BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 154 of 2008

Date of decision: 07.09.2009

Himani Patel
C/o Sunrise Fincap Ltd. B-802,
Premium House, Opp. Gandhigram
Railway Station, Ashram Road,
Ahmedabad – 380 009. ……Appellant

Versus

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

Mr. Zal Andhyarujina, Advocate for the Appellant.

Mr. Shiraz Rustomjee, Advocate with Ms. Daya Gupta. Advocate for the Respondent.

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

Per : Justice N. K. Sodhi, Presiding Officer (Oral)

The Securities and Exchange Board of India (hereinafter called the Board) received some information regarding the alleged abuse and misuse of the Initial Public Offering (IPO) allotment process. It initiated a probe. Preliminary investigations revealed that certain entities had cornered IPO shares reserved for retail investors by making applications in the retail category through the medium of thousands of fictitious/benami applicants with each application being for small value so as to be eligible for allotment under the retail category. Investigations revealed that the IPO of Suzlon Energy Limited (Suzlon) opened on September 23, 2005 and closed on September 29, 2005 and the shares were listed on the National Stock Exchange of India Limited on October 19, 2005. It was further revealed that Ms. Himani Patel, the appellant herein had received 10160 shares of Suzlon from 635 different demat accounts in off market transactions of 16 shares each. It further transpired that 61

persons filed 635 multiple applications for 96 shares each and that a sum of Rs.48960/- had been deposited alongwith each application. The Board also found that money was routed through 22 different bank accounts in which the appellant was the first account holder and that each application was allotted 16 shares. The basis of allotment by the issuer company to the retail investors was 6:1. In other words, for every 6 shares applied for by a retail investor, he was allotted 1 share. The application money for each application was given by the appellant which was debited to her account and that the refunds received for the excess number of shares applied for was received back in the accounts of the appellant. On the basis of the findings recorded by the investigating officer, the Board served on the appellant a show cause notice dated June 5, 2008 stating all the aforesaid facts therein. Noticing that the appellant had financed multiple applications on the basis of which she received as many as 10160 shares in her demat account in off market transactions before they were listed, it was alleged that the demat account holders from whom the shares had been transferred in the account of the appellant were mere name lenders and that some time after the listing of the shares the appellant sold them at the market price thereby making a wind fall gain. It was pointed out that the issue price of the shares was Rs.510/- per share and even though they opened upon listing at the rate of Rs.692/- per share, the appellant sold them in November and December 2005 at a much higher rate of Rs.839.75 per share. It was alleged in the show cause notice that from the aforesaid facts it was clear that the appellant was fully in control of the funds and that the shares having come to her, the demat accounts were just conduits for receiving the shares and transmitting them back to the appellant. The show cause notice further pointed out that a large number of demat accounts were used for the purpose of cornering shares in the IPO which was to the detriment of the genuine retail investors. The appellant was alleged to have violated Section 12A of the Securities and Exchange Board of India Act, 1992 (for short the Act), Regulations 3 and 4 of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (for short the regulations) and also the Securities and Exchange Board of India

(Disclosure and Investor Protection) Guidelines, 2000 (hereinafter referred to as the guidelines). The appellant was called upon to show cause why suitable directions be not issued to her under Sections 11 and 11B of the Act restraining her from buying, selling or dealing in securities and why she should not be called upon to disgorge an amount of Rs.33,52,636/- which was the illegal gain allegedly made by her.

The appellant filed her reply on August 25, 2008 denying the allegations leveled against her. She stated that she was lending funds to the borrowers for subscribing to different IPO's that sought listing on stock exchanges and it was a short term loan which was required to be repaid at the earliest but not later than the listing of the shares. She pointed out that the loanees would transfer the shares so purchased by them to her demat account and this was as per the obligations undertaken by them under the lending arrangement. Regarding the consideration for the transfer of the securities to her demat account, this is what she said in her reply:

> "That the consideration for the transfer of the securities to my demat account towards repayment of the loan would be calculate based on the cost of borrowing the funds from me."

It is pertinent to mention here that when the investigations were ordered some time in the year 2006, the Board by an ex-parte order dated April 27, 2006 pending the investigations, restrained, among others, the appellant from buying, selling or dealing in the securities till further orders. This detailed ex parte order was treated as a show cause notice and a post decisional hearing was given to all those against whom the interim directions had been issued. The appellant filed her reply to the ex parte order and took the same stand which is reproduced hereunder :

> "I am an investor in securities as well as a financier to creditworthy investors ('Loanees') who are in need of capital to make investments in the securities market. I have entered into agreements, mostly oral in nature with such Loanees whereby they purchase/invest in securities with short-term financial assistance from me and later transfer the shares so purchased to my dematerialized account in discharge of the obligations. The consideration for transfer of the securities to me would be calculated based on the cost of borrowing the funds from me. Depending on the circumstances, I may decide to retain the securities or to sell them at a profit."

Along with her reply she had filed annexure C giving the details of 635 applications filed by loanees for the allotment of shares in Suzlon IPO. This annexure also contained the details of the amount lent by her.

On a consideration of the replies filed by the appellant and the material collected during the course of the investigations as also during the course of the inquiry conducted under Section 11B of the Act, the whole time member by his order dated October 31, 2008 came to the conclusion that the appellant was the mastermind in the manipulation of the retail segment of Suzlon IPO and that she manipulated the demand for shares in the retail category and thereby distorted the market integrity. The whole time member found that the charges levelled against the appellant stood established and that it was she who applied for the shares in the IPO under different names and cornered 10160 shares which she later sold in the market at a much higher price than the issue price thereby making huge profits. The whole time member has also found that all the 61 persons through whom the applications had been filed shared a common address with her and that she claimed that they were her relatives and friends. Having regard to the issue price and the price at which the appellant sold the shares in the market in November and December 2005, the whole time member found that the appellant made an unlawful gain of Rs.33,52,636/-. Accordingly, by his order dated October 31, 2008 he directed the appellant to disgorge the aforesaid amount with interest @ 10% and taking note of the period of prohibition already undergone by the appellant under the interim order, he debarred her from accessing the securities market for a further period of three years from the date of the order. It is against this order that Appeal no.154 of 2008 has been filed. The Board had also initiated adjudication proceedings against the appellant under Chapter VIA of the Act for imposing monetary penalty for her wrongful acts. The Adjudicating Officer by his separate order dated October 31, 2008 also found that the charges levelled against the appellant stood established and accordingly imposed a monetary penalty of Rs. 55 lacs on her. Appeal no.2 of 2009 has been filed against this order. Since both the appeals arise out of the same set of facts and

allegations made against the appellant and they have been argued together, they are being disposed of by a common order.

We have heard the learned counsel for the parties on both sides. The whole time member in the impugned order has found that the appellant opened 22 joint bank accounts with 61 persons with herself as the first account holder and that all these persons made a total of 643 applications in the Suzlon IPO. He further found that out of these applications 635 applications were allotted 16 shares each and that the appellant financed all these applications and that there were debits of Rs.48,960/- for each application in her bank account. The shares that were allotted on these applications were credited to 635 demat accounts of the said 61 persons who are said to be the relatives and friends of the appellant. It has also been found that the appellant received 10160 shares from these demat accounts in off market transfers of 16 shares each which were sold by her making a profit of Rs.33,52,636/-. The amount deposited with the application money was paid by the appellant and the refund for the excess shares had also been credited to her account(s). These findings have not been disputed by the appellant in the present appeals. What is contended by the learned counsel for the appellant is that there is no prohibition in making multiple applications and that the applicants did no wrong when they filed multiple applications for the allotment of shares in the Suzlon IPO. It was also urged that there was no obligation on any applicant to maintain the sanctity of any quota even if there was one prescribed by the guidelines and/or by the issuer company and that the obligation to maintain such quota was only of the company. The learned counsel for the appellant strenuously contended that the guidelines are a self-contained code and even if there was any breach committed by any of the applicants, the remedial measures provided by the guidelines should have been resorted to by the Board and that no action could be taken against the appellant under the Act or the regulations. He further submitted that any prohibition in the prospectus by itself could not result in a breach of any regulatory provision and that the conduct of the appellant was not a ‘fraud’ in terms of Regulation 2(c) of the Regulations. The argument is that to arrive at a finding of fraud under Regulation 2(c),

it is essential that there be an independent breach of a statutory provision or an attempt to circumvent a prohibition imposed by law.

We are unable to accept any of these contentions. At the outset, we may refer to the various provisions of the guidelines which read together clearly indicate that there are specified categories of investors for whom reservations are required to be made in the matter of allotment in a public issue. We are only concerned with the retail investors in the present case and, therefore, reference is made only to such provisions of the guidelines which deal with such investors. Retail individual investor is defined in the guidelines to mean an investor who applies or bids for securities of or for a value of not more than Rs. 1 lac. A reading of this definition makes it clear that it is inherent that a person who wants to apply as a retail investor must not exceed the limit and if one were to apply in different names, it is obvious that he is trying to manipulate the provisions of the guidelines and corner shares more than what he may otherwise be entitled to. Clause 11.3.5 of the guidelines lays down the procedure for allocation / allotment where a company makes an issue to the public through 100% book building process. It is common ground between the parties that Suzlon had come out with a public issue through the book building process. The said clause of the guidelines alongwith the second proviso reads as under :

> "11.3.5 Allocation / Allotment Procedure
> (i) In case an issuer company makes an issue of 100% of the net offer to public through 100% book building process-
> (a) not less than [35%] of the net offer to the public shall be available for allocation to retail individual investors;
> (b) not less than [15%] of the net offer to the public shall be available for allocation to non-institutional investors i.e. investors other than retail individual investors and Qualified Institutional Buyers;
> (c) not more than 50% of the net offer to the public shall be available for allocation to Qualified Institutional Buyers:
>
> Provided that, 50% of [net offer to public] shall be mandatorily allotted to the Qualified Institutional Buyers, in case the issuer company is making a public issue under clauses 2.2.2 and 2.3.2 of these guidelines :
>
> Provided further that, in respect of issues made under rule 19(2)(the Board) of Securities Contracts (Regulations) Rules, 1957, with 60% mandatory allocation to Qualified Institutional Buyers, the percentage allocation to retail individual investors and non-institutional investors in terms of clause 111.3.5(i)(a) shall be 30% and 10% respectively."

A reading of the aforesaid provision leaves no room for doubt that every public issue through the book building process has necessarily to reserve 30% of the allotment for the retail individual investors and it is not in dispute that Suzlon in fact while issuing the prospectus which again is the mandatory requirement of the guidelines had reserved 86,26,500 equity shares as the retail portion to be allocated on proportionate basis. Again, the guidelines lay down the general instructions which every issuer company is required to follow. It must mention in the prospectus, the Do's and don'ts for the guidance of the investors. The issuer company is also required under the guidelines to specify in the prospectus the reservation for specified categories and, as already mentioned, Suzlon had mentioned the number of shares actually reserved for the retail individual investors. The guidelines further provide that in a public issue of securities, the Executive Director / Managing Director of the designated stock exchange alongwith the post issue Lead Merchant Banker and the Registrars to the Issue shall ensure that the basis of allotment is finalized in a fair and proper manner in accordance with the guidelines. The allotment is then to be made on proportionate basis within the specified categories depending upon the number of applications received in each category. It is, thus, clear that the guidelines and the prospectus issued by Suzlon clearly specify the reservation for the retail individual investors and the investors are clearly prohibited from making multiple applications as that would subvert the very process of allotment and reservation.

Now coming to the facts of the present case, we are in agreement with the findings recorded by the whole time member that it was the appellant who filed multiple applications in the names of different persons with a view to subvert the allotment in the IPO and corner larger number of shares than the number to which she would have otherwise been entitled to had she filed a single application in her own name. It is not in dispute that after the applications were received, Suzlon had allotted shares in the retail category in the proportion of 6:1, that is, for every six shares applied for, one share was allotted in the retail category. By filing 635 multiple applications, the appellant succeeded in getting 16 shares on each application and managed to corner 10,160 shares

in different demat accounts which, as already observed, were transferred to her demat account in off market transactions which she later sold in the market. This conduct of the appellant not only subverted the allotment process but was also fraudulent in nature. We say so in the light of the findings recorded by the whole time member which have not been disputed before us. It is admitted that there were no written agreements executed between the appellant and the persons to whom she is said to have advanced loans for investing in securities even though she lent a sum of over Rs. 3 crores. The money was not hers. She says she got it from her parents. It is also not in dispute that none of the so-called loanees repaid the amount and none of them had contributed any amount towards the application money which is normally done in the case of loans. In other words, the entire application money for all the 635 applications was contributed by the appellant. The shares on allotment were transferred to the demat account of the appellant from the demat account of the applicants prior to listing and these transfers, according to the appellant were a part of the lending arrangement. Another co-incidence is that each application was for the same number of shares and were filed by 61 persons each of whom made multiple applications which were funded by the appellant. Each application was kept below the amount of Rs. 50,000/- so as to avoid furnishing the details of the permanent account number which was mandatorily required if an applicant applied for shares worth more than Rs. 50,000/-. Further, 22 bank accounts were opened with the applicant in different combinations and the appellant was the first account holder in each account. Refunds received from Suzlon for the excess shares applied were also received in the account(s) of the appellant. It is further admitted that the appellant sold all the shares in the market much after the listing making huge profits. All the 61 persons who filed 635 applications are, according to the appellant, her friends and relatives and share a common address. All these factors clearly establish the fraudulent conduct of the appellant and the manner in which she tried to corner the shares in the retail category. They also establish the fact that it was the appellant who filed the applications in different names. There is yet another interesting factor to be taken note of which clearly indicates that the shares had actually been purchased by the

appellant in the name of the other applicants. The appellant herself has placed on record computation of actual profit that she made from the sale of Suzlon shares. In this computation which is on the record of Appeal no. 2 of 2009 shows that each applicant was paid a commission which is referred to in one of the columns in the said chart. If the appellant had really lent money to the applicants for applying for the shares of Suzlon, there is no reason why she should be paying commission to them. It is obvious that the applicants had lent their names for the allotment of shares to the appellant so that she could corner the portion of the retail segment more than her entitlement. In this view of the matter we have no hesitation in holding that the appellant was guilty of violating Regulations 3 and 4 of the Regulations and also the guidelines and section 12 (A) of the Act. The learned counsel appearing for the appellant strenuously argued that the conduct of the appellant did not fall within the Regulations 3 and 4 of the Regulations and, therefore, the findings recorded in the impugned order could not be sustained. We cannot agree with him. A bare reading of Regulation 3 would show that it prohibits a person from buying, selling or otherwise dealing in securities in a fraudulent manner. It also prohibits a person from employing any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange. We are satisfied that the appellant had indulged in unfair trade practice which is prohibited by the Regulations. We, therefore, uphold the findings recorded in the impugned order.

Now coming to the direction requiring the appellant to disgorge a sum of Rs. 33,52,636/- alongwith interest at the rate of 10% per annum. It is appellant's own case that she sold 10,000 shares on November 29, 2005 at the market rate of Rs. 839.75 per share and the remaining 160 shares on December 26, 2005 at the rate of Rs. 854.60 per share. It is common case between the parties that the issue price of the share was Rs. 510/-. The profit made by the appellant in the present case can be worked out mathematically as has been done in the impugned order and it cannot be disputed that she made an undue profit of Rs. 33,52,636/- as calculated by the whole time member. We had the occasion of dealing with the concept of disgorgement in Karvy Stock

Broking Ltd. versus Securities and Exchange Board of India Appeal no. 6 of 2007 decided on May 2, 2008 wherein we have observed as under :

> "(5) Before we deal with the contentions of the parties, it is necessary to understand what disgorgement is. It is a common term in developed markets across the world though it is new to the securities market in India. Black's Law Dictionary defines disgorgement as "The act of giving up something (such as profits illegally obtained) on demand or by legal compulsion." In commercial terms, disgorgement is the forced giving up of profits obtained by illegal or unethical acts. It is a repayment of ill-gotten gains that is imposed on wrongdoers by the courts. Disgorgement is a monetary equitable remedy that is designed to prevent a wrongdoer from unjustly enriching himself as a result of his illegal conduct. It is not a punishment nor is it concerned with the damages sustained by the victims of the unlawful conduct. Disgorgement of ill-gotten gains may be ordered against one who has violated the securities laws/regulations but it is not every violator who could be asked to disgorge. Only such wrongdoers who have made gains as a result of their illegal act(s) could be asked to do so. Since the chief purpose of ordering disgorgement is to make sure that the wrongdoers do not profit from their wrongdoing, it would follow that the disgorgement amount should not exceed the total profits realized as the result of the unlawful activity. In a disgorgement action, the burden of showing that the amount sought to be disgorged reasonably approximates the amount of unjust enrichment is on the Board."

It is thus clear that a person who has unjustly enriched himself by his unlawful conduct should be required to disgorge the illegal gains made by him. We have already held that the conduct of the appellant in cornering large number of shares in the retail category of Suzlon IPO was fraudulent and that by her wrongful conduct she had unjustly enriched herself to the extent of Rs. 33,52,636/-. The whole time member was justified in requiring the appellant to disgorge the aforesaid amount. No fault can thus be found with any part of the order passed by the whole time member.

This brings us to Appeal no. 2 of 2009 in which the adjudicating officer has also found that the appellant was guilty of misconduct in as much as she cornered shares more than her entitlement in retail category of Suzlon IPO. The findings recorded by the adjudicating officer cannot but be upheld in view of our findings recorded earlier. Section 15(H)(A) of the Act provides that if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to pay a penalty not exceeding Rs. 25 crores or 3 times the amounts of

profits made out of such practices whichever is higher. The adjudicating officer has wrongly calculated the profit made by the appellant by taking the assumed profit to be the difference between the issue price of Rs. 510/- and the closing price on the first day of listing which is Rs. 692.85. He should have calculated the profit as the difference between the issue price and the price at which the appellant had actually sold the shares in November and December, 2005 as has been done by the whole time member. This has resulted in a lower penalty being imposed on the appellant. In the present appeal filed by the appellant, we cannot enhance the penalty amount but certainly there is no scope for reducing the same. There is, thus, no ground for us to interfere with the order of the adjudicating officer.

Before concluding, we may mention that after the arguments had concluded from both sides, the learned counsel for the appellant on instructions from his client's representative who was present in Court, sought permission to withdraw the appeals which was declined on an objection being raised by the learned counsel for the respondent.

In the result, both the appeals fail and they stand dismissed. The appeals have been argued admirably by both sides. However, we are of the view that in these cases, the costs must follow the event. Accordingly, the Board shall have its costs in both the appeals which are assessed at Rs. 50,000/-.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

07.09.2009
Prepared and compared by :
msb/-