BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.242 of 2009

Date of decision: 7.4.2010

Pyramid Saimira Theatre Ltd.
C-1, IInd Floor, Temple Tower,
No.672 Anna Salai, Nandanam,
Chennai, Tamil Nadu – 600 035.

….. Appellant

Versus

The Securities and Exchange Board of India
SEBI Bhavan, Plot No.C-4A, G Block,
Bandra Kurla Complex,
Mumbai – 400 051.

….. .Respondent

Mr. Janak Dwarkadas, Senior Advocate with Mr. Ravichandra S. Hegde, Advocate and Mr. Vaibhav Ingole, Advocate for the Appellant.

Mr. Darius Khambata, Additional Solicitor General with Ms. Daya Gupta, Advocate and Ms. Chloris John, Advocate for the Respondent.

Mr. M.R. Ventakesh, Chartered accountant for the Intervenors.

CORAM : Justice N.K. Sodhi, Presiding Officer
Samar Ray, Member

Per : Justice N.K. Sodhi, Presiding Officer

This is one of those cases where the issuer company has misused its Initial Public Offer (IPO) to the detriment of the genuine investors including its employees by allotting 98.5% of the shares under the employee category to its seven chosen persons who were masqueraded as its employees. Pyramid Saimira Theatre Ltd. is the issuer company which is the appellant before us. It came out with an IPO in December, 2006 in which 4,22,200 shares representing 5% of the total size of the issue were reserved for its employees. 98.5% of these shares were allotted to seven persons who, on the appellant's own showing, joined just before the opening of the public offer and left soon thereafter.

The details of the allotment made to these persons including the duration of their employment is shown in the chart below:-

Seven Persons	No.of Shares		Duration of 'Employment' (Months)
	Applied	Allotted	
Mr. Kishore S. Jain	50,040	48,837	4+
Mr. Jayantilal R. Jain	48,000	46,846	5+
Mr. Shripal J. Shah	18,000	17,567	5+
Mr. Rajesh Prakashchandra Jain	22,020	21,490	5
Mr. Pravin Kumar Devichand Jain	48,000	46,846	5+
Mr. Dheeraj Jain	1,20,000	1,17,115	5+
Mr. Sanjay Jhabak	1,20,000	1,17,115	5+
Total	4,26,060	4,15,816	

These allottees sold the shares within 3 days of their listing on the stock exchange(s) and made an unlawful gain of more than Rs.2.31 crores.

2. The Securities and Exchange Board of India (for short the Board) on investigations found that the allottees were not the genuine employees of the company and that the company had orchestrated the whole scheme to enable the aforesaid persons to appropriate the employees' quota of shares. It further found that the company and the seven persons connived to deprive the lay investors including the genuine employees of the company from participating in the public issue. Accordingly, a common show cause notice dated February 22, 2008 was issued to the aforesaid seven persons and the appellant company alleging violation of Regulations 3(b) and 3(c) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as the Regulations). The noticees including the appellant were called upon to show cause why suitable directions under sections 11 and 11 B of the Securities and Exchange Board of India Act, 1992 (for short the Act) be not issued to them including directions to disgorge the profits made by them. None of the allottees (the aforesaid seven persons) has come up in appeal before us and in this case we are only concerned with the appellant company. The appellant filed its reply on August 17, 2009 denying all the allegations. In para 9 of the reply, the selection and recruitment of the seven persons was sought to be justified on the ground that it was done in the best interests of the company with a view to accomplish the key tasks at a fast pace. It was also pleaded that the employment of these persons was

necessary keeping in view the business model of the company. It is pertinent to note that at no stage of the proceedings and not even before us during the course of the hearing did the company disown itself from the fact of having employed them. On a consideration of the material collected by the whole time member during the course of the enquiry and on the basis of the records procured during the course of the investigations, he came to the conclusion that the allegations made against the appellant stood established. The whole time member found that the appellant company and the seven allottees had connived to deprive the common investors including the genuine employees of the company from allotment under the public issue. He further found that there was no credible evidence in the records of the company to show that the seven allottees were its genuine employees. Besides, there is also a finding by the whole time member that the seven allottees collectively made an unlawful gain of Rs.2.31 crores by selling the shares in the market though there is no material on the record to indicate whether the appellant company also shared the ill-gotten gains. Accordingly, by his order dated November 10, 2009 the appellant has been restrained from accessing the securities market and from dealing in securities in any manner whatsoever for a period of 7 years. It is against this order that the present appeal has been filed.

3. We have heard the learned senior counsel on both sides and they have taken us through the records of the case including the impugned order. The fact that the appellant company came out with an IPO in December, 2006 and allotted, among others, 4,15,816 shares to the aforesaid seven persons referred to in the chart above is not disputed. What is asserted by the appellant in the memorandum of appeal and also by its learned senior counsel at the time of arguments is that the seven allottees were its employees and they had been selected and recruited taking into account the best interests of the company with a view to accomplish the key tasks at a fast pace. This fact is seriously disputed by the learned senior counsel for the respondent Board.

4. The primary question that arises for our consideration is whether the allottees were the employees of the appellant company. The records placed before us clearly

answer this question in the negative. It is the appellant's own case that the seven allottees on employment had been posted in the Bangalore office of the company where a register for recording the attendance of the employees is maintained. Admittedly, the names of these seven allottees do not appear in that register. The only explanation furnished by the appellant for non appearance of their names in the register is that they had been given flexible working hours and that they were constantly travelling. This is no explanation at all and we cannot accept the same. Again, the seven allottees were singled out for payment of salary in cash when all others were paid through cheques or by bank deposits. The vouchers against which the cash payment was made to them were generated from the Chennai office when they were supposed to be working in Bangalore. There are several other discrepancies in the vouchers and the cash book as pointed out by the whole time member and we agree with him that these mitigate against their being employees of the company. The appellant has also placed on record a copy of the letter dated March 27, 2007 written by it to the Employees Provident Fund Commissioner, Chennai to enroll the seven allottees as members of the provident fund. It is amusing to note that by the time this letter was written, the so called employees had already left the service of the company as per its own showing. This apart, by the time this letter was written, the Board had started making enquiries asking for the details of the allottees. The Board by its letter of March 26, 2007 sent by fax had sought details from the appellant including details pertaining to the provident fund of the seven allottees. Obviously, the letter written on March 27 2007 was a crude patch up operation by the appellant. There is yet another reason why we cannot hold the allottees to be the employees of the appellant. When we look at their background, they were already well settled in Mumbai for a long time carrying on their established textile business. We say so because they were high net worth individuals and their bank accounts show debit and credit entries running into crores of rupees. Each one of them had several demat accounts and this would show beyond doubt that they were seasoned market players. With this background, would any one leave Mumbai and go to Bangalore to take up a traveling job for a mere paltry salary ranging from Rs.7,500/- to Rs.25,000/- per month. The answer has to be in the negative.

Interestingly, the applications by some of them for obtaining a job indicate that they were desperate in getting one. Some of them applied for “any office job” or “any suitable job”. Again, it is the appellant’s own case that each one of the allottees was in the employment from July/August 2006 to December 2006/early January 2007. They all joined a few months before the IPO and left immediately after the issue closed. As per the service rules of the company, every employee is put on probation for a period of 6 months but these allottees were kept on probation for a period of 3 months only to ensure that they become eligible for allotment. It may be mentioned that only permanent employees were eligible to apply for shares in the employee category. They were all allowed to resign and go without serving one months’ notice. The jobs advertised by the company and the ones for which the allottees applied were totally different in most of the cases. In this background, the whole time member was right in holding that the allottees were made to don the cloak of employees only to enable them to apply for the shares in the employee’s category in the IPO. We have, therefore, no hesitation in holding that the allottees were not the employees of the appellant company and if anything, they were ghost employees. Thus, the complicity and connivance of the appellant stands established. It follows that the appellant aided and abetted the seven allottees in receiving shares under the employee quota. In the written submissions of the appellant filed after the conclusion of the hearing, it is submitted that the finding that there was no material on the record that the appellant had shared the ill-gotten gains with the seven allottees mitigates against the conclusion that the allottees were not the employees of the appellant. We are not impressed with this argument. The appellant has been found to have violated Regulation 3(b) of the Regulations. This Regulation prohibits a person from using or employing any manipulative or deceptive device or contrivance in contravention of the Act or Regulations in connection with the issue, purchase or sale of any security listed or proposed to be listed on any stock exchange. The mere fact that the appellant so brazenly contrived to allot 98.5 per cent of the shares from the employee quota to the seven allottees who were not its employees is proof enough to establish the violation of this Regulation. It is not the requirement of this Regulation that the person violating it should

also have shared the ill-gotten gains. Therefore, if the Board could not establish that the appellant had shared the spoils with the allottees does not mean that the latter were its employees.

5. Having failed to satisfy us that the allottees were the employees of the appellant company, Sh. Janak Dwarkadas, learned senior counsel then argued that the appellant is an artificial juristic person and it cannot be said to have a mind of its own and it could act only through living persons. He contends that guilty mind or a state of mind for committing fraud could be attributed to the company only if the act complained of was committed by a responsible officer of the company acting as its agent and having the ostensible authority to perform such acts so as to bind the company. In that event, argues the learned senior counsel, the state of mind of the responsible officer could be the mind of the corporate entity for which the latter could be penalized. In short, the learned senior counsel is pressing into service the theory of the "directing mind". The argument is that since the Board has failed to identify the 'directing mind" of the appellant company or the person(s) who had performed the fraudulent act of allotting shares to the non-employees, the fraudulent action or the guilty state of mind could not be attributed to the company and the same is not liable. He relied upon a Division Bench judgment of the Bombay High Court in Esso Standard Inc. vs Uddharam Bhagwandas Japanwalla (1975) 45 Comp Cas 16 and a decision of the Supreme Court in Asstt. Commissioner vs. Velliappa Textiles Ltd. (2003) 11 SCC 405. We have considered very carefully this argument of the learned senior counsel and regret our inability to accept the same.

6. No such objection was raised by the appellant either in its reply to the show cause notice or even before the whole time member at the time of personal hearing. In any case, the theory of the directing mind is a criminal law doctrine which has been developed to attribute to a corporation which is an artificial person, a state of mind or mens rea of its employees or agents. Since a state of mind or mens rea is an essential ingredient of a crime there was a view earlier held that a corporation could never be guilty of a crime because an artificial person could not be said to have a mind of its own. It was with a

view to prevent the escapement of the corporate entity from criminal liability that the law came to be evolved that a company could be prosecuted for the acts done by its responsible officers. The theory of the directing mind developed over the years to hold that the state of mind or mens rea of a responsible officer or agent of a corporation could be imputed to the corporation itself provided that such officer or agent was so placed and empowered that he could be held to be 'the directing mind' of the corporation. In other words, it is not the state of mind of every employee that could be attributed to the corporation. Only such officers of the company who are acting as its agents and have the ostensible authority to perform such acts so as to bind the company could be said to be its directing mind. It is only then that their state of mind could be attributed to the corporation to hold it liable because they act as the company and not for the company. As already observed, this theory of the directing mind was evolved to attribute and impute criminal liability to a corporation. This is what has been held by the Supreme Court in Standard Chartered Bank and others vs. Directorate of Enforcement and others (2005) 4 SCC 530. This is also the ratio of the cases cited by the learned senior counsel for the appellant.

7. This theory can have no application to the facts of the present case where civil action has been taken against the appellant for the wrong that it has committed. There is no denying the fact that the present proceedings were initiated against the appellant company under Section 11B of the Act for imposing civil penalties and the enquiry that was conducted by the Board is of a civil nature. It is by now well settled that civil action could be taken against a delinquent even for a criminal act. It is trite law that proceedings initiated by the Board against a delinquent under the provisions of the Act are civil in nature and mens rea or criminal intent is not an essential element for imposing penalties for breach of civil obligations. A Division Bench of the Bombay High Court in SEBI vs. Cabot International Capital Corporation [2004] 51 SCL 307 while dealing with the provisions of the Act took the same view when it made the following observations:

> "25. Thus, the following extracted principles are summarized.
>
> (A) Mens rea is an essential or sine qua non for criminal offence.

(B) Strait jacket formula of mens rea cannot be blindly followed in each and every case. Scheme of particular statute may be diluted in a given case.
(C) If, from the scheme, object and words used in the statute, it appears that the proceedings for imposition of the penalty are adjudicatory in nature, in contra-distinction to criminal or quasi criminal proceedings, the determination is of the breach of the civil obligation by the offender. The word "penalty" by itself will not be determinative to conclude the nature of proceedings being criminal or quasi-criminal. The relevant considerations being the nature of the functions being discharged by the authority and the determination of the liability of the contravenor and the delinquency.
(D) Mens rea is not essential element for imposing penalty for breach of civil obligations or liabilities.
(E) There can be two distinct liabilities, civil and criminal, under same act.
(F) Even the administrative authority empowered by the Act to adjudicate have to act judicially and follow the principles of natural justice, to the extent applicable.
(G) Though looking to the provisions of the statute, the delinquency of the defaulter may itself expose him to the penalty provision yet despite, that in the statute minimum penalty is prescribed, the authority may refuse to impose penalty for justifiable reasons like the default occurred due to bona fide belief that he was not liable to act in the manner prescribed by the statute or there was too technical or venial breach, etc.

26 to 29. ……………………………………………….

30. The SEBI Act and the Regulations, are intended to regulate the Security Market and the related aspects, the imposition of penalty, in the given, facts and circumstances of the case, cannot be tested on the ground of "no mens rea, no penalty". For breaches of provisions of SEBI Act and Regulations, according to us, which are civil in nature, mens rea is not essential. On particular facts and circumstances of the case, proper exercise or judicial discretion is a must, but not on a foundation that mens rea is an essential to impose penalty in each and every breach of provisions of the SEBI Act.

31. …………………………………………..
32. However, we are not in agreement with the Appellate Authority in respect of the reasoning given in regard to the necessity of mens rea being essential for imposing the penalty. According to us, mens rea is not essential for imposing civil penalties under the SEBI Act and Regulations."

This judgment of the High Court and the observations referred to above have since been approved by the Supreme Court in Chairman, SEBI vs. Shriram Mutual Fund and another (2006)5 SCC 361 and this is what their Lordships have held:

> "In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant. A breach of civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether contravention must be made by the defaulter with guilty intention or not. We also further held that unless the language of the statute indicates the need to establish the presence of mens rea, it is wholly unnecessary to ascertain whether such a violation was intentional or not."

Even though the judgment of the Supreme Court in Shriram Mutual Fund's case (supra) was dealing with chapter VIA of the Act, the ratio laid down and the observations made therein apply to the all the provisions of the Act and the Regulations. Section 24 of the Act makes the contravention of any of its provisions or the Regulations a criminal offence also and the wrong doer could be punished by the criminal court as well.

8. There is yet another reason why the theory of the 'directing mind' will not apply to the case before us. This theory or any other doctrine by which liability is sought to be imposed vicariously upon a corporation for the acts done by its employees would apply only when the corporation disapproves of or disassociates itself from the action in question or contends that the acts of its employees were unauthorized and did not bind the corporation. In the present case the appellant company has categorically, repeatedly and unequivocally owned up the acts of its employees and is continuing to defend the employment of the seven individuals to whom the shares had been allotted under the employee category. In these circumstances, the doctrine of the directing mind cannot be invoked even if, for the sake of argument, we assume that this doctrine is also applicable to civil proceedings.

9. We may now deal with Regulations 3(b) and 3(c) of the Regulations for the violation of which the impugned action has been taken against the appellant. It is necessary to refer to these provisions which read as under:

> "Prohibition of certain dealings in securities
>
> 3. No person shall directly or indirectly –
> (a) ………………………….
> (b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made thereunder;
> (c) employ any device, scheme or artifice to defraud in connection with dealings in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;
> (d)………………………………………….."

A bare reading of Regulation 3(b) would make it clear that it does not import any concept of fraud at all and the words "any manipulative or deceptive device or contrivance" do

not require any state of mind. As long as the device or contrivance is manipulative in itself, no further state of mind or intention is required. Regulation 3(c), on the other hand, imports the concept of fraud but fraud as defined in Regulation 2(1)(c) of the Regulations which is reproduced hereunder for facility of reference:

> "2. (1) In these regulations, unless the context otherwise requires,-
> (a) ……………………………………..
> (b) ……………………………………………………
> (c) "fraud" includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include-
> (1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment;
> (2) a suggestion as to a fact which is not true by one who does not believe it to be true;
> (3) an active concealment of a fact by a person having knowledge or belief of the fact;
> (4) a promise made without any intention of performing it;
> (5) a representation made in a reckless and careless manner whether it be true or false;
> (6) any such act or omission as any other law specifically declares to be fraudulent;
> (7) deceptive behaviour by a person depriving another of informed consent or full participation;
> (8) a false statement made without reasonable ground for believing it to be true;
> (9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.
> And "fraudulent" shall be construed accordingly;
> ……………………………………………………………….."

It is clear from this definition that any act, omission or concealment to be a fraud within the meaning of the Regulations need not be committed in a deceitful manner. The words "whether in a deceitful manner or not" are significant and clearly indicate that intention to deceive is not an essential requirement of the definition of fraud as given in the Regulations. In other words, mens rea or criminal intent is not an essential ingredient to establish fraud. Even making a false statement without believing it to be true is by itself an act of fraud. In the circumstances, it was not necessary for the Board to allege and/or establish that the action in question of the appellant company was with a fraudulent intent. It is liable on the principle of strict liability. The conduct of the appellant in

allotting shares to those who were not its employees squarely falls within the prohibition contained in Regulations 3(b) and 3(c) of the Regulations and no fault can be found with the findings recorded by the wholetime member in this regard. In this view of the matter, we are unable to agree with the learned senior counsel for the appellant that the definition of fraud requires any state of mind to commit the prohibited act.

10. Before concluding, we may dispose of two Misc. Applications no. 98 of 2009 and 11 of 2010. The first application was filed by the appellant company soon after the filing of the appeal whereas the other application was filed by three shareholders who wanted to intervene in the matter. As regards the application filed by the company, it is stated that the appellant has investments in various companies as a part of its investment portfolio and one such company is Pyramid Saimira Production International Limited (PSPIL) which is an unlisted subsidiary company of the appellant. It holds 99,20,488 shares of PSPIL and wants to transfer these shares to its shareholders without consideration. In other words, the appellant company wants to disinvest a sizeable part of its portfolio. The prayer made in the application is that this Tribunal should hold that the aforesaid disinvestment by the appellant company is not barred / restricted by the impugned order. We are unable to grant this prayer. For the reprehensible conduct of the appellant, it has, by the impugned order, been restrained from "dealing in securities in any manner whatsoever or accessing the securities market directly or indirectly for a period of 7 years". Transfer of PSPIL shares by the appellant to its shareholders would tantamount to "dealing in securities" and, therefore, in view of the bar contained in the impugned order, it cannot be allowed to do so since we are upholding that order.

11. The other application filed by the three shareholders need not detain us for long. It was filed at the closing stage of the arguments and that too in court. This application deserves to be rejected because it appears to us to be motivated. The applicants in the garb of protecting the shareholders' interests are in fact wanting to protect the appellant company. The three applicants acquired shares in the years 2008 and 2009 in the secondary market by which time the Board had almost completed its investigations into

the allotment of shares reserved for the employees. The first applicant acquired 1480 shares in three tranches in January 2008 and the second applicant purchased 100 shares on 30.12.2008. The third applicant acquired 43 shares on 2.3.2009. It is, thus, clear that applicants 2 and 3 acquired the shares long after the show cause notice had been issued to the appellant company. Their total shareholding comes to 0.00074 per cent of the total share capital and when the application was filed in Court, we had our apprehensions that the same had been filed at the behest of the appellant company. The cat was out of the bag when the applicants filed their written submissions though they were not asked to do so and are singing the same tune as that of the appellant company with no new ground. We wonder why the applicants had to purchase the shares when the appellant company was facing the present proceedings. In any case, they have an option to exit by selling their shares. We are also of the view that the applicants have no locus standi to intervene in the matter as the impugned order has been passed against the company which has committed serious violations of the Regulations. In this view of the matter, the application cannot but be rejected.

In the result, the appeal fails and the same stands dismissed with costs which are assessed at Rs.1 lakh.

Sd/-
Justice N.K.Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

07.04.2010
Prepared and compared by ddg/-