



8TH KIIT NATIONAL MOOT COURT COMPETITION, 2021

16TH to 18TH July, 2021

MOOT PROPOSITION

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1. The Securities and Exchange Board of Indraprastha (“SEBI”) received several complaints between December 2019 to February 2020 inter alia alleging fraud, financial mismanagement and diversion of funds in Graystone Corporation Ltd (“GCL”) which is a company listed on National Stock Exchange of Indraprastha.
2. GCL was incorporated in the year 2010 and is registered with the Registrar of Companies, Mumbai. GCL consists of two promoters namely Mr. Nirav Shah and Mr. Harshad Damani, three Executive Directors namely Mr. Ketan Gupta, Mr. Mehul Kapadia and Mr. Nirav Shah and two Independent Directors namely Mr Suraj Jain and Mr. Ankur Jain. GCL is also registered as a non-banking financial institution with Reserve Bank of Indraprastha.
3. Pursuant to the complaints, SEBI initiated an investigation to examine the aforesaid allegations regarding diversion of funds from GCL for the benefit of GCL’s promoters / promoter connected entities and to ascertain whether there was any violation of the provisions of the SEBI Act and SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003 (**FUTP Regulations**), and/or any other SEBI rules / regulations, during the period between April 2018 to December 2019 by GCL and its officials/directors. During the course of investigation, SEBI exchanged a lot of correspondence with the GCL as well as its officers, directors, employees and called for various documents and records of GCL. As part of the investigation, SEBI also recorded the statements of the promoters, directors as well as various employees and executives of GCL. SEBI also directed a forensic audit to be conducted in connection with the financial statements of GCL by an independent forensic auditor. SEBI prepared an investigation report based on the findings of the forensic audit and its own investigation.
4. Based on the investigation report, SEBI issued an ex-parte interim order cum show cause notice dated 3rd November 2020 (“**Interim Order / SCN**”) under Section 11(1), 11(4), 11B(1) and 11(5) to the promoters and non-promoter executive directors of GCL. The said Interim order was also to be treated as a show cause notice and a reply was required to be filed within three weeks of the said order.
5. SEBI observed that the interest of the shareholders of the GCL was affected as funds to the tune of Rs. 500 crores lent as inter-corporate loans had moved out from the GCL for the benefit of the promoters during the period between April 2018 to December 2019.
6. SEBI further observed that the modus operandi of the diversion of funds by the Promoters entailed extending sums to various related parties of promoters through unsecured inter-corporate loans and investments.
7. It was observed that the borrower companies had weak financial standing with no revenue from operations, negative profit after tax, cash losses, accumulated losses and negative net worth. The loans

were unsecured and there was virtually no documentation or analysis of the financial standing of these companies by GCL while extending the loans except a one pager memorandum of understanding between GCL and the borrowing entities. There was also no record of the end use of the funds lent by GCL. Further, forensic investigation revealed that while funds were being advanced to promoters / promoter connected entities on one hand, bank statements of GCL were also being fabricated to show that part of the funds advanced were being repaid to GCL by the promoter entities.

8. SEBI in its investigation report observed that the aforesaid diversion of funds from GCL to the entities controlled by promoters will also have a significant impact on the shareholders of GCL. It was observed that funds amounting to Rs. 500 Crores had been diverted from the books of GCL for the utilization of promoters and promoter group entities.
9. In light of the large-scale diversion of funds of the listed entity by the promoters of the listed entity, SEBI was of the opinion that an urgent remedial action in the interest of investors was warranted under the circumstances.
10. Thus, the Whole Time Member of SEBI in the Interim Order, directed the freezing of the bank accounts of GCL's promoters namely, Mr. Nirav Shah and Mr. Harshad Damani and also the two non-promoter executive directors namely Mr. Ketan Gupta and Mehul Kapadia, pending final orders by SEBI.
11. The Interim order cum SCN, in addition to the various directions and actions it sought to take against the promoters, also called upon the two non-promoter executive directors Mr. Ketan Gupta and Mehul Kapadia to show cause as to why they should not be called upon to jointly and severally disgorge the amounts allegedly diverted by the promoters and why directions should not be passed against them restraining from taking up any position in a listed company or being associated with or accessing securities market.
12. In the meantime, the promoters of GCL, Mr. Nirav Shah and Mr. Harshad Damani were arrested by the Economic Offences Wing, Mumbai in connection with a criminal case filed on the same issue.
13. The two non-promoter executive directors Mr. Ketan Gupta and Mehul Kapadia, aggrieved by the Interim Order passed by SEBI, appealed the order before the Hon'ble Securities Appellate Tribunal, Mumbai ("**Hon'ble SAT**") who vide its order dated 1st January 2021 set aside the Interim Order passed by SEBI in so far as it related to the two non-promoter executive directors, stating that a pre-decisional hearing ought to have been granted by SEBI before freezing of accounts. The Hon'ble SAT also directed SEBI to expedite the proceedings and pass a final order within three months. SEBI appealed the order before the Hon'ble Supreme Court of India on the limited point that SEBI was not mandated to give a pre decisional hearing before passing the order in the given circumstances. The appeal is pending before the Hon'ble Supreme Court of India.

14. In the meantime, the two executive directors, Mr. Ketan Gupta and Mehul Kapadia addressed a letter to SEBI requesting for inspection of all the documents which SEBI collected during the course of its investigation. It was stated in the letter that while the said SCN issued to the two executive directors, annexed certain documents including the forensic report, a number of documents collected by SEBI during the course of investigation including the recorded statements of the promoters, and other company officials were not provided by SEBI. It was stated in the letter that if there was exculpatory material available as part of investigation, the same ought to be provided to them even if SEBI does not refer to or rely upon the same as part of the SCN. It was argued that they were entitled to rely upon such documents in their defence and hence it was important that all documents and material collected by SEBI during investigation ought to be provided to them.
15. SEBI however declined the request and stated that all documents referred to and relied upon by SEBI in the SCN were provided to the parties and only those documents will be available for inspection. It was stated that SEBI was not relying on the other documents which may have been collected as part of the investigation.
16. Thereafter, the two executive directors, Mr. Ketan Gupta and Mr. Mehul Kapadia filed their reply to the SCN along with the reply on merits. A preliminary objection on violation of principles of natural justice due to refusal of SEBI to provide them all the documents was taken. It was also argued by the two executive directors that they were not involved in any manner in the fraud perpetrated by the promoters and that there was no evidence suggesting that they were in any manner complicit with the promoters. It was also argued that in any case the directions sought to be imposed in the SCN are illegal, disproportionate and cannot be considered to be remedial in nature.
17. After hearing the parties, SEBI passed a final order dated 2nd March 2021 rejecting preliminary objection of the two executive directors in connection with inspection of all documents which formed part of the investigation and holding that only documents which are referred to and relied upon in the SCN by SEBI would be provided to parties. SEBI observed that being executive directors of GCL, it cannot be said that they were unaware of the modus operandi adopted and in the overall facts of the case it can be reasonably concluded that they were complicit with the promoters in perpetrating the fraud. It was held that their conduct was violative of Regulation 3 and 4 of the FUTP Regulations.
18. SEBI directed that the two executive directors were jointly and severally liable along with the promoters to disgorge an amount of Rs. 500 crores. It also passed a direction restraining them for taking up any position or being associated with the securities market in any capacity for a period of 2 years.
19. An appeal was preferred by and the two executive directors before the Hon'ble SAT. The Hon'ble SAT upheld the order passed by SEBI dated 2nd March 2021 and dismissed the appeal vide its Order dated 21st June 2021.

20. The two non-promoter executive directors filed an appeal before the Hon'ble Supreme Court of Indraprastha challenging the Order of the Hon'ble SAT dated 21st June 2021. The earlier appeal against the Hon'ble SAT's order dated 1st January 2021 filed by SEBI in connection with the necessity of a pre decisional hearing was tagged along with the said appeal and both the appeals were listed together for final hearing before the Hon'ble Supreme Court in August 2021. The following questions of law were framed:

1. Whether SEBI is mandatorily required to grant a hearing to parties before passing an order?

2. Whether SEBI is required to provide a Noticee with inspection and copies of all the documents collected and statements recorded by it during the course of investigation or whether SEBI is only required to provide inspection and copies of documents and statements which are referred to and relied upon by SEBI in the Show Case Notice?

3. Whether an order that the executive directors of GCL were jointly and severally liable with the promoters to disgorge an amount of Rs 500 crores was sustainable in light of the legal principles surrounding the concept of disgorgement?

4. Whether the order restraining the executive directors from taking up any position or being associated with the securities market in any capacity for two years was justified in terms of Section 11 and 11 B of the SEBI Act?

** Listed for hearing from 16th July 2021 to 18th July 2021.*

** Parties to file their Written Submissions / Memorandums by 10th July, 2021.*

** Laws of Indraprastha are pari materia to the Laws of India.*

Problem has been drafted by Zerick Dastur, Founder and Proprietor, Zerick Dastur Advocates and Solicitors.