BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.210 of 2011

Date of Decision : 29.3. 2012

Eaugu Udyog Ltd.
434, New Sonal Link,
Linking Road, Malad (West),
Mumbai – 400 064. ….. Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, C-4A, G Block,
Bandra Kurla Complex,
Bandra (East), Mumbai – 400 051. ..…Respondent

Mr. V.I. Garg, Director and Corporate Advisor for the Appellant.

Mr. Kumar Desai, Advocate with Ms. Daya Gupta and Ms. Harshada Nagare, Advocates for the Respondent.

CORAM : P. K. Malhotra, Member
S.S.N. Moorthy, Member

Per : S.S.N. Moorthy, Member

Challenge in this appeal is against imposition of a penalty of ₹ 12 lacs on the appellant under section 15HA of the Securities and Exchange Board of India Act, 1992 and 23H of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as SEBI Act and SCRA respectively). The adjudicating officer found the appellant guilty of violating regulations 3 and 4 of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (FUTP Regulations for short) and the Securities and Exchange Board of India notification G.S.R.219(E) dated March 2, 2000 read with sections 16 and 18 of the SCRA. For the former violation a penalty of ₹ 7 lacs and for the latter a penalty of ₹ 5 lacs (totaling ₹ 12 lacs) was imposed by the adjudicating officer.

2. The appellant is the erstwhile promoter of M/s. Hit Kit Global Solutions Limited (HKGS). HKGS was listed on the Bombay Stock Exchange and was engaged in the business of software development. The appellant held 58.75 per cent shares in HKGS. The appellant is an investment company and by way of a scheme of arrangement sanctioned by the Bombay High Court the appellant decided to divest its entire promoter

shareholding in HKGS partly by transfer to existing co-promoters and partly in the secondary market. Securities and Exchange Board of India (for short the Board) conducted investigation in the trading in the scrip of HKGS during the period October 1, 2004 to January 12, 2005. The Board noticed abnormal trading features which led to the suspicion regarding manipulation of trades by the appellant in collusion with a group of connected entities, Jayesh C. Shah, Haresh Soni, Jaiprakash Jain, Sanjay J. Soni, Dinesh Vijla and Abhijit Todi. The appellant offloaded 69,56,727 shares in the secondary market and 25,45,000 shares in off market transactions. The pattern of trade indicated that the appellant and the connected entities mentioned hereinabove acted together to create sufficient cushion for the sale prices of the scrip when huge volumes were traded in the market. During the investigation period the price of the scrip registered steady increase and this was considered to be on account of manipulated trades between the appellant and the connected entities which resulted in keeping the share value steady and on the rise so that while offloading the shares the appellant did not suffer any loss. The adjudicating officer also found that in off market transaction 20 lakh shares were transferred to Penta Electronics and Food Pvt. Ltd. (PEFPL), the consideration for which was received only after a period of nine months from the date of transfer. He concluded that there was violation of regulations 3 and 4 of the FUTP Regulations and of the Securities and Exchange Board of India notification G.S.R.219(E) dated March 2, 2000 read with sections 16 and 18 of the SCRA.

3. A show cause notice was issued to the appellant on May 10, 2010 setting forth the above mentioned allegations of synchronized trade and violation of the provisions of SCRA. The appellant filed a detailed reply denying all the allegations levelled against it in the show cause notice.

4. In the show cause notice the adjudicating officer provided a detailed account of the off-market transactions and the transactions in the secondary market. The transactions were mainly put through Haresh Soni, Jaiprakash Jain, Sanjay J. Soni, Anil Thakrel and Abhijit Todi who were connected by means of common introduction, fund transfer, third party payments, deliveries etc. The major counter party buyers in the market were the same entities to which the appellant had transferred shares off-market. In the background of the transactions in shares with the connected entities the share price

and volume increased substantially during the investigation period. To begin with, trades were in the range of 1 to 311 per month and the price range was ₹ 0.855 to ₹ 4.89. From July to September 2004 the trading volumes increased in the range of 4 to 11 lakh shares per month. The price of the scrip touched ₹ 5.48 in January 2005. There was steady increase in price during the period of investigation. Regarding off-market transactions the appellant submitted before the adjudicating officer that 5,45,000 shares were sold to sub-broker Shreeji Securities whose proprietor happened to be Sanjay Soni. The consideration for the transfer of 5,45,000 shares provided by the sub-broker was not realized since the cheque was dishonored. There was no attempt to recover the amount from Shreeji Securities**.** It was also noticed during investigation that the bill raised by Shreeji Securities was fake and the SEBI registration number was not correct. However, the fact remains that 5,45,000 shares were debited from the account of the appellant and credited to the account of Haresh Soni, Sanjay J. Soni and Jayesh Shah. The argument of the appellant that the transaction was in the normal course of business was not accepted by the adjudicating officer. In the secondary market too, the buy clients for the shares offloaded by the appellant were the connected entities already mentioned above. The trade logs revealed the increase in price and volumes during the investigation period and the trades between the appellant and the connected entities.

5. The appellant's learned representative very strenuously pointed out that there is no evidence regarding close connection, let alone, connivance between the appellant and impugned market players. According to him, the transactions of the appellant were bonafide market operations and there was no attempt to create artificial volumes and price rise. It was argued that the off-loading was done partly off-market and partly in the secondary market as per the directions of the High Court of Bombay and the sale effected through reputed brokers like Kotak Securities Limited and Anand Rathi Securities P. Ltd. The mischief of circular trading is totally denied by the appellant. It is observed that the appellant sold shares by 100 per cent deliverable transaction and had not reversed any sell transaction by buying equal number of shares on the same day. It was argued that synchronized trading per se is not illegal and the appellant had no connection with the persons alleged to be part of the connected group. According to the learned representative for the appellant, the transfer of shares off market to a handful of persons

and sale of shares in the secondary market also to the same persons could not make the transaction colorable and suspicious. It is argued by the appellant's learned representative that apart from the off-market transactions, no other concrete evidence is brought on record to establish the relationship/connivance of the parties. A reference is made to the orders of this Tribunal in Appeal nos. 42 and 43 of 2011 dated 9.9.2011 on two of the impugned market players Todi and Vijla wherein penalty has been substantially reduced.

6. The learned counsel appearing for the Board defended the order of the adjudicating officer. According to him, presence of identical persons in off-market trades and in the secondary market and the data of price and volume in the trade log would establish beyond doubt the connection of the parties. In off-market transactions the counter party is known and it cannot be a coincidence that the same counter parties appear in the trades in secondary market also. The trade logs which form part of the adjudication order highlighted the artificial volumes and price fluctuations intended to create a favourable market in the off-loading of the shares. The conduct of the appellant with respect to the non recovery of amounts though the cheques were dishonoured and transaction with the same parties in the secondary market sufficiently evidence the intention of the appellant to jack up the share value.

7. We have heard the learned counsel for the parties who took us through the details of the transactions. There is no dispute regarding off-loading of shares partly by way of off-market dealings and partly by way of secondary market transactions. There is also no dispute regarding the identity of the counter parties in the above transactions. The rise in price and volume during the investigation period also remains undisputed. The main thrust of the appellant's stand is that off-loading of shares was done as per the directions of the Bombay High Court and the transactions were genuine commercial dealings where beneficial ownership was transferred. We are unable to agree with the contention of the appellant that the transaction was normal, bonafide and transparent. The presence of same persons as counter parties both in off-market transaction and in secondary market dealings cannot be dismissed as a mere coincidence. The fact remains that the "connected persons" Haresh Soni, Jaiprakash Jain, Sanjay J. Soni, Anil Thakrel and Abhijit Todi were party to synchronized trades. Action has been taken separately in their

cases for market manipulation. Some of the penalty orders in respect of the connected persons were also cited by the appellant's learned representative. The synchronization of trades in the market during the investigation period resulted in artificial volumes and price rise. It is a matter of record that the same persons figure both in off-market and secondary market transactions. It was necessary for the appellant to obtain maximum benefit from the off-loading of shares. As already observed, the shares were not trading well at the beginning of the investigation period. Price and volume went up steadily during the investigation period providing a safe and profitable exit for the appellant. The circumstances in which the price of the scrip rose and the involvement of the appellant establish that the market was deliberately kept afloat by the appellant in connivance with the connected persons. Otherwise, there is no explanation for the presence of identical counter parties in off-market and secondary market dealings though the appellant would take a plea of bonafide market transactions.

8. The appellant's learned representative placed considerable emphasis on the proposition that synchronized trade per se is not illegal. A reference was made to a decision of this Tribunal in Ketan Parekh vs. Securities and Exchange Board of India, (Appeal no.2 of 2004 dated July 14, 2006) and Prashant J. Patel vs. Securities and Exchange Board of India, (Appeal no.150 of 2006 dated August 17, 2010). It is true that synchronized trade by itself may not be illegal if it is in the normal course of market operations and there are no facts which suggest manipulation or fraudulent intent. Every case has to be judged from the facts and circumstances relating to that case and not on the touchstone of general legal propositions. If the facts of the case bring out a different intent of the parties they may have to be considered in their proper perspective. This tribunal has held in the case of Prashant J. Patel mentioned supra that synchronized trades executed with a view to manipulating the market is illegal.

> "We have already held that negotiated/synchronized trades are not by themselves illegal but if a synchronized trade is executed with a view to manipulate the market or if it results in circular trading or is dubious in nature and is executed with a view to avoid regulatory detection or does not involve change of beneficial ownership or is executed to create false volumes resulting in upsetting the market equilibrium, it would be illegal. In other words, the intention with which a synchronized trade is executed would be the material factor to determine whether the trade is fraudulent. In the case before us, it is the appellant's own case that he executed negotiated deals/trades on behalf of his clients whose details were furnished by him to the Board in the reply to the show cause notice."

In the present case, the transactions entered into by the appellant cannot be termed as simple and straight. The circumstances of the case do point to something more than normal and transparent business transaction. So, the argument of the appellant's learned representative that the appellant was acting bonafide cannot be accepted. The appellant's learned representative also referred to the order of this Tribunal in the case of Dinesh R. Vijla vs. Adjudicating Officer, Securities and Exchange Board of India, (Appeal no.42 of 2011 dated 9.9.2011) wherein it has been observed that the Tribunal did not find any connection between the two appellants and the promoter. As already observed above, every case has to be judged in the background of the facts and circumstances of that case. The facts of the present case and the circumstantial evidence brought on record are quite different and we cannot arrive at a conclusion as in the case of Dinesh Vijla referred to above. The adjudicating officer has clearly brought out the nature of the trades and their relevance in the circumstances which required the appellant to obtain maximum benefit out of a scrip which was trading very poor at the beginning of the investigation period. In fact, inter se connection of parties can best be appreciated through the conduct of the parties. In the present case the appellant was motivated by the objective of maximum profit and the transaction with the connected entities helped in keeping the price and volume at a considerably higher level than in the normal circumstances. The adjudicating officer has brought out the role of the appellant and the market manipulation in a convincing manner.

i. "The Noticee was major seller in the market and for 25.02% of its total sales the counter party were the connected entities to whom Noticee also transferred shares in the off market.
ii. The synchronized trades of the Noticee constituted 17.02% of its total sales with the counter parties. There was exact matching of the price and time difference between the buy order and sell orders was within seconds.
iii. The synchronized trades were carried out for over a period of two months in 1034 trades.
iv. The Noticee not only synchronized the trades in the market with the counter party entities who were connected but by transferring the shares in the off-market to the connected entities enabled those entities to execute trades among themselves which were synchronized and created artificial volume as also influenced the price of the scrip."

9. In view of the facts discussed above and the conduct of the appellant, we have to come to the irresistible conclusion that the adjudicating officer has rightly found fault with the appellant for violating regulations 3 and 4 of the FUTP Regulations.

10. The second charge in this appeal relates to the violation of provisions of SCRA by the appellant. The appellant transferred 20 lac shares to PEFPL in two instalments on 16.12.2004 and 27.12.2004 off market. The contention of the appellant before the adjudicating officer was that the impugned transfer did not involve any sale of shares but only a transfer to a mandate holder for finding out a market for the shares. Considering the manner in which the shares were transferred and entry of the same in the depository account in the name of the transferee, the adjudicating officer took the view that beneficial ownership was transferred to PEFPL and all the attendant provisions of SCRA applied to the transaction. PEFPL transferred back 6,86,000 shares to the appellant and transferred 13,14,000 shares for which a consideration of 40 lacs was received. The appellant received the above consideration of 40 lacs on 8th September, 2005. The adjudicating officer concluded that receipt of payment on September 8, 2005 was in violation of the provisions relating to transfer of funds in spot delivery. On this count, the appellant was held to be liable to a penalty as per section 23H of the SCRA.

11. During the hearing of the appeal a preliminary objection was raised by the appellant's learned representative with regard to a corrigendum to the show cause notice. Show cause notice in this case was issued on 10th May, 2010 while a corrigendum was issued on 19th February, 2011. In the corrigendum the adjudicating officer mentioned the provisions of section 23H of SCRA with emphasis on the quantum of penalty relating thereto. In the original show cause notice, in paragraph 20, mention was made of section 23(h) of SCRA and the penalties attached thereto. The appellant's learned representative argued that no proper opportunity was given after the issue of the corrigendum to the show cause notice and this is vital in so far as the quantum of penalty in section 23H of SCRA is substantially high.

12. On a perusal of the records and the conduct of the appellant in its reply to the show cause notice we do not find any merit in this contention. It is true that the adjudicating officer has substituted part of the original show cause notice with the corrigendum issued on February 19, 2011. The penalty imposed in the adjudication order is in conformity with the provisions contained in the corrigendum. But a perusal of the reply to the show cause notice filed by the appellant makes it very clear that the appellant has properly understood the charge as one relating to section 23H of the SCRA Act. In

the reply filed by the appellant on 21st December, 2010 the following submissions are made:

> "d. Without prejudice to the above, the Noticee states that the said Show Cause Notice has been issued for alleged violation of the provision of section 15HA of the SEBI Act and section 23H of the SCRA Act. Section 15HA of the SEBI Act contemplates penalty for fraudulent and unfair trade practice. The term 'fraudulent' has been bought out by the definition of the word 'fraud' as per regulations 2(c) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (PFUTP Regulations, 2003)."

The appellant has also understood the correct charge as made out by the adjudicating officer and it is evident in paragraph 47 of the reply to the show cause notice.

> "47. In paragraph (19) of the SCN, it is alleged that by the act described in paragraph (18), the Noticee has violated SEBI notification GSR 219(E) dated 2 March 2000 read with sections 16 and 18 of the SCRA. This is denied."

Since the relevant provisions of the Act have been properly understood by the appellant and suitable reply relating thereto has been furnished in writing there is no case of denial of natural justice on this count.

13. The appellant's learned representative argued at length stating that a mandate letter given to PEFPL for sale of shares was not in the nature of "spot contract" and so there was no violation of the provisions of SCRA. According to him, there was only a contingent contract with the mandate holder for identification of a prospective buyer. The mandate was attached with elements of uncertainty because of price, quantity, time etc. and the mandate holder was expected only to locate a prospective buyer.

14. The learned counsel appearing for the Board submitted that the transaction was in the nature of spot delivery and there was transfer of beneficial ownership from the appellant to PEFPL. With reference to the mandate letter the learned counsel for the Board pointed out that the terms of the mandate letter were not complied with and PEFPL had behaved purely as the owner of the shares and transferred the proceeds to the appellant.

15. We have gone through the mandate letter. It is necessary to highlight the terms and conditions of the same:

> "Dear Sir,
>
> As per our mutual discussions we are giving you mandate for Placement of 20,00,000 equity shares of Rs.2/- each of Sun Beam Infotech Limited to the Corporate Investors in the price band of Rs.2.90 to Rs.4.90 per share on the following terms and conditions:-

1) Minimum lot of 5,00,000 shares shall be placed with one single investor.
2) The investor shall agree to hold the investment on long terms basis.
3) The delivery of the shares shall be given to the investor in Demat Form only against the receipt of the payment of full consideration, and if the basis of payment is on credit terms, the delivery of the shares shall be given strictly in physical form and they will be allowed to demat the same after the receipt of payment from them.
4) The mandate is valid for Three months from the date of this letter.
5) The payment shall be made on or before six months from the date of the final negotiation with the investor.

If you are unable to finalize the deal within the validity period of this mandate you will be under obligation to return back the shares to the company, which are to be given by us, pursuant to this mandate in your demat account, immediately after finalization of this mandate."

16. One of the conditions which is glaring in the mandate letter is that it is valid for three months from 10th December, 2004. Obviously PEFPL made the payment of 40 lacs only in September, 2005 which is much after the stipulated period of three months in the mandate letter. Another significant factor to be noted is that the shares are being transferred to the demat account of PEFPL. This implies transfer of beneficial ownership of the shares. Once PEFPL becomes the beneficial owner as per the provisions of the Depositories Act, it cannot be regarded as a mere custodian or mandate holder for the only purpose of identifying a prospective buyer. The conduct of the parties, which is important in any transaction, establishes that there was a transfer of the shares. Even though the appellant has made out a sale note for the sum of ₹ 40 lacs in its name making PEFPL a witness thereof much cannot be made out of this. The adjudicating officer has brought on record the nuances of the legal and factual matrix of the transactions in the impugned order. The conduct of the parties and nature of the transaction establish that the appellant entered into a transaction in off market with PEFPL and received the payment after nine months which is in contravention of the provisions relating to spot delivery contracts. As per section 2(i) of the SCRA 'spot delivery contract' is defined as under:-

2 (*i*) "spot delivery contract" means a contract which provides for,—

(*a*) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefore through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;
(*b*) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository;"

In the facts of the case, PEFPL has to be considered to be the real owner once the shares are transferred to its demat account. As observed above, the conditions of the mandate letter were not complied with. PEFPL sold the shares and transferred the balance to the account of the appellant. This is beyond the terms provided for in the mandate letter. The transfer of beneficial ownership comes along with the rights and liabilities attached to the ownership of the shares. In the present case, the credit of the shares in the depository account of PEFPL and the subsequent sale of part of the shares and return of the balance show that PEFPL was not a mere mandate holder as contended by the appellant. In the circumstances of the case, there is a spot delivery contract as envisaged in section 2(i) of the SCRA Act. Since the payment of consideration is not in conformity with the above provision of SCRA penalty under section 23H is called for.

In view of the forgoing discussion, we hold that the order of the adjudicating officer does not call for any interference. The imposition of penalty is confirmed. Appeal dismissed. No order as to costs.

Sd/-
P.K. Malhotra
Member

Sd/-
S.S.N. Moorthy
Member

29.3.2012
Prepared and compared by
RHN