BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Misc. Application No. 108 of 2010
And
Appeal No. 192 of 2010

Date of decision: 21.2.2011

1) Premchand Shah
81, Silver Beach Co-op. Hsg. Society,
Opp. Suryavanshi Sabhagruha Marg,
Dadar, Mumbai – 400 028.

2) Sharman P Shah
81, Silver Beach Co-op. Hsg. Society,
Opp. Suryavanshi Sabhagruha Marg,
Dadar, Mumbai – 400 028.

3) Nihal P Shah
81, Silver Beach Co-op. Hsg. Society,
Opp. Suryavanshi Sabhagruha Marg,
Dadar, Mumbai – 400 028.

4) M/s Sumaria Appliances Private Limited
81, Silver Beach Co-op. Hsg. Society,
Opp. Suryavanshi Sabhagruha Marg,
Dadar, Mumbai – 400 028.

5) Mradula V Shah
L J Road, Opp. Victoria School,
Mahim, Mumbai – 400 016.

6) Sushila P Shah
102, Maheshwar Mansion,
Bapubhai Vashi Road,
Vile Parle (W), Mumbai – 400 056.

7) Vijaykumar N Shah
102, Maheshwar Mansion,
Bapubhai Vashi Road,
Vile Parle (W), Mumbai – 400 056.

8) Shreya V Shah
102, Maheshwar Mansion,
Bapubhai Vashi Road,
Vile Parle (W), Mumbai – 400 056.

9) Bindi V Shah
102, Maheshwar Mansion,
Bapubhai Vashi Road,
Vile Parle (W), Mumbai – 400 056.

10) Vanechand N Vora
7th Floor, West Minister,
Chunabhatti, Sion, Mumbai – 400 022. ……Appellants

Versus

The Adjudicating Officer,
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, Advocate for Appellants.

Mr. Shiraz Rustomjee, Advocate with Ms. Daya Gupta, Ms. Harshada Nagare, Advocates for the Respondent.

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

Per : Justice N. K. Sodhi, Presiding Officer

Whether the appellants connived with Narendra Prabodh Ganatra and his related/connected entities (referred to hereinafter as the Ganatra group) to manipulate the price upwards of the scrip of Gemstone Investments Ltd. (hereinafter called the company) to off-load their stake at higher prices and thereby violated 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 (for short the regulations) is the primary question that arises in this appeal. Facts as they emerge from the record and which have not been disputed by the parties may first be stated.

2. The appellants are the promoters of the company which was incorporated in the year 1994 and they acquired it in November 1998 from the erstwhile promoters after making a public announcement under regulation 11(1) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (for short the takeover code). However, they did not make the necessary disclosures under the takeover code. Presently, all the appellants except appellant no. 1 have exited from the company and they do not hold any shares. Appellant no. 1 holds 3,61,070 shares and continues to be a promoter. The shares of the company are listed on the Bombay Stock Exchange Ltd. Mumbai and the audited profit for the financial year 2005-06 was ₹ 17.40 lacs and for the financial year 2007-08 it was ₹ 17.20 lacs. However, for the financial year 2006-07, the company reported a loss of ₹ 2.70 lacs on an equity capital of ₹ 3 crores.

3. The Securities and Exchange Board of India (for short the Board) carried out investigations in the scrip of the company for the period from August 28, 2006 to August 21, 2008 as it was during this period and thereafter that the Ganatra group made large purchases of shares of the company from the market. It was also during this period that the appellants sold their shares though they effected sales only up to July 3, 2007. It is on record that the appellants held 25,17,630 shares of the company (83.92 per cent) out of the total issued share capital of 30 lac shares. The appellants started selling their shares with effect from August 29, 2006 and the last sale was executed on July 3, 2007 and the sales were in the price range of ₹ 3.08 to ₹ 28.50 per share of the face value of ₹ 10. Sushila P. Shah, one of the appellants sold 20,000 shares on August 29, 2006 in the price range of ₹ 3.08 to ₹ 3.23 and thereafter the sales were gradually made at prices higher than these. It is also established on the record that out of 24,80,480 shares sold by the appellants, 18,42,119 shares (74.26 per cent of the total shares sold by the appellants) were purchased by the Ganatra group which, admittedly, consists of 17 persons whose details are given in Annexure II to the show cause notice. The rest of the shares were purchased by others. Investigations also revealed that after November 2005, trading in the scrip on BSE commenced only on August 28, 2006 and the price rose from ₹ 2.94 on August 28, 2006 to ₹ 45.45 on November 12, 2007 and thereafter it came down to ₹ 14.85 on April 15, 2008 and again increased to ₹ 51.80 on August 21, 2008. It is clear from the record that the Ganatra group consistently traded in the scrip from August 28, 2006 to August 21, 2008 and this group mainly made purchases and the price went up to ₹ 51.80 per share on August 21, 2008. It is alleged that the Ganatra group entered into circular/reverse trades which accounted for 50.33 per cent of the market volumes during the period from March 20, 2007 to August 21, 2007 which resulted in increase in price and volumes. However, we are not concerned with these allegations in the present appeal since the Ganatra group is not in appeal before us and the impugned order is not directed against that group. On the conclusion of the investigations, the Board decided to initiate adjudication proceedings against the appellants.

4. On the basis of the facts found during the investigations, the appellants were served with a show cause notice dated June 4, 2010 alleging that they acted in collusion with Ganatra group when they sold their shares as aforesaid. The primary reason for alleging collusion is that majority of the shares sold by the appellants had been purchased by the Ganatra group. It is also alleged that the Ganatra group "acting in collusion, consistently traded in the scrip from August 28, 2006 to August 21, 2008 and increased the price of the scrip from ₹ 2.94 (on August 28, 2006) to ₹ 51.81 (on August 21, 2008)". It is further alleged that "Once the price of the scrip had gone up, then the promoter/Company related entities started selling in the market after December 13, 2006". The show cause notice also states that "the scrip was not traded from August 31, 2006 to September 24, 2006 and during that period there were 93 buy orders (57 buy order placed by some entities of Narendra Ganatra group) placed by 12 brokers for their 21 clients for 10,12,200 shares (for 974000 shares orders placed by Narendra Ganatra group). These buy orders remained unexecuted due to non availability of sale orders in the system." The details of the trading done by the Ganatra group were provided to the appellants in Annexure IV to the show cause notice. Another charge that is levelled against the appellants is that even though they made a public announcement in accordance with the takeover code in 1998 when they acquired the company, appellants 1 to 4 did not make the necessary disclosures thereunder and thereby violated regulation 7(1A) of the takeover code. Appellants 1 to 6 were also required to make the necessary disclosures under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 (for short the insider regulations). Since they failed to make these disclosures they have been charged for violating regulations 13(3) and 13(4) of insider regulations. The appellants filed a reply to the show cause notice denying all the allegations. They did not seriously dispute that they had not made the necessary disclosures under the takeover code and also under the insider regulations. On a consideration of the material collected during the course of the investigations and the enquiry held by the adjudicating officer and after affording a personal hearing to the appellants, the adjudicating officer came to the conclusion that the appellants had connived with the

Ganatra group to manipulate the price and volumes of the scrip of the company with a view to off-load their stake at higher prices and thereby violated regulations 3 and 4 of the regulations. He also found that appellants 1 to 6 had failed to make the necessary disclosures under the takeover code and the insider regulations. Accordingly, by his order of September 6, 2010 he imposed a monetary penalty of ₹ 6 crores on the appellants for violating regulations 3 and 4 of the regulations and a consolidated penalty of ₹ 5 lacs on appellants 1 to 6 for violating the takeover code and the insider regulations as detailed in his order. Appellants 1 to 4 have been levied a penalty of ₹ 1 lac each whereas appellants no. 5 and 6 have been imposed a penalty of ₹ 50,000/- each. It is against this order that the present appeal has been filed.

5. We have heard the learned counsel for the parties at length and they have taken us through the records of the case. It is not in dispute that the appellants as a group are inter se related/connected to each other and that they, except appellant no. 1, have exited from the company by selling the shares held by them. Appellant no. 1 has also sold his shares but is continuing to hold 3,61,070 equity shares of the company which come to 1.22 per cent of its total issued share capital. It is also on record that 74.26 per cent of the shares sold by the appellants had been purchased by the Ganatra group. The question that we need to answer is whether the sale of the shares by the appellants and the purchase thereof by the Ganatra group was collusive. The appellants contend that they sold the shares in the market in the ordinary course of trading through the stock exchange mechanism and that they did not connive with the Ganatra group and that they did not know at the time of executing the sale transactions as to who the counter party was. The impugned order passed by the adjudicating officer records a finding of connivance primarily on the ground that the majority of the shares sold by the appellants had been purchased by the Ganatra group. This fact does raise some suspicion but, in the facts and circumstances of this case as discussed hereinafter, we cannot conclude that there was any connivance between the two groups. There is no denying the fact that the trading system of the stock exchange maintains complete anonymity and does not allow one party to a transaction or even his broker to know as to who the counter party is or the counter party’s broker. In other words, the trading

system does not permit any interaction between the buyer and the seller except through the system. A sell order put into the system will match the best buy order on the basis of price time priority. Similarly, a buy order will match a sell order on the same basis and it is the system which matches the orders. Despite the anonymity of the system, we have seen that traders and/or their brokers try to defeat the system by matching the buy and sell orders by punching them into the system simultaneously for the same amount and for the same price. This happens more frequently in illiquid scrips. In the case before us, there is no charge against the appellants that they matched/synchronized their sell orders with the buy orders of the Ganatra group by punching in the orders simultaneously in a manipulative manner. In the absence of any such allegation, the charge of connivance could be established only if there was some other contemporaneous material on the record to show connivance between the appellants and the Ganatra group. There is no such material on the record and, therefore, we have no hesitation to hold that the charge of connivance as levelled against the appellants must fail. Mere suspicion on the ground that majority of the shares sold by the appellants have been purchased by the Ganatra group cannot lead us to conclude that the charge is established. When we look to the other facts as established on the record and stated in the show cause notice and noticed in the impugned order, we find that the charge of connivance cannot succeed. It is common ground between the parties that the scrip of the company was illiquid and this fact is borne out from the show cause notice itself. For almost a month from August 31, 2006 to September 24, 2006, the scrip was not traded in the market and during this period there were 93 buy orders put in the system by 12 different brokers on behalf of their 21 clients for the purchase of 10,12,200 shares and these were pending and these remained unexecuted due to non availability of sellers. It is also a fact that out of these 93 buy orders, 57 buy orders were placed by the Ganatra group. If the appellants and the Ganatra group were conniving as alleged, then the appellants would have come forward to sell their shares when the buy orders were pending in the system. This did not happen and, therefore, no trade took place. This fact demolishes the allegation of connivance. Again, it is clear from the record that the appellants as a

group who were then controlling the company wanted to sell their shares for reasons which have been stated in their reply and the Ganatra group started purchasing the shares from August 2006 upto August 21, 2008 and even thereafter and gained control of the company by reason of their shareholding though appellant no. 1 continues to be one of the promoters. The allegation in the show cause notice is that the appellants and the Ganatra group connived with each other to increase the price of the scrip and when the price went up, the appellants off-loaded their stake at higher prices and violated the regulations. This allegation, too, must fail. It is established on the record that the appellants were selling their shares and the Ganatra group was buying the shares. To increase the price of the scrip could be in the interest of the appellants because they were sellers but it could not be in the interest of the Ganatra group which was buying from the market. Their interest in this regard would obviously clash. It is the case of the appellants that the Ganatra group is still holding the shares and is in control of the company. This fact could not be disputed by the learned counsel for the Board and, in any case, it is not the Board's case that this group has off-loaded the shares. This being so, why should the Ganatra group connive to increase the price when they were buying the shares. If at all it was to manipulate, it would bring the price down. In this view of the matter, we cannot uphold the charge of connivance. The charge of connivance is further belied from the fact that the appellants sold their shares from August 29, 2006 to July 3, 2007 as noticed earlier in the price range of ₹ 3.08 to ₹ 28.50. The last sale by the appellants was on July 3, 2007 at the rate of ₹ 28.50. The Ganatra group continued purchasing the shares upto August 2008 and, according to the show cause notice, the price of the scrip went up to ₹ 51.81 on August 21, 2008. The show cause notice also states that the Ganatra group was executing circular/reverse trades to raise the price upwards. If the appellants were conniving with the Ganatra group then they would not have exited on July 3, 2007 when the price of the scrip reached ₹ 28.50. They would have waited for some more time knowing that the price of the scrip was being manipulated upwards which did go upto ₹ 51.80. We cannot, therefore, accept the theory of connivance. The possibility of the shares having been sold and bought by the two groups in the ordinary course of

trading through the exchange mechanism cannot be ruled out in the circumstances of this case. The scrip was, admittedly, illiquid. The appellants as a group were in the market to sell a large chunk of shares and the Ganatra group consisting of 17 persons was also in the market to make big purchases to take control of the company. In such a scenario, it is possible that Ganatra group picked up around 74 per cent of the shares sold by the appellants. We must also remember that the remaining 25 per cent of the shares sold by the appellants were picked up by others. This would indicate that there were other buyers in the market as well. If the two groups were conniving, the easiest way for them would have been to synchronize their trades as is usually done when traders manipulate the scrips and, in that event, the entire lot could be purchased by the Ganatra group. This has not happened. This fact also does not support the charge of connivance.

6. There is yet another reason why the charge of connivance with Ganatra group to increase the price of the scrip cannot be sustained against the appellants. There is no gainsaying the fact that the price of the scrip did go up from ₹ 3.08 to ₹ 51.80 when the appellants sold the shares and the Ganatra group purchased them. The Ganatra group kept purchasing till August 21, 2008 whereas the appellants exited on July 3, 2007 when the price of the scrip was ₹ 28.50 per share. We have on record that during the period from August 28, 2006 to March 16, 2007 (described as patch I in the show cause notice) there were 4592 buy orders for 3,73,85,295 shares placed by 110 buy brokers on behalf of 333 buy clients and there were 1976 sell orders for 56,94,403 shares placed by 78 sell brokers on behalf of 213 sell clients which resulted in 1864 trades for 25,92,500 shares. These details had been furnished to the appellants alongwith the show cause notice. It is, thus, clear that during patch I, the buyers were far in excess than the sellers and the number of shares offered for sale were far less than those for which buy orders were in the system. In such a situation the price of the scrip had to go up. It must be remembered that the price discovery mechanism of the stock exchanges works on the principle of demand and supply and if the demand is more than the supply, the price is bound to go up and this is the reason why the price of the scrip went up during patch I and not because the appellants were conniving with

the Ganatra group. Same is the position with regard to patch II where the period is from March 20, 2007 to August 21, 2008. During this period there were 20,242 buy orders for 3,10,81,583 shares placed by 400 buy brokers on behalf of 1966 buy clients and there were 20,895 sell orders for 1,05,31,799 shares placed by 458 sell brokers on behalf of 1994 sell clients which resulted in 20176 trades for 2,29,44,675 shares. Since the demand was far in excess of the supply, the price went up. Another interesting feature to notice here is that there were large number of buyers and sellers in both patch I and patch II and the appellants who were the sellers are only 10 in number and the Ganatra group which was buying consists of only 17 persons. It is clear that apart from the appellants and the Ganatra group there were large number of other buyers and sellers in the market which led to price increase. In this background, we cannot hold that the appellants and the Ganatra group connived to increase the price of the scrip.

7. We may now refer to the circumstances that were pointed out by the learned counsel for the respondent Board on the basis of which he strenuously argued that the findings recorded in the impugned order be upheld. He contended that the scrip was illiquid from the year 2002 till August 2006 as there was no trading during this period and the fact that more than 74 per cent of the shares sold by the appellants were picked up by the Ganatra group should lead us to infer that they were both conniving with each other. We have already discussed this aspect earlier and we do not think that this fact alone could lead us to hold that there was connivance between the two groups. The learned counsel also pointed out that the financial performance of the company was poor and it had not declared dividend for the last five years and had suffered losses during the year 2006-07 and, therefore, there was no occasion for the Ganatra group to purchase such large quantity of shares. He also pointed out that the first appellant who was selling on behalf of other appellants knew Narendra Ganatra who was introduced to him in the year 2005 and on the basis on this acquaintance, Ganatra had been inducted as a director in the company in the year 2007. According to the learned counsel for the Board these factors taken collectively should lead us to conclude that the two groups were conniving to increase the price of the scrip. He also

referred to the run away price increase in the scrip between August 2006 and August 2008 when the price of the scrip increased and went up to ₹ 51.80 per share. He wants us to infer that this price rise was due to the connivance of the appellants with the Ganatra group. He also referred to the allegation that the Ganatra group had executed circular and reverse trades to increase the price of the scrip and that the appellants traded even during a part of patch II when the price was increasing due to the manipulation by the Ganatra group. We have noticed all these submissions in the earlier part of our order and we do not think that the factors now pointed out by the learned counsel would establish the charge against the appellants. The fact that the appellants made huge profits when they sold the shares is again no reason for us to hold that there was any connivance or manipulation in the price of the scrip. We have already discussed the reasons why the price of the scrip increased which was due to excessive demand. Having considered all the factors now pointed out by the learned counsel and taking a holistic view of the matter, we are satisfied that the charge levelled against the appellants has not been established. The question posed in the opening part of this order is, accordingly, answered in the negative.

8. This brings us to the other charge levelled against the appellants. It is alleged that when they acquired the company in the year 1998 they did not make the necessary disclosures required under regulation 7(1A) of the takeover code and also under regulations 13(3) and 13(4) of the insider regulations. The adjudicating officer has found them guilty on this score as well and imposed a monetary penalty of ₹ 5 lacs. The fact that the appellants did not make the necessary disclosures under the takeover code and the insider regulations has not been seriously disputed before us during the course of the hearing though it was argued by Shri P. N. Modi, Advocate that the required information was already on the website of the exchange. The argument is that the appellants had in substance complied with the disclosure requirements though the disclosures were not made in the prescribed format. We cannot accept this argument. When law prescribes a manner in which a thing is to be done, it must be done only in that manner or not at all. Both sets of regulations prescribe formats in which the disclosures are to be made and those are then put out for the information of

the general public through special window(s) of the stock exchange which did not happen in this case. The fact that non disclosure has been made penal makes it clear that the provisions of regulation 7(1A) of the takeover code and regulations 13(3) and 13(4) of the insider regulations are mandatory in nature. Non disclosure of the information in the prescribed manner deprived the investing public of the information which is required to be available with them when they take an informed decision while making investments. Lapse on the part of the appellants is obvious and no fault can, therefore, be found with the impugned order holding them guilty of not making the necessary disclosures.

In the result, the appeal is partly allowed and the findings recorded by the adjudicating officer holding the appellants guilty of violating regulations 3 and 4 of the regulations and imposing a monetary penalty of ₹ 6 crores are set aside. The findings on the other issue regarding non disclosures and the penalty imposed as a result thereof are upheld. There is no order as to costs.

Sd/-
Justice N. K. Sodhi
Presiding Officer

Sd/-
S. S. N. Moorthy
Member

21.2.2011
Prepared & Compared by
ptm