

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved On: 04.05.2018
Date of Decision : 30.05.2018

Appeal No. 222 of 2016

1. Pat Financial Consultants Pvt. Ltd.
3-3A, Churchgate House, 1st Floor,
32/34, Veer Nariman Road,
Fort, Mumbai- 400 001

2. Superior Financial Consultancy Services Pvt. Ltd.
201/B, Dev Neo Vikram,
Sahakar Nagar C.H.S.,
New Link Road,
Andheri (West)
Mumbai-400 053

...Appellants

Versus

Securities and Exchange Board of India,
SEBI Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai- 400 051

...Respondent

Mr. P. N. Modi, Senior Advocate with Mr. Neville Lashkari and
Mr. Rihal Kazi, Advocates i/b M&M Legal for Appellants.

Mr. Kumar Desai, Advocate with Mr. Mihir Mody and Mr. Nishant
Upadhyay, Advocates i/b K. Ashar & Co. for the Respondent.

WITH
Appeal No. 281 of 2016

Avadhoot L. Shilotri
C/o Atul S. Tungare and
Amit A. Tungare, Advocates,
High Court, 1A/14,
“Sahyadri”, Asha Nagar, Off 90 Ft. Road,
Kandivali (East),
Mumbai- 400 101

...Appellant

Versus

Securities and Exchange Board of India,
SEBI Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai- 400 051

...Respondent

Mr. Atul S. Tungare, Advocate for the Appellant.

Mr. Shyam Mehta, Senior Advocate with Mr. Mihir Mody and Mr. Nishant Upadhyay, Advocates i/b K. Ashar & Co. for the Respondent.

CORAM: Justice J.P. Devadhar, Presiding Officer
Dr. C.K.G. Nair, Member

Per: Justice J.P. Devadhar

1. These two appeals are filed to challenge the order passed by the Whole Time Member (“WTM” for short) of Securities and Exchange Board of India (“SEBI” for short) on 21.06.2016. By that order appellants in both the appeals are held to have violated Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (“PFUTP Regulations” for short) and accordingly restrained from accessing the securities market and prohibited from buying, selling or otherwise dealing in the securities market for a period of three years. Additionally appellant in Appeal No. 281 of 2016 is also restrained from holding any key managerial position in any listed company for a period of three years.

2. Since dispute in these two appeals arise from facts which are common, both these appeals are heard together and disposed of by this common decision.

3. Investigation in the present case commenced on SEBI receiving a complaint in April 2001 that Tata Finance Limited (“TFL”) a Non Banking Finance Company (NBFC) had made false disclosures in its

‘letter of offer’ dated 20.03.2001 issued in relation to the rights issue of 9% Cumulative Convertible Preference Shares (CCPS). The complaint was that TFL had failed to disclose in the ‘letter of offer’ the losses incurred by Niskalp Investment and Trading Company (“Niskalp”), a subsidiary of TFL.

4. On SEBI seeking comments, TFL by a letter dated 30.04.2001 informed its shareholders that Niskalp had incurred an actual loss of ₹ 14.57 crore as on 30.09.2000 and a provisional loss of ₹ 79.37 crore for the year ended 31.03.2001 as against a disclosed profit of ₹ 11.46 crore for the six months period ended 30.09.2000. By that letter, TFL gave an option to the applicants to the rights issue to withdraw their subscription.

5. Thereafter, TFL conducted an inquiry in relation to the financials of Niskalp as recorded in the ‘letter of offer’ dated 20.03.2001 and by a letter dated 18.10.2002 TFL complained to SEBI that on account of certain back dated transaction of sale and purchase in the shares of Global Telesystems Ltd. (“GTL”) and Global E-Commerce Services Ltd. (“GECS”) losses in the books of Niskalp as on 30.09.2000 were lower than the losses reflected as on 31.12.2000. Accordingly, SEBI conducted investigation and arrived at a conclusion that back dating of the transactions of sale of shares of GTL and GECS in September 2000 and reversal of such trades in December 2000 were at the behest of Mr. D.S. Pendse (the then Managing Director of TFL and Ex-Director of Niskalp), Mr. A. L. Shilotri (the then Chief Executive Officer of Niskalp) in

connivance with the broking firms/ entities connected to Mr. Bharat J. Patel and his relatives/ associates.

6. In the show cause notice issued by SEBI on 04.05.2009 to Mr. D.S. Pendse and Mr. A. L. Shilotri it was alleged that the back dating of the transactions of sale and accounting entries in the scrip of GTL and GECS were made in the books of Niskalp in order to give a better picture of its half yearly accounts in the 'letter of offer' of TFL and thereby induce the investors to subscribe to the rights issue of TFL.

7. Similarly, in the show cause notice issued to Pat Financial Consultants Pvt. Ltd ("Pat" for convenience) and Superior Financial Consultancy Services Pvt. Ltd. ("Superior") who are appellants in Appeal No. 222 of 2016 it was alleged that they had aided and abetted Mr. D. S. Pendse and Mr. A. L. Shilotri by executing back dated transactions of sale and purchase of GTL and GECS shares on 29.09.2000 and 28.11.2000 respectively.

8. Appellants in their reply denied the allegations made in the respective show cause notices. After giving an opportunity of hearing to the appellants, the WTM of SEBI has passed the impugned order. Issues framed at para 15 of the impugned order by the WTM of SEBI reads thus:-

“a) Whether there was any mis-statement in the 'letter of offer' of the rights issue of TFL?

- a) *Whether such mis-statement was due to any falsification of records? If yes, then who were responsible for the same?"*

FIRST ISSUE

9. With reference to the first issue, in para 16 of the impugned order it is held that SEBI had received a complaint in April 2001 alleging non-disclosure of losses of Niskalp in the 'letter of offer' issued by TFL. On SEBI seeking comments, TFL by its letter dated 30.04.2001 informed its shareholders that there was substantial erosion in the value of the stocks held by it and that Niskalp had incurred an actual loss of ₹ 14.57 crore as on 30.09.2000 and a provisional loss of ₹ 79.37 crore for the year ended 31.03.2001, as against the disclosed profit of ₹ 11.46 crore for the six months period ended September 2000. By that letter TFL gave an option to the applicants in the rights issue to withdraw their subscriptions.

10. In view of the above, the WTM of SEBI concluded that TFL had made false disclosures in its letter of offer about the financials of Niskalp and that the said false disclosure was corrected by issuing the aforesaid letter dated 30.04.2001. First issue was answered accordingly by holding that TFL had made false disclosures in its letter of offer dated 20.03.2001. However, strangely, even after holding TFL guilty of making false disclosures in the letter of offer, no action has been taken against TFL. It is obvious that for extraneous reasons TFL has been let off even after holding TFL guilty of committing serious violations.

SECOND ISSUE

11. In paras 17 to 21 of the impugned order, the WTM has held that false declarations were made in the letter of offer by TFL in view of the fictitious profits recorded in the books of account of Niskalp. According to SEBI, Mr. D. S. Pendse who had signed the letter of offer as a Director of Niskalp, Mr. Shilotri CEO of Niskalp and Pat and Superior (brokers) were responsible for the said fictitious entries made in the books of Niskalp and accordingly issued the impugned directions against the appellants which are challenged in these appeals.

12. Mr. Shilotri is held responsible, because, as the CEO of Niskalp he was required to be aware of the financial transactions of Niskalp and that Mr. Shilotri had not raised any voice or concern when the losses were converted to profits in the hands of Niskalp. Similarly, the WTM has held that Pat and Superior by recording fictitious transactions in their letters dated 29.09.2000 and 28.11.2000 have aided and abetted Niskalp in making backdated /fictitious transactions in the scrip of GECS.

13. At the outset, it is relevant to note that false declaration was made by TFL in its letter of offer, however, instead of taking action against TFL, action is inter alia taken against Mr. Shilotri on the presumption that as CEO of Niskalp he was required to be aware about the financial transactions of Niskalp and that he had not raised his voice or concern when fictitious profits were recorded in the books of Niskalp. It is equally important to note that no action has been taken against Niskalp.

Where false declarations/ false entries in the books of account of a company are noticed, invariably SEBI takes action not only against the company but also against its Board of Directors and other connected persons responsible for the false declarations/ false entries in the books of account. Why no action has been taken against TFL and Niskalp even after recording that they are guilty of committing serious violations is neither explained in the impugned order nor before us.

14. Fact that SEBI erroneously and for extraneous reasons failed and neglected to take action against TFL and Niskalp, cannot be a ground for the appellants to escape liability if they are also guilty of committing violations. Question, therefore, to be considered is, whether, SEBI is justified in holding that the appellants herein are guilty of violating PFUTP Regulations and accordingly issuing the impugned directions against the appellants.

15. Before considering merits of rival contentions, we may note the following relevant facts:-

- a) Niskalp was a wholly owned subsidiary of TFL as TFL was holding 99% shares of Niskalp. Office of Niskalp was in the office premises of TFL. Niskalp was managed by the Board of TFL of which Mr. Pendse was the Managing Director. Niskalp had no staff of its own and the books of accounts were maintained by the staff of TFL. Niskalp was an

investment arm of TFL and its business was to make investments from and out of the funds provided by TFL.

- b) On 04.01.2001 the Board of TFL decided to come out with the rights issue of 9% CCPS. TFL was required to furnish the financial statements of its subsidiaries in its letter of offer inter alia including Niskalp. Since Niskalp had incurred losses at the relevant time, according to SEBI, Mr. Pendse and Mr. Shilotri, in March 2001 engineered execution of fictitious transactions on behalf of Niskalp in complicity with Pat and Superior. Accordingly, backdated letters dated 29.09.2000 and 28.11.2000 were issued by Pat and Superior respectively.
- c) As per the backdated letter dated 29.09.2000, Pat had sold 16,35,100 shares of GECS on behalf of Niskalp @ 310/- per share less brokerage (delivery of shares within two months and payment within 7 days after delivery). Similarly, by the backdated letter dated 28.11.2000, Superior intimated to Niskalp that 16,35,100 shares of GECS have been purchased back on behalf of Niskalp @ ₹ 310/- per share plus brokerage (delivery within 7 days and payments immediately thereafter).

- d) Admittedly, name of the person to whom the shares of GECS were sold by Pat on behalf of Niskalp was not disclosed in the letter dated 29.09.2000. Admittedly, no physical/ demat transfer of GECS shares took place and admittedly no amount was received by Niskalp on account of alleged sale of shares. In such a case, neither Pat was justified in recording the sale transaction in its books and issuing a letter on 29.09.2000 about the sale of GECS shares to Niskalp nor Niskalp was justified in recording profits in its books on the basis of the alleged sale transaction which had not actually taken place.
- e) Similarly, Superior was not justified in recording the purchase transaction by its letter dated 28.11.2000 when in fact the shares of GECS were not transferred from the demat account of Niskalp.
- f) Appellants claim that the proposed transactions took place on 29.09.2000 and 28.11.2000 respectively. According to SEBI the above fictitious transactions were planned in March 2001 and backdated to 29.09.2000 and 28.11.2000. In either case, there was no reason for TFL to take the financials of Niskalp as on 30.09.2000 instead of taking financials of Niskalp as on 31.12.2000 in the letter of offer dated

20.03.2001. Admittedly, TFL in its letter of offer had taken the financials of all subsidiaries as on 31.12.2000 except in the case of Niskalp, wherein, the financials of Niskalp as on 30.09.2000 was taken into account. SEBI has failed to consider the motive behind TFL taking the financials of Niskalp as on 30.09.2000.

16. With these facts on record we may now consider merits of the rival contentions raised in the respective appeals.

Mr. A. L. Shilotri (Appellant in Appeal No. 281 of 2016)

17. Basic argument of Mr. Shilotri is that as CEO of Niskalp his main job was to recommend investments in stock market to the Board of Niskalp by using his knowledge and experience in investment and finance. It is further contended that Niskalp was managed by the Board of TFL and there being no staff of Niskalp, all the books of accounts of Niskalp were maintained in the regular course of business by the staff on the pay roll of TFL. It is also contended that Mr. P. B. Karyekar, Company Secretary of Niskalp never reported to Mr. Shilotri and at all times he had reported to Mr. Ramanujam, Chief Financial Officer of TFL. Accordingly, it is submitted that since Mr. Shilotri was in no way concerned with the fictitious sale/ purchase of GECS shares, impugned directions issued against Mr. Shilotri are wholly unjustified.

18. None of the aforesaid facts are disputed by SEBI. However, on behalf of SEBI it is contended that since Mr. Shilotri was closely involved in the management of TFL and Niskalp and was involved in the sale and purchase of shares on behalf of Niskalp, the WTM of SEBI was justified in arriving at a conclusion that Mr. Shilotri was required to be aware of the financial transactions of Niskalp. Since Mr. Shilotri had not raised any voice on concern when the losses were converted to profits in the hands of Niskalp, the WTM of SEBI was justified in issuing impugned directions against Mr. Shilotri.

19. In our opinion, directions issued by the WTM of SEBI against Mr. Shilotri are unjustified for the following reasons:-

- a) Fact that the books of account of Niskalp were maintained by the employees of TFL is not disputed by SEBI. Without holding the staff of TFL who had written the books of Niskalp and without establishing any role played by Mr. Shilotri in making the employees of TFL to record in the books of Niskalp, fictitious sale/ purchase of GECS shares held by Niskalp, the WTM of SEBI was not justified in holding Mr. Shilotri was aware of the fictitious transactions and that he had failed to raise his voice against fictitious profits being recorded in the books of Niskalp in violation of the PFUTP Regulations.

b) Assuming that the backdated sale/ purchase transactions in the shares of GECS were planned in March 2001 i.e. after Mr. Shilotri took over as CEO of Niskalp in February 2001, if TFL in its wisdom deemed it fit to take the financials of Niskalp as on 30.09.2000, instead of the financials as on 31.12.2000, Mr. Shilotri could not be blamed, because Mr. Shilotri had ceased to be an employee of TFL from February 2001. If financials of Niskalp as on 31.12.2000 were taken by TFL in its letter of offer, then the present dispute would not have arisen at all. Thus, for the failure on part of TFL and SEBI in not considering the financials of Niskalp as on 31.12.2000 which was available before issuance of the letter of offer, has led to miscarriage of justice.

c) Very fact that the WTM of SEBI has recorded that the auditor of Niskalp ideally should not have allowed booking of profits on proposed sale of GECS shares on 29.09.2000 clearly shows that according to the WTM, recording of such notional profit was not illegal or fraudulent or misleading. In such a case, having held that no action need be taken against the auditor of Niskalp for allowing the recording of notional profits in the quarter ended December 2000, the WTM is not justified in taking action against

Mr. Shilotri on the presumption that as CEO of Niskalp he must be aware of such profits being booked by Niskalp. As the profits were booked on the basis of the proposed sale of shares set out in letter dated 29.09.2000, the said profits must have been reversed on basis of reversal transaction contained in the letter dated 28.11.2000. Without looking to the fact as to how Niskalp had given effect to the letter dated 28.11.2000 in its books of account, SEBI is not justified in holding Mr. Shilotri guilty of violating PFUTP Regulations, merely because TFL in its letter of offer had failed to consider the financials of Niskalp as on 31.12.2000.

- d) Reliance placed by SEBI on its earlier order dated 02.01.2004 in the matter of TFL relating to insider trading wherein, it was held that Mr. Shilotri was hand in glove with Mr. D. S. Pendse is wholly misplaced because, firstly in the show cause notice no reference was made to the above decision. Secondly, the issue raised in that decision is in no way connected to the issue raised in the present case. Thirdly, even according to SEBI recording notional profits on account of proposed sale of GECS shares on 29.09.2000 was not illegal or misleading. In such a case, taking action against Mr. Shilotri by placing

reliance on the order of SEBI dated 02.01.2004 is wholly unjustified. For the same reason, reliance placed by SEBI on the decision of this Tribunal dated 21.05.2004 is also wholly misplaced.

20. For all the aforesaid reasons, in our opinion, impugned directions issued against Mr. Shilotri merely on the presumption that he must be aware of the financials of Niskalp as on 30.09.2000 is unsustainable, because on the same presumption Mr. Shilotri must also be aware of the financials of Niskalp as on 31.12.2000. In such a case taking action against Mr. Shilotri only on basis of financials of Niskalp as on 30.09.2000 is wholly unjustified.

Pat and Superior (Appellants in Appeal No. 222 of 2016)

21. By the impugned order it is held that by issuing letters dated 29.09.2000 and 28.11.2000 regarding the fictitious transactions, Pat and Superior have aided and abetted Niskalp in making backdated/ fictitious transactions in the shares of GECS. Admittedly no action is taken against Niskalp. If no action is taken against the main culprit, then SEBI is not justified in taking action against the appellants who are alleged to have aided and abetted Niskalp in making backdated fictitious transactions.

22. Specific case of Pat was that Mr. D. S. Pendse and Mr. A. L. Shilotri had approached its Director Mr. Bharat Patel and told him that

they had negotiated with a foreign party (whose identity was not disclosed) for purchase of 16,35,100 shares of GECS @ ₹ 310 per share, but the RBI permission was awaited for the proposed transaction. As Mr. Bharat Patel was asked to act as a middleman, the letter was issued on 29.09.2000 recording the agreement to sell the shares where it was specifically stated that delivery of shares would be within 2 months and payment would be 7 days after the delivery. As the said transaction did not go through, letter dated 28.11.2000 was issued by Superior (after the transaction was transferred from Pat to Superior) with a view to square off/ close out the open obligation.

23. On the basis of above letter dated 29.09.2000 Niskalp had booked profit on the basis that 16,35,100 shares of GECS have been sold @ ₹ 310 per share, when in fact actual sale had not taken place and no amount was received by Niskalp. There is nothing on record to suggest as to how the transaction has been squared off in the books of Niskalp on the basis of letter dated 28.11.2000. When sale transaction dated 29.09.2000 was nullified by purchase transaction dated 28.11.2000, SEBI is not justified in holding the appellants liable for the notional profits recorded by Niskalp on the basis of the letter dated 29.09.2000, by ignoring reversal transaction that took place as recorded in the letter dated 28.11.2000.

24. The letters issued by Pat and Superior which specifically recorded agreement to sell/ purchase shares could not be a ground for Niskalp to book profits when the shares were actually not sold and no amount was received. In any case according to SEBI booking profits in such

transactions was not illegal, because, in the case of the auditor who audited the books of Niskalp, SEBI has held that ideally the profits in such cases ought not to have been recorded and accordingly has not taken any action against the auditor of Niskalp. In such a case, where recording of profits is not found to be illegal, holding Pat and Superior guilty of issuing fictitious letters is wholly unjustified.

25. Assuming that the letters issued by Pat and Superior were backdated letters, it was obligatory on part of SEBI to consider as to how both letters were given effect to in the books of Niskalp. Merely because TFL for extraneous reasons chose to take the financials of Niskalp as on 30.09.2000 in its letter of offer, SEBI could not have restricted its investigation up to 30.09.2000. Failure on part of SEBI to consider the scope and effect of the letter dated 28.11.2000 in the books of Niskalp clearly shows that SEBI had not carried out impartial investigation which does not befit to the status of a market regulator. Very fact that SEBI even after holding that TFL is guilty of making false declarations in the letter of offer and Niskalp is guilty of booking fictitious profits has chosen not to take action against TFL, Niskalp and the auditor of Niskalp but chose to indict the appellants on the basis of perfunctory investigation clearly shows that SEBI has indulged in shielding the main culprits at the cost of the appellants which is detrimental to the interests of securities market.

26. However, conduct of Pat in transferring the sale transaction dated 29.09.2000 (which admittedly did not take place) to Superior cannot be

said to be a transaction carried out in the ordinary course of business. If agreement to sell shares set out in the letter dated 29.09.2000 did not go through then the proper course was to cancel the agreement. Very fact that Pat transferred the transaction to Superior and Superior by letter dated 28.11.2000 purported to sell same number of shares to Niskalp with brokerage clearly shows that it was not a genuine transaction. Moreover, very fact that neither Pat nor Superior have initiated proceedings against Niskalp for recovery of the brokerage which they were entitled to under the letters dated 29.09.2000 and 28.11.2000 clearly shows that the transactions recorded in the said letters were not genuine transactions. However, fact that Niskalp booked profits on the basis of letter dated 29.09.2000 and TFL chose to take financials of Niskalp only for the quarter ended on 30.09.2000 cannot be a ground for SEBI to take action against Pat and Superior because, if the transaction contained in the letter dated 28.11.2000 were also taken into consideration, then there would not be any case for taking action against Pat and Superior. Failure on part of SEBI to investigate as to how the letter of Superior dated 28.11.2000 was given effect to in the books of Niskalp and why TFL in its letter of offer chose to take the financial status of Niskalp as on 30.09.2000 instead of the financial status of Niskalp as on 31.12.2000, had led to miscarriage of justice.

27. For all the aforesaid reasons, we hold that issuance of the letters recording agreement to sell/ purchase shares being not per se illegal, SEBI is not justified in passing the impugned order against Pat and

Superior especially when no action is taken against TFL, Niskalp and the auditor of Niskalp.

28. In the result, we pass the following order:-

- a) Even after holding that Tata Finance Limited (TFL) is guilty of making false declarations in its letter of offer, SEBI has failed to take action against TFL which is not only unusual but also bound to send wrong signal to the securities market.
- b) For the reasons stated above, both appeals are allowed by quashing the directions issued by SEBI against the respective appellants, however, appellants in Appeal No. 222 of 2016 are warned to be careful in future while dealing in securities.

29. Both appeals are disposed of in the aforesaid terms with no order as to costs.

Sd/-
Justice J.P. Devadhar
Presiding Officer

Sd/-
Dr. C.K.G. Nair
Member