BEFORE THE SECURITIES APPELLATE TRIBUNAL

MUMBAI

APPEAL NO.33 OF 2001

Rakesh Agrawal **Appellant**

V/s

Securities Exchange Board of India **Respondent**

PRESENT

Shri Amit Desai

Advocate

Shri Zal T. Andhyarujina

Advocate

Shri Yash Ashar

Advocate

Ms. Arati Varma

Advocate

I/b Amarchand & Mangaldas & S. A. Shroff & Co., **For Appellant**

Shri Rafiq Dada

Senior Advocate

Shri Kumar Desai

Advocate

Shri A Patel

Advocate

I/b. Maneksha & Sethna

Shri K.R.C.V. Seshachalam

Asstt. Legal Adviser, SEBI **For Respondent**

ORDER

Order passed by the Securities and Exchange Board of India, the Respondent herein (SEBI) on 10.6.2001, under sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 (the SEBI Act) read with regulation 11 of the Securities and Exchange Board of India (Insider Trading) Regulations, 1992 (the SEBI Regulations) against Shri Rakaesh Agrawal, the Appellant herein, is under challenge in the present appeal. By the said order SEBI had directed that:

"Shri Rakesh Agrawal deposit Rs.34,00,000 with Investor Protection Funds of Stock Exchange , Mumbai and NSE (in equal proportion i.e. Rs.17,00,000 in each exchange) to compensate any investor which may make any claim

subsequently. Any investor who is aggrieved with sale of shares of ABS Industries to Mr. I.P. Kedia during September 9, to October 1, 1996 can approach SEBI within 15 days of this order."

By the same order SEBI directed to (i) initiate prosecution under section 24 of the SEBI Act and (ii) adjudication proceedings under section 15I read with section 15 G of the SEBI Act against the Appellant.

The Appellant is the Managing Director of ABS Industries Ltd., Vadodara (ABS) a company incorporated under the Companies Act 1956 (name of the company has been subsequently changed to Bayer ABS Ltd.). The main business of ABS is manufacture of ABS resins (Acrylonitrile Butadiene Styrene) and SAN, (Styrene Acrylonitrile resins). Shares of ABS are listed on Bombay Stock Exchange National Stock Exchange, Ahmedabad Stock Exchange and Vadodara Stock Exchange. Bayer AG (Bayer) is a company registered in Germany having many subsidiaries in various parts of the world. Bayer took controlling stake in ABS in October 1996 by acquiring

(a) 55,80,000 shares in the allotment made on a preferential basis by ABS (@ Rs.70/-)

(b) 20% shares from the existing shareholders @ Rs.80/- per share in a public offer.

It has been stated by SEBI that there were allegations of purchases being made prior to

announcement of Bayer acquiring controlling stake in ABS, on the basis of inside information. In that context investigations were undertaken by SEBI to ascertain the truth or otherwise of those allegations. SEBI's investigation is stated to have revealed that one Mr. I. P. Kedia, brother in law of the Appellant had purchased shares preceding Bayer's acquisition of ABS and that the said acquisition was made at the behest of the Appellant and the Appellant funded the acquisition. The investigation is also stated to have revealed that the shares were acquired on the basis of the unpublished price sensitive information relating to impending takeover of ABS by Bayer, available to the Appellant by virtue of his position as the Managing Director of ABS and also as the negotiator from the side of ABS, in the negotiations with Bayer.

The findings of the investigation was forwarded to the Appellant asking him to show cause as to why action should not be taken against him for violation of the SEBI Regulations. The Appellant replied to the notice denying the charges. SEBI thereafter adjudicated the notice. SEBI held the Appellant guilty of violating the provisions of regulation 3(i) of the SEBI Regulations and passed the impugned order.

Shri Amit Desai, learned Counsel appearing for the Appellant argued at length defending the Appellant. Shri Rafiq Dada, learned Senior Counsel appearing for the Respondent also advanced detailed arguments in support of the Respondent's order. Both the parties had referred several authorities – Indian and Foreign -- to support their contentions. Detailed written submissions have also been filed. The submissions made by the parties are furnished party wise, herein below:

Appellant's Submissions:

The Chairman by his order dated 10.6.2001 has held the Appellant in breach of Regulation 3(i) of the SEBI (Insider Trading) Regulations, 1992. In particular the impugned order has made the following findings:-

(a) the Appellant, being the Managing Director of ABS is a "connected person" pursuant to Regulation 2(c). Further, that the Appellant is an insider within the meaning of regulation 2(e) of the Regulations;

(b) the Appellant instructed his brother-in-law, Mr. I. P. Kedia to purchase, 1,82,500 shares of ABS on the basis of unpublished price sensitive price information that the said company was to be taken over/merged with Bayer prior to the public announcement to the NSE, BSE and VSE on October 1, 1996 in this regard;

(c) this purchase was financed by the Appellant;

(d) while holding that there was requirement to establish "profit" for the purpose of establishing a violation of Regulation 3 read with Regulation 4 of the SEBI Regulations and accordingly making no specific finding that the Appellant had made any profit from the said transaction, and further finding that in fact the action of the Appellant in this regard were beneficial to the Company, the Chairman found the Appellant in breach of Regulation 3, and in violation of the Regulation, pursuant to the provisions of Regulation 4 thereof;

(e) while finding that issuance of directions under the Regulation 11 would be "inoperative and infructuous" in the facts and circumstances, pursuant to section 11(1) Read with Section 11 B of the SEBI Act, the Chairman who Suo motu directed the Appellant to deposit a sum of Rs.34,00,000 with the Investor

Protection Funds of BSE and NSE to compensate the investors who may come forward at a later period of time seeking compensation for the loss incurred by them in selling at price which were lower than the offer price;

While making the above findings and in particular finding the Appellant in breach of Regulations 3 and 4 of the SEBI Regulations, the Chairman called upon case law from the United States of America to explain the Philosophy of Insider trading and to give conceptual clarity and to reinforce the said order. The Appellant submitted that the said order proceeds on a mis-reading of the said U.S. case law. The impugned order directs the initiation of adjudication proceedings pursuant to Section 15I read with Section 15G of SEBI Act against the Appellant. Further the impugned order holds that this is a fit case for invoking the provisions of Section 24 of the SEBI Act, which provides for criminal action against any person in contravention of the provisions of the said Act and any rules or regulations made thereunder. The Appellant denied any violation of the SEBI Regulations and submitted that the said order should be quashed and/or set aside. Further that in so far as the said Order directs the Appellant to pay the said sum of Rs.34,00,000/- by way of compensation, the said order is ultra vires the provisions of the SEBI Regulations and the SEBI Act, and illegal. Further the impugned order in ordering prosecution should be launched against the Appellant is illegal and excessive. SEBI had issued a Show Cause Notice dated June 18, 1999 to the Appellant. In response to that the Appellant filed a reply dated September 24, 1999. Written submissions were also submitted to SEBI on 24.8.1999 pursuant to receipt of the investigation report under Regulation 9(1) of the said Regulations. The Appellant had clearly explained that there was no violation of the Regulations on his part.

Brief facts submitted by the Appellant:

The Appellant has been the Managing Director of ABS for more than 25 years. ABS was incorporated under the Companies Act, 1956, in the year 1973 in the name of ABS Plastics Limited for the purpose of setting up an ABS manufacturing facility in India. ABS was

managed in a professional manner and the sole motivating criterion of the promoter, the Appellant, has been the growth and reputation of the Company. The Appellant has always acted with the best interest of the Company in mind. In the post economic liberalisation, several of the end-user industries of the products manufactured by the company (ABS and SAN resins), including automobiles, consumer durables, telecommunication instruments, were planning to put up facilities in India. The Appellant was aware of the importance of technological arrangements with foreign companies so as to remain an important market player in the new economic scenario. In this regard, ABS had serious dialogues with reputed global manufacturers of ABS resin, including Japan Synthetic Rubber ("JSR") (which was also the Company's existing technical collaborator), Mitsubishi Rayon, Toyo Engineering, Dow Chemicals, Monsanto Chemicals, etc. since 1994. There had been several frequent reports and articles in various newspapers and magazines from late 1994, all through 1995 and most of 1996 that ABS was seriously contemplating association with a foreign company. In this context paginated index copy of the relevant press clippings filed in the Tribunal was referred to. In mid – July 1995, the Company signed a secrecy agreement with Monsanto to explore the possibility of technical/foreign collaboration, while dialogues with other foreign companies continued. In November 1995, Monsanto's styrenic business worldwide was taken over by Bayer. As a result of this, the contractual rights and obligations under the secrecy agreement entered into by ABS with Monsanto were transferred to Bayer. Bayer approached ABS in February, 1996 as to the possibility of synergising the technical expertise of both the companies. The two companies had been in continuous discussions since on this aspect. In May 1996, the Technical Adviser to the Company and the Appellant had further discussions with Bayer. The discussion with Bayer and the Company since early May 1996 were at a preliminary stage with both companies only investigating the possibility of combining their expertise. However, ABS had kept all its options open in as much as it continued discussions with the other potential collaborators as well. In the month of July 1996, a team from Bayer visited the Company's plant to conduct a technical evaluation together with a preliminary due diligence. In September 1996, the Appellant was requested to visit Germany by Bayer on his

way back from the USA, where he had gone with his family for a personal visit. The Appellant accordingly stopped over in Germany on his way back to India between September 6, 1996 and September 8, 1996 for discussions with Bayer. This was the first meeting in Germany and there were initial discussions with the senior management and officers of Bayer, after Bayer had conducted a technical evaluation and due diligence. During these discussions, Bayer indicated that as per the worldwide policy of Bayer, any joint venture with Bayer would require that Bayer control 51% in the joint venture company. This firm pre-condition of Bayer was made known to the Appellant and ABS for the first time during his visit to Germany. However, the discussions for the proposed joint venture were still under way, and the method or modality of the investment by Bayer had not been initiated.

The pre-condition of Bayer that it always has had a majority stake in any company to which it licenses its technology is information in the public domain. In fact it is well known that Bayer has never licensed any technology in the world where they do not have a majority stake.

Subsequently, the proposal with Bayer was discussed by the Board of directors of the Company at its meeting held on September 20, 1996. The company and Bayer had merely discussed the viability of a possible joint venture but not the details thereof. The Appellant appraised the Board accordingly. At that stage, there was no agreement or understanding between the parties and there was no certainty that the parties would infact agree to go ahead with the joint venture. Accordingly the Board authorised the Appellant to undertake further discussions in the matter. There was no concrete proposal whatsoever before the Board on which it could take a decision, at that stage. The resolutions passed by the Extraordinary General Meeting were subject to the approval by the financial institutions. On September 29, 1996, the Appellant visited Germany again, with a view to obtain a definite commitment from Bayer to enter into the said joint venture/merger and to agree on the terms and conditions on the basis of which the parties would do so. The experts were involved for the first time at this stage to iron out the methodology and modality of investment. Appellant travelled with the Company's legal counsel for this purpose. Bayer had invited their merchant bankers and legal

advisors to be present at the said discussions in Germany. This was the first time that the said experts were involved in the discussions, as it was hoped that the discussions would for the first time culminate in a definite proposal. At the said meetings, several suggestions were made as regards the modalities of the transaction, including making a preferential allotment to Bayer and also a public offer by Bayer to the other shareholders of ABS to purchase their shares under the provisions of the SEBI (Substantial Acquisition and Takeovers) Regulations, 1994 (the "Takeover Regulations"). An understanding to proceed with the said joint venture/merger was arrived at in Germany only on October 1, 1996 for the first time. As soon as an understanding of the transaction was reached, the Bombay Stock Exchange, National Stock Exchange and Vadodara Stock Exchange were informed (i.e. on October 1, 1996 itself) of the Board Meeting that was going to be convened to discuss and decide o the raising of further capital through preferential offer, if any.

Between October 2, 1996 and October 3, 1996 the legal consultants of both parties prepared a share subscription agreement and shareholders agreement detailing the terms and conditions of the parties to the transaction. The subscription agreement was entered into on October 5, 1996. The said agreement contained a covenant on the Board of Directors of ABS as well as the Indian Promoters (being the Appellant) to co-operate with Bayer in enabling it to acquire 20% additional shares in the public offer. Further, the acquisition of 51% shares by Bayer (with 31% being through preferential allotment and 20% being through public offer) was a condition precedent to the successful completion of the joint venture/merger, including the execution of the shareholders agreement.

On October 5, 1996 the board of directors of Bayer and ABS approved the preferential allotment of shares to Bayer as also the notice for the extraordinary general meeting (EGM) of the Company to be convened on October 30, 1996. On October 8, 1996, a public announcement was made in the newspapers by Bayer (and their merchant bankers) offering to acquire 20% shares of ABS from the existing shareholders of ABS under the Takeover Regulations at a price of Rs.70/- per share. In the said public announcement, the Appellant's obligation to co-operate

with Bayer Industries to acquire 20% shares from the public was clearly disclosed. In the event that Bayer was unable to acquire the said 20% shares under the public offer, the entire transaction would have become null and void. Subsequently, the shareholders passed a special resolution on October 30, 1996 approving the preferential allotment of shares to Bayer. At this meeting, UTI categorically opposed the preferential allotment to be made to the promoters. This is recorded in the minutes of the meeting.

In the last week of December, 1996, owing to considerable pressure from the financial institutions, Bayer was forced to increase the offer price from Rs.70/- per share to Rs.80/- per share. The announcement to increase in the offer price appeared in the news papers on December 27, 1996. However, this decision was taken by Bayer and its merchant bankers pursuant to their discussions with the financial institutions. The Appellant was not involved in any manner in that decision.

The Company has significantly benefited by the induction of Bayer. All creditors continue to rate the Company with the highest creditworthiness having the entire loan repayments and schedules being met in a timely manner. It has also strengthened the relations with vendors, suppliers, and employees and also in relation to research and development. If the joint venture/merger was not successful, the Company would have been unable to remain prosperous. Therefore, the acquisition of 51% shares by Bayer was critical to its induction.

As regards the transactions carried out by Rakesh Agrawal's brother-in-law, Shri I. P. Kedia, the position was stated that:

(a) The Appellant has been holding shares in the Company since its inception. Neither the Appellant nor any of his investments companies have ever sold any shares in the Company (except once in December, 1994). The Appellant and his family have constantly held approximately 40% shares in the Company (till

February 1997).

(b) During the period between September 9, 1996 and October 1, 1996 , the Appellant's brother-in-law, Shri I. P. Kedia purchased about 1,82,500 shares in the Company. Pursuant thereto the Appellant had informed Shri Kedia that if shares are offered by any of his relatives or any other person, he can procure shares on his behalf. However, at no stage did the Appellant express any reason or any objective thereto for requesting Shri Kedia to purchase the said 1,82,500 shares. The Appellant did not inform Mr. I. P. Kedia about any discussion

with Bayer for any possible joint tie up. There was never a communication of price sensitive information by the Appellant to his brother-in-law.

(c) Although during the period between September 9, 1996 and October 1, 1996 the Appellant was conscious of the pre-condition imposed by Bayer that Bayer would not enter into any transaction unless it was successful in attaining 51% shareholding in the company, the discussions/ negotiations with Bayer, which were not in the Appellant's control, were still in progress and not conclusive. There was no certainty as to whether the transaction would occur at all and was in the realm of possibility. The discussions relating to the modalities of investment had not yet taken place. It was only on October 1, 1996 that the basic agreement of the tie-up was finalised, namely that Bayer would participate in ABS through its wholly owned subsidiary in India – M/s. Bayer Industries Ltd., upon which the stock exchange was immediately informed and a board meeting was convened to consider the matter.

(d) Shri Kedia continued to acquire shares during the period between October 1, 1996 and October 7, 1996 at an average price of more than Rs.70/- per share i.e. after intimation had been given to the stock exchanges that a Board meeting was going to be convened to discuss and decide on raising of further capital through

preferential offer, if any.

(e) Further, the Appellant had instructed Shri Kedia again to purchase further shares from the market. In fact, after the press advertisement on October 8, 1996 1,24,250 shares were purchased at a price of over Rs.80/- Therefore, clearly the shares were acquired only to fulfill the obligation undertaking by the Appellant to Bayer to ensure that it obtains 51% shares in the Company. The Appellant did not seek to acquire the shares in order to make any profit therefrom. Bayer's induction was extremely critical to the Company, and it is only with this objective in mind, i.e. in order to ensure that Bayer succeeds in obtaining 51% shares in the Company, that the Appellant requested Shri Kedia to acquire the shares.

The Principles of Insider Trading

The SEBI Regulations on insider trading seek to prohibit persons who by virtue of their connection with a company received unpublished sensitive information from using such information/dealing in the securities of the company on the basis of such information to make secret profits / person gains. SEBI has extensively referred to the US Law while interpreting the Insider Trading Regulations not only in the case of the Appellant but also in the case of SEBI Vs. Hindustan Lever Ltd. Even upon perusal of the High Powered Committee Report, it is apparent that the Committee has considered the US Law on insider trading. The jurisprudential principles behind the prohibition of insider trading were enunciated by the Securities and Exchange Commission (SEC) in its decision rendered in the matter of Cady Roberts & Co., on November 8, 1961.(40 SEC 907 1961) The SEC while considering Section 1(a) of the Securities & Exchange Act and Rule 10(b-5) of the Rules thereunder *inter alia of particular acts or practices which constitute fraud but rather we designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others.* The SEC went on to observe that an insider must disclose material fact known to them by virtue of his position

but which are not known to persons with whom he deals and which if made known could affect their investment/judgement. They also observed that if the disclosure prior to effecting a purchase or sale of shares could be improper or unrealistic, the alternative is to forgo the transaction. The SEC went to observe

"*Analytically, the obligation rests on two principle elements;*

1) The existence by a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of any one,

2) Inherent unfairness involved where the party takes advantages of information knowing it is not available to others with whom he is dealing"

It was this decision which introduces the 'disclose or abstain' rule in securities transactions. It is submitted that the disclose or abstain rule is not an absolute rule and there is no contravention of Regulation 3 merely because there may be purchase or sale of securities without a disclosure by the corporate insider. The disclose or abstain rule has been misrepresented to suggest that in law, there is no absolute obligation or duty to either disclose the material information or to abstain from dealing the securities.

The aforesaid observations in Cady Roberts & Co., clearly indicate that the prohibition on trading on undisclosed information is only when information is entrusted for a corporate purpose and should not be used for personal benefit on the principle that there is inherent unfairness when the party takes advantage of such information knowing that it is unavailable to others. Consequently it is only when the information is being misused for personal benefit or where a person takes advantage of such information that there would be a contravention of fiduciary obligation cast upon the corporate insider who is in possession of the material information. The decision of the SEC does not suggest that the information cannot be used even for a corporate purpose. In fact, the SEC has recognised that if there are conflicting fiduciary

obligations the obligation to the company is paramount and there is no compulsory bar to the use of such information. In the context in Cady Roberts at page 11 it is stated that "*even if we assume the existence of conflicting fiduciary obligations, there can be no doubt which is primary here."* Additionally on page 12 the court has considered what fiduciary duty was owed and in this context stated: " *In the circumstances, Gintel's relationship to his customers was such that he would have a duty not to take a position adverse to them, not to take secret profits at their expense, not to misrepresent facts to them, and in general to place their interests ahead of his own."*

The aforesaid decision was considered by the US Supreme Court in Chiarella Vs. United States (445 US 222) in its decision rendered on March 18, 1980. The Supreme Court while considering the argument that there is an absolute duty to 'disclose or abstain' and while dealing with the decision of the SEC, inter alia observed the decision which solely rested *upon its belief that federal securities laws have "created a system providing equal access to information necessary for reasoned and intelligent investment decision" id. At 1362. The use by anyone of material information not generally available is fraudulent, this theory suggests, because such information gives certain buyers or sellers an unfair advantage over less informed buyers and sellers.*

This reasoning suffers from two defects. First, not every instance of financial unfairness constitute fraudulent activity under Section 10(b). (Santa Fe Industries Inc. Green 430 US 462, 474, 477 (1977). Second the element required to make silence fraudulent – a duty to disclose – is absent in this case. No duty could raise from the petitioner's relationship with the sellers of the target company's securities, for petitioner had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was in fact a complete (455 US 233) stranger who dealt with the sellers only through impersonal market transactions.

….. "*As we have seen, no such evidence emerges from the language or legislature history of*

S.10(b). Moreover, neither the Congress nor the Commission ever has adopted a pairty-of-information rule. Instead, the problems caused because by misuse of market information have been addressed by detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets…."

The dissent of Mr. Chief Justice Burger J. of the US Supreme Court also reiterates this underlined principle. Burger J. in his descent, inter alia observed "*Finally, it bear emphasis that this reading of Section 10(b) and Rule 10b-5 would not threaten legitimate business practices. So read, the anti fraud provisions would not impose duty on a tender offeror to disclose its acquisition plans during the period in which it "tests the water" prior to purchasing the full 5% of the target co.'s stock. Nor would it proscribe "warehousing". Likewise, market specialists would not be subject to a disclosure or refrain requirement in the performance of their every day (455 US 243) market functions. In each of these instances, trading is accomplished on the basis of material non-public information, but the information has not been unlawfully converted for personal gain.*

Justice Blackmun in his dissent inter alia observes "*The duty to abstain or disclose arose, not merely as an incident of fiduciary responsibility, but as a result of the "inherent unfairness" of turning secret information to account for personal profit."* He went on to observe "*the concept of 'insider' itself has been flexible; wherever confidential information has been abused prophylaxis has followed.*

The US Supreme Court had once again considered the principle of disclose or abstain in *Dirks v. Securities and Exchange Commission.* (463 us 646) The Supreme Court in its decision rendered on July 1, 1983, has inter alia, made the following observations in the context of the arguments of an absolute principle of disclose or abstain. *"Not all breaches of fiduciary duty in connection with a securities transaction" however, come within the ambit of Rule 10(b)-5. Santa Fe Industries v. Green 430 US 462, 472, (1977). There must be "manipulation or deception" id, at 473. In an insider trading cause this fraud derives from the "inherent*

unfairness involved where one takes advantage" of "information intended to be available only for a corporate purposes and not for the personal benefit of any one", In re Merrill Lynch, Pierce, Fenner & Smith 438 SEC 933, 936 (1968). Thus, an insider will be liable under Rule 10 b-5 for insider trading only where he fails to disclose material non-public information before trading on it and thus make "secret profit" Cady Roberts Supra 916 n.31". The Supreme Court went on to observe *"Whether disclosure is a breach of duty depends in large part of the personal benefit the insider receives as a result of the disclosure. Absent an improper purpose, there is no breach of duty to stockholders. Performance of the disclosure. SEC argues that, if insider trading liability does not exist when the information is transmitted for a proper purpose, but is used for trading, it would be a rare situation when the parties could not fabricate the same ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the Courts are not required to read the parties mind. Scienter in some case is relevant in determining whether the tipper has violated his Cady Roberts duty. N. 23 But to determine whether the disclosure itself "deceives, manipulates or defrauds shareholders. The initial inquiry is whether there has been a breach of duty by an insider. This requires courts to focus on objective criteria, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings."* In the context of the facts of that case, the Supreme Court went on to observe "*As the facts of this case clearly indicate, the tippers were motivated by the desire to expose the fraud see supra 648-649. In the absence of a breach of duty to shareholders by the insider, there was no derivative breach by Dirks.* Blackman J. in his descent in footnote 11 explained requirement of scienter in insider trading cases. The Court observed *"....when the disclosure to an investment banker or some other advisers, however, there is normally no breach because the insider does not have scienter; he does not intend that the insider information be used for trading purpose to the disadvantage of shareholders. Moreover, if the insider in good faith does not believe that information material or non-public, he lacks the necessary scienter, Earnst & Earnst v. Hochfelder 425 US, at 197.*

In fact, the scienter requirement functions in part to protect good faith errors by this type Id, a 211, n.31"

In the context of the facts and circumstances of the case, and in view of the said lega position it cannot by any stretch of imagination have been said that the Appellant had breached Regulation 3 and rendered himself liable for penalty. In this regard, the Appellan submitted that:

(a) There is no allegation or averment that the Appellant made profit, direct o indirect, as a result of the impugned share transaction;

(b) There is no allegation or averment that the Appellant undertook the impugne share transaction for the purpose of making any profit;

(c) There is no allegation or averment that the Appellant has acted in a manne disadvantageous to the shareholders;

(d) There is no allegation or averment that in all, the actions of the Appellant ha caused detriment to the shareholders of the Company;

(e) The averment in the findings of investigation relied upon in the Show Cause Notice, issued by the Adjudicating Officer, on the basis of directions issued by the Chairman dated June 21, 2000 (the "Show Cause Notice") indicates that eve according to the Department, the acquisition of the impugned shares wa undertaken with a view to enable Bayer in reaching its 51% target. The Show Cause Notice also relied upon the statement dated April 7, 1996 of the Appellan in support of its allegations. In that statement in response to question 4, the Appellant had inter alia stated "*I realized looking into the future that it wa pertinent to our Company to enter into a technological tie-up with any of these*

companies for sustained growth and even for survival" Again in response to a question 4, the Appellant inter alia stated "…..*our share subscription agreement which was arrived and which was approved by the Board of Directors and subsequently sent to financial institutions for their approval had a clear condition that the whole agreement was conditional upon Bayer acquiring open 51% share in ABS. It also meant that if they do not have 51%, the whole agreement would become null and void. That was a very scaring scenario in the light of the development in industry in the country, and particularly the heavy capacity being created in South East Asia."*

(f) In the inquiry under Regulation 9, the Appellant in his submission dated August 24, 1999 had further elaborated that in the past liberalization scenario, the polymer industry was reeling under a negative bottom line due to lack of demand and loss of margin, and the producers of ABS resin in the country were suffering heavily. It was also pointed out that the other three competitors of ABS viz. (1) M/s. Rajasthan Polymer & Resin Ltd., (2) M/s. Polychem Ltd., and (3) M/s Bhansali Engineering and Polymer Ltd., have suffered significant loss and that their networth had been wiped out significantly and they were nearly sick companies for the past several years. It was also pointed that in this background it was imperative and in the interests of company and its stakeholders, such as shareholders, lenders, employees, suppliers, etc., that the company survived. The only way for ABS to survive was the introduction of a foreign partner. Bayer was one of the largest and most reputable global conglomerates in this business and their induction into the company would go a long way in the survival and growth of the Company.

(g) The Chairman in his decision of 1st June 2001, appreciated the fact that the

Company gained substantially from the take over by Bayer AG, as mentioned in para 14 (x) of the Reply. The Chairman went on to observe "*however, there are many advantages (some of which are listed in para 14 above) which are not possible to quantify in terms of gain, there is no doubt ABS Industries really gained immensely from the take over by Bayer AG.*"

(h) The Appellant made no profits from the said transactions and did not receive any personal profits from the same. The question of the Appellant making a profit was alleged by the Respondents for the first time during the hearing before the Hon'ble Tribunal.

(i) All the impugned shares were submitted in the open offer by Bayer to enable and assist Bayer in the acquisition of 51% control over the company.

(j) The Appellant also tendered 9 lakhs and odd shares from his own promoter quota to enable Bayer to acquire 51% on account of shortfall in the target of the open offer. Thus not only was there no personal profit made by the Appellant but the whole purpose of the impugned acquisition was a corporate purpose, namely to ensure the induction of Bayer AG into the Company for the very survival of the company. This induction, infact, resulted in the survival of the company in as much as the other three competitors of the Company named earlier have been ultimately gone under and became sick. The stakeholders of the Company, including the shareholders, have benefited from that induction. Consequently in view of the law set out above and especially observations of the US Supreme Court in Dirks Vs, Securities and Exchange Commission it cannot be said that Appellant has breached his fiduciary duty to the shareholders or misused any information in his possession and thereby contravened regulation 3 and Section 15-G of the SEBI Act and rendered himself liable for penalties in that regard.

The underlying principle enunciated by the US Supreme Court in the aforementioned two decisions, which interpreted the decision of the Commission in Cady Roberts & Co., was reported once again by the US Supreme Court in united State v. O'Hagan (521 us 642)in its decision rendered on June 25, 1997. The US Supreme Court while extending the prohibition of the US Securities Laws from a fiduciary to a person in possession of information and who misappropriated this information reiterates the underlying principles of the prohibition on insider trading stated earlier. The Court made the following observations:

> *"9….two theories are complementary, each addressing efforts to capitalize on nonpublic information through the purchase or sale of the securities. The classical theory targets a corporate insider's breach of duty to shareholders with whom the insider transacts; the misappropriation theory outlaws trading on the basis of non-public information by a corporate 'outsider' in breach of a duty owed not to a trading party, but to the source of the information."*
>
> *11 and 12 The misappropriation theory advanced by the Government is consistent with Santa Fe Industries Inc Vs. Green 430 US 462, a decision underscoring that section 10 (b) is not an all purpose breach to fiduciary duty ban; rather it trains on conduct involving manipulation or deception."*

The Court while considering the earlier decisions of the US Supreme Court in Chiarella and Dirks observed:

> "*……This Court found no obligation, see id., at 665 – 667, 103 S.Ct. at 3266 – 3268, and repeated the key point made in Chiarella; There is no "general duty between all participants in market transactions to forego action based on material, the non-public information."*

Consequently even while continuing with the misappropriation theory in the context of insider theory the US Supreme Court did not lose sight of the underlying principles of insider trading

and breach of fiduciary duty which it settled in its earlier decision while dealing with the classical theory on insider trading.

It has been held by SEBI in several decisions, US Law on insider trading is invaluable in interpreting the Regulations. Regulation 3 must be interpreted bearing in mind the underlying principles of insider trading and without losing sight of the reasons why the obligations for disclosing the information or abstaining from trading were imposed.

The law in England relating to insider trading is no different. In *Attorney-General's Reference* (1) of 1988,(1988) IAC 971) Lord Lane while referring to White Paper on the conduct of a company director (1977) referred to paragraph 22 of the Paper which is inter alia stated:

> "*….Public confidence in directors and others closely associated with companies requires that such people should not use inside information to further their own interests. Furthermore, if they were to do so, they would frequently be in breach of their obligations to the companies, and could be held to be taking an unfair advantage of the belief with whom they were dealing".*

Lord Lane then went on to observe:

> *"What is in our view much more significant is obvious and understandable concern which the Paper shows about the damage to public confidence which insider dealing with, is likely to cause and the clear intention to prevent so far as possible what amounts to cheating when those with inside knowledge use that knowledge to make a profit in their dealing with others. This is the reason for the proposal in paragraph 25 of Paper."*
>
> *…….The prosecution will need to show that the insider knew or had reasonable grounds to believe that the information was not generally known and was price sensitive and that he dealt nevertheless. Also, it will be possible for a person to offer a defence*

that his purpose in dealing was not to make a profit or avoid a loss by the use of his insider information."

An Appeal against the decision of the Court of Appeal was turned down by the House of Lords.

The Hon'ble Supreme Court of India in K. P. Verghese Vs. Income Tax Officer, Ernakulam & Another (1981) 3 SCC 173 observed that while dealing with interpretation on statutory provisions "*The task of interpretation of a statutory enactment is not a mechanical task. It is more than a mere reading of mathematical symbols. It is an attempt to discover the intent of the legislature from the language used by it and it must always be remembered that language is at best an imperfect instrument for the expression of human thought and as pointed by Lord Denning, it would be idle to expect every statutory provision to be "drafted with devine prescience and perfect clarity. We can do no better than to repeat the famous words of Judge Learned Hand when he said:*

..."it is true that the words used, in another literal sense, are the primary and ordinarily less reliable source of interpreting and meaning of any writing; be it a statute, a contract or anything else. But it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning"

6.It is a well recognized rule of construction that a statutory provision must be so construed, if possible, that absurdity and mischief may be avoided."

Considering the settled principles of interpretation, Regulation 3 must be interpreted bearing in mind the basic underlying assumption and the intent of the legislature in introducing such Regulations. The Regulations was never intended as an all purpose ban on trading. Legitimate transactions undertaking to achieve a corporate purpose or to discharge a fiduciary duty or in the interest of a body of public shareholders or stakeholders in a company or transactions in the

public interest or transactions undertaken without an intent to make profit or to gain unlawfully or without a view to misuse information, or the like, would not be hit by the prohibition contained in the Regulations. The whole function of the Regulation is to regulate, not to stop transactions from taking place. Any other interpretation will lead to stifling the genuine transactions undertaken for legitimate corporate purpose or the like. The whole Regulation is an anti-fraud regulation.

The Regulation was preceded by a High Powered Committee on Stock Exchange Reforms which in its report has explained insider trading as follows:

> *"Insider trading generally means trading in the shares of a company by the persons who are in the management of the company or are to close to them, on the basis of undisclosed price sensitive information regarding the working of the company which they possess but are not available to others. Such trading as it involves misuse of confidential information, is unethical*
>
> *tantamounting to betrayal of fiduciary position of trust and confidence.*
>
> The preface to the draft regulations on insider trading which was circulated to the various intermediaries associated with the securities market, gives a fair idea of the rationale for the regulations that:
>
> *"The smooth operation of the securities market and its healthy growth and development depend to a large extent on the quality and integrity of the market. Such a market can alone inspire confidence in investors. Factors on which such confidence depend include, among others, the assurance the market can afford to all investors, that they will be protected against improper use of inside information. Inequitable and unfair practices such as insider trading, market manipulation and other security frauds affect*

the integrity, fairness and efficiency of the securities market, and impair the confidence of investors.

Insider trading takes place when insiders or other persons, who by virtue of their position in office or otherwise, have access to unpublished price sensitive information relating to the affairs of a company, and deal in securities of such company or cause the trading of securities while in possession of such information or communicate such information to others who use it in connection with the purchase or sale of securities. Thus, by benefiting certain investors as compared to others. Insider trading prejudices smooth functioning of the securities market and undermines investor's confidence."

In the light of the underlying principles relating to the prohibition of insider trading as well as the objects and reasons and intention behind the Regulations, it is abundantly clear that what was intended to be prohibited under Regulation 3 was the dealing in securities which was with a view to misuse information for obtaining unfair advantage. One of the indicia of that unfair advantage was making of profit. Consequently if the dealing in securities was not with a view to misuse the information or gain unfairly from the use of the information or to use information to make profit, that dealing in securities was not prohibited or covered by Regulation 3.

The impugned transactions were undertaken by the Appellant in discharge of his fiduciary obligations as director with a view to save the company and to ensure its survival as going concern. The object of the transaction was clearly bonafide and to achieve the Corporate purpose. The Hon'ble Supreme Court of India in *Needle Industries (India) Ltd. and Ors. Vs. Needle Industries Newey (India) Holders Ltd., & Ors.* AIR 1981 SC 129, while dealing with director's fiduciary obligations and the discharge of such fiduciary obligations has held as under:

"*the fact that by the issue of shares the Directors succeed, also or incidentally, in maintaining their control over the Company or in newly acquiring it, does not amount to an abuse of their fiduciary power. What is considered objectionable is the use of such*

powers merely for an extraneous purpose like maintenance or acquisition of contro over the affairs of the Company.

Admittedly the intention of the transactions being to ensure the Bayer acquires 51% and there being no other intentions in undertaking transactions, none of the indicia set out above has been satisfied.

Such actions are proscribed because the information is given to such persons, by virtue of thei connection with company, for corporate purposes and not for personal benefit. Further, that it is inherently unfair for such "insiders" to personally benefit from the use of such information a the expense of other shareholders, who are disadvantaged by lack of such information (Cady Robert & Company 40 SEC 907 1961).

Since the insiders receive unpublished price sensitive information by virtue of their connectio with the company and for corporate purposes only, such insiders owe a fiduciary duty (or a duty akin to a fiduciary duty) to the company not to misuse or misappropriate such information fo an unlawful purpose i.e. to make secret profits or personal gains for themselves. (Chiarella v US 455 US 222).

Such insiders are therefore either required to disclose the said unpublished price

sensitive information to other transacting parties or to abstain from acting on the said information/dealing in such securities altogether. This requirement has come to be known as the 'disclosure or abstain' rule.

To establish the offence of insider taking, it is essential to establish a breach of such duty owed to the company by the insider. This necessarily requires some "manipulation or deception" by the insider (Dirks v. US SEC 403 (646), that proof of mens rea to manipulate or deceive is therefore necessary. The clearest evidence of the "manipulation" or "deception" being

perpetrated by a corporate insider is when an insider uses the unpublished price sensitive information to make secret profit/personal gains. The necessary circumstance for liability is to ascertain whether the insider has made any secret profits or personal gains. If such benefit can be established, the insider is liable for the offence for insider trading (Dirks v. SEC 406 US 646).

The U.S. Supreme Court, while considering the Appeal in the case of Dirks v. SEC, while holding that personal benefit/personal gains form the basis of liability of insider trading stated:

> *"In some situations the insider will act consistently with his fiduciary duty to shareholders and yet release of the information may affect the market. For example, it may not be clear – either to the Corporation insider or to the recipient analyst – whether the information be viewed as material non-public information. The Corporation Official may mistakenly think information already has been disclosed or that it is not materially enough to affect the market. Whether disclosure is a breach of the duty therefore depends in large part on the purpose of the disclosure. This standard was identified by the SEC in Cady Robert's purpose of securities laws to eliminate use of the inside information for personal advantage. 40 SEC 1912, n d15.seen d 10, supra. Thus the test is whether an insider personally will benefit directly or indirectly from his disclosure. Absent some personal gain, there has been no breach of duty to shareholders. And absent a breach by the insider there is no derivative breach"*

The duty to disclose or abstain is not an absolute duty. When the insider acts / uses unpublished price sensitive information for a corporate purpose, he is not subject to such duty. In any event, the failure to either to disclose or abstain cannot in such circumstances give rise to liability. (Burger J while dissenting on the principle established in Chiarella's case (Supra) Page 13).

In US v. O'Hagan 521 US 642, the US Supreme Court, while holding that liability for insider trading of a tipper/tippee was also based on the 'misappropriation theory', reiterated and

restated the aforesaid principles on the basis of which corporate insiders are liable.

In the case of SEC v. David E. Lipson (U.S.Court of appeal (7th circuit) Docket No.01-1226) it was held that merely because an insider had two purposes further to which he dealt in securities, one being legitimate, and the other merely for the purpose of making unlawful gains, the existence of the legitimate purpose would not 'sanitize' the illegitimate one. In this case there was a clear benefit by the father in favour of his son and the Appellant had not benefited from the present transaction. In Lipson the primary or principal purpose was personal benefit not the corporate purpose for the benefit of the larger body of shareholders.

In the facts of the matter, both purposes were motivated by the desire to make personal gains by the diversion of unpublished price sensitive information to private ends, and not further to any corporate purpose. Lipson's case does not in any manner contradict the aforesaid principles or the basis of which insiders are held liable.

The necessary requirement to successfully establish liability for insider trading is unlawful conversion of unpublished price sensitive information resulting in secret profits/ personal gains.

The Regulations

The prohibition against Insider Trading in India is provided for in Regulation 3 of the said Regulations which so far as relevant, reads :

> *Prohibition on dealing, communicating or counseling on matters relating to insider trading – No insider shall –*
>
> *either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information"*

Regulation 2(e) defines an insider :

"Insider means any person who is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access, by virtue of such connection, to unpublished price sensitive information in respect of securities of the company or who has received or has had access to such unpublished price sensitive information."

Connected person is defined by a Regulation 2 (c):

"Connected person" means any person who –

(i) is a director, as defined in clause 13 of section 2 of the Companies Act, 1956 (1 of 1956) of a company, or is deemed to be director of that company by virtue of sub-clause (10) of section 307 of that Act, or

(ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company."

Regulation 2(5) enumerates a class of persons who shall for the purpose of the Regulation to be regarded to be "deemed connected persons".

The requirement for establishing a breach of fiduciary duty to successfully make out a violation of insider trading under Regulation 4 is implicit in the provisions of Regulation 3, and necessarily needs to be read into the same, that this requirement is imported into R 3, by the use of the defined term "insider", that an insider is necessarily a "connected person" or "a person deemed to be connected" with the company. A "connected person" is a person who owes the company a fiduciary duty (or a duty akin to a fiduciary duty) not to misappropriate or to divert unpublished price sensitive information for the purpose of making secret profits or personal gains

as is apparent from the nature and class of persons enumerated in S. 2(c) above. Section 2(h) (a person deemed to be connected) is a deeming provision by which the said duty is extended to the class of persons mentioned therein.

Regulation 3 merely aims to prohibit the insider from breaching this duty to the company. The breach of this duty necessarily involves an element of "manipulation" or "deceit", and the making of some secret profits or personal gain / benefit by the insider.

The predominant purpose of the transaction was the corporate purpose. The object of the transaction was not to secure personal benefits or secret profits. The position of SEBI that absolute disclosure or complete abstention is the only option is not tenable. For example, SEBI has in fact provided for creeping acquisitions under the Takeover Regulations, by inter alia promoters and other existing shareholders who would qualify as insiders under the said Regulations. Therefore, it is clear that transactions entered into even on the basis of unpublished price sensitive information would not be in breach of the Regulations if they are undertaken for a corporate purpose, that any other interpretation of Regulation 3 would render the same absurd for inter alia the following reasons:

a) All corporate activities on the basis of unpublished price sensitive information would stand proscribed.

b) Corporate insiders would be subject to a form of strict liability against dealing in securities even if they act in furtherance of their duty to the Company.

c) A corporate insider would be liable although he has committed no breach of his fiduciary duties, to the Company.

d) Promoters cannot consolidate their holdings in their company subject to limit prescribed by the SEBI (Substantial Acquisition of Shares and Takeovers)

Regulations, 1997, on basis of unpublished price sensitive information.

Chapter III of the SEBI Regulations on insider trading sets out SEBI's powers to investigate into suspected breaches of the said Regulation. Regulation 5 empowers SEBI to inter alia investigate and inspect the books of account and other records and documents of the insider. Regulation 6 prescribes the procedure to be followed for the purpose of investigation. Regulation 7 obliges of the insider to assist the said investigation. Regulation 8 provides for the submission of an investigation report, by the investigating authority to SEBI upon the conclusion of the investigation.

Regulation 9 provides inter alia for the communication of the findings of the investigation to the insider. Regulation 9 provides that the insider shall be given an opportunity of being heard before any action is taken by the Board on such findings. Further, that upon the receipt of an explanation, if any, from the insider the Board may take such measures as it deems fit to protect the interest of the investors and in the interest of the securities market and for due compliance with the provisions of the Act, Rules and said Regulations.

Regulation 11 provides for the directions that may be given by the Board to the alleged insider in the course of investigation, and read as under:

"11. *Directions by the Board*

On receipt of the explanation, if any, from the insider under sub-Regulation(2) of Regulation 9, the Board may without prejudice to its right to initiate criminal prosecution under Section 24 of the Act, give such directions to protect the interest of the investors and in the interest of the securities market and for due compliance with the provisions of the Act, rules made thereunder and these regulations, as it deems fit for all or any of the following purposes namely:-

(a) directing the insider not to deal in securities in any particular manner;

(b) prohibiting the insider from disposing of any of the securities acquired in violation of these regulations;

(c) restraining the insider to communicate or counsel any person to deal in securities;

Regulation 11 therefore empowers the board to give directions only for the purposes

enumerated therein viz. to prevent the insider from dealing in securities in any particular manner, to prohibit the insider from disposing of any securities acquired in violation of these Regulations and restraining the insider from communicating or counseling any other person to deal in securities. Regulation 11 does not empower the Board to pass any other wider directions. The power under regulation 11 is only to pass necessary interim directions for the purpose of preserving the status quo during or immediately after the investigation. Regulation 11 does not empower the Board to make any final and/or conclusive determination as to whether the insider has acted in breach of the Regulations. It is for that reason that advisedly the Regulation does not empower the Board to call for any Documentary evidence or to summon any persons it considers necessary as witnesses before passing the said directions provided for therein. It is significant to note that in contrast Section 15-I(Power to Adjudicate) of the said Act expressly confers upon the Adjudication Officer the power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the Adjudicating Officer may be useful for or relevant to the subject matter of the inquiry.

From the scheme of the SEBI Act read with the Regulations it is apparent that a final and conclusive determination as to whether an insider has breached the Regulations can only be done by the Adjudicating Officer, pursuant to the provisions of Sections 15- G, 15-I and 15-J of the said Act and not by the Board pursuant to Regulation 11.

The fact that SEBI, while framing the said Regulations did not intend to confer upon the Board

any wider power, is clear from the language of the said Regulation 11 which states that the directions pursuant thereto may be passed "for all or any of the following purposes namely –". This language be contrasted with language or Regulation 44 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 that:

> *"The Board may, in the interests of the securities market, without prejudice to its right to initiate action including criminal prosecution under Section 24 of the Act give such directions as it deems fit including;*
>
> *(a) directing the person concerned not to further deal in securities;*
>
> *(b) prohibiting the person concerned from disposing of any of the securities acquired in violation of these Regulations;*
>
> *(c) directing the person concerned to sell the shares acquired in violation of the provisions of these Regulations;*
>
> *(d) taking action against the person concerned'"*

From the said Regulation 44, it is clear that when SEBI intends to confer a wider power upon itself it uses express language to that effect. For example under Regulation 44 it has expressly empowered the board to "give such direction as it deems fit including" for the purposes enumerated therein below. Regulation 44 of the SEBI Takeover Code therefore is unlike Regulation 11, being inclusive is merely illustrative of the various purposes for which the Board may pass directions and not exhaustive.

The impugned order, in so far as it purports to make a final and/or conclusive determination of whether the Appellant has acted in breach of the said Regulation is ultra vires the said Regulation, and in particular Regulation 11. The impugned order is illegal and should be

quashed and set aside on this ground alone.

Unpublished price sensitive information:

Paragraphs 16 and 17 of the Impugned order:

> *"16. Mr. Agarwal being a Managing Director of ABS Industries is a "connected person" under the Regulation 2 (c). He was also an "insider" under Regulation 2 (e) as he being a person negotiating on behalf of his company, was in a position to know about the impending tie up/takeover with/by Bayer Industries.*
>
> *The information about takeover, amalgamation, mergers, etc. is a price sensitive information within the meaning of Regulation 2 (k) (v) of the SEBI (Insider Trading) Regulations, 1992 and this information was not available to sellers and public at large.*
>
> *17. The information about the "takeover" is price sensitive information, this can be seen from expression "unpublished price sensitive information" which is defined in Regulation 2 (k) of the Regulations.*

This expression reads as under:

> *"unpublished price sensitive information" means any information which relates to the following matters or is of concern directly or indirectly, to a company, and is not generally known or published by such company for general information, but which it published, is likely to materially affect the price of securities of that company in the markets-*
>
> *(i) financial results (both half yearly and annual) of the company*

(ii) intended declaration of dividends (both interim and final);

(iii) issue of shares by way of public rights, bonus shares

(iv) any major expansion plans or execution of new projects;

(v) amalgamation, mergers and takeovers;

(vi) disposal of the whole or substantially the whole of the undertaking;

(vii) such other information as may affect the earning of the company;

(viii) any changes in the policies, plans or operations of the company."

Similarly the fourth paragraph on page five at the Show Cause Notice reads that: "From the above it is unequivocally clear that it has always been SEBI's case that the alleged unpublished price sensitive information on the basis of which the Appellant is purported to have entered into the said transaction was information about the said tie up/take over by Bayer AG".

Regulation 2 (k) defines the information on the basis of which the insider is prohibited from dealing in shares to make secret profits or personal gains. The unpublished information relating to mergers and takeovers may be construed to be price sensitive. But all unpublished information regarding mergers, etc. need not necessarily be price sensitive. To be price sensitive the information should be of such quality that it is likely to "materially" affect the price of securities of the company in the market, that this requirement is inherent in the concept of price sensitivity. In view of the definition in Regulation 2(k), it is only upon crystallization of the decision of the merger/takeover that the information would be price sensitive. At no point of time prior to 1st October, 1996 was the fact of merger / joint venture between the said companies certain or definite, that this fact became certain and definite only on 1st October 1996 when the Appellant visited the head quarters of Bayer AG in Germany.

The lack of certainty regarding the Company's merger with Bayer is apparent from

the fact that between June and September, 1996 merger discussions were in fact progressing not only with Bayer but also with JSR Further that, as late as September 20, 1996, the Board of ABS merely authorized the Appellant to undertake further discussion with Bayer in this regard. The Appellant reiterated that at that Board meeting, no concrete proposal whatsoever regarding the merger was discussed with the Board. In fact the minutes of September 20, 1996 meeting did not indicate that any informal understanding had already been arrived at in this regard, that the minutes in fact, clearly state that the salient features of the agreement are in the process of being discussed.

From the very day i.e. October 1, 1996 when ABS and Bayer entered into the said share subscription agreement, the said stock exchanges were informed that a Board Meeting was to be convened to discuss and decide raising of further capital through a preferential offer, for the purpose of the said merger/takeover. Further, it is empirically able to establish that the general information that the company was merging/entering into a joint venture with another company and/or Bayer AG was not price sensitive information and did not materially affect the price of securities of ABS Industries in the market, e.g. in February 1996, the Express Weekly (Edition of 8th January to 14th January, 1996) carried an article wherein it was mentioned that ABS Industries was contemplating a tie-up with Monsanto (subsequently, publicly taken over by the Bayer AG). On the very next day after the article was published, the price of ABS's share on the Bombay Stock Exchange dropped to Rs.72.28 from prior high of Rs.84.74 as on 2nd January 1996. The share price continued to decline and as at 31st January 1996, stood at Rs.76.80. Similarly the price of ABS share on the NSE on 9th January 1996 dropped to Rs.73 from a high of Rs.83 on 1st January, 1996. Similarly, when ABS Industries informed the Stock Exchanges that Board will be meeting to consider the investment of Bayer on October 1, 1996 the price of ABS's share was materially unaffected. The share opened at a price of Rs.62/- and closed at Rs.64/- on that very day. Similarly during February – March 1995, there were several reports and press notes appearing in various capital market related and other newspapers/magazines in regard to the Katol Plant expansion and other

technical tie-up news. During this period the price of ABS Industries share fluctuated between Rs.152.50 on 9th February 1995 and Rs.136 on March 101, 1995. Similarly, on Maya 28, 1996 and June 2, 1996, there was an article in Business India, discussing the future expansion plans of ABS Industries, however the prices dropped from Rs.71.78 on 31st May 1996 to Rs.68.79 on 6th June 1996. The Board of Directors on September 20, 1996 declared dividend at the rate of Rs. 3 per share for the year ended June 30, 1996. This news did not in any manner affect the price of ABS..

Prior to October 1, 1996, the quality of information regarding the merger / joint venture between ABS and Bayer that was available to the Appellant, was not appreciably different from the type of information which was in public domain and which had failed to materially affect the price of ABS's shares. Prior to October 1, 1996, he did not possess any price sensitive information, that prior to October 1, 1996 the fact that ABS Industries was negotiating with Bayer AG for a possible collaboration was published and/or generally known and in the public domain. For example in a Article dated March 20, 1995, the Financial Express 'investor' expressly mentioned that the company is negotiating with Bayer Germany for possible collaboration in the manufacture of ABS Alloys.

Although it has never been SEBI's case nor was it a point even considered by the Chairman in his order, it was argued on behalf of SEBI that the information regarding Bayer's said requirement to hold 51% equity of the said company was the unpublished price sensitive information on the basis of which the Appellant entered into the said transactions. This argument was for the first time taken during the course of the said hearing and is contrary to the notice issued by SEBI and the impugned Order, which proceeded on the basis that the information regarding the take-over/merger was the relevant unpublished price sensitive information. It is not open to SEBI to make the said submission and the same should be struck off from the record of the proceedings. If the same is considered at this stage the same would violate natural justice as the Appellant has had no opportunity to place on record and plead that the said information was neither material nor price sensitive no unpublished. It was Bayer's

world wide policy that it required to hold 51% equity of any company it enters into a tie-up/ merger / take-over with, which fact is widely known, therefore the said information can not be regarded to be unpublished.

Power to direct disgorgement / compensation

The impugned order directs the Appellant to deposit a sum of Rs.34.00,000/- with the Investor Protection Funds of BSE and NSE, purportedly to compensate investors who may come forward at a later period of time seeking compensation for the alleged loss incurred by them in selling the said shares to I. P. Kedia at a price lower that the aforesaid price. The said direction is in breach of principles of Natural Justice, unreasonable, arbitrary and ultra vires the provisions of Regulation 11 and /or Section 11 read with Section 11 B of the SEBI Act on the ground that: (i)that no point of time prior to the impugned order have the Respondent put the Appellant on notice that any such order was contemplated against him, (ii) in any event, the Appellant has not been given any opportunity whatsoever to present his case on the matter of quantification of the purported compensation, payable by him if any, therefore the impugned order in so far as it directs the Appellant to pay the said sum of Rs.34,00,000/- purportedly by way of compensation, is in breach of the principle of Natural Justice, that on this ground alone the impugned order is liable to be quashed and set aside. (iii) further, the impugned order, in so far as it directs the Appellant to deposit a sum of Rs.17,00,000/- each with the Investor Protection Fund of both the BSE and NSE is unreasonable and arbitrary. The said purchases of shares by I. P. Kedia, during the said period from the BSE and the NSE were unequal, that accordingly, even if it is assumed, that compensation is payable by the Appellant, it is unreasonable and arbitrary to direct the Appellant to deposit Rs.17,00,000/- each with the Investor Protection Fund of both the said exchanges, (iv) that paragraphs 31 and 32 of the impugned order so far as relevant read that:

> "31 Regulation 11 of SEBI (Insider Trading Regulations, 1992 empowers SEBI to issue directions for the purpose of prohibiting the insider from dealing in the

securities, and prohibiting an insider from disposing of the securities acquired, in violation of the Regulations. These securities were given in the open offer of Bayer Industries by Mr. Kedia and they are no more with Mr. Kedia. Therefore, issuance of directions under this Regulation would be inoperative and infructuous.

In view of the above, reliance is now placed on section 11B of the SEBI Act which reads as under:-

"Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary;

(i) in the interest of investors, or orderly development of securities market, or;

(ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interest of investors or securities market;

(iii) to secure the proper management of any such intermediary or person.

It may issue such directions;

(a) to any person or class of persons referred to in section 12, or associated with the securities marked; or

(b) to any company is respect of matters specified in section 11A, as may be appropriate in the interests of investors in securities and the securities market."

Paragraphs 33, 34 & 35 of the said notice issued to the Appellant pursuant to Regulation 9, reads that:

"33. Section 11B was inserted by the Securities (Amendment) Laws, 1995. This provision of the Act operates independently of and in addition to the regulations. Besides section 11B being a part of the SEBI Act, is superior and wider to the regulations which are pieces of subordinate legislation.

34. To protect the interest of investors and integrity of the market it is considered, fit and proper, in the facts of the case, to issue a direction because SEBI as a regulatory body would be failing in its duty if it does not take corrective steps to protect the interest of investors and integrity of the market. Besides it is also the duty of SEBI to ensure that the transactions in the securities market are carried out in a fair and transparent manner and there is a level playing field for the investors transacting in the securities market. In this case it has been concluded that shares were purchased by Mr. Agrawal in the name of Mr. Kedia on the basis of unpublished price sensitive information. Mr. Agrawal, thus, acquired the shares in violation of the Regulation of the Act.

35. In view of the aforesaid, I, D.R. Mehta, under the provisions of section 11(1) read with section 11B hereby direct Mr. Rakesh Agarwal to deposit a sum of

Rs.34,00,000/- with investor protection fund of BSE and NSE to compensate the investors who may come forward at a later period of time seeking compensation for the loss incurred by them in selling at a price which was lower than the offer price."

It is thus clear that the impugned order has proceeded on the basis that Regulation 11 merely empowers SEBI to issue directions for the purposes enumerated therein and in the present facts and circumstances of the matter passing such directions would in the opinion of the Board result in the same being inoperative and infructuous. Accordingly, the impugned order purports to direct the Appellant to deposit the said sum of Rs.34,00,000/- purportedly by way of compensation, pursuant to the provisions of Section 11 B of the said Act.

It is well established in law that, any pecuniary burden sought to be imposed by the legislature upon citizens, must be expressly for in the

concerned Act/ Regulation. Section 11 B of the said Act does not contain any such specific provision. The only specific provision pursuant to which a pecuniary burden may be imposed upon a person in breach of the said Regulations is section 15G of the said Act, pursuant to which powers are only exercisable by the Adjudicating Officer. The Board does not have any power to direct the Appellant to pay the said amount by way of compensation, pursuant to Section 11 B of the said Act. Accordingly, that the impugned order in so far as is does so, is ultra vires the provisions of the said Act, and liable to be struck down.

It was urged on behalf of the Respondents, that the Board had inherent powers under Section 11B of the said Act to issue all necessary directions in the interest of the investors, and the orderly development of the securities market. In this regard the Respondents sought to rely upon the judgement and order of the Hon'ble Bombay High Court in the matter of B.P. Plc v. SEBI (SEBI Appeal No.10 of 2001 in Appeal no.37 of 2001) dated May 2, 2002 by which the Hon'ble Bombay High Court upheld SEBI's directions to the Appellants therein to pay interest to the aggrieved investors. This judgment and order is clearly distinguishable from the facts and circumstances of the present matter. In B.P. Plc's case it was held that SEBI has the power to direct the payment of interest to aggrieved investors on a conjoint reading of the provisions of the said Regulation 44 and Section 11B of the said Act. Regulation 44 confers wide powers upon the board which include "taking action against the person concerned", in the interest of the securities market, that it is due to these wide powers conferred by Regulation 44 that it was held that SEBI has the power to award interest to the aggrieved investors.

It was also argued on behalf of SEBI that the power to direct disgorgement of alleged profits, to aggrieved investors is an equitable power which vests in SEBI, and that such a direction of disgorgement is compensatory in nature. It is well established that equitable powers can only be exercised by courts and not any quasi-judicial tribunals/ bodies. Accordingly, SEBI does not have the power to direct disgorgement of any alleged profits. Further, the disgorgement of alleged profits is always directed as a measure of deterrence and not compensation. (SEC V. Maurice Rind 991F. 2d 1486, SEC v. Manor

Nursing Centers 458 f 2d 1082 (2nd circuit 1972)). Directions of disgorgement are therefore penal in nature, and accordingly can not be passed pursuant to Section 11 B of the said Act, under which only remedial directions may be passed. (Sterlite Industries v. SEBI, BPL v. SEBI, Videocon V. SEBI).

It was further argued on behalf of the Respondent that if the power to direct disgorgement of alleged profits is not read into Section 11B of the SEBI Act, pursuant to Section 20A of the SEBI Act no civil court would have jurisdiction to award such compensation, as its jurisdiction in this regard would be barred, this submission is incorrect and proceeds on a misreading of the said Section 20A, that Section 20 A bars the Civil Court Jurisdiction only in respect of matters in which the Board is empowered by or under the said Act to pass orders. SEBI does not have the equitable power to direct disgorgement of any alleged profits and therefore the jurisdiction of the Civil Court is preserved in this regard, that it is always open to any aggrieved investors to seek disgorgement of any alleged profits, made in breach of the said Regulation, by using the process of a Civil Court.

It is clear that the impugned order proceeds on the basis that the Board has no power under the said Regulation 11 to direct any person in breach of the said Regulations to compensate the persons aggrieved. Despite this, during the course of the hearing before the Tribunal it was argued on behalf of the Respondent that the impugned direction of deposit purportedly to compensate any aggrieved, investors who may come forward in the future was made pursuant to the said Regulation 11. This submission is contrary to the record as aforesaid, and should accordingly be struck out.

Regulation 11 merely empowers the Board to pass certain interim directions, for the purpose of maintaining the states quo during the course of the investigation and/or, immediately thereafter upon receipt of the said investigative report. Further, that the directions which may be passed pursuant to Regulation 11 are limited to the purposes enumerated therein, which do not include compensating any aggrieved parties. Further that the said Regulation 11 does not empower the Board to arrive at any final and/or conclusive

determination as to whether any person has acted in breach of the said Regulations for reasons more particularly stated above. Such final and conclusive determination can only be made by the Adjudicating Officer, pursuant to the powers conferred upon him by sections 15-G, 15-I and 15-J of the said Act or pursuant to a prosecution initiated by the Board pursuant to Section 24 of the said Act. Therefore there is no question of any award of compensation being made by the Board pursuant to Regulation 11.

No aggrieved party has come forward till date, despite the fact that the impugned order is dated June 10, 2001 and was widely available and publicized shortly thereafter, that there appear to be no aggrieved persons, to compensate, that this being the case, the said directions to deposit Rs. 34,00,000/- is in the nature of penalty.
It is well established in law that power exercisable pursuant to Section 11 B of the said Act is purely remedial in nature, and that no penal orders can be passed pursuant thereto. [Sterlite Industries v. SEBI, BPL v. SEBI Appeal Nos. 14/2001 to 19/2001, Videocon v. SEBI 23/2001 to 26/2001] and accordingly the impugned direction is ultra vires the provisions of the SEBI Act, illegal and liable to be struck down.

Imposition of penalty

The direction to deposit the said sum of Rs. 34,00,000/- is in the nature of a penalty. Even if it is assumed that the Appellant has committed a breach of the Regulations by instructing the said I.P.Kedia to purchase the said shares between September 9, 1996 and October 1, 1996, the breach is merely a technical or venial breach. Further, and in any event the Appellant submits that he had a bona fide belief that he had not acted in breach of the Regulations. It is well established in law that the deciding authority should exercise his discretion and decline to impose a penalty in such cases. In Hindustan Steel Limited v. State of Orissa [1970(1) SCR 753], the Hon'ble Supreme Court in this regard stated:

> "The discretion to impose a penalty must be exercised judicially. A penalty will ordinarily be imposed in cases where the party acts deliberately in defiance of law, or is guilty of contumacious or dishonest conduct, or acts in conscious disregard of its

obligation; but not, in cases where there is a technical or venial breach of the provisions of the Act or where the breach flows from a bonafide belief that the offender is not liable to act in the manner prescribed by the statute."

This principle has been followed in Akbar Badruddin Jiwani v. Collector of Customs [1990 (47) E.L.T. 161(SC)], Merck Spares v. Collector of Excise &

Customs, [1983 ELT 1261], New Delhi, Shama Engine Values Ltd. Bombay v. Collector of Customs, Bombay [1984 (18) ELT 533] and Madhusudan Gordhandas & Co. v. Collector of Customs, Bombay [1987 (29) ELT 904]. There is in fact no such findings whatsoever on this point by the investigating officer or in the impugned order. The investors have not incurred any loss by the said transactions. Furthermore the said transactions by ensuring the investment of Bayer AG into ABS Industries has ensured the survival and profitability of the company, which in the long run has benefited general body of shareholders, therefore this accusation by SEBI at this stage of the proceedings has no basis in fact.

Specific allegations of profit/personal benefit

The impugned order at paragraph 20 stated:

"It was contended that in the absence of any evidence that acquisition was for trading purpose, i.e. the process of buying and selling with intent to make profit, there cannot be violation or contravention of the insider trading Regulations. The contention is not acceptable as the word used in the Regulations is "dealing in securities". This expression is defined in Regulation 2(d) which reads as "dealing in securities means and act of buying, selling or agreeing to buy, sell or deal in any securities by any person either as principle or gent". Thus, mere act of buying is covered under the Regulation."

From paragraph 20 it is clear that the impugned order proceeds on the basis that profit

is not an essential ingredient for the purpose of establishing a breach of the said Regulations. Therefore the impugned order fails to make any finding whatsoever with regard to any alleged profit made by the Appellant. Despite this in the course of the hearing before the Tribunal it was for the first time submitted on behalf of the Respondent that the Appellant had made a profit by entering into the said transactions through the said I.P.Kedia. Further, that the profit amounted to Rs.34,00,000/- , being the sum which the impugned order directed the Appellant to deposit with the BSE and NSE as aforesaid. That in light of paragraph 20 of the impugned order and the fact that the said order fails to make any finding whatsoever on any alleged profit made by him, that the said submissions is contrary to and inconsistent with the impugned order, that it is pertinent to note that even the said investigation report did not make any findings whatsoever in this regard. It is not open to the Respondents to make this submission for the first time before the Tribunal.

The charge that the Appellant made profit by instructing the said I.P.Kedia to enter into the said transactions denied. The Appellant's sole intention in entering into the said transaction was to ensure the entry of Bayer AG into the said company. It was also argued on behalf of the Respondents that the Appellant has secured certain personal benefit by entering into the said transactions, that these submissions were also taken for the first time during the course of the said arguments in appeal. Further, that these submissions are inconsistent and contrary to the view taken in the impugned order has pointed above that these submissions be striked up.

Referring to the Respondent's argument that by securing the entry of Bayer by entering into the said transactions through I.P.Kedia the Appellant secured for himself Management control over the newly formed joint venture company, the Appellant submitted that he did not enter into the said transaction with a view to gain any such personal benefit, that his sole objective in entering into the said transactions was to benefit the said company by ensuring the entry of Bayer. The Shareholders Agreement dated 27th February 1997 between

Bayer India Ltd. and the Appellant, belies any such suggestion that the Appellant has retained Management control over the newly formed joint venture company. Clause 2(Board structure) and in particular Clause 2.1 thereof provides that so long as Bayer owns not less than 50.9% of the equity shares in joint venture company the board of directors shall always be in odd number and that Bayer shall have the right to appoint/designate majority of the directors on the Board. Further, that at present the Board of directors was to consist of the total number of nine directors out of which Bayer was entitled to appoint and nominate the majority number of directors i.e. five directors on the Board. Clause 2.2 further provides that as long as the Appellant owns not less than the minimum required shares of the said joint venture company, he would be entitled to appoint and nominate only four directors, which appointments include the nominees of Financial Institutions. Further, that in case the Financial Institutions decide to appoint more than two nominee directors, Bayer would also have the right to appoint additional directors in order to maintain its majority on the Board. From the said Clause 2.1 and 2.2, it is abundantly clear that the Management control of the resultant joint venture company does not vest with the Appellant, and in fact vests with Bayer. Clause 3 (Management) and in particular Clause 3.3. thereof expressly provides that although the Appellant was continued as managing director of the resultant joint venture company till 1998 and thereafter till 2003, and as such was in charge of the day to day management of the resultant joint venture this power was subject to the superintendence, control and direction of the Board of directors of the said joint venture company, which as stated above was in the control of Bayer.

Clause 5 (Voting Rights) and in particular Clause 5.2 thereof provides that so long as the Appellant holds the minimum require shares of the joint venture company all special resolutions of the said joint venture company will require the affirmative vote of the Appellant, that Clause 5.2 of the said Agreement merely confers upon the Appellant a veto right in respect of any special resolution, that no Management control is conferred upon the Appellant by the said Agreement. The Appellants position under the said Shareholders

Agreement to influence the affairs of the company is far weaker, in comparison to his earlier position in the said company where he was in completer Management control of the same, that the Appellant has not in any way secured any personal benefit by instructing the said I.P. Kedia to enter into the said transaction.

It was also argued on behalf of the Respondent that by instructing the said I. P. Kedia to enter into the said transaction, and by using those shares to ensure the entry of Bayer, into the said company, the Appellant benefited as he did not have to offer his own shares to Bayer, to ensure its entry. Accordingly, it was argued that the Appellant was able to retain his minimum required shareholding under the said Shareholders Agreement. The Appellant did not instruct the said I.P. Kedia to enter into the said transactions for the reason alleged. At the time of instructing I.P.Kedia to enter into the said transactions, as mentioned above, the said merger/takeover was merely in the realm of possibility and was not in any manner definite or certain. This being the case the Appellant was not even aware that there might be any requirement in the future to hold a certain minimum number of shares. In any event, that there was no agreement whatsoever between the parties at that time, of any minimum shareholding which would be required to be held by the Appellant, that therefore no such motivation prompted him to instruct the said I.P. Kedia to enter into the said transactions. The Appellant denied such intention. In fact ultimately the Appellant was constrained to put in his own shares to ensure the success of the open offer and the Appellant consequently was unable to hold the quantity of shares as contemplated in the original draft shareholders agreement. Infact the financial institutions opposed allotment of any additional shares to the Appellant as originally contemplated. Consequently, in fact the Appellant has personally suffered in the process of ensuring the successful entry of Bayer into ABS.

It is incorrect that the Appellant made any profit/personal benefit by entering into

the said transactions through the said I.P. Kedia. The Appellant has not contravened Regulation 3 of the SEBI Regulations as alleged and the impugned order is accordingly liable to be set aside.

The Respondent's submissions

This is a case which essentially deals with violations of the SEBI Insider Trading Regulations by the Appellant. The facts relating to acquisition of shares are not seriously disputed by the Appellant. The Appellant has only argued that purchase of shares was not done on the basis of price sensitive information and in any event the said purchases were not effected on the basis of unpublished price sensitive information. The Appellant has further contended that the purchase of shares even if held to have been made on the basis of unpublished price sensitive information, or otherwise the same having been done for corporate benefit only and not for any personal gain, the Appellant has not committed any breach of the Insider Trading Regulations.

The following facts were stated:

In August 1996 the price of the shares in ABS was around Rs.48/- which reached around Rs.82/- by October 1996. The show cause notice has alleged that the Appellant had financed the purchase of the shares of ABS through his brother-in-law Mr.I.P.Kedia during the period August 1996 to October 1996, on the basis of insider information available with the Appellant relating to the merger of ABS with Bayer. The order passed by SEBI relates however, only to 1,82,500 shares which were purchased during the period 9th September to 8th October 1996 i.e.

after the Appellant returned to India from Germany after having concluded an agreement with Bayer and the date of the open offer to be made by Bayer respectively. Between July -- September 1995 ABS held discussions with Monsanto Chemicals to explore the possibility of technical/financial collaborations with ABS. ABS was also holding similar discussions with JSR., Mitsubishi Rayon and Toyo Engineering. In January 1996 Bayer made a global public announcement that Bayer AG had taken over the styrenics business of Monsanto worldwide with effect from November 1995. In February 1996 Bayer approached ABS for a possible tie-up. In May 1996 Bayer held discussions with ABS and sent a questionnaire seeking various details relevant to the discussions. On 28th June, 1996 Board of ABS considered the prospects of foreign collaboration. In July, 1996 Bayer team visited ABS for technical and financial evaluation of ABS and asked for further details which were furnished by ABS. On 5th and 6th September 1996 Appellant visited Germany and held meetings with Bayer's officials and concluded an "in principle" agreement whereunder interalia Bayer insisted that Bayer wanted to have a majority stake of 51% but that and the Appellant was to continue in management and in control of the merged company etc. On 8th September 1996 Appellant returned to India from Germany. On 20th September 1996 the Board of ABS was informed of the Appellant's visit to Germany and the minutes recorded the salient features of the agreement that were discussed with Bayer. From the available facts nothing has happened between the 8th and 20th of September 1996; therefore it can safely be concluded that the "in principle" agreement was arrived at on the 5th and 6th of September 1996. On 29th September, 1996 the Appellant once again visited Germany alongwith his legal advisors and the Merchant Banker and the legal advisors for Bayer in India. On 2nd and 3rd October, 1996 Legal consultants of both companies worked out a draft subscription agreement and shareholders agreement setting out the terms and conditions and obligations of the respective parties. These agreements were approved by the respective Board of Directors of ABS and Bayer respectively on 5th October 1996. On 8th October, 1996 Bayer made an open offer for purchase of 20% shares of ABS at Rs.70/- per share, which was raised to Rs.80/- per share on 26th December 1996.

On 30th October, 1996 ABS held an Extra Ordinary General Meeting at which resolutions are passed inter alia for allotting to Bayer 55,80,000 equity shares and the Appellant 4,20,000 shares on preferential basis @ Rs.70/- per share. Between 9th September and 8th October 1996 the Appellant himself and through his investment companies Tash Investment Pvt. Ltd and Geet Ganga Leasing and Finance Co. Ltd. provided a sum of Rs.1.15 Crores., Rs.1.50 Crores and Rs.30 lakhs respectively to Mr. Kedia for financing purchase of shares of ABS by Mr. Kedia. Mr. Kedia had himself invested Rs one to two lakhs only for purchase of ABS shares.

During the course of inquiry/investigation, the Appellant had tried to distance himself from the purchases made by Kedia but had thereafter admitted having instructed Mr. Kedia to purchase shares of ABS and having provided him the necessary funds for the same. The Appellant however has stated in his reply to the Show Cause Notice that he never informed Mr. Kedia the reasons for the purchase. This fact itself is sufficient to show that the Appellant was aware that the said information relating to the merger with Bayer was unpublished price sensitive information and the argument now put forwarded by the Appellant is clearly an afterthought and cannot be accepted.

The Appellant has alleged that he purchased shares of ABS and financed the purchases of ABS shares by Kedia only for the purpose of ensuring that Bayer's pre-condition for the proposed merger that Bayer control 51% of the share capital of ABS was met. The Appellant has contended that the shares were purchased in order to ensure that if there was a short-fall in the public offer and Bayer's were unable to obtain the requisite 20% at the public offer, the shares purchased at his instance could be tendered at the public offer to make up the short-fall if any. The Appellant has submitted that all this was only done not for any personal gain but to ensure that Bayers obtain 51% of the share capital of ABS and that if Bayer did not get the said 51%, the joint venture or merger would have fallen through and it was in the interest of ABS that the joint venture with Bayer goes through.

The entire basis of the Appellant's argument is based on a totally incorrect principle and

is clearly an after thought. Shares of ABS were being freely traded at stock exchanges. The purchases effected by Kedia clearly demonstrated that shares of ABS were available for purchase in the market even at prices well below the open offer price of Rs.70/- It is incorrectly sought to be suggested that whilst the sellers were ready and willing to sell their shares to Kedia, they would have been unwilling to sell their shares to Bayer at a public offer. There is nothing in the submission made by the Appellant to substantiate this incorrect premise. It is therefore clear that Bayer would have been able to obtain the necessary 20% at the open offer and there is no material available on record to suggest anything to the contrary. As per the

agreements disclosed by the Appellant, he was only required to co-operate with Bayer in the public offer, such co-operation can never extend to or justify acting contrary to law. In this context referred to Caddy Robert's case.

Under the Insider Regulations, profit element is not an ingredient of the offence of insider trading. The Appellant has admitted that the price at which the shares were purchased during the said period was between Rs.59/- and Rs.62/-. The

entire 1,82,500 shares were offered in the open offer to Bayer at the rate of Rs.80/- per share. SEBI has taken the average cost of purchase during the said period at Rs.61.50 per share and accordingly has arrived at the profit made on sale of the said shares to Bayer at the open offer at Rs.34,00,000/- During the course of inquiry the Appellant was shown the basis of computation and had not disputed the same. Therefore there is no substance in the Appellant's contention that the Appellant has not made any personal gain. From the chart submitted by the Respondent during the course of arguments, it is clear that the Appellant had made a profit of Rs.34 lakhs on the 1,82,500 shares purchased during the period 9th September to 8th October 1996. Apart form the aforesaid the Appellant was to continue as Managing Director of ABS Industries Ltd and have management and control of ABS Industries Ltd even after merger with Bayer, where Bayer held 51% of the share capital of the merged entity.

Further it is clear that inspite of the fact that Bayer held 51% of the share capital of the merged entity no special resolution could be passed without the consent of the Appellant, as the Appellant was required to hold a minimum of 26%. Further from the facts and documents disclosed by the Appellant it is clear that the Appellant's purchases were not necessarily only for the purpose of ensuring that the joint venture was a success but to ensure that the Appellant's holding was not diluted as he was required to maintain the 26% shares in the merged entity. The said purchases were therefore also for personal gain. i.e. to enable him to maintain his shareholding in the merged entity @26%.

The SEBI Act, 1992:-

Under the provisions of Section 11(2)(g) SEBI is to prevent insider trading and take such measures to protect the interest of investors as insider trading is per se a wrong and is prohibited.

Insider Trading:-

Insider Trading may be described as trading which is based on an imbalance of information resulting in one party to the transaction having advantage over the other party by reason of his having unpublished price sensitive information.

According to the Respondent the growth of the securities market depends on investor's confidence in the fairness of the securities market which can only be achieved by ensuring that the securities markets operate freely and fairly with all participants having equal access to all information so that they can make informed investment decisions.

It cannot be disputed that:

i. the Appellant as Managing Director of ABS was an insider

ii. the Appellant had unpublished price sensitive information.

iii. at the relevant time i.e. between 9th September and 8th October 1996 the Appellant had financed Mr. Kedia and directed him to purchase shares of ABS on the basis of the aforesaid price sensitive information. The Appellant is therefore guilty of having breached Regulation 3.

It is clear from the bare reading of Regulation 3 that the prohibition of insider trading by an insider is an absolute offence and that benefit or gain is not an ingredient of the offence.

The SEBI (Insider Trading) Regulations, 1992

The relevant provisions of SEBI (Insider Trading) Regulations, 1992 are:-

Regulation 2(c)

"connected persons" means any person who:

(i) is a director as defined in clause (13) of section 2 of the Companies Act 1956 (1 of 1956) of a company or is deemed to be a director of the company by virtue of sub clause (10) of Section 307 of the Act or

(ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company and who may reasonably be expected to have access to unpublished price sensitive information in relation to that company."

Regulation 2(e)

""Insider" means any person who is or was connected with the company or is deemed to have

been connected with the Company and who is reasonably expected to have access by virtue of such connection to unpublished price sensitive information in respect of securities of the company or who has received or has had access to such unpublished price sensitive information":

> The definition of insider covers within it's scope connected person and deemed connected person as defined in Regulation 2(c) and 2(h) respectively. The Appellant being the Managing Director of ABS Industries Limited (ABS) at all relevant times falls squarely within the definition of "connected persons" and "Insider" as defined in Regulation 2(c) and 2(e) above respectively.

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Regulation 2(h)

2(h) "person is deemed to be a connected person" if such person –

(i) is a company under the same management or group or any subsidiary company thereof within the meaning of sub-section (1B) of section 370, or sub-section (11) of section 372, of the Companies Act, 1956 (1 of 1956) or sub-clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969) as the case may be; or

(ii) is an official or a member of a stock exchange or of a clearing house of that stock exchange, or a dealer in securities within the meaning of clause (c) of section 2, and section 17 of the Securities Contracts (Regulation) Act, 1956 respectively or

any employee of such member or dealer of a stock exchange;

(iii) is a merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio managed, investment advisor, sub-broker, Investment Company or an employee thereof, or, is a member of the Board of Trustees of a mutual fund or a member of the Board of

Directors of the Asset Management Company of a mutual fund or is an employee thereof who has a fiduciary relationship with the company.

(iv) is a member of the Board of Directors, or an employee, of a public financial

institution as defined in section 4A of the Companies Act, 1956; or

(v) is an official or an employee of a self regulatory organisation recognised or authorised by the Board of a regulatory body; or

(vi) is a relative of any of the aforementioned persons;

(vii) is a banker of the company;

Regulation 2(i)

2(i) "relative" means a person, as defined in section 6 of the Companies Act, 1956 (1 of the 1956);

Regulation 2(k)

"Unpublished Price Sensitive Information" means any information which relates to the following matters or is of concern directly or indirectly to a company and is not generally known or published by such company for general information but which if published or known is likely to materially affect the price of securities of that company in the market-

(i) financial results (both half yearly and annual) of the company

(ii) intended declaration of dividends (both interim and final)

(iii) issue of shares byway of public right bonus etc.

(iv) any major expansion plans or execution of new projects

(v) amalgamation, mergers and takeovers

(vi) disposal of whole or substantially the whole of the undertaking

(vii) such other information as may be affect the earnings of the company

(viii) any changes in policies plans or operations of the company.

Information gained relating to issue of shares by way of preferential allotment (Regulation 2(k) and relating to amalgamation, mergers, and takeovers (Regulation 2(k)(v)) are undoubtedly "price sensitive information."

Regulation 3

"3. prohibition on dealing, communication or counseling on matters relating to insider trading; No insider shall-

(i) either on his own behalf or on behalf of any other person deal in securities of a company listed on any stock exchange on the basis of any unpublished price

sensitive information.

(ii) Communicate any unpublished price sensitive information to any person, with or without his request for such information, except as required in the ordinary course of business or under any law; or

(iii) counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information."

Regulation 4:

4. Violation of provisions relating to insider trading:-

Any insider who deals in securities or communicates any information or counsels any person dealing in securities in contravention of the provisions of Regulation 3 shall be guilty of insider trading.

Regulation 9: Communication of findings and measures that may be taken by the Board to protect the interest of investors and the interest of the securities market..

9. Communication of findings, etc- (1) The Board shall after consideration of the investigation report communicate its findings to the insider and he shall be given an opportunity of being heard before any action is taken by the Board on the findings of the investigating authority.

Regulation 11 Directions by the Board

11. Directions by the Board.- On receipt of the explanation, if any, from the insider under sub-regulation (2) of Regulation 9, the Board may without prejudice to its right to initiate criminal prosecution under section 24 of the Act, give such directions

to protect the interest of investors and in the interest of the securities market and for due compliance with the provisions of the Act, rules made thereunder and these Regulations, as it deems fit for all or any of the following purposes, namely:-

(a) directing the insider not to deal in securities in any particular manner;

(b) prohibiting the insider from disposing of any of the securities acquired in violation of these regulations;

(c) restraining the insider to communicate or counsel any person to deal in securities.

The Appellant has not seriously disputed that information relating to the issue of

shares by preferential allotment (Regulation 2(k)(iii) and information relating to mergers Regulation 2(k)(v) are price sensitive information. Merely to reinforce the point that information relating to mergers is unpublished price sensitive information, SEBI in the impugned order has cited the following judgements of the U.S. Courts.

1. Basic Incorporated 484 US page 224.

2. TCS Industries Inc. Vs. Northway 426 US 449.

With reference to the Appellant's objection that the information relating to the

merger with Bayers was not an unpublished price sensitive information, the Appellant had referred to articles published in various newspapers and magazines. SEBI in the impugned order at pages 70 to 74 had effectively dealt with the same. Even the Appellant himself had treated the said information as confidential and the Appellant had not even disclosed the same to his own brother-in-law, whom he had instructed and put in funds for the purpose for purchasing shares of ABS. This itself proves that the said information was unpublished price sensitive information and the Appellants arguments to the contrary cannot be and ought not to accepted.

Insider Trading in the United States of America.

The Insider trading law in the USA is part of the general law relating to fraud. Under the federal system prevailing in the USA there were state laws known as "blue sky" laws which contained anti-fraud provisions which are used to deal with Insider trading.

"Rule 10b-5- Employment of manipulative and deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, {445 U.S.226}

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any unture statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

The said Rule is merely an enabling provision not intended to deal with the problem of Insider trading. It prohibits the use of manipulative or deceptive devices in relation to purchase and sale of securities on the stock market. The rule itself makes no reference to insider trading let alone gives a definition of it. The provision

is clearly aimed at fraud in the traditional sense and finds its UK equivalent in Section 47 of The Financial Services Act, 1986. It came to be applied to insider trading by Courts, through private litigation and then by the SEC in 1960 as part of SEC enforcement policy on insider trading. In the USA since the law governing insider trading is part of the general law of fraud, mens rea, motive, intention to make a profit, who is an insider, duty of an insider and outsider etc. are relevant and are required to be established before a charge of insider trading can be made and/or said to have been proved.

In UK pursuant to the European Communities Directive on Insider Dealing (18th

November, 1989) the Criminal Justices Act, 1993 was enacted. Chapter V of that Act contains provisions which repeals the Company Securities (Insider Dealing) Act, 1985, under which Insider trading became an offence for the first time in UK in 1980. The provisions under the Criminal Justice Act, 1993 are very different from the SEBI Act and Regulations. Therefore reference to USA and UK judgements must be read in the context of the USA and UK law's relating to insider trading. Concepts and developments in Insider trading law by judge made law in the USA and UK have also to be considered with reference to the existing legislation relating to insider trading in the USA and UK and those concepts and developments cannot be imported into the Indian legislation relating to insider trading which is a well defined and self contained code.

Under Regulation 2(k) of the Insider Regulations what is meant by Unpublished Price Sensitive Information is clearly defined. The 3 Judgements of the U.S. Courts referred to in this regard in of the impugned order are only to re-inforce the fact that information about merger is Price Sensitive Information and has been consistently recognised as such all over the world and especially in the U.S.A. where the law of insider trading is the most developed.

It was submitted that in the Impugned Order SEBI has merely cited the classic statement of the law relevant to insider trading as was very eloquently set out in the case of SEC Vs. Texas Gulf Sulphur Co.(410 F 2d.848) that " Anyone in possession of material insider information must either disclose it to the investing public or, if he is disabled from disclosing it in order to protect a corporate confidence, or if he chooses not to do so, must, abstain from trading in or recommending the securities concerned while such insider information remains undisclosed."

The statement quoted in the Impugned Order from the Judgement of the U.S. Court in Shapiro v/s. Merrill Lynch (495 5 F 2d.235) i.e. "disclose or abstain" theory has been enforced by stating that this "is to protect the investing public in to secure fair dealing in the securities market by promoting full disclosure of insider information so that an informed judgment can be

made by all the investors" was quoted merely to reinforce the point.

In the Impugned Order the Judgement in the case of U.S. V/s. O'Hagan 138 L.E. d.2d 724 had been cited merely to record the fact that the U.S. Supreme Court had endorsed the "Misappropriation theory", in relation to insider trading.

The Judgement in the case of Kohler Vs. Kohler was cited only to show that under U.S. law fiduciary relationship between the insider and the outsider were elements required to be approved. The judgment in the case of Speed Vs. Trans

American Corp. (99 F. Supp.808) was cited because of the similarity of facts as is apparent from the quoted passage "It is unlawful for an insider, such as majority stockholder, to purchase the stock of minority stockholders without disclosing material facts affecting the value of the stock, known to the selling minority stockholders, which information would have affected the judgment of the sellers."

During the course of arguments SEBI cited judgement in the case of SEC v/s David E. Lispon (U.S. court of Appeal (7th Circuit) Docket No.01 -1226) to illustrate the point that in USA even though benefit/ motive is required to be proved in order

to make out the charge of insider trading and that insider trading for a legitimate purpose may be defence to the charge of insider trading, the U.S. Court nevertheless held, "if the existence of an alternative legitimate purpose were a defence to a charge of insider trading, any insider who wanted to be able to engage in such trading with impunity would establish an estate plan that required him to trade in his company's stock from time to time. He could then trade on the basis of inside information yet defend on the ground that he was also trading in implementation of his estate plan. He would be doing both. Yet even to regard the good and the bad purpose as alternative is to sugar coat the pill. In the case just put, the insider would be using insider information to implement his estate plan more effectively. He would be like someone who robbed a bank with the intention of giving the money to charity. The noble end would not immunize the ignoble

means of achieving that end from legal punishment". This case was specially cited to meet the Appellants argument in defence that since the Appellant had traded on the basis of insider information but had done so for a corporate benefit he had not committed a breach of the Regulations.

The Judgement of the U.S. Supreme Court in the case of Dirks Vs. SEC reported in 463 U.S. 646 is totally inappropriate as it was a tipper-tippee" case, whereas the present case is one of an insider himself trading on the basis of the Unpublished Price Sensitive Information, and the concept of gain is irrelevant to the offence of insider trading under the SEBI Act and the Regulations. Dealing in securities as defined under Regulation 2(d) i.e. the mere act of buying/selling or

agreeing to buy/sell or deal in any security by any person as principal/agent on basis of Unpublished Price Sensitive Information is covered and is made an offence under Regulation 3. Profit motive is therefore not an ingredient of the offence.

During the course of Arguments, SEBI had relied upon the U.S. decision in the matter of Cady Roberts & Co., (1961 SEC LEXIS 385; 40 SEC 907) only because Cady Roberts has been considered as the classic case illustrating the proposition – "Disclose or abstain". The said judgement was also cited to illustrate and meet the Appellant's case of conflicting fiduciary duties, as the said case had held that even

conflicting fiduciary duties, would not justify actions contrary to law. It was contended by the Appellant that the purchase of shares of ABS made on the basis of Unpublished Price Sensitive Information was done, in pursuance of the Agreement with Bayer where by the Appellant was required to co-operate with Bayer say that Bayer obtained 51% of the Capital of ABS. Such corporation could not extend to the Appellant committing breach of the insider trading regulations in order to ensure that Bayer got 51% of the equity share capital of ABS.

Chiarella V. United States 445 U.S. 222 cited by the Appellant was a case whether an outsider,

i.e. a printer could be held guilty of Insider trading under the U.S. legislation relating to Insider trading since the facts of that case bear no resemblance to the facts with which we are concerned in the present appeal, the said judgement has no relevance. It was on the basis of this judgment that it was sough to be agued that legitimate corporate purpose was an exemption to the rule prohibiting insider trading. But under the Indian legislation relating to insider trading no such exemption can be carved out even on the basis of a purposive interpretation. The Regulations are clear and explicit and do not require any interpretation aids in understanding its meaning/purpose and intent. The said judgment was really a case where incorrect instructions had been given to the jury which was the basis of the decision and if correct instructions had been given to the jury what the decision would have been, has expressly been left open.

Attorney General's Reference- 1988 1 A.C. 971 case cited by the Appellant has no relevance in the present context. The issue in that matter, related to the construction

of the word "Obtained", in Section 1(3) of the Companies Securities (Insider Dealing) Act 1985. In the present Appeal, there cannot be any dispute that the Appellant was an insider at the appropriate time and that by reason of his possession he had Price Sensitive Information.

The Appellant also relied on the above Judgement of the erstwhile Appellate Authority, in Hinudstan Lever Ltd. vs. Securities & Exchange Board of India 1998 SCL 311 which was at that time the Central Government. The Appellate Authority held, that there was no power to invoke the provisions of Section 11(1) read with Section 11B of the Act, for the purpose of imposing an Order directing compensation to be paid to the UTI, this is evident from Para 23 of the Order whereby the Appellate Authority held inter alia that the general powers of the Act could not be used and that only the powers under Section 15G of the Act, could be invoked. The Appellate Authority also held that an Order directing prosecution, should be based on conclusive determination of all aspects of insider trading and on specific justification in terms of the gravity of the offence. The Respondent have filed a Writ Petition against the Order of

the Appellate Authority in the above matter. The Hon'ble Bombay High court, has not only stayed the Order but also stayed the following part of the judgment

> "an order of prosecution should be based on conclusive determination of all aspects of insider trading and on specific justification in terms of the gravity of the offence" and
>
> "SEBI has chosen not to use this specific provision for imposing a penalty but has instead decided to use omnibus powers under Section 11 and 11B to adjudicate for awarding compensation. We are of the view that it is a settled principle of law that for imposing a pecuniary burden, there must be specific provisions in law and there should be specific Regulations for giving an opportunity to the affected person to present its (his) case before any burden can be imposed on it by an authority like SEBI. Use of omnibus powers for imposing pecuniary burden cannot be the intent of law."

No reliance can be placed on the Judgement of the Appellate Authority to urge that powers under Section 11(1) and 11B cannot be exercised. The Respondent submitted that an Order for prosecution need not be based on a conclusive determination as held by the Appropriate Authority as this portion of the Judgement has been separately stayed by the Hon'ble Bombay High Court.

SEBI in its Order, and its Counsel in the course of argument have taken aid of judgements of the U.S. Courts only for the purpose of enforcing well established principles relating to Insider trading which are enshrined as a part of the Regulations and not on the basis that U.S. law relating to Insider trading is in any way similar to or in para materia with the Indian Regulations relating to insider trading.

With reference to SEBI's power to pass directions to disgorge profit made pursuant to insider trading, it was submitted that under Section 11(2) (g) of the SEBI Act, SEBI is empowered to

prevent insider trading by taking such measures to protect interests of investors. The term "such measures" is very wide and is not couched with any conditions/restrictions. Regulation 9 (2) also empowers SEBI to call upon the Insider who has been found guilty of committing breach of regulations 3 and 4 to take such measures as SEBI may deem fit to protect interest of investors and the integrity of the securities market and for due compliance with the provisions of the Act/Rules made thereunder and the Regulations.

SEBI's power under Regulation 9(2) is also very wide and is not couched with any restrictions or conditions. Regulation 11 refers to Regulation 9(2) and empowers SEBI to give such directions, "….. to protect interest of investors, and in the interest of the securities market……". The powers under Regulation 11 are also very wide and are not couched with any conditions/restrictions, the directions set out in Regulation 11(a)(b) and (c) can therefore only be illustrative, in spite of the use of the word "namely". Unless the provision is so interpreted, it would impose a restriction on the powers of SEBI to give directions, when the operative part of the section contains no restriction on the power of SEBI to pass orders in the interest of investors and the securities market. On a proper and purposive interpretation of Section 11(2)(g) read with Regulation 9(2) and Regulation 11, it is clear that SEBI

has the power to order a person found guilty of Insider trading under Regulations 3 and 4 and to whom directions under Regulations 11(a)(b) and (c) are applicable and pass direction to call upon the insider to take such measures including inter alia to disgorge profits made as a result of insider trading. In this context Hon'ble Bombay High Courts decision in (Shirish Finance & Investment (P) Ltd. V. Sreenivasulu Reddy (2002) 35 SCL 27 (Bom) at para 59. page 89) was referred to. SEBI had directed the Appellants to disgorge the profits of Rs.34,00,000/- made as a result of Insider trading done by the Appellants on the basis of Unpublished Price Sensitive Information relating to the merger with Bayer. The Appellant was aware as to how the amount of Rs.34,00,000/- was computed and the said computation was never disputed by the Appellant. SEBI had cited the case of SEC V/s. David E. Lipson as an example that disgorging of profits is one of the various orders that a court may pass in a matter relating to

Insider trading. The Order passed by SEBI to disgorge the profits is compensatory and remedial in nature and not penal. It was submitted that any order passed by SEBI would, when looked at from the view point of the person against whom the order is passed would always be seen as a punishment and therefore penal. In order to ascertain whether an order passed is remedial/compensatory/ penal, the order itself has to be looked at. The Appellant as a result of Insider trading has made a profit as stated earlier. The Appellant therefore cannot be allowed to retain such ill-gotten gains, and in the circumstances SEBI by the said impugned order has directed the Appellant to disgorge the ill-gotten gains and pay it into the two Investor protection funds, which will be utilized to compensate Investors who had sold their shares to the Appellant acting through Mr. Kedia. Suitable orders to that effect can be passed to identify such sellers. In any event even if such sellers cannot be identified or do not come forward to receive the compensation the amount having been deposited with the Investor protection fund of NSE and BSE will be put to use for the general benefit of Investors, that in the circumstances the Impugned Order is clearly remedial/compensatory in nature and is not a penal order.

The two Judgements of the United States Courts cited by the Appellant are not

insider trading cases though they relate to orders passed to disgorge profits. In USA there does not appear to be any investor protection fund as there exists in India. Even otherwise in fact and law the cases cited are not applicable to the facts of the present case or the Indian law.

Tribunal's findings:

I have carefully considered the detailed submissions and the material available on record. I have also perused the authorities cited by the Counsel for the parties.

The charge against the Appellant is that of violating the SEBI Regulations on insider trading. Though much has been said in the order about the acquisition of shares by Mr.Kedia on behalf of the Appellant, ultimately it has boiled down to the purchase of only 1,82,500 shares by Shri Kedia during the period September 9, 1996 1st October, 1996. Both the parties have chronicled the sequence of developments preceding the acquisition of shares of ABS by Bayer. I do not consider it necessary to repeat the same and further burden this order. From the particulars furnished by the parties, it appears to me that ABS was considering to diversify its product range. For the purpose it was considering proposals from overseas companies from the beginning of 1995. It was in July 1995 ABS signed a secrecy agreement with Monsanto Chemicals to explore the possibility of technical/financial collaboration. At that time also ABS was exploring the possibilities with a Japanese company. But negotiations are negotiations. Negotiations may sometimes fail. It may some times fructify. Till the negotiations are concluded, and a decision is taken, it is not possible to conclude the ultimate result of the negotiations. But some times half way through a shrewd negotiator would be in a position to see the would be outcome of the negotiation. ABS's negotiations/discussions with the overseas parties is in no way different. The Appellant had stated that it had in fact signed a secrecy agreement with Monsanto Chemicals in July 1995 to explore the possibility of technical/financial collaboration and ABS & Monsanto were discussing the possibility of tie up during the period July – September 1995 and in 1995 Bayer acquired the styrene business of Monsanto Chemicals worldwide. According to the Appellant, consequently the rights and obligations under the secrecy agreement between ABS and Monsanto were transferred to Bayer. I have noted that a secrecy agreement to explore the possibility of technical/financial collaboration, can not be viewed as a decision as such by Monsanto to takeover ABS. It, as the Appellant rightly stated was only for exploring the possibility. The fact that Bayer came in place of Monsanto on its takeover by Bayer does not change the nature of the undertaking. The Appellant has stated in its Appeal Memorandum that in February Bayer approached ABS to discuss the possibility of an association between ABS and Bayer. This also indicates that the matter was not crystallized then, but was in a fluid stage. From the sequence of

developments chronicled by the Appellant in his memorandum of appeal it appears that the discussions were going on and on from February, 1996 followed by supply of various details to Bayer. It is seen from the records that even though the Board of Directors of ABS considered the prospects of foreign collaboration in their meeting held on 28.6.1996 they desired to examine the matter further. It was on 5th –6th September, 1996 the Appellant held discussions with Bayer in Germany regarding the possible joint venture. He returned to India on 8.9.1996. He appraised the Board of Directors of ABS of the developments with reference to his discussion with Bayer. It is also noted that on 29th September 1996 to October, 1996 the Appellant visited Bayer's office in Germany along with legal Counsel to "work out legal modalities". Bayer's legal advisers and merchant bankers were also present in the said meeting and in these meetings all modalities, valuations and offer price were finalised, subject to Board approvals. According to the Appellant on 1.10.1996 "a commercial understanding to proceed with the transaction was arrived in Germany. It was only at this stage that the transaction as well as the terms thereof acquired certainty." It seems that the meetings of legal advisers and merchant banker of ABS and Bayer was held only to "work out legal formalities" in pursuance of the discussion the Appellant had with Bayer people in Germany on 5/6th September, 1996. If there was no clear understanding and any decision about the nature of association of Bayer with ABS there was no question of working out legal formalities. Meeting held during September 29 to 3rd October, 1996 was only to complete the modalities/formalities with reference to the decision arrived at in the meeting the Appellant had with Bayer people on 5/6th September, 1996. It appears that it was in the said meeting it was decided that Bayer would require 51% holding in ABS and that "they were ready to concede the day to day management/minority protection rights and several other concessions**.** In this context it is noted that the Appellant returned to India on 8th September, 1996 after the said meeting. It is noted from the Appellant's statement recorded by SEBI on 26.5.1998 that the Appellant had furnished details wherein he had stated that he had given loans amounting to Rs.1.5 crores from his own account between 12.9.96 to 28.9.96 to Shri I. P. Kedia. He had admitted that on 18.9.96 when he lent Rs.35 lakhs to Shri Kedia he knew that Shri Kedia was purchasing shares

of ABS. According to him "At that point of time, we were only contemplating to have further discussions with Bayer and one cannot say that there was certainty of these discussions culminating into joint venture. However I do agree that there was a probability of having joint venture with Bayer". The Appellant's following statements also need be noted:

> "The agreement reached with Bayer clearly stipulates that the same would be binding only if Bayer acquires 51%. This is reflected both in the shareholders agreement and the share subscription agreement……."
>
> "There was ample reason to believe that if Bayer did not have eventually 51% we had no agreement. This situation would have been extremely damaging for the future of our company. Hypothetically, I may have offered more shares from my investment companies to meet the short fall as long as I was doing so with the confines of the law".
>
> "You will observe that the structure that was worked out for equity holding and approved by the Boards indicated 51% equity holding by Bayer and 26% equity by me. Any sale of shares from me or my companies would have brought my equity holding below 26%, the situation I wanted to avoid particularly in the context of the agreement that I was to continue in the identical management capacity.
>
> "As mentioned earlier, I wanted to get as many shares for completing 51% for Bayer for the success of the arrangement.

It appears that the Appellant was frantic to ensure that Bayer's holding in ABS reaches 51% and he had even directed Mr.Kedia to purchase 1,24,250 shares at the rate of Rs.82/- on 8th October, 1996 after publication of public announcement, by way of negotiated deal. To a question "when it can be said the general public came to know about strategic alliance between Bayer Industries and ABS Industries ? – The first news item appear to be carried out in the second week of October, 1996 by various financial dailies."" The Appellant's answer was that "The information on the strategic alliance with Bayer was first given out by way of

communique to Bombay

Stock Exchange/NSE on 1st of October, 1996 indicating that in the Board meeting of 5th October a preferential allotment to M/s. Bayer Industries may be discussed." This statement from the Appellant confirms that till 1.10.96 arrangement with Bayer was an unpublished price sensitive information. To another question the Appellant had stated:

"I would like to state that when I instructed Mr. Kedia between 9th September to 1st October 1996, date of intimation to Stock Exchange to purchase the shares of ABS Industries Ltd., I did not think even in my wildest imagination that I was committing any offence of any nature. My action was prompted by my focus on acquiring as many shares from the market without disturbing the prices or violating any law, so as to complete 51% shares for Bayer which was a condition precedent to our possible joint venture with Bayer. My further instructions to purchase the shares on 8th October was also for fulfilling this motive. We were getting continuous information on daily basis from the Registered Lead Manager about the extent of the shares being offered in the public offer. As on 1st January 1997 only 1,10,295 shares were offered as per the available information through the Lead Manager/Registrar. Upon getting information from financial institutions about their offering of the shares in the public offer and from the information available from various centers it was deduced that there could be a shortfall of approximately 9,50,000 shares. I deposited 9,33,250 shares on 3rd January, 1997 to make the offer successful. Bayer eventually got 33,83,000 odd shares which mad the holding of Bayer in the company at 50.97%. Bayer in any case could not have exceeded 51% because of the FIPB and other approvals."

In the deposition made by the Appellant on 7.4.98, before SEBI officials he had stated that "in the year 1995 the Co. started having serious dialogues with three cos. I.E. JSR our existing collaborator, Mitsubishi corpn. and Monsanto from USA. Since Monsanto's Technology was preferred the co. entered into a secrecy agreement with

Monsanto in July 1995 to explore the possibilities of a technology tie up. While the discussion with Monsanto was going on in November 1995 Monsanto sold their worldwide styrene business including ABS/SAN Resins to M/s. Bayer AG. The deal was completed by the end of 1995. In February/March the co. once again started with JSR Mitsubishi and explored the possibilities once again from GE and DOW. M/s.GE Plastics and Dow Plastics both denied out request since they did not want to licence technology. GE Plastics however announced to enter India through collaboration with IPCL or by themselves. Then Bayer AG approached us because of our secrecy agreement and history of Monsanto. The co. was keeping all its option open upto June 1996. Having independent discussion with all these cos. M/s. Bayer AG was known to have the best technology specially after acquired from Monsanto Styrene business. It was discussed in the board meeting of 28.6 to explore the possibilities further and accordingly a team, from Bayer AG was allowed to visit in the first week of July 1996 to have Technological evaluation alongwith preliminary due diligence which was to be carried out by M/s. C.S. First Boston, USA on their behalf and part of their team. The information required by them have been given to the visiting team. Since the second half of July and August are traditionally holiday period in Europe, it was indicated that we could have further discussion some where in September, 1996".

To a question as to "Have you or any of your Pvt. Limited Cos. given any loan to Shri Ishwar Kedia? If yes, who negotiated this loan and what was the terms and conditions" the Appellant's answer was

"When I returned from my trip from USA and Germany around 8/9/96 I learnt that Mr. IP Kedia telephoned my accountant Mr. S.R.Patel who is in my office handling my files. Mr. Patel informed me that Mr. IP Kedia is in urgent need of around Rs.10 lacs. I told him to organise this money from Bank of Baroda against the FDR Deposit of my brother. The money was organised on my instruction from BOB and the money was sent to Mr. Ishwar Kedia. After couple of days there was a fresh need of money from Mr. IP Kedia and Mr. Patel came and talked to me. I told to organise the same but then I got in touch with Mr. Kedia at his

residence. I enquired Mr. Kedia why he needed this money. Mr. Kedia informed that he bought some ABS Shares and therefore he needed this money as a temporary loan. I dissuaded him from entering into any purchase and sale of shares not only of ABS but of any company. After couple of days again there was a demand of money and I spoke to him then. He then explained to me that since I had purchased around 50000 shares of my relatives even at Rs.68/-, he told me that there was a possibility of getting more shares from my relatives. I was conscious at that time of my discussions with Bayer, who had very clearly in no uncertain terms indicated that any possible joint venture could not be without Bayer getting 51% equity. Since there were so many Indian companies interested and were wanting to have an agreement with Bayer for producing ABS Resins there was need of urgency of taking decision. Co. like Reliance had also initiated discussion with Bayer for a joint tie up on the same project. I therefore realized that it was critically important for me to ensure that Bayer get 51% shares which means getting as many share from the market should the discussions eventually result into joint venture with Bayer. Discussion about this matter was going to take place on the Board meeting on 20th Sept. But Bayer would not consider any proposal unless they were guaranteed for 51% equity into the Co. I therefore told Mr.Kedia that if the shares are offered by my relatives or for that matter anybody he can procure on my behalf and I will finance the purchase. I had expressly informed him that the purchases should not be in a manner, to have any undue price rise or undue movement. I had told him to purchase the shares as long as offered in the natural course at the prevailing market price. While I was instructing Mr.Kedia I considered it to be a natural process. In my wildest imagination also I could never have thought that I was committing any crime or offense. The figure of 51% for Bayer was important for me and all the while I was thinking that should this discussion result into joint venture how to muster up this 51% of share by Bayer. The share holding pattern of 12 crores equity was that I was holding, 30% institutions were holding, around 25% my relations and friends were holding, 10% and balance was held by the public. I thought without creating any unnatural movement in the market either in price or sentiment if I could muster up some shares it would eventually help me reaching 51% target for Bayer as and when

required. There was no intention at any point of time to make any financial gain out of such transaction. After our discussion in the Board meeting on 20th Sept. Board gave direction to proceed to have negotiation with Bayer and we left to Germany for such discussions around 29th Sept. From the time I gave instruction to Mr.Kedia to purchase such share until the date of public announcement he had procured on my behalf roughly more than 2 lacs shares. I categorically confirm that I had not informed Mr. IP Kedia about any discussion with Bayer AG for any possible joint tie up. As a matter of fact on the morning of 8th Oct. he was angry with me for not informing him earlier. Later on at 11.00 a.m. he called me and told on telephone that a lot of shares 1 lacs – 120000 at a price of around Rs.81/- was available. By this time he had procured roughly about 225000 shares and I sensed a good opportunity of procuring 1 lacs – 120000 share even though the price was over Rs.80/-, I directed him to purchase on my behalf because it would have helped me achieve the objective of acquiring as many shares possible in natural course for meeting 51% target. The capital because of preferential allotment was deemed to have raisen to around Rs.18 crores. Bayer industries was required to get around 36 lac shares from the market to complete their 51%. Our share subscription agreement which was arrived and which was approved by the directors and subsequently sent to Financial Institutions for their approvals. The whole agreement was conditional upon Bayer acquiring upon 51% share in ABS. It also meant that if they did not have 51% eventually, the whole agreement would become null and void. That was very scaring scenario in the light of developments in the industry in the country and particular heavy capacity being created in South East Asia.

I also directed Mr.Kedia later on to purchase shares again in natural course further about 50000 shares were procured. In all roughly 180000 shares were purchased by him on my behalf after the public announcement, to meet target was still herculian. We approached all Fin. Instns. which were holding shares and eventually got their consent to offer their shares into the public offer. The Fin. Instns. realizing the necessity of joint venture with Bayer helped by offering

part of their equities in the public offer. As on last date there was still short fall of 933250 shares. I was left with no option but to offer my shares from my investment co. i.e. Tash Investment Co. to complete the transaction to get Bayer 50.97%. The shareholders agreement was subsequently signed amending 51% figure to 50.97%. I never wanted to dilute my holding in the Co. Since by virtue of the agreement I still continued to hold the management and managing directorship for next 7/10 years and all the advantages which I was enjoying before the joint venture. The agreement stipulated that the technology would be available free but no German would come to manage affairs of the Co. The agreement also had stipulated giving me minority protection in the form of around 26% voting rights. Even in case at a future date if with the equity expansion, my equity was diluted to much lower level. The only condition was that I had to maintain my shareholding as on the date they acquired ….. . It was therefore important for me not to dilute my shareholding but to get as much shares from the market in the natural course and accordingly with the best of the intention I had borrowed money from I-Sec at 27%. I had also borrowed money ranging 25-29% to finance these purchase. I once again would like to reiterate that I had no intention to make any money out of it. Only condition paramount in my mind was that Bayer gets 51% for the success of the discussion leading to possible joint venture. At any point of time I had no knowledge of committing any offense. The share subscription agreement which were approved by the Board and also sent to financial institutions and our communications to the Fin Instns requesting their approvals will amply support my above submissions".

On a perusal of the material available on record it is clear that the Appellant was frantic to bring in Bayer and that since Bayer's entry was subject to the condition that it would associate with ABS only if it held 51% in the capital of ABS this 51% procurement was required to be organised. The Appellant in that process did not want to bring down his holding below 26%. The importance of the magical figure of 26% is that a person holding 26% capital has the power to Veto down certain major decisions of the company by defeating the special resolution

proposed for such purpose. So the Appellant was in a peculiar situation. On one side the desire to bring in Bayer so as to improve the activities of ABS and at the same time to preserve his strategic voting strength in the company. It is in this context one has to see the funding for purchase of shares and acquisition of shares by Shri I.P. Kedia. Shri Kedia is Appellant's brother in law. It appears that the Appellant was almost certain of the negotiation with Bayer concluding favourably after his meeting with Bayer people in Germany in May 1996. On 28.8.1996 "Board of ABS considered prospects of foreign collaboration and expressed desire to look further into" Thereafter things moved really fast. In the first week of July, 1996 technical team from Bayer visits India for financial evaluation of ABS. On July 12 ABS sent the details to Bayer with respect to value of shares of ABS from 1993, on 22.7.1996 Bayer asks for details of ABS's assets and this was promptly furnished, on 26.7.1996 ABS informs Bayer about the commissioning of SAN Plant. Thereafter on 5th /6th September, 1996 the Appellant visits Germany and discusses the matter. The speed with which things moved thereafter need be noted. On 8th he returned to India from Germany; reports the matter to the Board of Directors on 20.9.96, on 29.9.96 Appellant visits Germany with legal adviser to work out legal formalities, discussion continues upto 3.10.1996. On 3.10.1996 a formal share subscription and shareholders agreements were entered into. Board of ABS approves the agreement on 5.10.1996. It is to be noted that the Appellant has admitted that the public came to know of the "deal" only on 1.10.96 on ABS informing the stock exchanges about the matter.

I have perused all the press clippings/reports filed by the Appellant in support of his version that the information relating to acquisition of ABS by Bayer was not an unpublished information. But I do not find any one of those clippings/reports supporting the Appellant's version. The sensitive information is the specific fact that Bayer was entering into ABS by acquiring51% of its capital. This specific information is the price sensitive information, which I do not find having been disclosed in any of those press cuttings/reports. The fact that ABS was negotiating with few companies to bring in a partner

was there since 1995. But specific details were not known to the public till 1.10.1996 i.e. the date on which the Stock Exchanges were informed.

SEBI is mandated to protect the interests of investors and promote the development of and to regulate the securities market. For the purpose SEBI is empowered to take suitable measures. In Section 11 of the SEBI Act, the powers and functions of SEBI have been specified. In terms of clause (g) of sub section (2) of section 11, SEBI is empowered to take measures for "prohibitting insider trading in securities". SEBI in exercise of its regulation making power available under section 30 of the SEBI Act has notified on 19.11.1992 Securities and Exchange Board of India (Insider Trading) Regulations, 1992 (the SEBI Regulations). This regulation has been substantially modified vide amendments made in the year 2002. The applicable regulation to the present case is the unamended regulation as it was the one in position at the time of the alleged transactions – relating to the year 1996.

Before proceeding further in the matter it is considered necessary to briefly discuss the conceptual aspect of insider trading. Healthy growth and development of securities market, depends to a large extent on the quality and integrity of the market. Transparency in transaction is very important. Such a market can alone inspire the confidence of investors. Factors on which this confidence depends include, among others, the assurance the market can afford to all investors, that they are placed on an equal footing and will be protected against improper use of inside information. Inequitable and unfair trade practice such as insider trading affect the integrity and fairness of the securities market and impairs the confidence of the investors. It is to remedy the malady of insider trading in securities, the Insider Regulations was notified by SEBI, which provide for various measures.

Insider dealing is understood broadly to cover situations where a person buys or sells securities when he, but not the other party to the transaction, is in possession of confidential information which affects the value to be placed on those securities.

Furthermore the confidential information in question will generally be in his possession because of some connection which he has with the company whose securities are to be dealt on (e.g. he may be a director, employee or professional adviser of that company) or because some one in such a position has provided him directly or indirectly (para – 2 of the White Paper on Conduct of Company Directors 1977 (Comnd 7037)(UK).

High Powered Committee on Stock Exchange Reforms (1985) in its report submitted to the Ministry of Finance, Govt. of India had explained the concept of Insider Trading. According to the said report 'Insider trading' generally means trading in the shares of a company who are in the management of the company or are close to them, on the basis of undisclosed price sensitive information regarding the working of the company, which they possess but is not available to others. Insiders or persons connected with companies are in a position to take advantage of confidential, price sensitive information before it becomes public and thereby make speculative profits for themselves to the detriment of uninformed public investors. An insider coming in possession of inside information in relation to a company with whom he is connected which will have a material effect on the market price of the company's securities will be tempted to take advantage of such inside unpublished price sensitive information before it became public and make profit by buying the securities if the information is likely to lead to a rise in price and selling the shares already held if the information is likely to cause a fall in the price of such securities. By virtue of the confidential information, the insider gains an unfair secret advantage which will benefit him at the expense of the person he deals with".

The rationale behind the prohibition on insider trading, as Lord Lane puts it "is the obvious and understandable concern…about the damage to public confidence which insider dealing is likely to cause and the clear intention to prevent so far as possible what amounts to cheating when those with inside knowledge use that knowledge to make a profit in their dealing with others" (Attorney General's Reference No.1 of 1988 (1988) BCC 765 affirmed by the House of Lords as reported at (1989) BCC 625. The objective of the Insider Regulation framed by SEBI is to ensure that all persons in the market are placed on an equal footing – provides a level playing field.

As stated earlier the charge against the Appellant is that he has violated regulation 3(i)of the SEBI Regulations. In this context it is necessary to know what is this regulation 3(i) allegedly violated by the Appellant. SEBI Regulations on insider trading in terms of number of clauses is a short one which contains 12 clauses spread out in three chapters – Chapters I, II and III. Chapter I, as usual is on preliminary matters such as Short title, commencement and definitions. Chapter II is on prohibition on dealing, communicating or counselling on matters relating to insider trading. It is under this chapter regulation 3(i)comes. Since this is the core chapter I propose to extract the same for reference purpose.

3. No insider shall

(i) either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange on the basis of any unpublished price sensitive information; or

(ii) communicate any unpublished price sensitive information to any person with or without his request for such information, except as required in the ordinary course of business or under any law; or

(iii) counsel or procure any other person to deal in securities of any company on the basis of unpublished price sensitive information.

4. Violation of provisions relating to insider trading.

Any insider who deals in securities or communicates any information or counsels any person dealing in securities in contravention of the provisions of regulation 3 shall be guilty of insider trading.

Chapter III is on investigation. It provides for investigation by SEBI, procedure to be followed for investigation, obligation of insider on investigation by the Board, submission of report to the Board by the investigating authority, nature of follow up of the investigation report etc. Power to issue directions in appropriate cases has also been stated under this chapter. Apart from the power to appoint investigating authority, SEBI, under this Chapter is empowered to appoint a qualified auditor to investigate into the books of account or the affairs of the insider. Appeal provisions against SEBI's orders has also been provided under this chapter" Chapter III by and large is on procedural aspects. Chapter II is the "charging" chapter.

Back to Chapter II. As stated earlier the Appellant has been found guilty of indulging in dealing in securities prohibitted by regulation 3(i)thereby attracting the provisions of regulation 4. We have seen the provisions of the said regulation. Regulation 3 is not only on dealing or trading in securities. There are three prohibitions. These are with respect to (i) dealing (ii) communication and (iii) counselling. In other words an insider in possession of price sensitive information is prohibitted from doing these three things with regard to concerned securities. We are here concerned on the applicability of clause (i) of regulation 3. The person who is prohibitted is "insider". What is prohibitted is dealing in listed securities on the basis of any unpublished price sensitive information. Expressions "insider", "dealing in securities" "unpublished price sensitive information" etc. have been defined in regulation 2 of the SEBI Regulations as follows:

2(d) "dealing in securities means an act of buying, selling or agreeing to buy, sell or deal in any securities by any person either as principal or agent".

This definition covers transactions which normally take place.

2(e) "insider means any person who is or was connected with the company or is deemed to have been connected with the company and who is reasonably expected to have access, by virtue of such connection to unpublished price sensitive information in respect of securities of the company or who has received or has had access to such unpublished price sensitive information."

It is clear from the definition that a person to be considered as insider should be one who is or was actually connected with the company or deemed to have been connected with the company. 2nd limb is that by virtue of such connection the person is reasonably expected to have access to unpublished price sensitive information or has received or has had access to such unpublished price sensitive information. The expression security has not been defined in the SEBI Regulation and therefore the meaning assigned to in the Securities Contracts (Regulation) Act has to be accepted.

The definition of the expression securities under the said Act include "shares, scrips, stocks, bonds, debentures, debenture stocks or other marketable securities of a like nature in or of any incorporated company or other body corporate." The security involved in the instant case is the shares of a public company viz ABS Industries Ltd., (ABS) It is not disputed. The fact that the shares of ABS are listed on stock exchanges is also not in dispute. Therefore, the subject share is covered under regulation 3(i). The regulation 3 (i) has referred to "persons connected with the company" and "persons deemed to have been connected." Both these type of persons have been defined in the regulation 2(c) and 2(h) as follows:

2 (c) “connected person” means any person who –

(i) is a director, as defined in clause (13) of section 2 of the Companies Act, 1956 (1 of 1956), of a company, or is deemed to be a director of that company by virtue of sub-clause (10) of section 307 of that Act; or

(ii) occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company;

2(h) “person is deemed to be a connected person”, if such person –

(i) is a company under the same management or group, or any subsidiary company thereof within the meaning of sub-section (1B) of section 370, or sub-section (11) of section 372, of the Companies Act, 1956 (1 of 1956) , or sub-clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969 (54 of 1969), as the case may be; or

(ii) is an official or a member of a stock exchange or of a clearing house of that stock exchange, or a dealer in securities within

the meaning of clause (c) of section 2, and section 17 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), respectively, or any employee of such member or dealer of a stock exchange;

(iii) is a merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, Investment Advisor, sub-broker, Investment Company or an employee thereof, or, is a member of the Board of Trustees of a mutual fund or a member of the Board of

Directors of the Asset Management company of a mutual fund or is an employee thereof who has a fiduciary relationship with the company;

(iv) is a member of the Board of Directors, or an employee, of a public financial institution as defined in section 4A of the Companies Act, 1956;

(v) is an official or an employee of a Self-regulatory Organisation recognised or authorised by the Board or a regulatory body;

(vi) is a relative of any of the aforementioned persons; or

(vii) is a banker of the company;

Trading in the shares of a listed company by an insider is not prohibitted. Prohibition is only on trading on the basis of any unpublished price sensitive information. What is unpublished price sensitive information has been defined in regulation 2(k).

Regulation 2(k) is extracted below:

(k)"unpublished price sensitive information" means any information which relates to the following matters or is of concern, directly or indirectly, to a company, and is not generally known or published by such company for general information, but which if published or known, is likely to materially affect the price of securities of that company in the market –

(i) financial results (both half-yearly and annual) of the company;

(ii) intended declaration of dividends (both interim/final)

(iii) issue of shares by way of public rights, bonus, etc.;

(iv) any major expansion plans or execution of new projects;

(v) amalgamation, mergers and takeovers;

(vi) disposal of the whole or substantially the whole of the undertaking;

(vii) such other information as may affect the earnings of the company;

(viii) any changes in policies, plans or operations of the company;

Any information, in order that it is unpublished price sensitive information must be related to any of the specified matters. Whether any information is price sensitive, not withstanding that it relates to one or more of the specified matters will always be a question of fact to be answered having regard to the facts and circumstances in each case. The information must, however relate to one or more of the matters enumerated in the definition. Further more, the information must be such that it is not generally known or published by the company and it is likely to materially affect the price of the company's securities.

It is in the light of the legal position explained above, the question as to whether the Appellant has violated or not the provisions of regulation 3(i) of the SEBI Regulations, need be considered.

The Appellant, admittedly is the Managing Director of ABS. It is also on record that he was privy to the discussions with Bayer in the matter of Bayer acquiring shares of ABS, eventually leading to ABS's merger with Bayer. Since, by virtue of his position in ABS, and his role in the active transactions it can be easily concluded that he had access to the information relating to the entry of Bayer in ABS. Therefore, he can be safely considered as insider. The Appellant has not denied SEBI's finding that he is an insider. The dispute is as to

whether the material information was an unpublished price sensitive information.

The Appellant's claim is that he had acted in the interest of ABS. According to him the company has benefitted by the induction of Bayer. He has stated that all creditors continue to rate the company with the highest credit worthiness having the entire loan repayments and schedules being met in a timely manner, that it has also strengthened the relations with vendors, suppliers and employees and also in relation to research and development. According to the Appellant, if the joint venture/merger with Bayer had not fructified, the company would have been unable to remain prosperous and therefore, the acquisition of 51% shares by Bayer was critical to its induction.

According to the Appellant at the relevant period the polymer industry was reeling under a negative bottom line due to lack of demand and loss of margin and most of the producers of ABS had suffered significant loss and that their networth had been wiped out significantly and they were sick companies for the past several years. (by way illustration names of three companies were cited). It was also stated that in this back ground of industry scenario it was imperative and in the interest of the company and its shareholders, employees, suppliers etc. that the company survived. The only way according to the Appellant for the company to survive was the induction of a foreign partner. Bayer being one of the largest and most reputed global conglomerates in this business, their induction into the company was considered necessary for the survival of the company. The fact that ABS gained substantially from the take over by Bayer, has been admitted by the Respondent also as could be seen from its observation in the order that "there is no doubt ABS Industries really gained immensely from the takeover of Bayer AG."

The Appellant has not denied the fact of acquiring shares through his brother in law in the days preceding the acquisition of ABS's shares by Bayer. But his reasoning is that at the relevant time, the information relating to Bayer entry was already in the public domain.

The Appellant's version that he had also tendered 9 lakh and odd shares from his own promoter quota to enable Bayer to acquire 51%on account of short fall in the target of the open offer, requires to be noted. The cold response from the public share holders to the Bayer's offer has been stated by the Appellant in his deposition before the SEBI officer that "Even after making considerable efforts, the shares obtained by Bayer upto 20th September (December ?) were not even 5% The merchant bankers of Bayer Industries M/s. DSP Merril Lynch were in active discussions with financial institutions particularly UTI and LIC which had a large chunk of shares for offloading the shares into a public offer. I believe after such communication they must have advised Bayer to revise the offer price to Rs.80/- by 25th of December just 5 days of closure to get the shares from financial institutions and the success of the offer. UTI and LIC did offer a large chunk of shares at Rs.80/- which confirms my belief. However, I had no role to pay in the revision of the price since it was purely the matter between the merchant bankers of Bayer Industries and themselves." It is in the context of the said uncertainty, and in his anxiety to make some way or other to bring into a reality the induction of Bayer to ABS, the Appellant has stated that "I wanted to get as many shares for completing 51% for Bayer for the success of the arrangement. I therefore authorised Mr. I. P. Kedia even to buy at around Rs.81/- since there was bulk lot of 1,20,000 shares even if it meant a certain financial loss." It is noted that this purchase was made after publication of the public announcement by Bayer to acquire 20% of ABS's shares at the rate of Rs.70/- This is indicative of the Appellant's commitment to see that Bayer comes in as a joint partner for the benefit of ABS.

There is no denial of the fact that the shares tendered by Mr. Kedia in the public offer

made by Bayer was at a price higher than the price at which those shares were purchased . There is no reason to believe that the Appellant was aware that the initial price of Rs.70/- offered by Bayer would be raised to Rs.80/- subsequently. On a perusal of the material available on record, there is every reason to believe that the Appellant was keen to bring in Bayer as a partner and for that purpose he had to ensure that Bayer's requirement of its holding 51% capital of ABS is met with. To me it appears that it was with this target in mind the Appellant had purchased the shares in September 1996.

It is crystal clear that Mr. Kedia had purchased 1,82,000 shares at the behest of the Appellant with the funds provided by the Appellant and therefore it could be viewed as a dealing by the Appellant. There can not be any doubt as to whether the Appellant is an insider or not. By virtue of his position in the company (Managing Director) and the role played by him in the acquisition process, he can be safely considered as an insider. Even though the Appellant had produced a large number of press cuttings/reports to show that Bayer joining as a partner to improve the efficiency of ABS, in my view none of these statements/reports has given any specific indication as to the entry of Bayer as a 51% partner. In terms of regulation 3 (k) the information relating to the matters or of concern in respect of the matters stated therein (which clearly covers amalgamation mergers and takeovers)to not to be considered as unpublished price sensitive information, it should be shown that it was generally known or published by such company for general information. It is on record that the company furnished the information only on 1.10.1996 i.e. the date on which the subject matter of the agenda of the Board meeting of ABS to be held on 5.10.1996. There is nothing on record to show that ABS had published the information for general information at any time except notifying the stock exchanges preceding the acquisition of ABS by Bayer. It is to be noted that the nature of Bayer association, the extent of its involvement, its financial stake in the company etc. are of considerable importance from the point of view of other investors. None of the press cuttings/reports produced by the Appellant gives any specific indication of Bayer's entry as a

51% stake holder. There is nothing on record to show that the relevant information was "generally known" as has been claimed by the Appellant.

Thus the charge that the Appellant, an insider, on the basis of the unpublished price sensitive information' purchased the shares of ABS, remains established. But in my opinion the purchase of shares in the light of the facts and circumstances as stated, can not be considered to be in violation of the SEBI Regulation so as to be proceeded against the Appellant.

While making the finding that the Appellant is in breach of Regulation 3 and 4 of the said Regulations the Respondent has relied upon case laws from the United States of America to "explain the philosophy of insider trading and to give a conceptual clarity and to reinforce the said order". According to the Appellant the impugned order proceeds on a misreading of the US case law. The Appellant had submitted that since the Respondent has extensively referred to the US law while interpreting the SEBI Regulations on insider trading not only in the case of the Appellant but also in the case of Hindustan Lever, decided earlier, it is apparent that the Respondent has considered the US law on insider trading and based on its understanding/misunderstanding of the US law on insider trading the order has been passed. But it is noted that the Respondent has not decided the matter as per the provisions of the US law. The Respondent has taken aid of the judgements of the US Courts only for the purpose of enforcing well established principles relating to insider trading which are enshrined as a part of the SEBI Regulations and not on the basis of US law. US law relating to insider trading is not similar to or in paramateria with the SEBI Regulations relating to insider trading. It is to be noted that the insider trading law in the United States of America is part of the general law relating to fraud. Anti fraud provisions in the laws are used to deal with insider trading in the USA.

The reference in the American cases to rule 10 b-5 is to be noted. Rule 10 b-5 is on Employment of manipulative and deceptive devices. According to the said Rule 10b-5:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails of any facility of any national securities exchange (445 US 226)

(a) to employ any device, scheme, or artifice to defraud

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

The provision is clearly aimed at curbing fraud. So is the case in UK.

In my view reference to USA and UK judgements must be read in the context of the USA and UK law and these concepts and principles cannot be imported into the SEBI Regulations on insider trading which is a separate code by itself. In my view US/UK law relating to insider trading is not similar to or para materia with SEBI Regulations. Therefore, I do not consider it necessary to consider various decision of USA/UK courts cited by the Counsel for the parties.

The whole idea behind prohibitting insider trading as stated earlier is to ensure that persons by virtue of their position in the company and based on the confidential information available to them by virtue of their position in the company do not gain an unfair advantage

which will benefit them at the expense of the persons they deal with. What is being aimed at by the regulation is to prevent insiders taking unfair advantage over other shareholders. SEBI's argument is that regulations 3 & 4 of the SEBI Regulations do not require anything else to be proved to proceed against the person except that the person is an insider and that he had dealt with in the securities on the basis of the unpublished price sensitive information According to the Respondent under the SEBI Regulations profit element is not an ingredient of the offence of insider trading. SEBI had submitted that from a bare reading of regulation 3 it is clear that prohibition of insider trading by an insider is an absolute offence and that benefit or gain is not an ingredient of the offence. It is difficult to accept the version of SEBI. Once SEBI's view is accepted the very purpose of imposing prohibition on insider dealing in the securities on the basis of the unpublished price sensitive information would become meaningless. If an insider, based on the unpublished price sensitive information deals in securities for no advantage to him, over others, how it can be said to be against the interest of investors. In my view taking into consideration the very objective of the SEBI Regulations prohibiting the insider trading, the intention/motive of the insider has to be taken cognizance of. It is true that the regulation does not specifically bring in mens rea as an ingredient of insider trading. But that does not mean that the motive need be ignored. In this context I would like to refer to the discussion on mens rea in the Law Lexicon by Shri Venkatramaiya –

"Mens rea – There is a presumption that in any statutory crime the common law, mental element, mens rea, is an essential ingredient. A crime may or may not contain an express definition of the necessary state of mind. A statute may require a specific intention, malice, knowledge, willfulness or recklessness. On the other hand it may be silent as to any requirement of mens rea and in such a case in order to determine whether or not mens rea is an essential element of the offence, it is necessary to look at the objects and terms of the statute

It has always been a principle of the common law that means rea is an essential element in the commission of any criminal offence against the common law. In the case of statutory offences it depends on the effect of the statute….. There is a presumption that mens rea is an essential ingredient in a statutory offence, but this presumption is liable to be displaced either by the words of the statute creating the offence or by the subject matter with which it deals (State of Maharashtra V Mayer Hans George AIR 1956 SC 722 AT PG. 728)

It is to be noted that as per the SEBI Act insider trading is a statutory offence. In this context it is also to be noted that the persons violating the provisions of SEBI Act, rules and regulations are liable to criminal prosecution. The penalty for violation of the provisions of SEBI Act, rules and regulations has been provided in Section 24 of the SEBI Act. As per the said Section 24 the offender "shall be punishable with imprisonment for a term which may extend to ten years or with fine, which may extend to twenty five crore rupees or with both". This penalty is the revised one brought in vide amendment effected to the SEBI Act on 29.10.2002. Prior to the said amendment the person found guilty of an offence "was punishable with imprisonment for a term which shall not be less than one month but which may extend to three years or with fine which shall not be less than two thousand rupees but which may extend to ten thousand rupees or with both." Further in terms of section 15G of SEBI Act persons indulging in insider trading are liable to a monetary penalty not exceeding twenty-five crore rupees or three times the amount of profits made out of insider trading whichever is higher (prior to the amendment to the section on 29.10.2002 the maximum penalty leviable was rupees five lakhs). The monetary penalty provided in section 15G is in the case of adjudication of the offences by an adjudicating officer appointed by SEBI. Penalty provided in section 24 is "without prejudice to any award of penalty by the adjudicating officer under the Act."

It is an accepted fact that the practice of insider trading requires to be checked and those who indulge in insider trading should be severely dealt with by awarding harsh penalties, as insider trading is outright cheating and not compatible with fair market transactions. Considering the gravity of the offence, the legislature has provided for heavy penalty vide section 15G and section 24. The fact that section 24 covers all types of offences does not mean that insider trading is a minor offence and therefore penalty leviable will be small for proven charge of insider trading. So looking from the gravity of the charge and penal consequences that could visit the insider for indulging in insider trading, it is difficult to accept the proposition that the intention/motive of the person indulging in insider trading is irrelevant. It is true that regulations 3 and 4 per se are pure vanila sections without specific mention of the requirement of the motive or intention. But these regulation, if read with the objective of prohibitting the insider trading makes clear that motive is built in and the insider trading without establishing the motive factor is not punishable. What is sought to be prohibitted is gaining unfair advantage by the insider by indulging in insider trading. In my view if it is established that the person who had indulged in insider trading had no intention of gaining any unfair advantage, the charge of insider trading warranting penalty can not be sustained against him.

In the instant case it is clear that the Appellant was frantically trying to get a joint venture partner to strengthen the company, when the particular industry was facing problems. The partner was Bayer. It put stiff condition of holding 51% capital in the company. The Appellant's intention in acquiring the share was to facilitate the entry of Bayer for the betterment of the company and its other shareholders, employees etc. The object was not to gain unfair personal gain. It is true that in the process the shares which he purchased at a lower price fetched a higher price when offered in the public offer. But this gain was only incidental, and certainly not by cheating others. If the Appellant's intention was to make money in the process, he could have cornered much more shares and profitted considerably. His bonafide is

evident from the fact that he had instructed Mr. Kedia to buy even 1,20,000 shares @ Rs.80/- when the public offer response was not that warm, so as to meet the deficiency, if any, in obtaining 20% shares by Bayer in the public offer..

From the facts of the case, it is clear that the Appellant was acting in the interest of the company and to protect the interest of the company shares were purchased and, therefore the Appellant can not be considered to have violated the prohibition contained in regulation 3(i). The fact that the Appellant in the process of tendering the shares in the public offer, tendered the shares at a price higher than the rate at which he purchased the same can not be viewed as an action to gain unfair advantage over other shareholders. The gain was incidental to the main objective of enhancing the interest of ABS. He was already in management of the control of the company. It is too presumptuous to say that he had traded in the securities to protect his interest. He has not retained his managerial position at the cost of any other person.

In the totality of the facts and circumstances and in view of the underlying objective of the insider trading regulation, I am not inclined to agree with the finding that the Appellant is guilty of indulging in insider trading as alleged by the Respondent. Since there is no evidence to show that he had gained unfair advantage over other shareholders the direction to deposit Rs.34 lakhs to compensate any investor who seeks compensation as a result of the sale of shares of ABS to Shri I. P. Kedia during September 9 to October 1, 1996 is untenable.

On a query from the Tribunal, during the appellate proceedings, the Appellant had stated that not even a single shareholder had come forward seeking compensation even after one year from the date of the order. It can not be that the investors were unaware of SEBI's

order. The reason obviously is that no shareholder felt that he has been wronged. This also helps to support the view that the Appellant had not gained any undue advantage at the cost of other shareholders as a result of the share dealing under reference.

It is also seen from the show cause notice that SEBI had not asked the Appellant to show cause as to why he should not be directed to compensate the shareholders from whom shares were purchased in the relevant period. Since it was not a matter addressed in the show cause notice the Appellant could not put forth its view. The compensation amount, it seems was arbitrarily calculated. The order directing the Appellants to deposit Rs.34,00,000 in the Investor protection Fund to compensate the shareholders is, therefore in violation of the principles of natural justice.

In any case as stated in this order since the Respondent has not made out a case to hold the Appellant guilty of indulging in insider trading no action is called for under section 11, 11B of the Act read with regulation 11 of the SEBI Regulations on insider trading. Therefore, that part of the order directing "Rakesh Agrwal to deposit a sum of Rs.34,00,000/- with Investor Protection fund of BSE and NSE to compensate the investors who may come forward at a later period of time seeking compensation for the loss incurred by them in selling at a price higher than the offer price" can not be sustained. The said part of the order is set aside.

SEBI has power to order adjudication under section 15 G and launch prosecution under section 24. In case the Appellant is aggrieved by the order of the adjudicating officer or the decision of the competent court in the criminal complaint, the Appellant is not short of appellate remedies. This Tribunal, is of the view that it is beyond its jurisdiction to issue any

order setting aside the Respondent's direction to launch prosecution and initiate adjudication against the Appellant. No order on that part of the order directing adjudication/launching prosecution.

Appeal, allowed in the above lines.

Sd/-

(C.ACHUTHAN)
PRESIDING OFFICER

Place: Mumbai

Date:November 3 , 2003.