BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.132 of 2010

Date of Decision : 27.05.2011

Mr. Manmohan Shetty
21, Golden Beach, Ruia Park,
Juhu, Mumbai. …..Appellant

Versus

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

Mr. Janak Dwarkadas, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Ravichandra Hedge and Ms. Farah Karachiwala, Advocates for the Appellant.

Mr. Darius Khambatta, Additional Solicitor General with Mr. Shiraz Rustomjee, Mr. Mihir Mody and Mr. Karan Vyas, Advocates for the Respondent.

CORAM : Justice N. K. Sodhi, Presiding Officer
P.K. Malhotra, Member
S. S. N. Moorthy, Member

Per : P.K. Malhotra, Member

This appeal has been filed by the appellant against the order dated June 9, 2010 passed by the adjudicating officer of the Securities and Exchange Board of India (for short the Board) holding the appellant guilty of violating the provisions of the code of conduct prescribed under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 (for short the Regulations) and imposing a monetary penalty of ₹1,00,00,000 (Rupees one crore only) under section 15HB of the Securities and Exchange Board of India Act, 1992 (for short the Act).

2. The facts of the case, in brief, are that the Board conducted investigations into the alleged irregularities in the trading in the shares of Adlabs Films Limited (for short the company) and the possible violation of the provisions of the Act and the Regulations made thereunder. The appellant is a shareholder and director of the company. He was holding 82,91,234 shares and was also classified as ‘designated employee’ under the Regulations. On April 23, 2006 the company held its board meeting to approve the audited accounts for the financial year ending March 31, 2006; to recommend dividend and to consider proposal for demerger of the company’s FM radio business. The Board of Directors of the company approved the proposal for demerger of the FM radio business to a wholly owned subsidiary company (SPV) and also issuance of pro rata shares by SPV

to the existing shareholders of the company in the ratio of two shares of the SPV for every one share of the company. The company also recommended a dividend of 45 per cent for the year ending March 31, 2006.

3. The company sent the information about the decision of the Board of Directors recommending dividend to the National Stock Exchange (NSE) on April 24, 2006 at 09.21 hours and the NSE disseminated the information on its website on the same day at 09:40:44 hours. The required information was also sent by the company to the Bombay Stock Exchange (BSE) on April 23, 2006 (Sunday) at 10:47 hours and the BSE disseminated the said information on its website on April 24, 2006 at 09:53:25 hours. The decision regarding demerger of FM radio business was also sent by the company to NSE on April 24, 2006 at 09.21 hours which was disseminated by NSE on its website at 09:40:44 hours. The same information was sent by the company to BSE on April 23, 2006 at 10:46 hours which was disseminated by BSE on its website at 09:56:35 hours on April 24, 2006. It was noted by the Board from the trade logs and order logs of April 24, 2006 that the appellant had sold 10,00,000 shares of the company. 7,50,000 shares were sold between 10:11:30 hours to 10:12:34 hours and 2,50,000 shares were sold at 15:16:44 hours. The sale of 10,00,000 shares was reported to BSE under bulk deal. The Board observed that the appellant had sold these shares of the company before the expiry of 24 hours of the outcome of the Board being made public and thus violated Regulation 12(1) read with clauses 3.2-3 and 3.2-5 of the code of conduct prescribed under Part A of Schedule I of the Regulations. Adjudication proceedings were initiated and a show cause notice was issued to the appellant on February 21, 2008. The appellant responded to the same by his letter dated April 10, 2008 denying the allegation and stating that the sale of shares was a normal market transaction. The outcome of the Board meeting held on April 23, 2006 had no impact on the stock price of the company and by selling the shares on April 24, 2006 he had not made any financial gain. It was submitted by him that the sale was not based on any insider information since the decision of the Board had already been sent to the stock exchanges and was disseminated on the website of the stock exchanges. It was further submitted that the sale of shares before expiry of 24 hours of the outcome of the Board meeting being made public was purely an inadvertent and technical error and there was no malafide intention. The appellant also desired to avail the facility of consent order in the proceedings. It seems that the consent proceedings

failed. The adjudicating officer, by his impugned order, found the appellant guilty of violating Regulation 12(1) read with Clause 3.2-3 and 3.2-5 of the code of conduct specified under Part A of Schedule I of the Regulations and imposed a penalty of Rs.1 crore under section 15HB of the Act. Hence this appeal.

4. For the purposes of model code of conduct for prevention of Insider Trading for listed companies, under Part A of Schedule I, the term 'designated employee' is defined to include:-

> "(1) officers comprising of the top three tiers of company management;
>
> (2) the employees designated by the company to whom these trading restrictions shall be applicable keeping in mind the objective of the Code of conduct."

Admittedly, the appellant is a shareholder and director of the company and classified as designated employee under the Regulations. Para 3.2-5 of Part A in Schedule I under the Regulations provide that all directors/officers/designated employees of the company shall conduct their dealings in the securities of the company only in a valid trading window and shall not deal in any transaction involving purchase or sale of the company's securities during the period when trading window is closed. It also provides that the trading window shall inter alia be closed at the time of declaration of financial results, declaration of dividend etc. The trading window shall be opened 24 hours after the information regarding the Board decisions is made public. The company can penalize and take appropriate action against an employee for contravention of the code of conduct. Such an action by the company does not preclude the Board from taking any action in case of violation of the Regulations. It may also be relevant to state that Regulation 12 of the Regulations mandates all listed companies to frame a code of conduct of internal proceedings and conduct as near thereto the model code specified in Schedule I of the Regulations. The company, in compliance with the revised corporate governance norms advised by the Board, laid down a code of conduct for all Board members and senior management of the company. The said code of conduct mandated its employees to comply with the company's insider trading rules and follow the pre-clearance procedure for trading and trade only when the trading window is open.

5. Mr. Janak Dwarkadas, learned senior counsel for the appellant argued that the Regulations essentially prohibit dealing in securities by any person when in possession of

unpublished price sensitive information and that the information ceases to be price sensitive when it reaches the public domain. It was also argued that the rationale of closing trading window, as contained in clause 3.2-3 of the model code of conduct, is to prevent insiders from trading in securities while in possession of information which they alone possess. Referring to the provisions of the model code, it was submitted that the length of time for which the trading window should be shut is left to the discretion of the listing company. The fact that the information on the outcome of the meeting was communicated to the exchanges on April 23, 2006 in compliance with the listing agreement was demonstrated by the fact of issuance of press release immediately after the meeting on April 23, 2006. It was also argued that the show cause notice proceeds on the incorrect presumption that the information is deemed to have been made public only when the exchange uploads the same on its website. According to him, Regulation 12 of the Regulations casts a duty upon listed companies to formulate the code of conduct as specified therein and it is for the listed company concerned to take action for violation of the code, if any. It was further submitted that the appellant cannot be proceeded against under section 15HB of the Act as it cannot be alleged that the appellant had violated any provisions of the Act or Regulations made thereunder which is a pre-requisite for invoking the said section. The appellant has neither violated any provisions of the Act nor of the Regulations and hence no penalty can be imposed under section 15HB of the Act. Assuming that there was any violation of the code of conduct framed by the company, as mandated by Regulation 12, it was for the company to take action against the appellant and not for the Board. Learned senior counsel also pointed out that a show cause notice was issued to the company also in this case and the request for consent proceedings in respect of the company was accepted by the Board and the company was let off on payment of a sum of ₹15 lacs. The appellant also requested for consent proceedings but the Board has not agreed to the same and has imposed a penalty of ₹ 1 crore which is the maximum penalty prescribed under the Act which, in the facts and circumstances of the case, is excessive and uncalled for. Learned senior counsel reiterated that the model code of conduct prescribed in Schedule I of the Regulations is for the company to be adopted and hence not a part of the Regulations. Learned senior counsel has also drawn our attention to some other Regulations framed by the Board under the Act where, according to him code of conduct is an integral part of the Regulations but in the case in hand, Regulations

mandate the company to formulate a code of conduct for its employees based on the model code of conduct as prescribed in Schedule I of the Regulations. He emphasized that when the language of a statute is precise and clear it cannot be ignored. In support of his contention, he relied on the decision of the Supreme Court in case of Aphali Pharmaceuticals Ltd. vs. State of Maharashtra 1989(4) SCC 378 where the Supreme Court has observed that "expression in the Schedule cannot control or prevail against the express enactment and in case of any inconsistency between the Schedule and the enactment, the enactment is to prevail and if any part of the Schedule cannot be made to correspond, it must yield to the act." He also made reference to the Supreme Court judgment in the case of R. Kalyani vs. Janak C, Mehta & Ors. 2009 (1) SCC 516 where the Supreme Court has quoted with approval a passage from Maxwell on interpretation of statutes:-

> "The strict construction of penal statutes seems to manifest itself in four ways: in the requirement of express language for the creation of an offence; in interpreting strictly words setting out the elements of an offence; in requiring the fulfillment to the letter of statutory conditions precedent to the infliction of punishment; and in insisting on the strict observance of technical provisions concerning criminal procedure and jurisdiction."

According to the counsel, it is not the appellant's case that a breach of the code of conduct is not at all actionable. According to him, such action has to be taken by the company and not by the Board. The appellant had requested for permission to sell his shares in accordance with the provisions of the code of conduct. His trades were pre-cleared by the company. If at all there was any violation, it was on the part of the company and the matter was settled by the Board with the company on payment of an amount of ₹ 15 lacs. On the other hand, the appellant has been severely penalized by imposing maximum penalty of ₹ 1,00,00,000 for violation of the code of conduct.

6. Shri Darius Khambatta, learned Additional Solicitor General who appeared on behalf of the Board submitted that the undisputed fact is that the appellant sold 10,00,000 shares of the company on April 24, 2006 before the expiry of 24 hours of the outcome of the Board meeting of the company was made public. The Regulation mandates the company to formulate a code of conduct as near thereto the model code of conduct specified in Schedule I of the Regulations. Such a code was in existence which has been violated by the appellant by trading in shares of the company when the trading window was closed. The company had prepared its own internal code of conduct which prohibited the designated employees from selling or purchasing shares during trading period beginning

one exclusive day before and concluding one exclusive day after certain enumerated corporate actions. In his two letters dated July 22, 2008 and December 19, 2008 the appellant himself had admitted his lapse stating that it was an inadvertent and technical error. The company did not take any action against the appellant because he had resigned as managing director. If it is held that the Board also cannot take any action against the appellant because he had violated only the code of conduct formulated by the company, the appellant will go unpunished for a serious lapse on his part in selling his shares in violation of the code of conduct. Learned Additional Solicitor General further submitted that Regulations mandate the company to formulate a code of conduct for its employees which should be in conformity with the model code of conduct as prescribed in Schedule I of the Regulations. Such a code of conduct is as much a part of the statute as the provisions of the Regulations itself. According to him, it is no longer necessary for a statute to contain indulging words providing that the Schedule is to be construed and shall have effect as part of the Act. In support of his proposition, he relied on the decision of the Supreme Court in the case of Ujagar Prints vs. Union of India AIR 1989 SC 516, Aphali Pharmaceuticals Ltd. vs. State of Maharashtra 1989(4) SCC 393 and Bennion on Statutory Interpretation (Fifth Edition) page 721-723. According to him, the crucial question is whether or not the provisions in Schedule I of the Regulations form part of the Regulations, notwithstanding that there are no express words in the body of the Regulations providing that the Schedule is to be construed to have effect as a part thereof. According to him, the question is squarely answered in the affirmative by the ratio of the Supreme Court at paragraph 24 in the case of Ujagar prints. It was further submitted by him that the Board, as a regulator is the primary enforcing agency in respect of the violations whether of the Regulations or of any code of conduct framed in accordance with the Regulations. To leave it exclusively to the companies to enforce individual code of conduct is something that Parliament could not have intended while enacting the law. The language of the Regulation 12 makes it clear that once there is violation of the Regulations then nothing precludes the Board from initiating proceedings for such violation. It was, therefore, submitted by him that no interference is called for in the order passed by the adjudicating officer.

7. We have considered the submissions made by learned senior counsel for the parties. We have also perused the documents available on record. It needs to be noted that the charge against the appellant in the show cause notice is of violating Regulation 12(1) read

with clause 3.2-3 and 3.2-5 of the code of conduct specified under Part A of Schedule I of the Regulations. In the impugned order, the appellant has been held to be guilty of violating the provisions of code of conduct only. There is no allegation of insider trading against the appellant. It is not in dispute that the appellant had sold shares within the period when trading window was closed and thus violated the code of conduct prescribed by the company in terms of the obligations imposed upon it under the Regulations. The case of the appellant is that such violation of code of conduct does not amount to violation of the provisions of the Act or the Regulations framed thereunder and hence not punishable by the Board. It is for the company alone to take action against the appellants. The question that needs to be answered, therefore, is whether violation of the code of conduct formulated by the company in compliance with the requirements of Regulations amounts to violation of Regulations. Let us have a look at the relevant provisions of the Regulations. The Regulations were framed by the Board in exercise of the powers conferred by section 30 of the Act and with the previous approval of the Central Government. Regulation 3 thereof deals with prohibition of dealing, communicating or counseling in matters relating to insider trading and inter alia provides that 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 when in possession of any unpublished price sensitive information. Regulation 12 prescribes code of internal procedures and conduct for listed companies and other entities and reads as under:-

> **"Code of internal procedures and conduct for listed companies and other entities.**
>
> **12.** (1) All listed companies and organisations associated with securities markets including :
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> (*a*) the intermediaries as mentioned in section 12 of the Act, asset management company and trustees of mutual funds ;
>
> (*b*) the self-regulatory organisations recognised or authorised by the Board;
>
> (*c*) the recognised stock exchanges and clearing house or corporations;
>
> (*d*) the public financial institutions as defined in section 4A of the Companies Act, 1956; and
>
> *(e)* the professional firms such as auditors, accountancy firms, law firms, analysts, consultants, etc., assisting or advising listed companies,
>
> shall frame a code of internal procedures and conduct as near thereto the Model Code specified in Schedule I of these Regulations without diluting it in any manner and ensure compliance of the same.
>
> (2) The entities mentioned in sub-regulation (1), shall abide by the code of Corporate Disclosure Practices as specified in Schedule II of these Regulations.

(3) All entities mentioned in sub-regulation (1), shall adopt appropriate mechanisms and procedures to enforce the codes specified under sub-regulations (1) and (2).

(4) Action taken by the entities mentioned in sub-regulation (1) against any person for violation of the code under sub-regulation (3) shall not preclude the Board from initiating proceedings for violation of these Regulations."

Para 3 of the model code of conduct for prevention of insider trading for listed companies, as prescribed in Schedule I of the Regulations, makes provisions for prevention and misuse of price sensitive information and relevant portion thereof reads as under:-

"3.0 Prevention of misuse of "Price Sensitive Information"

3.1 All directors/officers and designated employees of the company shall be subject to trading restrictions as enumerated below.

3.2 Trading window

3.2.1 The company shall specify a trading period, to be called "trading window", for trading in the company's securities. The trading window shall be closed during the time the information referred to in para 3.2.3 is unpublished.

3.2.2 When the trading window is closed, the employees/directors shall not trade in the company's securities in such period.

3.2.3 The trading window shall be, *inter alia*, closed at the time :—

(*a*) Declaration of financial results (quarterly, half-yearly and annually).
(*b*) Declaration of dividends (interim and final).
(*c*) Issue of securities by way of public/rights/bonus etc.
(*d*) Any major expansion plans or execution of new projects.
(*e*) Amalgamation, mergers, takeovers and buy-back.
(*f*) Disposal of whole or substantially whole of the undertaking.
(*g*) Any changes in policies, plans or operations of the company.
3.2.3A The time for commencement of closing of trading window shall be decided by the company.

3.2-4 The trading window shall be opened 24 hours after the information referred to in para 3.2.3 is made public.

3.2-5 All directors/officers/designated employees of the company shall conduct all their dealings in the securities of the Company only in a valid trading window and shall not deal in any transaction involving the purchase or sale of the company's securities during the periods when trading window is closed, as referred to in para 3.2-3 or during any other period as may be specified by the Company from time to time."

Paragraph 5 of the code of conduct provide for reporting requirements for transactions in securities by all directors/officers/designated employees and the compliance officer of the company is required to maintain records of all such declaration in the appropriate form. Paragraph 6 thereof makes provision for penalty for contravention of code of conduct and reads as under:-

"6.0 Penalty for contravention of code of conduct

6.1 Any employee/officer/director who trades in securities or communicates any information for trading in securities in contravention of the code of conduct may be penalised and appropriate action may be taken by the company.

6.2 Employees/officers/directors of the company who violate the code of conduct shall also be subject to disciplinary action by the company, which may include wage freeze, suspension, ineligible for future participation in employee stock option plans, etc.

6.3 The action by the company shall not preclude SEBI from taking any action in case of violation of SEBI (Prohibition of Insider Trading) Regulations, 1992."

8. The company, vide letter dated February 25, 2003, had circulated a copy of the code of conduct to its officers including the appellant with a request to adhere to the provisions of the code and provide timely disclosures as stated therein. The main objective of the said circular was stated to be to prohibit the use of inside information and other price sensitive information to gain an advantage therefrom as compared to general investors while dealing in shares and securities of listed companies. The said circular makes a specific provision that any sale/purchase or acquisition of shares and securities by all directors/officers/designated employees shall not be allowed during a period of one exclusive day before and conclude one exclusive day after the specified corporate actions which include declaration of financial results and declaration of dividends etc. The company had also issued another circular on April 1, 2006 in compliance with the revised corporate governance norms advised by the Board vide its circular dated October 29, 2004 laying down code of conduct for all board members and senior management of the company. A copy of this letter is addressed to the appellant also. The said instructions mandate that the designated persons should comply with the companies insider trading rules, follow the pre-clearance procedure for trading and trade only during the trading window. It also provides that any sale/purchase or acquisition of shares and securities by all directors/officers/designated employees shall not be allowed during a period of one exclusive day and conclude one exclusive day after the specified corporate action including declaration of financial results and declaration of dividends.

9. Having considered the submissions made by learned counsel for the parties and after going through the records and the provisions of the regulations referred to above, we are of the considered view that the only possible conclusion that can be arrived at is that

the code of conduct prescribed by the company for prevention of insider trading as mandated by the Regulations for all practical purposes is to be treated as a part of the Regulations and any violation of the code of conduct can be dealt with by the Board as violation of the Regulations framed by it. It needs to be appreciated that each company may like to add certain activities regulation of which may be necessary for preservation of price sensitive information. The Board, cannot foresee all such contingencies and, therefore, it has laid down model code of conduct prescribing bare minimum conduct expected from the directors/designated employees of the companies. The framing of code of conduct as near to the model code of conduct specified in the Schedule to the Regulations is mandatory for each company. The use of the word "shall" makes it abundantly clear that this is a bare minimum conduct expected from the employees of the company. Paragraph 6 of the model code of conduct also makes it clear that the action by the company shall not preclude the Board from taking any action in case of violation of the Regulations.

10. Mr. Dwarkadas, learned senior counsel for the appellant, tried to distinguish the model code of conduct as prescribed in the Regulations from the code of conduct as prescribed in other Regulations framed by the Board and contended that it is only where the code of conduct forms part of the Regulation, the violation of the code of conduct, will become punishable for violation of Regulations but if the code of conduct is prescribed by the company on the basis of model code of conduct given in the Regulations, such code of conduct will not be punishable with violation of the code of conduct framed under the Regulations. We do not agree with him. As stated above, the different nomenclature given to the code of conduct as a model code of conduct is to provide sufficient leverage to the company to make additions to the bare minimum code as prescribed in the Schedule to the Regulations.

11. The provisions of the Regulations have to be interpreted keeping in view the aims and objectives of the Act. The main object of the Act is to protect the interest of investors in securities and to promote the development of and to regulate the securities market. In case the interpretation given by learned senior counsel for the appellant is accepted, it may lead to a situation where a person is not punished by the company for violating the code of conduct based on the model code of conduct prescribed in the Regulations and the Board finds itself unable to take action because the code of conduct is framed by the company. In

fact this is what has precisely happened in this case. The company vide its letter dated February 11, 2008 has informed the Board that the appellant resigned from the office of the Managing Director and it was not possible to persue any action against him and the company decided to close the matter. We have given our thoughtful consideration to the judgments cited by learned senior counsel for the appellant and we are of the considered view that the ratio of those judgments is not applicable to the case in hand. The purpose of the insider trading regulations is to prohibit trading by which an insider gains advantages by virtue of his access to price sensitive information. The evil of insider trading is well recognized. A construction should be adopted that advance rather than suppress this object. To adopt the construction as suggested by learned senior counsel for the appellant would result in allowing insider trading within a period set by the Board or by the company during which no trading is permissible. In the case of L.I.C. vs. Escorts Ltd. 1986 (1) SCC 264, relied upon by the learned counsel for the appellant, the Supreme Court merely held that the provision of the Foreign Exchange Manual under consideration was by way of a suggestion rather than a mandate and that a form could not control the provisions of the Act. This is not the case here. In Pepsico India Holding P. Ltd. vs. Food Inspector, decided by the Supreme Court on November 18, 2010, the Act did not contain any prescribed and validated method of analysis and hence it was held that there had been no violation by not sending a sample to Forensic Laboratory for testing with regard to any different tolerance limit as to the presence of pesticides. This case has no application to the facts of the present case since Schedule I is a part of the Regulations and mandates the company to formulate a code of conduct as prescribed therein.

12. We are, therefore, of the considered view that violation of the code of conduct, as framed by the company in accordance with the mandates prescribed in the Regulations, is nothing but part of the Regulations and any violation thereof is punishable by the Board also as violation of the Regulations in addition to such action that may be taken by the company. Any other view taken in the facts and circumstances of the case will defeat the very purpose of the Regulations in question.

13. We would now like to deal with the issue of penalty imposed on the appellant by the Board. The learned counsel for the appellant has placed on record a copy of the order showing that adjudication proceedings were initiated against the company also for alleged opening of the trading window before the expiry of 24 hours thereby violating Regulation

12(1) read with clause 3.2-3 and 3.2-4 of the code of conduct specified under Part A of Schedule I to the Regulations. The company had settled the dispute with the Board by payment of a settlement amount of ₹ 15 lacs but the appellant has been severely punished. Learned senior counsel for the appellant submitted that if a breach by the listed company in administering the code of conduct in a manner that fell short of compliance is treated as a technical violation, it is not open to the Board to treat the appellant's sale of shares as a substantive violation warranting the maximum penalty that can be imposed for violation of the insider trading regulations. We find merit in this argument of learned senior counsel for the appellant. The charge is not of violation of insider trading regulations but only of violation of the code of conduct by selling shares during the period when trading window was closed and after the decision of the Board was communicated to the stock exchanges and disseminated on their websites. The company has also settled the dispute with the Board on payment of settlement amount of ₹ 15 lacs. In the facts and circumstances of the case, we are of the considered view that the ends of justice would be met if the penalty under section 15HB of the Act is reduced to ₹ 25 lacs. We order accordingly.

In the result, we uphold the finding of the adjudicating officer that the appellant had violated the provisions of the code of conduct framed under the Regulations and is liable to penalty under section 15HB of the Act. However, the amount of penalty is reduced to ₹ 25 lacs. There will be no order as to costs.

Sd/-
P.K. Malhotra
Member

I have gone through the order prepared by the learned Member and I agree that the appellant is guilty of violating the code of conduct as alleged and that the penalty be reduced to ₹ 25 lacs.

Sd/-
Justice N.K.Sodhi
Presiding Officer

I also agree.

Sd/-
S.S.N. Moorthy
Member

27.05.2011
Prepared & Compared by:
RHN/PMB