# BEFORE THE SECURITIES APPELLATE TRIBUNAL
# MUMBAI

**Appeal No. 22 of 2008**

**Date of Decision: 20.11.2008**

Dilip S. Pendse …… Appellant

Versus

Securities and Exchange Board of India …… Respondent

Mr. R.A. Kapadia, Senior Advocate with Mr. V. M. Singh, Advocate for the Appellant.
Mr. Kumar Desai, Advocate with Ms. Daya Gupta, Advocate for the Respondent.

Coram: Justice N.K. Sodhi, Presiding Officer
Utpal Bhattacharya, Member

Per: Utpal Bhattacharya, Member

This order will dispose of three Appeals no.22, 29 and 30 of 2008 involving identical questions of law and fact. All these Appeals are directed against the order dated December 28, 2007 passed by the whole time member, Securities and Exchange Board of India (the Board for short) under sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 (the Act for short). By this order, the appellants have been found guilty of violation of the provisions of section 13 of the Securities Contracts (Regulation) Act, 1956 (SCRA for short) and Regulations 6(a) and (d) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995 (FUTP Regulations for short) and have been restrained from accessing the securities market and prohibited from buying, selling or otherwise dealing or associating with the securities market for a period of two years. The arguments were addressed in Appeal no.22 of 2008 from which the facts have been taken. The learned counsel for the parties agree that the order in Appeal no.22 will govern the other two Appeals as well.

2. On the basis of a complaint received from Tata Finance Limited (TFL) regarding illegal carry forward transactions in the shares of Global Telesystems Limited (GTL for short) by the appellant who is a former managing director of TFL, the Board started investigations into the matter. It was found in the investigations that Nalini Properties Private Limited (Nalini), a company controlled by the appellant of which he was also a director, had executed certain transactions in the shares of GTL through the broker Jhunjhunwala Stock Broker Private Limited (the Broker for short) which were not in accordance with the SCRA. A show cause notice (SCN) was issued to the appellant by the Board on 12.3.2003 alleging violation of section 13 of SCRA. The SCN also alleged that the impugned transactions had not actually been executed and by passing only book entries relating to these transactions, Nalini and certain other entities, acting in concert with the Broker indulged in falsification of accounts and records causing wrongful loss to Inshaallah Investments Ltd. and Niskalp Investments & Trading Company Ltd., (hereinafter referred to as Inshaallah and Niskalp respectively) which are associate companies of TFL. Niskalp was at that time a subsidiary of TFL and had substantial financial stake in Inshaallah. The appellant was a director of Niskalp as well as Inshaallah. Thus, there was a charge in the SCN of violation of Regulation 6(d) of the FUTP Regulations though there was no specific reference to that Regulation. Having set out the charges against the appellant, the SCN called upon him to show cause why action in terms of section 23 of the SCRA and section 11B of the Act read with Regulations 11 and 12 of FUTP Regulations should not be initiated against him.

3. In the three cases that we are concerned with, there were two distinct sets of allegedly irregular transactions in shares. The first set of transactions started off on 19.9.2000 with the purchase of 60,000 shares of GTL by Nalini (appellant in Appeal no.29 of 2008) from the Broker on the Bombay Stock Exchange (BSE for short) through its electronic trading system. The second set of transactions started off on 14.12.2000 with the sale of 40,000 shares of GTL by Nalini, Khuda Gawah Investments Pvt. Ltd (appellant in Appeal no.30 of 2008 and hereinafter referred to as Khuda Gawah) and another company (which is not in appeal before us) to the Broker on a principal to principal basis in an off market deal. Pendse, the appellant was a Director

in both Nalini and Khuda Gawah. Both sets of transactions culminated in all the shares being procured by Niskalp and being finally sold on the BSE by it. However, before going into the details of the transactions, it is necessary to refer to the system of trading on BSE, including the system of settlement for a better appreciation of the exact nature and implications of the transactions.

4. During the time when the impugned transactions were executed, the trades executed during a particular week were required to be settled during the next week. Settlement refers to the process whereby shares are delivered by the sellers and received by the purchasers. At the same time, payment is made by the purchasers and received by the sellers. The period of one week during which trades could be executed pending settlement is called a settlement cycle. It is possible to buy and sell as many times as a trader wishes during a settlement cycle and the effect of all these transactions is netted at the time of the settlement during the next week. Thus, the traders settle only their net outstanding positions at the end of the settlement cycle – it may be a net purchase position or a net sale position. However, another mode of settlement was permitted on BSE. Instead of settling the trades by receiving/delivering shares and making/receiving payments for the net purchases or sales of shares during a settlement cycle, traders could, at their option, carry forward their obligations for payment or delivery of shares by paying a specified amount of additional margin money and in that event, they could meet their obligations at the time of the next settlement(s). This facility was a special feature of BSE. Another important point to be noted in connection with these transactions is that the Broker executed the transactions in the shares of GTL from 21.9.2000 onwards on “principal to principal” basis. This only means that while executing these transactions, the Broker was buying and selling the shares in his own proprietary account. In other words, it was acting as a trader itself which is permissible. For example, on 21.9.2000, the Broker purchased 25000 shares of GTL from Nalini on principal to principal basis and issued a contract note to Nalini. In this transaction, while Nalini was selling to the Broker and the latter issued a contract note to Nalini as its broker, the buyer was the Broker itself. No other buyer or buyer’s broker was involved in this transaction.

5. We may now take a look into the details of the transactions which are not disputed by the parties. In the first set of transactions, after purchasing 60,000 shares of GTL through the Broker on 19.9.2000, Nalini sold 35,000 shares on the BSE on the same day. This sale is not an issue in the appeals. On 21.9.2000, Nalini sold the remaining 25,000 shares of GTL to the Broker on principal to principal basis in an off market transaction. At the time of this sale, Nalini did not have physical possession of 25,000 shares because it had neither received these shares after purchase on 19.9.2000 nor made payment therefor since the settlement was due only during the next week beginning 24.9.2000. The Broker issued contract notes to Nalini for this transaction in Form B which is meant for off market deals. It is the Board's case that there was no delivery and no payment against this transaction. On the same day, i.e. on 21.9.2000, the Broker, in turn, sold the same 25000 shares to Inshaallah on a principal to principal basis in yet another off market deal. Since the transaction had not yet been settled on BSE but the shares had been traded in off market deals only, Nalini still had the liability of settling the transaction on the stock exchange. But with the off market purchase by Inshaallah, the latter stepped into the shoes of Nalini and the liability of settling the transaction on BSE devolved on it. Inshaallah, however, carried forward the position through the next few settlements as is permitted by BSE, and on 20.2.2001 sold these shares to the Broker in yet another off market deal on a principal to principal basis. On the same day, the Broker sold the shares to Niskalp again in an off market transaction and it was Niskalp which finally settled the transaction on the Bombay Stock Exchange after carrying forward the position till the end of March 2001.

6. In the second set of transactions, the Broker purchased 20,000 shares of GTL from Nalini, 17,500 shares of GTL from Khuda Gawah and another 2,500 shares of GTL from another entity not in appeal before us in off market transactions on 14.12.2000 on a principal to principal basis. On the same day, the Broker sold all 40,000 shares to Inshaallah in another off market deal on a principal to principal basis. On 20.2.2001 Inshaallah sold all these shares off market to the Broker on a principal to principal basis and on the same day the Broker sold the same shares to Niskalp off

market. Finally, Niskalp settled the transactions on BSE after carrying forward the position till the end of March 2001.

7. Before proceeding to examine how the Board has dealt with the transactions in the impugned order, we may set down here a few relevant regulations for facility of reference.

Section 13 of the SCRA reads as under:

> " If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or States or area that it is necessary so to do, it may, by notification in the Official Gazette, declare this section to apply to such State or States or area and thereupon every contract in such State or States or area which is entered into after the date of notification otherwise than between members of a recognized stock exchange or recognized stock exchanges in such State or States or area or through or with such members shall be illegal:
>
> Provided that any contract entered into between members of two or more recognized stock exchanges in such State or States or area shall—
> (i) be subject to such terms and conditions as may be stipulated by the respective stock exchanges with prior approval of the Securities and Exchange Board of India;
> (ii) require prior permission from the respective stock exchanges the stock if so stipulated by the stock exchanges with prior approval of the Securities and Exchange Board of India."

Regulations 6(a) and (d) of FUTP Regulations are reproduced below:

> "6. **Prohibition on unfair trade practice relating to securities**—No person shall—
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> (a) in the course of his business, knowingly engage in any act, or practice which would operate as a fraud upon any person in connection with the purchase or sale of, or any other dealing in any securities;
> ……
> … (d) indulge in falsification of the books, accounts and records (whether maintained manually or in computer or in any other form;
> …….
> ."

8. The essence of the findings in the impugned order is contained in paragraphs 13, 14 and 15 thereof which are reproduced below:

> "13. The object of Section 13 is to make a transaction in securities in an area other than between the members of a recognised stock exchange or through or with such

> member, illegal after Section 13 has been made applicable in the said area. The effect of this provision is that if a transaction in securities has to be validly entered into, such a transaction has to be either between the members of a recognised stock exchange or through a member of a stock exchange or with a member of a recognised stock exchange. This view has been upheld by the Hon'ble Bombay High Court in the case of Dahiben Umedbhai Patel and Others v Norman James Hamilton and Others.
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> 14. By a notification dated November 29, 1957, Section 13 has been made applicable to Greater Bombay. As a result, the said transactions were in contravention of the provisions of Section 13 and thus illegal, as the contracts were not entered into between members of the stock exchange. Secondly, the purchase of shares by the Broker from Nalini and KGIPL and by Inshallah from the Broker on September 21, 2000 and December 14, 2000 respectively did not result in delivery of shares or payment of price consideration. They are, therefore, not "spot delivery contracts" as defined under Section 2, sub-section (i), of the SCRA.
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> 15. A contract for sale of shares, in order to qualify as a "spot delivery contract" must provide for actual delivery of shares and the payment of price either on the same day as the date of the contract or on the next day, etc. this view was reiterated by the Hon'ble Bombay High Court in a similar situation in the case of Norman J. Hamilton v Umedbhai S. Patel and Others. It is, therefore, clear that as the said transactions did not result in delivery of shares or in payment of price consideration, they cannot be termed as spot delivery contracts. These transactions were, therefore, not exempted under Section 18 of the Act from being governed by Section 13 of the SCRA and thus were illegal contracts by virtue of the provisions of the SCRA."

9. Section 13 of SCRA makes it very clear that in an area where the Central Government makes this section applicable, all transactions in securities other than those saved by this section are illegal. It is common ground between the parties that the Central Government by its notification no. SRO 3842 dated 29.11.1957 made section 13 of SCRA applicable to Greater Bombay. Therefore, there is no dispute that apart from transactions between members of a recognised stock exchange or through such a member or with such a member, all other transactions in securities are illegal in Greater Bombay. In other words, a transaction to be legal, within the meaning of section 13 of the SCRA, must necessarily involve a broker. But as Mr. Kapadia, the learned senior counsel for the appellant tellingly argued, having specifically noted this correct legal

position in paragraph 13 of the impugned order, the whole time member of the Board in the very next paragraph concludes that the transactions which took place on 21.9.2000 between Nalini and the Broker and between the Broker and Inshaallah were illegal as the contracts were not entered into **between** members of the stock exchange. As we have already noted, in the first set of transactions 25,000 shares of GTL changed hands from Nalini to the Broker to Inshaallah to the Broker again and finally to Niskalp which settled the transaction on the BSE. Similarly, in the second set of transactions 40,000 shares GTL were acquired by the Broker from Nalini, Khuda Gawah and another seller and thereafter these shares changed hands from the Broker to Inshaallah and finally to Niskalp which settled the transactions on BSE. All these transactions were clearly **through or with** a member broker of BSE and, therefore, in accordance with the requirements of section 13 of SCRA. Thus, the wholetime member's aforesaid conclusion was not only contrary to his own observation in paragraph 13 of the impugned order but was clearly an incorrect conclusion. After erroneously concluding that these transactions were violative of section 13 of the SCRA, the wholetime member further concluded that the validity of these transactions could not be protected under section 18(1) of the SCRA which provides that "nothing contained in sections 13, 14, 15 and 17 shall apply to spot delivery contracts", because the impugned transactions Niskalp were not in the nature of spot delivery contracts. It is not necessary for us to go into this question because we are of the opinion that the transactions did not violate section 13 of the SCRA to begin with.

10. The primary stand taken by Mr. Kumar Desai, the learned counsel for the Board, was that the impugned transactions are in breach of the notification dated 27.6.1969 issued by the Government of India under section 16(1) of SCRA which reads as under:

> "S.O. 2561. In exercise of the powers conferred by sub-section (1) of Section 16 of the Securities Contract (Regulation) Act, 1956 (42 of 1956) the Central Government being of opinion that it is necessary to prevent undesirable speculation in securities in the whole of India, hereby declares that no person in the territory to which the said Act extends, shall save with the permission of the Central Government enter into any contract for the sale or purchase of securities other than such spot delivery

> contract or contract for cash or hand delivery or special delivery in any securities as is permissible under the said Act and the rules, bye-laws and regulations of a recognised stock exchange:
> …….”

According to the learned counsel, the impugned order is entirely justified since the transactions executed by Nalini did not fall under any of the categories permitted by the Government Notification of 27.6.1969 and were, therefore, completely illegal. We cannot accept this argument because violation of section 16 of SCRA has not been alleged in the SCN nor was this point ever raised during the enquiry. The impugned order also makes no reference to any such violation. Since the appellant had not been charged with the alleged violation of section 16 of SCRA, it could not possibly put up any defence during the enquiry and allowing any argument on this aspect at the appellate stage will be a clear denial of natural justice to the appellant. Such a plea cannot, therefore, be allowed to be raised for the first time before this appellate tribunal. This tribunal had taken a similar view in Appeal no.123 of 2006 decided on 29.5.2008 Holcim (India) Private Ltd. v. the Adjudicating Officer, Securities and Exchange Board of India following the judgment of the Supreme Court in SACI Allied Products Ltd. U.P. v. Commissioner of Central Excise (2005) 7 SCC 159. This is what the learned judges observed in that case:

> “This finding of the Appellate Tribunal is based on first proviso to Section 4(1)(a) of the Act. While the show-cause notice and the order of the Collector proceeded on the basis of the invocation of third proviso to Section 4(1)(a) of the Act, the Appellant Tribunal for the first time in the impugned order has sustained the proceedings on the basis of first proviso to Section 4(1)(a) of the Act. It was argued that the first proviso to Section 4(1)(a) of the Act was never invoked by the Department in the show-cause notice or in the impugned order and it was for the first time that the Appellate Tribunal in the impugned order has sought to sustain the impugned order by invoking the first proviso to Section 4(1)(a) of the Act. It is thus seen that the Tribunal has gone totally beyond the show-cause notice and the order of the Collector, which is impermissible. The Appellate Tribunal cannot sustain the case of the Revenue against the appellants on a ground not raised by the Revenue either in the show-cause notice or in the order.”

11. When we put it to the learned counsel for the Board that violation of section 16 of SCRA cannot be pleaded for the first time before this tribunal, he shifted his stand back to that adopted by the Board in the impugned order and contended that the impugned transactions were violative of section 13 of SCRA. The learned counsel

argued that the sale amounted to an off market transfer to a third party of the purchase position of a trader on the exchange and this is not permitted under the bye-laws of BSE and could have been saved only if the same was executed as a spot delivery transaction. According to the learned counsel, all transactions to be considered valid under section 13 of SCRA have to be necessarily compliant with the bye-laws of the stock exchange concerned. If there has actually been any violation of the bye-laws of a stock exchange, as contended by the learned counsel, it would call for some remedial or punitive action primarily from the stock exchange itself which functions as the first level market regulator. In this particular case we have not been told that BSE had found any fault with the impugned transactions. Advancing such arguments at the appellate stage by the respondent Board thus, appears to be only an afterthought with the object of justifying the impugned order. These arguments, again, were being advanced for the first time at the appellate stage and the appellant had not had any opportunity to meet this allegation at any earlier stage. We cannot, therefore, entertain this argument.

12. Regarding the charge of violation of the FUTP Regulations, there is no evidence on the record to establish any falsification of books of accounts and records by the appellant; so the charge under Regulation 6(d) of the FUTP Regulations fails. Regarding the charge under Regulation 6(a) ibid, the Board's case is that on 21.9.2000 the appellant sold 25000 shares off market to the Broker at Rs.1400 per share and when the shares were finally sold on BSE by Niskalp, the latter got a price of only Rs. 125 per share. There was, thus, a substantial loss incurred by Niskalp. According to the Board, this loss had actually been incurred by Nalini but through the chain of fictitious transactions which were created by making only book entries in the accounts and records of all the parties concerned, this loss was transferred to Niskalp. This was the complaint that TFL had made to the Board and we understand that this alleged fraud is the subject matter of separate criminal proceedings launched against the appellant. In the appeals before us, there is no evidence to show that the accounts and records were falsified to perpetrate the alleged fraud. In any case, the matter is really a dispute between TFL and the appellant with which this tribunal is not concerned and it is not necessary for us to take a view on this allegation.

13. Two other points regarding the validity of the procedure followed by the Board in proceeding against the appellant under the FUTP Regulations, 1995 were raised by the learned senior counsel for the appellants. The first point related to waiver of the notice to be given by the Board before starting the investigations in terms of Regulation 8 of the FUTP Regulations. According to the learned senior counsel, the notice had been waived as provided in Regulation 8(2) ibid but, only after the investigations had started and not before. The second point related to the validity of invoking the Board's powers under Regulations 11 and 12 of the FUTP Regulations which, according to the learned senior counsel, had not been saved by the FUTP Regulations, 2003 when the 1995 Regulations were repealed. It is not necessary for us to deal with these questions since on merits, we are deciding the case in favour of the appellants.

In the result, the appeals are allowed and the impugned order set aside. No order as to costs.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Utpal Bhattacharya
Member

20.11.2008
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