(2022) 03 SEBI CK 0102

In the Securities Appellate Tribunal Mumbai

Case No : Appeal No. 498, 499, 500, 501 Of 2021

Kaushik Bhatt And Others — APPELLANT

Vs

Securities And Exchange Board Of India — RESPONDENT

Date of Decision : 25-03-2022

Acts Referred:

Securities And Exchange Board Of India (Prohibition Of Fraudulent And Unfair Trade Practices Relating To Securities Market) Regulations, 2003 — Regulation 3, 3(a), 3(b), 3(c), 3(d), 4, 4(1), 4(2)(f), 4(k), 4(r)
Securities And Exchange Board Of India Act, 1992 — Section 11, 11B, 12A, 12A(a), 12(b), 12(c)
Companies Act, 2013 — Section 177
Companies Act, 1956 — Section 292A

Citation : (2022) 03 SEBI CK 0102

Hon'ble Judges : Tarun Agarwala, Presiding Officer;M. T. Joshi, J;Meera Swarup, Member

Bench : Full Bench

Advocate : Pradeep Sancheti, Pulkit Sharma, Saurabh Bachhawat, Saachi Purohit, Venkatesh Dhond, Chirag Shah, Akash Jain, Rishab Jain, Daksha Kasekar

Final Decision : Allowed

Judgement

Tarun Agarwala, Presiding Officer

1. Four appeals have been filed by two appellants against two orders, one passed by the Whole Time Member ("WTM" for convenience) of the Securities and Exchange Board of India ("SEBI" for convenience) dated January 27, 2021 and the other passed by the Adjudicating Officer ("AO" for convenience) dated April 28, 2021. Since the issue is common, all the four appeals are being decided together. For facility, the facts stated in Appeal No. 498 of 2021 Mr. Kaushik Bhatt vs. SEBI is being taken into consideration.

2. By the impugned order dated January 27, 2021 the WTM has debarred the two appellants from dealing in the securities market for a period of 6 months on the ground that the appellant was a party to the fraudulent scheme to make the

investors believe that the Global Depository Receipts ("GDR" for convenience) issued by Kemrock Industries & Exports Ltd. (KIEL) ("The Company" for convenience) were genuinely subscribed by foreign investors by concealing information that the Company had facilitated the subscription of GDR by Vintage FZE ("Vintage" for convenience), who was the only subscriber to the GDR on the strength of a loan obtained by Euram Bank by keeping the GDR proceeds received as security with Euram Bank and, therefore, violated the provisions of Section 12A (a), (b) & (c) of the Securities and Exchange Board of India Act, 1992 ("SEBI Act, 1992" for convenience) read with regulations 3 (a), (b), (c) & (d), 4 (1) and 4 (2) (f), (k) & (r) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 ("PFUTP Regulations, 2003" for convenience).

By another order dated April 28, 2021 passed by the AO for the same violation, on the same issue, a penalty of Rs. 10 lakhs was imposed on each of the appellants.

3. The facts leading to the filing of the present appeal is, that the Board of Directors of the Company known as Kemrock Industries & Export Ltd. passed a resolution on March 16, 2010. The said resolution is extracted hereunder:-

"RESOLVED THAT a bank account of Kemrock Industries and Exports Limited (Company) be opened with EURAM Bank ("the Bank") or any branch of EURAM Bank, including the off-shore branch, outside India for the purpose of receiving subscription money in respect of the Global Depository Receipts issue (GDRs) of the Company.

RESOLVED FURTHER THAT, Mr. Kalpesh Patel, the Chairman & Managing Director and Mr. Shailesh Patel, the Manager Accounts, the Authorized Signatories of the Company, be and are hereby severally authorized to sign, execute, any application, agreement, escrow agreement, document, undertaking, confirmation, declaration and other papers from time to time as may be required by the Bank and to carry and affix common seal of the Company thereon, if and when so required.

RESOLVED FURTHER THAT, Mr. Kalpesh Patel, the Chairman & Managing Director and Mr. Shailesh Patel, the Manager Accounts, the Authorized Signatories of the Company, be and are hereby severally authorized to draw cheques and other documents, and to give instructions from time to time as may be necessary to the said EURAM Bank or any of branch of EURAM Bank , including the off-shore branch, for the purpose of operation of and dealing with the said bank account and carry out other relevant and necessary transactions and generally to take all such steps and to do all such things as may be required from time to time on behalf of the Company.

RESOLVED FURTHER THAT, the Bank be and is hereby authorized to use the funds so deposited in the aforesaid bank account as security in connection with loans if any as well as to enter into any Escrow Agreement or similar arrangements if and when so required.”

4. The resolution approved by the Board of Directors resolved that a bank account with Euram Bank be opened for the purpose of receiving the subscription money in respect of the GDR issue. Further, Mr. Kalpesh Patel, Chairman & Managing Director and Mr. Shailesh Patel, Manager Accounts, were authorized to sign, execute any application, agreement as may be required by the bank and take such steps and do such things as may be required from time to time on behalf of the Company. The resolution further resolved that the bank was authorised to use the funds so deposited in the aforesaid bank account as security in connection with loans, if any as well as enter into any Escrow Agreement for similar arrangement.

5. Based on the aforesaid resolution, the Company issued 4.83 million GDRs for USD 50.00 million equivalent to 48,27,200 equity shares of Rs 10/ each. The entire GDR was subscribed by one Vintage and a corporate announcement was made by the Company on April 30, 2010 that the entire issue was subscribed.

6. SEBI conducted an investigation pertaining to the issuance of the GDR by the Company for the period April 01, 2010 to May 31, 2010. Based on the investigation, a show cause notice dated August 28, 2018 was issued against the Company and its Directors and employees including the appellants to show cause why suitable directions under Section 11 and 11B of the SEBI Act should not be issued for violation of Section 12A and Regulations 3 and 4 of the PFUTP Regulations. The show cause notice indicated that pursuant to the resolution dated March 16, 2010, not only a bank account was opened in Euram Bank but the Managing Director, Kalpesh Patel executed a pledge agreement on April 23, 2010 on behalf of the Company with Euram Bank and another loan agreement dated April 23, 2010 was executed with Vintage wherein the proceeds of GDR was to be kept as security with Euram Bank. The show cause notice further revealed that the pledge agreement and the loan agreement was not disclosed on the stock exchange platform and, consequently, the investors and the shareholders of the Company were kept in the dark. The show cause notice further alleged that based on the loan agreement and the pledge agreement, Euram Bank advanced USD 50.00 million to Vintage. This fund was utilized by Vintage to subscribe to the entire issue. The GDR proceeds were pledged as security in favour of Euram Bank till such time the loan was repaid by Vintage. The fact that Vintage was the sole subscriber was also not intimated to the stock exchange platform and to the Indian investors.

7. The Company and its Managing Director were charged with violation of Section 12A and Regulations 3 and 4 of the PFUTP Regulations. The WTM after considering the evidence on record found that the entire scheme of using the GDR proceeds as security for the purpose of enabling Vintage to subscribe the GDR issues was a fraudulent scheme and violative of Section 12A and Regulations 3 and 4 of the PFUTP Regulations. A specific finding has also been given against the Managing Director, noticee no. 2 that he was in complete

command and control of the Company and was answerable to the Board of Directors for not sharing or disclosing the implication behind moving the aforesaid Board Resolution and the intention behind signing the pledge agreement which he executed without disclosing the same to the Directors and to the public. A further finding was given by the WTM that the Managing Director, noticee no. 2 was actively involved in the fraudulent arrangement of GDR issued by the Company.

8. In so far as the present appellants Mukund Bakshi and Kaushik Bhatt are concerned they were noticee nos. 3 & 4 before the WTM. The WTM categorically held that the present proceedings against the appellants have not arisen on account of their involvement in the day to day affairs of the Company but have arisen on account of their involvement in certifying the copy of the resolution of the Board of Directors dated March 16, 2010 which was used by the Company to pledge the GDR proceeds and, therefore, the appellants were aware of the fraudulent scheme and consequently, were party to this fraudulent scheme. The WTM further held that the appellants before certifying the resolution should have asked probing questions as to why the company required a certified copy of the resolution and, further, should have asked as to why the GDR proceeds is required to be kept as security.

9. The WTM further admitted that there was no evidence to ascertain that the appellants had attended the meeting of the Board of Directors dated March 16, 2010, nonetheless, the stand of the appellants that they were not signatory to the resolution of the Board cannot be accepted, because, they have not provided evidence, namely, intimation seeking leave of absence for attending the meeting of the Board of Directors. In addition to the aforesaid, the WTM concluded that they were part of the commissioning of the fraud since they were members of the Audit Committee. The WTM found that Kaushik Bhatt was the Chairman of the Audit Committee till June 30, 2010 and thereafter appellant Kaushik Bhatt became the Chairman. The WTM found that the appellants ought to have shown due diligence by raising a red flag by asking the management about the GDR proceeds not being received and should have raised probing questions with regard to its utilization. In the absence of asking these probing questions, the appellants failed to perform their duties and, consequently, were part of the commissioning of the fraud and were part of the fraudulent scheme and, therefore, also had violated Section 12A of the SEBI Act read with Regulations 3 and 4 of the PFUTP Regulations.

10. The admitted facts, as culled out from the record is, that Mukund Bakshi, noticee no. 3 was a Non-Executive Independent Director appointed in 2004 and resigned on August 28, 2010 and is a practicing Chartered Accountant since 1987. The appellant was not involved in the day to day affairs of the Company and specifically contended that he did not attend the meeting of the Board of Directors dated March 16, 2010 relating to the issuance of the GDR and opening of a bank account, etc. The said appellant further stated that he was not aware

of the fraudulent arrangement being executed by the Company and its Managing Director and was not aware of the signing of the documents between the Company, Vintage and Euram Bank. On the issue of certifying the resolution, the appellant contended that he was informed that the Company was in the process of opening an account with Euram Bank for which purpose the resolution was required to be certified by two Independent Directors and, on this basis, the appellant had certified the resolution.

11. The appellant Kaushik Bhatt, noticee no 4 is a practicing Advocate in Vadodara for the last 40 years and was appointed on February 10, 1996 and resigned on April 01, 2014. The said appellant contended that he was not involved in the day to day affairs of the Company nor received any remuneration as a Director and was only looking after the legal proceedings filed against the Company. The said appellant also specifically contended that he did not attend any meeting of the Board of Directors relating to the issuance of the GDR.

12. We have heard Shri Pradeep Sancheti, the learned senior counsel for the appellants and Shri Venkatesh Dhond, the learned senior counsel for the respondent.

13. The appellants have attacked the findings of the WTM and AO on various grounds. It was contended that the initiation of the proceedings were belated. The GDR issue was made in 2010, the investigation was conducted by the SEBI immediately thereafter but the show cause notice was issued on August 28, 2018 after more than 8 years. It was contended that on account of this inordinate delay the entire proceedings should be quashed.

14. The appellants further contended that they were Non-Executive Independent Directors and was not involved in the day to day affairs of the Company. They did not attend the Board meeting dated March 16, 2010 in which the GDR resolution was passed. Consequently, they cannot be made party to the alleged fraudulent scheme hatched by the Company and its Managing Director. Even otherwise, the only charge against the appellants is, that they had certified the resolution and, therefore, they become part of the fraudulent scheme. Such finding is wholly perverse which no reasonable man could arrive at. It was also alleged that the finding that they were members of the Audit Committee and, therefore, they should have raised a red flag and should have asked probing questions relating to the non-deposit of the GDR proceeds and/ or its utilization was wholly erroneous in as much as the show cause notice did not make any such allegation. It was thus contended that in the absence of any allegation of this nature in the show cause notice, the WTM and the AO have exceeded its jurisdiction. It was urged that had an opportunity been given the appellants would have adequately replied and would have satisfied the authorities as to why they could not have raised a red flag at that moment of time but in the absence of any opportunity, the authorities could not have delved on this aspect of the matter.

15. Having heard the learned counsel for the parties and having perused the record we find that admittedly there is no finding recorded by the authorities that the appellants were signatory to the resolution dated March 16, 2010. The two appellants have specifically denied that they were signatories to the resolution. No proof has been submitted by SEBI in this regard. The burden to prove that the appellants were signatories to the resolution dated March 16, 2010, was upon SEBI which they have failed to prove. The finding given that the appellants should have given proof of leave of absence to prove that they were not present in the meeting is patently erroneous and misconceived in as much as there is no requirement in law for the appellants to prove a negative or to file proof of leave of absence. Even if leave of absence is not filed, the burden still remains with SEBI to prove that they were signatories to the resolution. The burden is discharged only when a finding is given by SEBI which in the instant case was lacking. We are thus of the opinion, that there is no proof on record to indicate that the appellants were signatories to the resolution dated March 16, 2010 with regard to the issue of GDR.

16. In any case, the WTM in its order admits in paragraph 35 of its order that the present proceedings initiated against the appellants have been initiated not because they were involved in the day to day affairs of the Company but on account of certifying the Board resolution dated March 16, 2010. We are of the opinion, that the finding given by the respondent that by certifying the resolution dated March 16, 2010 they are part and parcel of the fraudulent scheme and are part of the commissioning of the fraud is patently erroneous. Admittedly, they have certified a genuine document, namely, a resolution that was actually passed by the Board of Directors. By certifying a genuine document, the appellants have not committed a crime nor can it lead to an inference that they are part of the scheme hatched by the Company and its Managing Director especially when the WTM admits that the appellants were not involved in the day to day affairs of the running of the Company coupled with the fact that the appellants were professionals in their field, one was a Chartered Accountant and other was a practicing Advocate. Making the appellants culpable only on the ground that the appellants did not ask probing questions as to why the certified copy was required does not make them an accomplice to the crime nor do they become part of the fraudulent scheme. We further find that in this regard an explanation was given by the appellants that the certification was done for the purpose of opening an account of the Company with Euram Bank which has not been considered and, on the other hand, a finding has been given that the certification of the resolution by the appellants was used for the purpose of the pledge agreement. In our view, this finding is purely conjectural and based on surmises and conjectures. This finding is not based on any evidence. No proof in this regard has been filed to show that the resolution so certified by the appellants was used for the purpose of pledge agreement. We further find, that a specific finding has been given by the WTM in paragraph 34 of the impugned order, namely, that noticee no. 2 Kalpesh Patel was in complete control of the affairs of

the Company and did not disclose the implication behind the Board resolution nor disclosed the intention behind signing the pledge agreement which he executed without disclosing the same. For facility, the relevant finding is extracted hereunder:-

“It becomes clear that Noticee no. 2 was very much seized of the intent behind the Board Resolution passed on March 16, 2010 pursuant to which he has signed the Pledge Agreement to secure the loan taken by the Vintage for subscribing to the GDR of Kemrock. Undoubtedly, Noticee no. 2 was the Managing Director and was responsible for the day to day affairs of the Company hence, it was certainly his primary duty to come out completely clean before the Board with all the facts, strategy, steps to be followed and compliances to be made with respect to the proposed GDR issue, before moving a Resolution before the Board. Being the Managing Director, it was he, who was statutorily required to drive, guide and manage the affaires of the Company….”

“….He has not even brought on record any documents to show to what extent the Board of Directors was aware of the entire scheme and which Directors were specifically involved in the said scheme. He, being in the driving seat of the Company knew how to steer the proposed issuance and therefore ought to have clarified to the Board Members about the pre-arrangement with the sole subscriber and about the proposed Pledge Agreement that was devised to be executed with the Bank….”

“….Noticee no. 2 being in complete command and control of the Company, is answerable to the Board for not sharing or disclosing the true implications behind moving the aforesaid Board Resolution and the intention behind signing the Pledge Agreement which he executed without disclosing the same to the Public….”

17. In view of the aforesaid finding given by the WTM it is apparently clear that noticee no. 2 Kalpesh Patel was the Managing Director and Chairman of the Company was in complete control of the affairs of the Company. He was totally involved in the fraudulent scheme and knew the intention behind the resolution of the Board of Directors by executing the pledge agreement, the loan agreement etc. A specific finding has been given that he did not disclose his intention to the Board of Directors. It is thus apparently clear that the appellants were unaware of the pledge agreement or the loan agreement that was executed on behalf of the Company by Kalpesh Patel as it was never disclosed either to the shareholders or to the Board of Directors or to the general public. Thus, merely by certifying a resolution, we are of the confirmed view that the appellants cannot be made culpable or party to the alleged fraudulent scheme. The finding given by the respondents in this regard is patently erroneous and cannot be sustained.

18. The finding given by the respondents that the appellants being part of the Audit Committee did not act diligently and, therefore, were part of the commission of fraud and were party to the fraudulent scheme is patently

erroneous. In the first instance, this charge is not part of the show cause notice and, therefore, the respondents have gone beyond the charges made in the show cause notice. Such findings cannot not be relied upon nor can be taken into consideration on this short ground. Further, if any further evidence came forward during the course of inquiry the appropriate procedure for the respondent was to issue a supplementary show cause notice bringing such allegation on record and require the appellants to reply and give an opportunity to show cause. In the absence of any such procedure being followed and in the absence of giving any opportunity to deny or reply to the allegations that the appellants were members of the Audit Committee and were therefore aware of the fraudulent activities of the Company cannot be sustained.

19. In any case, the issue was subscribed on April 29, 2010, evidence has come on record to show that noticee no. 3 was Chairman of the Audit Committee till June 30, 2010. Thus, during this period no occasion arose for the appellant to raise any red flag. So far as the appellant Kaushik Bhatt is concerned, the general finding that probing questions should have been raised regarding non-deposit of GDR proceeds is incorrect in as much as the GDR proceeds were already deposited in the bank and, therefore, the questions of non- receipt of the GDR proceeds does not arise. In so far as utilization of the GDR proceeds is concerned, it is clear that the appellants were unaware of the pledge agreement as the same was not disclosed by the Company or by its Managing Director. Therefore, the appellant Kaushik Bhatt had no reason to raise a red flag on non-utilization. In any case, we are of the confirmed view that since no allegations was raised in the show cause notice with regard to the appellants being members/ Chairman of the Audit Committee such issue could not be raised nor can it be decided in the proceedings. The findings given by the respondents in this regard cannot be considered.

20. The respondents in their written submissions have relied upon various decisions of this Tribunal on the issue of being a member of the Audit Committee in Mr. Ajay Sethi vs SEBI (Appeal No. 184 of 2020 decided on May 12, 2021), Mr. Mohandas Shenoy Adige vs SEBI (Appeal No. 511 of 2020 decided on July 28, 2021), Soumen Ghosh vs. Mr. G. Mahalingan (Appeal No. 171 of 2020 decided on March 07, 2022). In our view these decisions are not relevant in view of what we have held earlier. Reliance on Section 177 of the Companies Act, 2013 is patently erroneous and inspite of pointing it out to the senior counsel for the respondents the learned counsel insisted in showing us these provisions which are not applicable. Section 177 of the Companies Act, 2013 which relates to the duties of the Audit Committee is not applicable in as much as the GDR issue relates to the period 2010 when the Companies Act, 1956 was in force and the Companies Act, 2013 was not in existence. Thus, reliance on Section 177 of the Companies Act, 2013 is misconceived. Section 292A of the Companies Act, 1956 which refers to the role and function of the Audit Committee could be relevant but this provision does not indicate the monitoring and end use of the fund raised through public efforts and related matters which are covered under Section 177 of the

Companies Act 2013. Further, reliance of a decision of the Supreme Court in the matter of SEBI vs Adi Cooper dated September 21, 2021 on the issue of Board Resolution being a fraudulent transaction is misconceived and not relevant to the issue as in the instant case the appellants were admittedly not signatories to the Board Resolution.

21. In this regard, we may observe that the respondents while making submissions before this Tribunal should stick to the issues that was placed before the authorities concerned and should not improve the case by taking new grounds which were not argued or dealt with by the authority.

22. In view of the aforesaid it is not necessary for us to go into the question of inordinate delay. For the reasons stated aforesaid, the impugned orders cannot be sustained and are quashed. All the appeals are allowed with no order as to costs.

23. This order will be digitally signed by the Private Secretary on behalf of the bench and all concerned parties are directed to act on the digitally signed copy of this order. Certified copy of this order is also available from the Registry on payment of usual charges.