state or area, it may, by notification in the official gazette declare that no person in the area specified in the notification shall enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein. Sub section 2 of Section 16 declares that all contracts in contravention of the notification shall be illegal after the date of the notification. The learned counsel for the parties are agreed that the central government had issued a notification in the year 1969, and thereafter the Board issued a similar notification in March, 2000 in exercise of its delegated authority under section 16 of SCRA prohibiting any person in the territory of India to enter into any contract for sale or purchase of securities other than spot delivery or contract for cash or hand delivery or special delivery or contract in derivatives as is

permissible under SCRA or the Act and the Rules and Regulations made there under and Rules, Regulations and Bye laws of a recognized stock exchange. In other words, the prohibition contained in the notification means that no security could be traded in an off market transaction except by way of spot delivery contract as defined in section 2(i) of SCRA. 'Spot delivery contract' referred to in this section means a contract which provides for actual delivery of securities and payment of a price therefore either on the same day as the date of the contract or on the next day. In the instant case 9,00,000 equity shares with distinctive numbers and folio number were allotted to the appellant on June 20, 1999 as is clear from the letter of allotment a copy of which is on the record as Exhibit 'C'. It is further clear from the record that the appellant sold the shares of Shivesh Computers Pvt. Ltd. when he raised a bill against that company on 25.08.1999. The shares had not been listed by then and it is common case of the parties that these were listed on Delhi Stock Exchange on 23.12.1999 and on the Bombay Stock Exchange on 30.12.1999. It is also not in dispute that the appellant received a sum of Rs.22,50,000/- the sale consideration of the shares on 12.01.2000 and he made payment on 19.01.2000 to the company for the allotment. These facts were admitted by the appellant when he appeared before the Board at the time of hearing. He filed his detailed written submissions on April 28, 2006 wherein he stated as under:

- "XI) Mr. SK asked me that as the allotment has been already made by the Company in my name kindly issue memo in the name of Shivesh Computers Pvt. Ltd. and accordingly a memo was issued in the name of Shivesh Computers Pvt. Ltd. for the same shares allotted in my name thought I don't have any clear title to the said shares as no consideration was paid by me.
- XII) The shares of the Company on the date of Memo i.e. 25.08.1999 were not listed on any Stock Exchange and were not tradable.
- XIII) I was given to understand that no payment will be made by me for the said shares and payment to the Company will be made by the said buyer in whose name I was asked to prepare the memo and there will be no involvement of me in

any capacity. Later on the 7th January, 2000, I was given a demand draft for payment of the said amount of Rs.22,50,000/- to be made to the Company on behalf of the buyer Shivesh Computers Pvt. Ltd. Payment of the said amount was only rotated through me and I have no role in the said transaction and it was only at the behest of SK that the said payment was made.”

In view of the aforesaid admitted fact it is clear that the appellant sold his unlisted shares on 25.08.1999 in an off market transaction and received the sale consideration of Rs.22,50,000/- only in January, 2000 which is much beyond the time permitted by section 2(i) of the SCRA. Since the transaction was off market the contract for the sale of shares could only be by way of spot delivery in view of the restriction imposed by the Board under section 16 of SCRA which mandates that the sale consideration ought to have been received either on the same day of the transaction or on the following day. It is, thus, clear that the sale of shares by the appellant on 25.08.1999 in the off market transaction is violative of the restriction imposed under section 16 read with section 2(i) of SCRA.

Shri. P. N. Modi, Advocate however contended that what the appellant had traded/ sold on 25.08.1999 was the letter of allotment issued to him and not the shares. He strenuously urged that the appellant had not received the shares in the physical form even though distinctive numbers had been allotted and, therefore, it could not be said that he had traded in any security. According to the learned counsel, the appellant had traded the letter of allotment which was tradable and this, according to him, did not violate either section 16 or section 2(i) of SCRA. The argument is that the letter of allotment by itself is not a security the trading of which could violate the provisions of SCRA. We cannot accept this contention. It is not in dispute that the notification under section 16 of SCRA imposes a restriction on the trading of securities. The word “securities” has been defined in section 2(h)

of this Act to include rights or interests in securities. May be, the appellant had not received the shares in the physical form but surely the letter of allotment that he received created a right in him and his interest in the specific shares which had actually been allotted. The distinctive numbers and folio number of those shares were clearly mentioned in the letter of allotment. We are, therefore, of the view that the letter of allotment by itself was a security which was traded by the appellant. Since the trade was in contravention of the restriction imposed under section 16 of SCRA the same was illegal. The second charge also stands established.

The next question that arises for our consideration is as to what penalty should be levied on the appellant. The Board in the impugned order clubbed him with the other entities after recording a finding that all of them acted as conduits to facilitate the Ketan Parekh entities to manipulate the shares of the company and in the process interest of investors were adversely affected. We have already held that the Board was in error in clubbing the case of the appellant with other entities because in his case there is no allegation that the shares irregularly acquired by him were passed on to the Ketan Parekh entities for further manipulation in the matter. He cannot, therefore, be equated with the other entities in the matter of imposition of penalty. The irregularity committed by him is not that grave as in the case of others who have allegedly after obtaining irregular allotment passed on their shares to Ketan Parekh entities for further manipulation in the market. In this view of the matter the penalty to be imposed on him has to be considerably less as compared to the others. Keeping in view the facts and circumstances of this case we are of the opinion that the ends of justice would be adequately met if the appellant is restrained from associating with the capital market or from accessing the same for a period of three months. We order accordingly. The impugned order qua the appellant will stand

modified accordingly. The appeal is partly allowed leaving the parties to bear their own costs.

**Sd/-
Justice N. K. Sodhi
Presiding Officer**

**Sd/-
Arun Bhargava
Member**

**Sd/-
Utpal Bhattacharya
Member**