BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 182 of 2009

Date of decision: 12.11.2010

1) Dushyant N. Dalal
2) Ms. Puloma D. Dalal
120/123, Arun Chambers,
First Floor, Tardeo Road, Mumbai ……Appellants

Versus

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

Mr. E. P. Bharucha, Senior Advocate for the Appellants.

Mr. Kumar Desai, Advocate with Ms. Harshada Nagare, Advocate for the Respondent.

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

Per : Justice N. K. Sodhi, Presiding Officer

This case also arises out of the Initial Public Offerings (IPO) scam that was unearthed by the Securities and Exchange Board of India (hereinafter called the Board) in the year 2005-06. The short question that arises for our consideration is whether the appellants acted as financiers in the scam.

2. Before we deal with the facts of the case, let us briefly state (shorn of the details not necessary) how the scam/fraud was perpetrated. On receipt of information regarding alleged abuse and misuse of the IPO allotment process, the Board initiated a probe. During preliminary analysis of the buying, selling and dealing in the shares allotted through IPOs of various companies during the years 2003-05, it transpired that certain entities opened many demat accounts in fictitious/benami names and these entities cornered/acquired the shares of those companies allotted in the IPOs by making large number of applications of small value so as to make them eligible for allotment under the retail category. The strategy adopted was that subsequent to the receipt of IPO allotment, these fictitious/benami allottees transferred the shares to their principals called the key operators who controlled their accounts and who, in turn, transferred most of the shares to the financiers who had originally made available funds for executing the game plan. In

view of the booming market, the key operators in some cases and the financiers in most of the cases then sold most of the shares on the first day of listing or soon thereafter thereby making a windfall gain of the price difference between the issue price and the listing/sale price. The appellants are alleged to have played the role of financiers by financing some of the transactions of two key operators namely, Mr. Purushotam Budhwani and M/s. Sugandh Estates and Investment Pvt. Ltd. referred to hereinafter as Budhwani and Sugandh respectively.

3. The two appellants before us are husband and wife and they are both practicing chartered accountants by profession. The Board issued to them a show cause notice dated November 28, 2008 under Sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 (for short the Act) alleging that they provided finance to Budhwani and Sugandh, the key operators to enable them to apply for shares in the retail category of ten IPOs namely, ILFS, IDFC, Sasken Communications, FCS Software, Gateway Distripark, Provogue, MSP Steel, Nectar Life Sciences, Shoppers Stop and Suzlon Energy. It was further alleged that these two key operators acted in concert with the appellants in cornering shares in the aforesaid IPOs that were meant for the retail investors and on allotment, quite a few of them were transferred to the demat accounts of the appellants. It is also the case of the Board that Budhwani and Sugandh transferred to the appellants the refund amounts as well received by them from the issuer companies. It is in this manner that the appellants are alleged to have employed fraudulent, deceptive and manipulative practices thereby violating Section 12 A of the Act and Regulations 3 and 4(1) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 (for short the Regulations). The appellants are also said to have made an unlawful gain of ` 4,94,19,379/- and they were called upon to show cause why action be not taken against them for the aforesaid violations and why they should not be asked to disgorge the amount of illegal gains made by them.

4. The appellants filed a detailed reply dated May 7, 2009 denying the allegations. Even though the reply runs into 60 pages, most of the pleas taken therein are not of any substance and the only theme that runs through the reply is that the appellants had simply lent money to Budhwani and Sugandh and that they had not colluded with either of them

to exploit the IPO allotment process in any manner. The appellants have also pleaded that the mere act of providing finance for investing in different IPOs is neither illegal nor prohibited by any law and that they did no wrong in loaning the amount to the key operators. The precise stand taken by them in their reply is as under:

> "The Noticees say, submit and reiterate that :
> - there was no 'game-plan' as alleged,
> - the relationship between the Noticees and the so-named 'key operators' was always on principal to principal basis,
> - post disbursement of loan by the Noticees to SEIPL, and PB, **all** decisions and actions were taken by the so-named 'key-operators' solely on their own account, at their respective risks, costs and consequences and the Noticees had played no role whatsoever in such decisions and/or actions."

It is also the case of the appellants that "loans were given to SEIPL and PB in the ordinary course on well recognized commercial terms and the said borrowers deployed the same in the manner deemed appropriate by the said borrowers at their sole risks, costs and consequences". The appellants admit that they accepted a part of their loan repayment by transfer of shares but deny that they were involved in any attempt to corner the shares meant for retail investors or that they were privy to or involved in any scam as alleged by the Board.

5. On a consideration of the material available on the record, the reply furnished by the appellants and after affording to them a personal hearing, the whole time member of the Board by his order of July 21, 2009 did not accept the plea of the appellants that they had lent money to Budhwani and Sugandh or that they were not involved in cornering of shares in different IPOs that were meant for retail investors. The whole time member found that the appellants had manipulated the IPO allotment process by providing finance to Budhwani and Sugandh, the two key operators who with that money made applications in large numbers through fictitious/benami accounts to corner the shares meant for the retail investors. He further found that by doing this, the appellants had not only cornered shares but had also deprived the retail investors of their legitimate right of allotment of shares in different IPOs and that the shares received by the appellants from the two key operators were not by way of return of loan as claimed by them but the same had been received in pursuance to a prior understanding between them. He, therefore, concluded that the appellants had employed fraudulent, deceptive and manipulative process to corner the shares and thereby violated Section 12 A of the Act and Regulations 3 and

4(1) of the Regulations. He also found that the appellants made an unlawful gain of ` 4,05,61,579 to the detriment of the retail investors. In view of these findings the appellants have been prohibited from buying, selling or dealing in securities or from accessing the securities market in any manner whether directly or indirectly for a period of 45 days in addition to the period during which they remained out of the market pursuant to the interim order passed by the Board. The appellants have also been directed to disgorge the unlawful gain of ` 4.05 crores (rounded off) made by them together with interest of ` 1.95 crores thereon. It is against this order of the whole time member that the present appeal has been filed.

6. We have heard the learned senior counsel on behalf of the appellants and Mr. Kumar Desai Advocate on behalf of the Board and are of the view that the appeal deserves to be dismissed. From the rival stands of the parties as noticed above, what we need to decide is whether the appellants had lent money to the two key operators on a principal to principal basis as claimed by them or is it that the appellants financed all the applications filed through the key operators to corner the shares in the retail category. If the appellants had merely lent the money to the key operators without being a party to the game plan of cornering shares in the IPOs, then they are right in contending that they did no wrong but if they were instrumental in getting the applications filed through the key operators by giving finance to them, then obviously it were the appellants who were cornering the shares through a manipulative process as found by the Board. Let us see which of the two versions is correct.

7. The fact that the appellants had provided funds to Budhwani and Sugandh which funds they utilised for making large number of applications in the retail category for the allotment of shares in different IPOs is not in dispute. The details of the funds provided by the appellants to the two key operators for different IPOs, the number of applications filed by them and the shares allotted in those IPOs alongwith other necessary information including the refunds received are contained in Table A which has been relied upon in paragraph 5 of the impugned order. This table which has not been disputed by the appellants is reproduced hereunder for facility of reference:

Table A: Transaction Details by the Noticees

KO (Key Operators)	IPO	Amount (Rs.) provided by Dushyant	Issue Details					No. of Applications made	Receipt of Shares and Refunds by Dushyant/ Puloma./ Natwarlal/ Rasila				Balance with Kos (Rs.)
			Issue Price (Rs.)	Retail Application Size		Retail Allotment Size			Receipt of Shares		Refund (Rs.)	Roll over (Rs.) for IDFC	
				No. of shares	Amount (Rs.)	No. of shares	Amount (Rs.)		No. of shares	Value of Shares (Rs.)			
1	2	3 =(6*9) =(11+12+13+14)	4	5	6=(4*5)	7	8 = (4*7)	9	10	11=(4*10)	12	13	14
SEIPL (Sugandh)	ILFS	5,46,87,500	125	350	43,750	50	6,250	1,250	19,650	24,56,250	46,31,250	4,76,00,000	0
	IDFC	4,76,00,000	34	1,400	47,600	266	9,044	1,000	1,98,968	67,64,912	4,08,35,088	0	0
	Sasken	13,65,00,000	260	175	45,500	25	6,500	3,000	7,200	18,72,000	13,46,28,000	0	0
	FCS	6,97,50,000	50	900	45,000	100	5,000	1,550	24,600	12,30,000	6,85,20,000	0	0
Budhwani	Gateway	4,09,74,350	72	630	45,360	90	6,480	903	38,340	27,60,480	3,70,00,000	0	12,13,870
	Provogue	12,90,72,000	150	320	48,000	40	6,000	2,689	8,000	14,16,000*	12,57,28,000	19,28,000	0
	MSP	6,57,00,000	10	4,500	45,000	500	5,000	1,460	20,200	2,02,000	5,24,09,250	1,30,88,750	0
	Nectar	7,20,00,000	240	200	48,000	25	6,000	1,500	13,500	32,40,000	2,10,36,110	4,77,23,890	0
	IDFC	8,47,00,000 + Roll overs = 15,67,18,750	34	1,400	47,600	266	9,044	3,260	8,67,160#	2,94,83,440	12,56,92,560	0	15,42,750
	Suzlon	8,64,14,400	510	96	48,960	16	8,160	1,765	15,532	79,21,320	7,90,00,000	0	-5,06,920@

* valued at Rs.177 per share; # includes 7,23,160 disposed of through Budhwani; @ returned to Budhwani on February 13, 2006

A bare perusal of the chart leaves no room for doubt that the relationship between the appellants and the two key operators was not one of lender and borrower as claimed by the former. The amounts shown in column 3 of the chart were provided by the appellants. The chart clearly shows that the two key operators made large number of applications for the allotment of shares in different IPOs and the refunds received by them from the issuer companies were being returned to the appellants. If the money had been lent on a principal to principal basis as is the case of the appellants, then the refunds should not have been returned to the appellants and only the principal amount needed to be returned alongwith interest. It is interesting to note that the entire amount which came by way of refund was not returned to the appellants and only a part thereof was returned and a major portion was retained by the key operators as roll over money which was used for making applications for the next IPO that was to follow shortly. To illustrate, in the case of IPO of ILFS, the key operators received a refund of ` 5,22,31,250 because the number of shares allotted were less than those applied for. Instead of returning this entire amount, the key operators returned to the appellants only a sum of ` 46,31,250 and retained ` 4.76 crores with them which was the exact amount required by them for making applications in the next IPO of IDFC that was coming out within a few days. This, according to Budhwani against whom separate action has been taken, was done "As per mutual understanding of profit sharing, shares were to be transferred to Mr. Dushyant Dalal, a financier. However, as per his advice, a part of his shares were transferred". It was on the basis of this understanding between the appellants and the key operators that on allotment of 62,500 shares in the IPO of ILFS, the latter transferred only 19,650 shares. We also notice that in the case of all the ten IPOs, the appellants had provided the exact amount that was required for making the requisite number of applications instead of a round figure which would have been the case had these been ordinary loan transactions. Be that as it may, it is the appellants' own case that they advanced loans to the key operators without executing any document(s) or taking any security. The appellants in their written submissions filed on the conclusion of the hearing have clearly stated that "THERE IS NO NEXUS BETWEEN THE APPELLANTS AND PB OR SUGANDH".

They have given detailed reasons in paragraph 19 of their submissions as to why there is no nexus between them. Assuming this to be so, (though we are holding to the contrary) we wonder how such large sums of money could be given on loan without any documentation or security to persons with whom the appellants had no nexus. To say the least, this is most incredible and we are not willing to accept this argument. Besides the mere ipse dixit of the appellants, there is no material on the record to show that they advanced loans to the two key operators. Since the appellants had provided funds to them, the onus to establish that those were given as loans only as money lending transactions was on the appellants and they have miserably failed to discharge the same. We also cannot lose sight of the fact that both the appellants are practicing chartered accountants by profession and are not money lenders. We also have on record the stand taken by Budhwani in one of his replies to the Board that there was a prior understanding between the appellants and the two key operators for profit sharing on the basis of which part of the cornered shares were transferred to the appellants. For all these reasons we cannot but hold that the appellants did not advance any loan to the key operators and that it was their money that was being used for making applications for cornering shares in different IPOs in the retail category and that they were the beneficial owners of those shares. We are satisfied that the two key operators were none other than the front entities for the appellants. The role that the appellants have played in the scam is by providing finance to the key operators and that they were acting in concert with each other for cornering shares. In this view of the matter, we answer the question formulated in the opening part of this order in the affirmative and hold that the appellants dealt in securities in a fraudulent manner and indulged in unfair trade practices in securities and thereby violated Section 12 A of the Act and Regulations 3 and 4(1) of the Regulations. The findings recorded by the whole time member in this regard are affirmed.

8. The appellants manipulated the IPO allotment process and cornered large number of shares in the retail category which they subsequently sold in the market on their listing or soon thereafter and made huge profits. It is not in dispute that during the financial years 2003-05 the market was booming and the price of the shares on their listing was way higher than the issue price. In the show cause notice issued to the appellants they

had been called upon to show cause why they should not be directed to disgorge a sum of ` 4,94,19,379 which, according to the Board, represented the unlawful gain made by the appellants on the sale of the shares. This amount of illegal gains has been worked out on the basis of the difference between the sale price and the issue price. The data in this regard was furnished to the appellants in the show cause notice and the same has been compiled in a tabular form (Table B) in the impugned order. On an objection being raised by the appellants that the cost of acquisition of some of the IDFC shares at the rate of ` 34 per share had not been deducted from the profits made by the appellants, a sum of ` 88,57,800 was reduced from the ill-gotten gains made by them. The whole time member has directed the appellants to disgorge a sum of ` 4.05 crores (a round figure) on account of the ill-gotten gains made by them. In addition, he has also directed them to pay ` 1.95 crores as interest on the aforesaid amount which has been calculated at the rate of 12 per cent per annum. The learned senior counsel for the appellants strenuously challenged this part of the order by contending that the Board has no power to direct any delinquent to disgorge the ill-gotten gains made by him. The argument is that there is no provision in the Act which gives such a power to the Board and in the absence of a specific provision, a direction to disgorge could not be issued. He also challenged the calculations made by the whole time member in the impugned order regarding the notional profit on the unsold shares and argued that no direction for disgorgement could be issued on unrealised gains. The learned senior counsel also very strenuously challenged the direction regarding the payment of interest on the amount sought to be disgorged.

9. The question whether the Board has the power to direct a delinquent to disgorge the ill-gotten gains made by his unlawful acts came up for the consideration of this Tribunal in Karvy Stock Broking Ltd. Vs. Securities and Exchange Board of India Appeal no.6 of 2007 decided on May 2, 2008 and this is what was held:

> "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 acts(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."

A similar view was taken by this Tribunal in Dhaval Mehta vs. Securities and Exchange Board of India Appeal no. 155 of 2008 decided on September 8, 2009 which was also a case that had arisen out of the IPO scam. Since disgorgement is not a punishment but only a monetary equitable remedy meant to prevent a wrong doer from unjustly enriching himself as a result of his illegal conduct, we are of the view that there need be no specific provision in the Act in this regard and this power to order disgorgement inheres in the Board. We cannot, therefore, agree with the learned senior counsel that the Board had no power to issue a direction for disgorgement. The next argument of the learned senior counsel is that the Board was in error in taking into account the unrealized gains for the shares which are still being held by the appellants and the said amount should be omitted for calculating the gains. It is true that the appellants did not sell all the shares that were cornered by them through the key operators and that some of them are still lying in their demat accounts. The whole time member in the impugned order has worked out the notional gain with reference to the closing price of the shares on the first day of listing and deducted the issue price therefrom. As at present advised, we can think of no better way of calculating the notional gain made by the appellants. Even if there is a better method of calculating the notional gains, we do not think that the method adopted by the whole time member is in any way arbitrary or unfair calling for our interference. Surely the appellants cornered the shares through illegal means and they cannot be heard to say that notional profits should not be worked out merely because they continue to hold some of them. They cannot be allowed to unjustly enrich themselves. We, therefore, reject this argument of the appellants as well.

10. Now we come to the direction by which the appellants have been directed to pay interest on the disgorged amount. We are unable to agree with the learned senior counsel for the appellants that in the absence of any provision in the Act, the Board could not direct payment of interest on the disgorged amount. It is true that the provisions of Section 34 of the Code of Civil Procedure have not been specifically made applicable to the proceedings under the Act but the principles underlying this provision which are based upon justice, equity and good conscience would certainly authorise the Board to also grant appropriate interest having regard to the circumstances of the case. Undoubtedly, the appellants made huge profits through their illegal acts and have used the money since then. They must pay interest. Taking note of the reprehensible conduct of the appellants in cornering shares through devious means whereby they deprived the genuine retail investors of their rightful claim and also having regard to the general rate of interest at which loans are advanced by commercial banks, we do not think that the rate of 12 per cent as fixed by the whole time member is excessive by any standard. We are further of the view that it was not necessary for the Board to mention in the show cause notice that the appellants would also be liable to pay interest once they are ordered to disgorge the ill-gotten gains. The question of payment of interest is a matter of discretion which, in the facts of this case, has been judiciously exercised.

In the result, the appeal fails and the same stands dismissed leaving the parties to bear their own costs.

Sd/-
Justice N. K. Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

Sd/-
P. K. Malhotra
Member

12.11.2010
Prepared and compared by
RHN