BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 164 of 2007

Date of decision : 29.7.2008

Vidyut Investments Limited …… Appellant

Versus

Securities and Exchange Board of India …… Respondent

Mr. Cicur Mukhopadhya and Mr. Prashant Mehta Advocates for the Appellant.

Mr. Rafique Dada Senior Advocate with Dr. Mrs. Poornima Advani and Ms. Sejal Shah Advocates for the Respondent.

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

Per : Justice N.K. Sodhi, Presiding Officer

Vidyut Investments Limited which is a 100 per cent subsidiary of Ranbaxy Laboratories Limited is the appellant before us. It is a non banking finance company (NBFC) registered with the Reserve Bank of India. It is also an investment company. The Securities and Exchange Board of India (hereinafter referred to as the Board) conducted investigations in the wake of excessive volatility in the securities market during the period from April 2000 to March 2001. The investigations revealed that one Shri Ketan Parekh and some of his companies (collectively referred to as KP entities) had indulged in manipulative activities such as synchronized and circular trades and created artificial volumes in the scrips of different companies including DSQ Software Limited, Global Telesystems Limited, Zee Telefilms Limited, Himachal Futuristic Communications Limited, Ranbaxy Laboratories Limited, Aftek Infosys Limited and Global Trust Bank (hereinafter referred to as DSQ, GTL, Zee, Himachal, Ranbaxy, Aftek and GTB respectively) and rigged the securities market through fictitious trades which did not affect any change of beneficial ownership in the traded shares as they were merely rotated from one KP entity to another. The Board by its order dated

December 12, 2003 prohibited KP entities from buying, selling or dealing in securities in any manner directly or indirectly and debarred them from associating with the securities market for a period of 14 years. That order was upheld by this Tribunal on July 14, 2006 and it was observed that "We have, therefore, no hesitation to hold that if Ketan Parekh and his entities are allowed to continue with their operations they would pose a serious threat to the integrity of the securities market and endanger the interests of the investors".

2. Investigations conducted by the Board revealed that the appellant as NBFC had financed the dealings of KP entities some of which were Classic Credit Ltd. (Classic) and Panther Fincap & Management Services Ltd. (Panther) which were controlled by Ketan Parekh. In the light of these findings, the appellant was served with three show cause notices dated February 5, 2003, June 30, 2004 and December 31, 2004 (hereinafter referred to as the first, second and third SCN respectively) alleging therein that the appellant had lent moneys to KP entities and was holding shares in its own name which actually belonged to those entities. The appellant is alleged to have funded KP entities to the tune of Rs.106 crores during the period from January 1999 to October 1999 and another sum of Rs.245 crores during the period from November 1999 to December 2000, totaling about Rs.351 crores. In the first SCN it is alleged that there was market manipulation in the scrip of Aftek by KP entities during the period from November 1999 to December 1999 and that the manipulation was facilitated by lack of floating stock in the market due to concentration of shareholdings in the hands of the promoters of Aftek, KP entities and the appellant. It is further alleged that manipulation by KP entities was made possible by the appellant by holding shares of Aftek which actually belonged to KP entities. The appellant is alleged to be guilty of violating clauses (a) to (e) of Regulation 4 of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 (for short the regulations). The appellant is said to have aided, abetted and assisted KP entities in the creation of artificial market and volumes in the scrip of Aftek which disturbed the market equilibrium. In the second SCN the appellant

is alleged to have associated itself with KP entities which had used it to park the shares of GTB with a view to create artificial market for the scrip. It is also alleged to have extended finance to the group against the security of GTB shares. The precise charge against the appellant in this SCN reads as under:

> "Vidyut Investments Ltd., has lent the shares of GTB to Classic Credit Ltd. and Panther Fincap & Management Services Ltd. without going through the approved intermediaries. This is in violation of SEBI Stock Lending Scheme. Apart from this it has also lent funds to the Ketan Parekh group. Thus, the actions of Vidyut Investments Ltd. served a dual purpose in assisting the Ketan Parekh group. On one hand, they extended finance to the group against the security of Global Trust Bank shares and on the other they were used for parking of the Global Trust Bank shares."

The Board alleged that by entering into trades with and financing KP entities, the appellant had aided and abetted those entities thereby violating Regulation 4(b) of the regulations. In the third SCN also, the charge against the appellant is that it had funded KP entities during the period from January 1, 1999 to October 31, 1999 and again from November 1, 1999 to December 31, 2000 in a big way, which entities in turn indulged in manipulation in the scrips of DSQ, GTL, Himachal, Aftek and Zee. It is on this account that the appellant is said to have aided and abetted KP entities thereby violating clauses (a) to (e) of Regulation 4 of the regulations. In all the three SCNs the appellant was called upon to show cause why suitable directions under section 11B of the Securities and Exchange Board of India Act, 1992 (for short the Act) be not issued to it. The appellant filed a short reply to the first and second SCNs stating that on the basis of exactly the same allegations levelled against it, adjudication proceedings had been initiated against it for contravening Regulation 10 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (for short the takeover code) and that the adjudicating officer by his order dated April 22, 2003 found the appellant guilty and imposed a monetary penalty of Rs.5 lacs on it. It was pointed out that the appellant had preferred an appeal before this Tribunal which was then pending and requested the adjudicating officer to stay the proceedings in regard to the first and second SCN till such time the appeal was decided. It also filed a

detailed reply on February 22, 2005 to the third SCN pointing out that the appellant was an NBFC registered with the Reserve Bank of India and was engaged in the business of advancing loans for capital market operations, leasing and other activities as per its memorandum of association. It is pleaded that in the ordinary course of its business it had agreed to extend a line of credit to Panther and Classic and several others with whom we are not concerned in this appeal. These lines of credit were extended pursuant to agreements executed between the parties prior to the disbursement of funds to them. The agreements provided that the loans were to be secured by equity shares of listed Indian companies acceptable to the appellant and such securities were to be lodged prior to the disbursement of the credit facility. The borrowers had agreed to provide a 50 per cent margin of security to be retained by the appellant. It is the case of the appellant that it was in pursuance to such an arrangement that it advanced loans to Panther and Classic and that the shares of Indian companies that were offered by way of security were transferred in its name with a view to secure the loan so that the shares could be easily sold in case of default. This transfer in the name of the appellant was in pursuance to the agreement between the parties and is said to be a common practice with all financing institutions. It is the case of the appellant that loans were advanced to KP entities in the ordinary course of its business and that it played no other role in the market transactions which were carried out by KP entities alone. It was pleaded that merely because the appellant advanced loans to KP entities and several others in the course of its ordinary business, it could not be said that the appellant had aided and abetted those entities in manipulating the market. If they did so, it were they who were responsible for their acts. It was pointed out that such loans were granted to several other companies as well which were not connected with KP entities and that the shares which were offered by way of security even by KP entities were of different Indian companies in which KP entities had not manipulated the market.

3. On a consideration of the reply filed by the appellant and the material collected by the Board during the course of the investigations and having regard to the submissions made by the appellant both oral and written, the whole time member found

that the appellant had aided and abetted KP entities in manipulating the scrips of different companies by lending money to such entities and thereby violated clauses (a) to (e) of Regulation 4 of the regulations. He recorded his findings in para 3.17 of the impugned order in the following words:

> "I find that VIL has funded huge amount of loans to KP entities who were indulging in market manipulations. It is obvious that such funds will be ploughed into the market having regard to Shri Ketan Parekh's penchant for market. Further, VIL had also taken proprietary positions in various scrips. On a cumulative view of the entire role of VIL, I am convinced that its role is not that of a mere lender. On the basis of the pattern of funding and subsequent trading by KP entities as well as by VIL, it can fairly be concluded that VIL has aided and abetted in market manipulation."

In this context the whole time member also observed in para 3.25 as under:

> "It is a matter of record that Ketan Parekh entities have been held liable for market manipulation under FUTP Regulations as confirmed by SAT's order dated July 14, 2006. If that is so, the entities who have dealt with Shri Ketan Parekh et al in some capacity or other in the scrips he traded for rigging the market would have definitely had a role in market manipulation."

The same finding has been reiterated in para 3.28 and the relevant part of the same is reproduced hereunder:

> "Given the fact that there was enormity of market manipulation by Shri Ketan Parekh and his related entities in certain scrips and that Shri Ketan Parekh and his related entities could not have manipulated the market to such huge proportions alone, it stands to reason that the entities who had direct dealings with KP entities can't escape their responsibility on the plea that they were not aware of Shri Ketan Parekh's manipulative intentions in the market. There can be no direct evidence in the context of market operations as to whether there was a constructive knowledge on the part of the entities on manipulation while dealing with Shri Ketan Parekh and his entities. Proof of manipulation always is drawn from a mass of details and accordingly, it is purely inferential on the materials available in a given case."

After holding that the appellant had aided and abetted KP entities by advancing loans, the whole time member also found in para 3.18 of the impugned order that the appellant had lent shares of GTB to Classic and Panther without going through the approved intermediaries which lending was in violation of the Securities Lending Scheme, 1997

(for short the scheme) framed by the Board. He recorded his finding in the following words:

> "It is clear from above that VIL had lent the shares of GTB to Classic Credit Ltd. and Panther Fincap & Management Services Ltd. without going through the approved intermediaries which is in violation of SEBI Stock Lending Scheme. VIL had admitted that it used to provide funds on interest basis while shares in the demat account were received as collaterals/securities for loans given to entities connected to Ketan Parekh and other entities."

Accordingly by his order dated 24.1.2007 the whole time member found the appellant guilty of the charges levelled against it and issued directions under section 11B of the Act restraining the appellant from selling or dealing in securities for a period of two years except for the shares pledged with it in its capacity as NBFC. It is against this order that the present appeal has been filed.

4. At the outset, it may be mentioned that KP entities at the time of borrowing moneys as per the line of credit extended to them by the appellant had offered, among others, a large quantity of shares of Aftek by way of security and as per the practice and the terms and conditions of the credit, the shares were transferred in the name of the appellant and this meant acquisition within the meaning of the takeover code. The charge against the appellant was that it was acting in concert with KP entities when it loaned the money and since it failed to make the necessary disclosures and did not come out with public announcement, it violated Regulations 7 and 10 of the takeover code. The Board initiated adjudication proceedings against the appellant. The adjudicating officer by his order dated April 22, 2003 held the appellant guilty and imposed a monetary penalty of Rs.5 lacs on it. Feeling aggrieved by this order, the appellant filed Appeal no.135 of 2005 before this tribunal and urged that the transfer of shares of Aftek in its name did not amount to acquisition within the meaning of the takeover code and, therefore, it did not violate the provisions of that code. In the alternative, it was argued that the appellant did not act in concert with KP entities when it advanced loan to them in the course of its ordinary business and that the shares were taken by way of security to secure the loan. The tribunal referred to the provisions of the Depositories Act 1996

and held that with the transfer of the shares in the name of the appellant, it became the legal owner though the beneficial ownership in those shares continued to remain with KP entities. The alternative argument was, however, accepted and it was held that the appellant did not act in concert with KP entities. While referring to clause 2(i)(e) of the takeover code which defines "person acting in concert", this is what the Tribunal held:

> "A reading of the aforesaid clause leaves no room for doubt that persons who are said to be acting in concert must have a common objective or purpose of substantial acquisition of shares or voting rights in a target company pursuant to an agreement or understanding and they must cooperate by acquiring or agreeing to acquire shares or voting rights in that company. In other words, before two or more persons can be said to be acting in concert they must act for a common objective which has to be substantial acquisition of shares or voting rights in a target company. The essential ingredient of the definition is that they must act in furtherance of a common objective. Let us see whether this essential requirement is satisfied in the case of acquisition of shares by the appellant. As already noticed earlier, the appellant acquired shares by getting them transferred in its name which were received by way of security for the loans which it had granted to Classic and Panther. The object of Classic and Panther for entering into an agreement was to acquire shares in the target company whereas the object of the appellant in getting those shares transferred in its name was to secure the loan which it had advanced to them. In other words, the object of the appellant was not the same as that of Classic and Panther. The learned counsel for the respondent Board while referring to the terms and conditions of the agreement mentioned hereinabove very strenuously contended that by executing the agreement had enabled Ketan Parekh through Classic and Panther which are his entities to exercise voting rights in respect of the shares held by it by way of security. This may be so, but does it mean that the appellant and Classic and Panther were acting in cert. We do not think so. As already noted there has to be a common objective and since there was none, rather their objectives were entirely different, they cannot be said to be "persons acting in concert". In this view of the matter we cannot uphold the findings of the adjudicating officer that the appellant and Classic and Panther acted in concert while acquiring the shares."

During the course of the hearing we were informed that the Board did not prefer an appeal against the order of the tribunal. The order has, therefore, become final between the parties.

5. Referring to the aforesaid order of the tribunal in Appeal no. 135 of 2005 the learned counsel for the appellant strenuously urged that the appellant cannot be said to have aided and abetted KP entities in manipulating the market when it advanced loans to them in the ordinary course of its business. There is merit in this contention. The transactions which were in issue in Appeal no. 135 of 2005 are also the subject matter of the present dispute and in addition thereto there are other scrips as well. The findings recorded in the earlier appeal obviously clinch the matter in favour of the appellant and it is not open to the Board to contend otherwise. In view of the earlier order of the tribunal, the learned senior counsel appearing for the Board very fairly stated that he would not contend that the appellant had acted in concert with KP entities. As already observed in the earlier order, the appellant was a mere lender. In this view of the matter, the findings recorded in the impugned order to the effect that the appellant by lending moneys to KP entities had aided and abetted them in manipulating the securities market cannot be upheld.

6. We will now deal with the finding recorded by the Board that the appellant had lent 49 lac shares of GTB to KP entities in violation of the scheme. As already noticed, the second SCN contains two charges. One pertains to the lending of funds by the appellant to KP entities and the other is in regard to the lending of securities to Classic and Panther which is alleged to be in violation of the scheme. The first charge in this SCN is the same as in the other two SCNs and the same has been dealt with hereinabove and for those reasons this charge cannot be sustained. Now coming to the other charge regarding the lending of securities, it is alleged that the appellant held 49 lac shares of GTB in its own name as a beneficial owner and had lent the same to KP entities. 25 lacs were lent to Panther on 15.11.2000 and 24 lacs to Classic on 4.12.2000. The appellant admits that these shares which were actually owned by it had been lent as alleged. In fact a statement to this effect was made on behalf of the appellant before the Board during the course of the investigations. The charge is that this lending was not done through the appropriate intermediaries and, therefore, it violated the scheme. This

allegation is also admitted by the appellant. It is thus established that the appellant lent 49 lac shares to two KP entities without going through the approved intermediaries as provided in scheme. The learned counsel for the appellant, however, contended that it was not mandatory under the scheme to lend shares only through the approved intermediaries and that those could be lent outside the scheme as well and that the appellant did no wrong in lending these shares. We cannot agree with the learned counsel for the appellant. The scheme has been framed by the Board with a view to regulate the lending and borrowing of securities in the securities market through approved intermediaries and it is a measure adopted under section 11 of the Act. Para 4(1) of the scheme reads as under:

> "The lender shall enter into an agreement with the approved intermediary for depositing the securities for the purpose of lending through approved intermediary as per the scheme and the borrower shall enter into an agreement with the approved intermediary for the purpose of borrowing of securities and as such there shall be no direct agreement between the lender and the borrower for the lending or borrowing of securities."

A reading of the aforesaid provision leaves no room for doubt that lending and borrowing of securities has to be only through an approved intermediary and that the lender and borrower cannot directly enter into an agreement for that purpose. Since the appellant did not lend the securities through an approved intermediary as envisaged by the scheme, there can be no doubt that it violated the said scheme. The question that now arises for our consideration is as to what directions should be issued to the appellant under section 11B of the Act. The Board in the impugned order debarred the appellant from accessing the capital market for a period of two years but this direction was issued because the Board found that the appellant had not only violated the scheme but had also aided and abetted KP entities by lending moneys for the purchase of shares of different companies with which they manipulated the market. The charge regarding aiding and abetting by the appellant has been set aside by us as noticed earlier. The appellant is only found to have violated the scheme. It is the case of the appellant that it was not aware of the scheme at all. This, of course, is no excuse. It is also pleaded that

this was a one time lending to Panther and Classic and that the appellant had never lent any shares to any other entity including KP entities either before or after the lending in issue. The fact that the lending by the appellant to Panther and Classic was an isolated transaction could not be disputed on behalf of the Board whose representatives were present in court. The learned senior counsel appearing for the Board however contended that even though the lending by the appellant was an isolated act, it would not really matter and that the provisions of Regulation 4(b) of the regulations stood violated. We are unable to agree with the learned senior counsel. Regulation 4(b) of the regulations which is alleged to have been violated and which is now the only charge left in the second SCN reads as under:

> "4. Prohibition against market manipulation. – No person shall –
> (a) ……..
> (b) Indulge in any act, which is calculated to create a false or misleading appearance of trading on the securities market;
> (c) ……
> (d) ……..…….
> (e) ……..……"

Lending of shares in contravention of the scheme cannot by any process of reasoning be "calculated to create a false or misleading appearance of trading on the securities market". It is not the case of the Board that the appellant traded in these shares. The trading was done by KP entities and we have already found that the appellant was not acting in concert with them. In this view of the matter we are satisfied that mere contravention of the scheme is not covered by Regulation 4(b) of the regulations. The fact still remains that the appellant violated the scheme as already observed. Since the act of the appellant in lending shares to Panther and Classic was an isolated act and is not a continuing wrong, we do not think that it was appropriate to debar the appellant from accessing the capital market for a period of two years. After all, it is an investment company and its business is to invest in the capital market. It is not a KP entity and belongs to a different group altogether. Had it been acting in concert with Ketan Parekh or his entities, the matter would have been different. The appellant has already remained out of the market for almost 18 months under the impugned order. In

the circumstances, we deem it appropriate to direct the appellant to be careful in future and not to lend or borrow securities otherwise than in accordance with the scheme.

For the reasons recorded above, we allow the appeal, set aside the impugned order and issue directions to the appellant under section 11B of the Act to be careful in future and not to lend or borrow securities otherwise than in accordance with the scheme. There is no order as to costs.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Arun Bhargava
Member

Sd/-
Utpal Bhattacharya
Member

29.7.2008
ddg/-