

**BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI**

Appeal No. 94 of 2007

Date of decision: 1.7.2008

1. Satyanarayana Agarwal
2. Vivek Agarwal
3. Umah Agarwal
4. Siddhartha Agarwal
5. Satyanarayana Vivek Kumar (HUF)
6. M/s. Prabhu Securities Ltd.
7. M/s. Boruka Engineering Industries Ltd.
8. M/s. Pragma Enterprises
9. Umah Agarwal (Partner of Pragma Enterprises)
10. Vivek Agarwal (Partner of Pragma Enterprises)
11. Satyanarayana Agarwal (Partner of Pragma Enterprises) Appellants

Versus

Adjudicating Officer, Respondent
Securities and Exchange Board of India

Mr. P.N. Modi Advocate with Mr. Vinay Chauhan Advocate for Appellants.

Mr. J.J. Bhatt Senior Advocate with Dr. Poornima Advani and Ms. Sejal Shah Advocates for the Respondent.

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

Per: Utpal Bhattacharya, Member

In this appeal, Shri Satyanarayana Agarwal and other promoters of Boruka Financial Services Limited (BFSL for short), a company listed on the Bangalore Stock Exchange (BgSE for short) have challenged the order dated 20.2.2007 passed by the Adjudicating Officer of the Securities and Exchange Board of India (the Board for short) imposing a penalty of Rs.1 crore on them collectively under section 23H of the Securities Contracts (Regulation) Act (SCRA for short) for violation of section 19 thereof.

2. The facts of the case may be noted at the outset. BFSL is a non-banking finance company incorporated in 1971. It held land admeasuring 15 acres at Bangalore since June 2004. The promoters of BFSL wanted to sell off the land and DLF Commercial Developers Limited (DLF for short), a public limited company was agreeable to purchase the same. Since the sale of this land would attract short term capital gains tax for the

seller and stamp duty for the buyer, it was decided by them to carry out the transaction as a sale of the entire shareholding of the promoters of BFSL through a recognized stock exchange which would not attract either the tax or the duty. The adjudicating officer in his order has accepted such tax planning as legal and justified; in any case, this was not an issue before him for adjudication. The appellants, as promoters of BFSL, held 98.73 per cent of the equity shares of the company; the remaining shares were held by only 26 public shareholders. Since the acquisition of the shares of the promoters by DLF would trigger the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 and a public offer for acquisition of shares would be necessary, DLF applied to the Board in October 2004 seeking exemption from making the public offer and observing other connected procedures and formalities. Since there were only 26 public shareholders and DLF was willing to make an offer to all of them by issuing individual registered acknowledgement due letters, the Board on 29.6.2005 agreed to grant the exemption applied for by DLF. Prior to this, the appellants had approached BgSE requesting that their trading of the shares with DLF may be carried out on that stock exchange. According to the appellants this request for trading was turned down by the Executive Director of BgSE on 18.1.2005. In June 2005, the appellants got in touch with one Bimal Kumar Agarwal (Bimal for short), Director of Rajat Share and Stock Brokers Private Limited (Rajat for short), a member broker of Magadh Stock Exchange Association (MSEA for short). At that time there was no trading on MSEA but Bimal informed the appellants that trading on MSEA would start shortly and as and when that happened, the shares of BFSL could be traded on that stock exchange under the permitted category of shares, subject to the permission of MSEA. On 27.7.2005 a notification was issued by MSEA stating, inter alia, that trading on the exchange was going to commence shortly. Trading commenced on MSEA from 1.8.2005 and on being informed by Bimal that MSEA had permitted trading in the scrip of BFSL on its floor, the appellants and DLF traded between them on MSEA in the shares of BFSL between 1.8.2005 and 12.8.2005 at the finally negotiated price of Rs.4490 per share. The transactions were executed by Rajat as the broker for both the parties. The Board took the

view that by executing the trades in the sale of the shares of BFSL on the floor of MSEA between 1.8.2005 and 12.8.2005, the appellants violated the provisions of section 19 of SCRA since MSEA did not have the statutory recognition as a stock exchange. A show cause notice to that effect was issued to them which led to the imposition of the penalty of Rs 1 crore after adjudication proceedings.

Section 19 of SCRA reads as under:

“19. (1) No person shall, except with the permission of the Central Government, organise or assist in organizing or be a member of any stock exchange (other than a recognized stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities.

(2) This section shall come into force in any State or area on such date as the Central Government may, by notification in the Official Gazette, appoint.”

3. At this stage it is necessary for us to take a look into the status of MSEA as a recognized stock exchange. MSEA was first recognised by the Government of India under section 4 of SCRA in December 1986. Due to breakdown in internal administration of the exchange and the malfunction of the Council of Management (CoM) of MSEA, the CoM was superseded by the Board in December 1997 under section 11 of SCRA and remained superseded till 7.6.2000. The recognition of MSEA was renewed by the Board for three years on 9.12.2000 and was again renewed on 19.2.2004. MSEA was granted recognition for a further period of one year with effect from 11.12.2004 subject to the following conditions:

- “(i) The Exchange shall set up Settlement Guarantee Fund in compliance with SEBI Circular SMD/POLICY/SUB BROKER/Cir-12/97 dated June 09, 1997, after final approval by SEBI.
- (ii) Trading shall commence only after setting up of Settlement Guarantee Fund, duly approved by SEBI.
- (iii) The Exchange shall repay the balance amount of Rs.7,50,000/- (Seven Lakhs fifty thousand only) towards refundable financial support extended by SEBI to the Exchange.”

The appellants pointed out the fact that in the website of the Board, MSEA was shown as a recognised stock exchange during the relevant time without any mention about trading not being permitted there. It was also pointed out by the learned counsel for the

appellants that it was finally on 3.9.2007 that the Board issued a notification cancelling the recognition of MSEA confirming, if further confirmation was needed, that MSEA had been a recognized stock exchange prior to that. The learned senior counsel for the Board accepted that MSEA was recognised by the Board when the trades in BFSL shares were executed but since it did not have the Board's permission to allow trading on its floor, it was not permissible for anybody to trade on MSEA.

4. The learned counsel for the appellants argued that they were not engaged in organising or assisting in organising any unrecognised stock exchange nor were they members of any such stock exchange and therefore they did not come under the purview of section 19 of SCRA. MSEA was an old recognized stock exchange organized and managed by its Council of Management, Board of Directors, Executive Director etc as provided in its articles of association. The Adjudicating Officer in the impugned order summarily rejected this argument without any detailed reasoning. According to him "the noticees by participating in the trades have been found as organising and assisting and no matter whether they were members of stock exchange or not". We are not in agreement with the conclusion of the Adjudicating Officer, considering that MSEA was a recognized stock exchange where the trades of the appellants were executed on the screen based trading system through a member-broker who was registered with the Board and who issued the requisite contract notes to the appellants. The trades had been specifically permitted by the Officiating Executive Director of the exchange. Surely, by executing the trades under such circumstances, the appellants can not be said to have engaged in organizing or assisting in organizing an unrecognized stock exchange.

5. The learned senior counsel for the Board drew our attention to the fact that the appellants and DLF executed the share purchase agreement on 28.7.2005, the very next day after the issue of the MSEA notification dated 27.7.2005 indicating that trading would start there shortly. He also pointed out that the stamp paper used for the agreement bore the date of 22.7.2005 showing that the appellants had clearly anticipated the MSEA notification of 27.7.2005. The agreement stipulated 19.8.2005 as the last date for payment of the consideration money by the buyer which again made it clear that even

before trading actually started on MSEA, the appellants were sure that trading would start very soon. According to the learned senior counsel for the Board, the appellants were very much a party to the manipulations that resulted in the illegal trades being executed on MSEA and they were keen to execute the trades on MSEA where those were not likely to attract much attention and regulatory action could be avoided.

6. The learned counsel for the appellants pointed out that they had not, at any stage, made any secret of their intention to purchase all the shares of BFSL through a recognised stock exchange. It is their case that they first went to the only stock exchange namely BgSE where the shares of BFSL were listed and were refused the facility of trading there. In the impugned order, the Adjudicating Officer merely expresses surprise at the refusal which, according to him, was not legally correct and points out that the appellants made no efforts to enforce their legal right to trade on BgSE. He, however, does not question the fact of refusal by BgSE. After their effort to trade on the BgSE failed, the appellants got in touch with Bimal, who was Director of Rajat, a member-broker of MSEA and also a member of the CoM of MSEA at that time. The appellants relied upon the information regarding trading on MSEA furnished by Bimal. No case has been made out by the Board that the appellants knew that though MSEA was a recognised stock exchange, trading was not allowed on its floor because it had not fulfilled certain conditions stipulated by the Board.

7. From the discussions above, we are satisfied that the appellants can not be held to have violated section 19 of SCRA, which is the charge against them. Accordingly, we allow the appeal and set aside the impugned order of the Board. No order as to costs.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Arun Bhargava
Member

Sd/-
Utpal Bhattacharya
Member

1.7.2008
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