

BEFORE THE SECURITIES APPELLATE TRIBUNAL  
MUMBAI

**Appeal No. 216 of 2011**

**Date of Decision : 09.11.2012**

Shri Dipak Patel  
Permanent Address:  
01, Shivnagar Society,  
Bhavpura, Kadi,  
Gujarat – 382715.  
Present Address:  
3207, Washington Boulevard,  
Fremont, California,  
USA – 94539.

...Appellant

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. Janak Dwarkadas, Senior Advocate with Mr. Sanjay Israni, Ms. Prachi Doshi and Mr. Mayur Shetty, Advocates for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Mobin Shaikh, Advocate for the Respondent.

CORAM : P.K. Malhotra, Member & Presiding Officer (*Offg.*)  
S.S.N. Moorthy, Member

Per : P.K. Malhotra

This order will dispose of three Appeals no. 216 of 2011, 74 and 78 of 2012. The counsel for the parties agree that they arise out of common set of facts and can be disposed of by a common order.

2. A short but interesting issue that arises for our consideration in these appeals is whether trading done in the securities market by a person who is not an intermediary, on the basis of information about forthcoming orders of another trader in the market, is violative of regulation 3 of the Securities and Exchange Board of

India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 (for short FUTP regulations).

3. The facts of the case, in brief, which are taken from Appeal no. 216 of 2011, are that the Securities and Exchange Board of India (the Board) conducted investigations into the trading activity of Shri Kanaiyalal Baldevbhai Patel (for short 'KB') an individual trader and Passport India Investment (Mauritius) Ltd. (for short 'Passport'), a foreign institutional investor, for the period January, 2007 to March, 2009. It was noted that KB had placed and executed orders before the order of Passport and consequently squared off his position when the orders of Passport were placed in the market. Mr. Dipak Patel, appellant in Appeal no. 216 of 2011 (for short 'Dipak') was the portfolio manager of Passport and is also cousin of KB, appellant in Appeal no. 74 of 2012 and Shri Anandkumar Baldevbhai Patel (for short 'AB'), appellant in Appeal no 78 of 2012. The modus operandi of these persons, as noted by the Board, was that Dipak provided information to KB and AB regarding forthcoming trading activity of Passport. Taking advantage of the same KB indulged in 'front running' i.e. he placed and executed orders before the order of Passport and consequently squared off the position when the orders of Passport were placed in the market. It was noted by the Board that trades were executed using telephone number registered in the name of AB at the common residential address of KB and AB. Thus AB allegedly aided and abetted KB and Dipak in these transactions. By adopting this method KB earned a total profit of ₹ 1,56,32,364/- from the alleged trades. The Board was of the view that such trading is violative of Regulation 3(a),(b),(c) and (d) of FUTP regulations. According to the Board, it also breached the integrity of the market and therefore in exercise of the powers under section 19 read with section 11(4) and 11B of the Securities and Exchange Board of India Act, 1992 (for short the Act), the whole time member of the Board passed an ad interim order on May 28, 2009 giving directions as under, pending investigation:

- “a. Dipak Patel, Portfolio Manager of M/s Passport India Investment (Mauritius) Ltd not to buy, sell or deal in any securities, directly or indirectly till further directions in this regard.

- b. Dipak Patel may not be associated with any FII or sub- account or any registered entity of SEBI till further orders.
- c. Kanaiyalal Baldev Patel, Anandkumar Baldevbhai Patel, BhoomiIndustries are hereby directed not to buy, sell or deal in any securities, directly or indirectly till further directions in this regard. The details with regard to the PAN and Passport number of the above stated entities are given below:

<b>Name of the Entity</b>	<b>PAN/ Passport Number</b>
Dipak Patel (Citizen of the United States of America)	U.S.A Passport No.209189753
Kanaiyalal Baldev Patel	AEWPP1442H
Anandkumar Baldevbhai Patel	AACFB8866B
Bhoomi Industries	AACFB8866B

- d. Kanaiyalal Baldev Patel and Anandkumar Baldevbhai Patel to deposit the profits amounting to Rs. 1,12,68,659.35 made by him, as per the calculations shown in Annexure-A of this ad-interim order, with the National Stock Exchange of India Ltd (NSE) within 15 days from the date of issue of this order. NSE shall keep this amount in their custody till further directions from SEBI. Failure to deposit the amount by the identified clients within the prescribed time would result in further actions against the client as may be deemed fit under the Acts, Rules, and Regulations that govern the same.
- e. M/s.Passport Capital, LLC (SEBI Registration No IN-US-FA-1016-05) and its Sub-account M/s Passport India Investment (Mauritius) Ltd to conduct an internal enquiry into the above matter and initiate appropriate actions against their employee Dipak Patel (Portfolio Manager of Passport India Investment (Mauritius) Ltd) named in this order and submit an action taken report within 30 calendar days of this order to SEBI.
- f. I further direct M/s. Passport Capital, LLC and its sub-account M/s Passport India Investment (Mauritius) Ltd to take steps to ensure that their trading information and other trade related details are not misused to the detriment of market integrity. I also direct them to exercise due diligence in supervising their employees to the above end.
- g. A copy of this Order shall be served on all recognized stock exchanges and depositories to ensure that the above mentioned entities are not allowed to undertake transactions prohibited in Para a & c above.”

The said ad interim order was also a show cause notice giving opportunity to the entities named therein to file their objections, if any, to the said order. After considering the reply filed by the entities against whom ad interim order was passed, the whole time member of the Board felt that there is no need to revoke or modify the interim direction and the same was confirmed by an order dated February 9, 2010.

During the course of hearing, we were told that no further action has been taken by the Board in these proceedings under section 11(4) and 11B of the Act.

4. The Board also initiated adjudication proceedings against the appellants under Chapter VIA of the Act and issued a show cause notice dated February 28, 2011 giving details of the investigation carried out by the Board. The said show cause notice also made reference to the response received from Passport in reply to the direction contained in the ad interim order dated May 28, 2009. The show cause notice records the contents of the Passport's letter dated September 17, 2009 as under:

“Passport Capital LLC, vide letter dated September 17, 2009 has made the following submissions with regard to the above:

- a. They employed the law firm Paul, Hastings, Janofsky and Walker LLP (Paul Hastings) to conduct an internal inquiry in the matter. The investigations of Paul Hastings found that Dipak Patel participated in a trading arrangement substantially similar to that alleged in the SEBI's interim order with KB and violated written policies and procedures.
- b. The investigation determined that some time during 2007, Dipak Patel would set up an arrangement with KB where KB would “warehouse” shares. The term in this context is used to describe a situation in which a broker collects small lots of shares for a potential buyer who is looking to purchase a large position. Once the full order is reached, the broker will then make those shares available to the buyer. Under Dipak Patel's warehousing arrangement, KB was filling the role of the broker by acquiring the shares prior to upcoming trades by Passport.
- c. The ostensible purpose of Dipak Patel's warehousing arrangement with KB, as described by Dipak Patel, was to obtain the best execution price for Passport, by both avoiding “front running” by brokers and reducing the impact that information relating to Passport's trades might otherwise have on the price of the securities.
- d. Paul Hastings and Passport concluded that Dipak Patel's actions violated Passport's written policies and procedures. Accordingly, Dipak Patel was disciplined and Passport provided Dipak Patel the option of resigning from the firm. Subsequently, on June 26, 2009, Dipak Patel resigned from Passport.
- e. Based on the interviews conducted and extensive review of documents, Paul Hastings found no evidence that any other Passport employee or principal authorized, was aware of, or was otherwise involved in the trading arrangement that Mr. Patel had with KB.”

The show cause notice concluded that as portfolio manager of Passport for India, Dipak was placing trade order for Passport coupled with the fact that KB bought and sold shares of various companies which were common between KB and Passport. The show cause notice also stated that during the investigation period, 557 synchronized

trades were executed on National Stock Exchange of India Ltd. (NSE) across 11 scrips between KB and Passport wherein both the buy order by the Passport and sell order by KB with identical price were placed within the gap of a few seconds. Similarly, there were 192 synchronized trades in 8 scrips between KB and Passport wherein both the sell order by the Passport and buy order by KB with identical price were placed within a time gap of a few seconds. Out of 228 scrips, 214 were common between KB and Passport. Similarly there were 50 synchronized trades executed between KB and Passport in 6 scrips on the Bombay Stock Exchange Ltd. (BSE) where buy and sell orders with identical price were placed within a few seconds. Such a large number of synchronized trades between KB and Passport resulted in a profit of ₹ 1,56,32,364/- to KB. The show cause notice alleged that the said action of the appellants was violative of the provisions of Regulation 3(a),(b),(c) and (d) of FUTP regulations making them liable to penalty under section 15HA of the Act.

5. The appellants filed their replies and submissions at the time of personal hearing. The adjudicating officer of the Board found them guilty of violating the provisions of Regulation 3(a),(b),(c) and (d) of FUTP regulations and imposed monetary penalty under section 15HA as under:

Sr. No.	Appeal no. and Name of the Appellant	Amount of penalty imposed
1.	Appeal no. 216 of 2011 Shri Dipal K. Patel (Dipak)	₹ 5 crore
2.	Appeal no. 74 of 2012 Shri Kanaiyalal Baladevbhai Patel (KB)	₹ 5 crore
3.	Appeal no. 78 of 2012 Shri Anandkumar Baldevbhai Patel (AB)	₹ 1 crore

Aggrieved by the aforesaid order passed in adjudication proceedings, the present appeals have been filed.

6. We have heard Mr. Janak Dwarkadas, senior counsel for the appellant in Appeal no. 216 of 2011, Mr. P.N. Modi, counsel in Appeals no. 74 and 78 of 2012 and Mr. Shiraz Rustomjee, senior counsel for the respondent Board. It was

strenuously argued by learned counsel for the appellants that all trades executed by KB were in the normal course; were screen based; at the prevalent market price and hence there was no market manipulation. KB had traded in 34 scrips and matching of trade with Passport was only in 17 scrips. The communication through telephone among cousins is in no way unnatural or unusual. KB has been dealing in the stock market since long and communication between him and Dipak was regular for a long time. According to learned counsel for the appellants, the adjudicating officer had ignored the submissions that Dipak has been advising his cousin in his newly established business of import of metal scrap. There is no finding that either Dipak or AB had dealt in the securities market or earned profit or shared profit. Therefore, adverse inference drawn on the ground of constant communication with each other is totally uncalled for. It was further submitted that selection of exchange and price generally depends on real time basis on the factors such as value, liquidity, price differential etc. and the investor chooses to trade or not to trade based on his rationale or behavioral judgment. Therefore, no adverse inference can be drawn against the appellant on these counts also. If at all there is any wrongdoing, it may be between Passport and Dipak who was the portfolio manager of the Passport and it is for Passport to take action, if any, against Dipak. The Passport has, in fact, terminated services of Dipak for violation of Passport's policies. However, that, by itself, does not mean that appellants can be charged for violation of FUTP regulations. Passport has not made any complaint to the Board against the conduct of Dipak. The transactions had not affected the market in any way as all transactions were screen based and at the prevailing market price. It was further argued by the learned counsel for the appellants that according to impugned order the transactions in question amount to front running but there was no such charge in the show cause notice.

7. Our attention was also drawn to the provisions of Regulation 4(2)(q) of the FUTP regulations which prohibit such front running by intermediaries. The appellants before us are not intermediaries and the Board has not consciously charged them for violating Regulation 4(2)(q) of the FUTP regulations. It was then argued that prior to coming into force of the FUTP regulations of 2003, Securities and Exchange Board of

India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 1995 were in force and under these regulations, the prohibition on front running was not confined to intermediaries alone but was applicable to 'any person' trading in the securities market. According to learned counsel for the appellants, the Regulations of 2003 make a clear departure from the earlier position and now front running is prohibited only by the intermediaries and not by other entities trading in the securities market. According to learned counsel for the appellants, this is the first case of this type and Board had not charged any person in the past for such activity. It was, therefore, contended that the impugned order deserves to be set aside.

8. Learned senior counsel for the respondent Board supported the order passed by the adjudicating officer and submitted that Dipak was handling sensitive affairs of a foreign investor and he was supposed to maintain highest standards of integrity. His conduct is unbecoming of holding such a high position with a foreign institutional investor. It is because of information provided by Dipak that KB could make huge profit. According to learned senior counsel for the respondent Board, this amounts to fraud against the market and employer of Dipak and has misled the investors as well. Passport had also conducted investigation as per direction given by the Board and Dipak has since been discharged of services from Passport. The services of Dipak were terminated by Passport because his conduct was in violation of Passport's policies. Although, Dipak has not made any profit, KB, cousin of Dipak made profit because of information provided by Dipak. According to learned senior counsel for the Board, it is incorrect to say that this is the first case of its kind since the Board has initiated proceedings in the past as well under similar circumstances against various entities. Reliance was placed on the following orders:

- (a) Order No. WTM/GA/30/ISD/10/07 dated October 1, 2007 passed by the whole time member of the Board in the matter of M/s. Ballarpur Industries Ltd.
- (b) Order No. WTM/KMA/IVD/267/06/2010 dated June 17, 2010 passed by the whole time member of the Board against Nilesh Kapadia and Ors.

Learned senior counsel for the Board had also drawn our attention to the order passed by this Tribunal in the case of M/s. Jayant Amaerchand Kalidas, [Appeal no.123 of 2010 decided on October 14, 2010] wherein this Tribunal had observed that front running is an irregular practice of a stock broker executing orders on behalf of its clients in a security while taking advantage of advance knowledge of pending orders from its other clients. This is something akin to insider trading and is not permitted in the market. He has also referred to various definitions of front running and argued that the activities of the appellant squarely fall within the definition of front running. He further argued that there is no shift in the charge from show cause notice to the impugned order. The charge in the show cause notice and charge in the impugned order is the same. The alleged act of the appellants is in violation of regulation 3(a),(b),(c) and (d) of the FUTP regulations by whatever name we may call it. Simply because the term 'front running' is not used in the show cause notice and was used in the impugned order will not amount to change or shifting of stand. It was, therefore, submitted by him that no interference with the impugned order is called for.

9. We have given our thoughtful consideration to the arguments on both sides and also perused the relevant documents. The allegation against the appellants in these appeals is that Dipak, portfolio manager of the Passport, passed on information about the impending trades of the Passport to his cousins KB and AB, based on which KB traded in the stock market and placed opposite matching orders first and then squared off the position with the orders of Passport. The said act of passing of information by Dipak by various means of communications including use of telephone of AB and trading done by KB using the said information is violative of Regulation 3(a),(b),(c) and (d) of FUTP regulations. Let us see what Regulation 3 of the FUTP regulations provides for:

**“Prohibition of certain dealings in securities**

3. No person shall directly or indirectly-

(a) buy, sell or otherwise deal in securities in a fraudulent manner;

- (b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made thereunder;
- (c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;
- (d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made thereunder.”

10. With a view to understand the provisions of the aforesaid regulations it is also necessary to look at the definition of ‘fraud’ as provided in Regulation 2(c) of the FUTP regulations, relevant portion of which reads as under:

**“Short title and commencement**

1.(1) These regulations may be called the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.

(2) .....

**Definitions**

2.(1) .....

(a) .....

(b) .....

(c) “fraud” includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include-

(1) a knowing misrepresentation of the truth or concealment of material fact in order that another person may act to his detriment;

(2) a suggestion as to a fact which is not true by one who does not believe it to be true;

(3) an active concealment of a fact by a person having knowledge or belief of the fact;

(4) a promise made without any intention of performing it;

(5) a representation made in a reckless and careless manner whether it be true or false;

(6) any such act or omission as any other law specifically declares to be fraudulent;

- (7) deceptive behavior by a person depriving another of informed consent or full participation;
- (8) a false statement made without reasonable ground for believing it to be true;
- (9) the act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.

And “fraudulent” shall be construed accordingly;

.....”

As the title of the regulation itself suggests, these regulations are for prohibition of fraudulent and unfair trade practices relating to securities market. It is, therefore, necessary to bring on record as to how the fraud perpetrated by the appellants has affected the securities market. It will also be necessary to look at the modus operandi of the appellants in the trading done by them. The allegation in the show cause notices is that on the basis of information provided by Dipak, KB has done front running in relation to the trades of the Passport. The term front running is not defined in the FUTP regulations. However, the adjudicating officer, in paragraph 6 of the impugned order, has referred to front running in the following words:

“It was alleged that the Noticee provided information to KB and AB with regard to the forthcoming trading activity of Passport and KB took advantage of the same and indulged in front running i.e. he placed and executed orders before the order of Passport and subsequently squared off his positions when the orders of Passport were placed in the market.”

11. Learned senior counsel for the respondent Board has also placed on record certain definitions of ‘front running’ as it is commonly understood. As per the Major Law Lexicon by P Ramanatha Aiyar (4<sup>th</sup> Edition 2010), ‘front running’ is defined as under:

“Front running. Buying or selling securities ahead of a large order so as to benefit from the subsequent price move.

This denotes persons dealing in the market, knowing that a large transaction will take place in the near future and that parties are likely to move in their favour.

The illegal private trading by a broker or market-maker who has prior knowledge of a forthcoming large movement in prices. (*Investment*)”

The Black’s Law Dictionary (Ninth Edition) defines the term ‘front running’ as under:

“front-running, n. Securities. A broker’s or analyst’s use of nonpublic information to acquire securities or enter into options or futures contracts for his or her own benefit, knowing that when the information becomes public, the price of the securities will change in a predictable manner. This practice is illegal. Front-running can occur in many ways. For example, a broker or analyst who works for a brokerage firm may buy shares in a company that the firm is about to recommend as a strong buy or in which the firm is planning to buy a large block of shares.”

It will thus be seen that if a person trades in stocks or other investments having knowledge of the upcoming transaction by a third party which is likely to affect the market price of the investment, the person can be said to be doing front running. Examined in the above perspective, is clear that the appellants were doing front running in relation to the trades of the Passport. The Board, while dealing with the matter, has used the word “customised front running”. We are unable to agree with learned counsel for the appellants that the Board has given up the charge of front running in the impugned order. Simply because the term front running is not used in the show cause notice, it does not mean that the charge has been given up. The conduct of the appellants as described in the show cause notice and as finally attributed to them in the impugned order, is the same. What we have to see is whether such front running is barred by the regulatory framework. Our attention was drawn to Regulation 4(2)(q) of the FUTP regulations which reads as under:

**“4.Prohibition of manipulative, fraudulent and unfair trade practices**

- (1) .....
- (2) Dealing in securities shall be deemed to be a fraudulent or an unfair trade practice if it involves fraud and may include all or any of the following, namely :-
  - (a) to (p) .....
  - (q) an intermediary buying or selling securities in advance of a substantial client order or whereby a futures or option position is taken about an impending transaction in the same or related futures or options contract.”

12. It is an admitted position on both sides that the aforesaid clause applies only to intermediaries and not to other persons trading in the securities market. Reference was made to the earlier FUTP regulations i.e. Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 1995 wherein Regulation 6 prohibits front running by any person and reads as under:

**“Prohibition of unfair trade practice relating to securities.**

6. No person shall -

- (a) in the course of his business, knowingly engage in any act, or practice which would operate as a fraud upon any person in connection with the purchase or sale of, or any other dealing in, any securities;
- (b) on his own behalf or on behalf of any person, knowingly buy, sell or otherwise deal in securities, pending the execution of any order of his client relating to the same security for purchase, sale or other dealings in respect of securities.

Nothing contained in this clause shall apply where according to the clients instruction, the transaction for the client is to be effected only under specified conditions or in specified circumstances;

- (c) intentionally and in contravention of any law for the time being in force delays the transfer of securities in the name of the transferee or the deapatch of securities or connected documents to any transferee;
- (d) indulge in falsification of the books, accounts and records (whether maintained manually or in computer or in any other form);
- (e) when acting as an agent, execute a transaction with a client at a price other than the price at which the transaction was executed by him, whether on a stock exchange or otherwise, or at a price other than the price at which it was off set against the transaction of another client.”

13. We are inclined to agree with learned counsel for the appellants that the 1995 Regulations prohibited front running by any person dealing in the securities market and a departure has been made in the Regulations of 2003 whereby front running has been prohibited only by intermediaries. The cases cited by the learned senior counsel for the Board and referred to above also relate to front running by intermediaries and not by other traders in the market. In the absence of any specific provision in the Act, rules or regulations prohibiting front running by a person other than an intermediary, we are of the view that the appellants cannot be held guilty of the charges levelled

against them. There is no denying the fact that when the appellants placed their order, these were screen based and at the prevalent market price. Admittedly Passport was the major counter party for trading in the market and was placing huge orders and hence possibility of order of traders placing orders for smaller quantities matching with orders of Passport cannot be ruled out. Therefore, it cannot be said that they have manipulated the market. The alleged fraud on the part of Dipak may be a fraud against its employer for which the employer has taken necessary action. In the absence of any specific provision in law, it cannot be said that a fraud has been played on the market or market has been manipulated by the appellants when all transactions were screen based at the prevalent market price.

We are of the considered view that in the facts and circumstances of the present case, the Board has erred in holding the appellants guilty of violating regulation 3 of the FUTP regulations. We, therefore, set aside the impugned orders and allow the appeals with no order as to costs.

Sd/-  
P.K. Malhotra  
Member &  
Presiding Officer (*Offg.*)

Sd/-  
S.S.N. Moorthy  
Member

09.11.2012

Prepared and compared by:

msb