

De Jure

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**FACEBOOK – CONNECTING PEOPLE TO
CONNECTED PERSONS...!!!**



INTRODUCTION

This article gives an analysis of one of the most recent SEBI's order on Insider Trading especially where it is concerning Promoters of a listed company and persons "CONNECTED" with them who have allegedly engaged in insider trading. SEBI for the first time ever has chosen the social media 'Facebook' to determine and to establish a connection between the parties who have committed Insider Trading.

The SEBI (Prohibition of Insider Trading) Regulations, 1992 was essentially brought in force by SEBI to deter the practice of insider trading in the securities of listed companies. Eventually various amendments to the said Regulations and also judicial paradigm through various case laws had also evolved to prohibit insider trading. But major overhaul of the Regulations have not been done. But SEBI on January 15, 2015 had notified SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**SEBI (PIT) Regulations**") and has been done in order to strengthen the legal and enforcement framework, toughen the insider trading rules, align Indian regime with International practices and to provide clarity to certain definitions and concepts.

To catch manipulators, market regulator Securities and Exchange Board of India ("**SEBI**") has begun looking into social media accounts of suspected persons, with 'mutual friends on Facebook' being cited as evidence. While SEBI has been examining Twitter and Facebook for quite some time for investigation purposes, this is the first time ever that SEBI has used Facebook account as evidence for proving charges against an individual.

This article gives an analysis of the latest SEBI's order passed in the matter of Palred Technologies Limited (the "**Company**") against persons connected with the promoters of the Company who have allegedly engaged in insider trading by using a Facebook account as evidence for proving charges against an individual.

FACTS OF THE MATTER

Palred Technologies Limited, is a micro-cap which runs LatestOne.com, an online mobile accessories store. By way of an order dated February 4, 2016, SEBI has held Mr. Palem Srikanth Reddy, Chairman and Managing Director (CMD) along with fifteen (15) others guilty of insider trading. The Company had undergone financial crises from which it recovered. Subsequently, the Company decided to sell its business on a slump sale

basis to another entity. It is pertinent to note that the price of the scrip was extremely low (₹ 16.80) following the period of recovery. Further, the Company decided to declare special dividend and also carry out a buyback of shares post the aforementioned transaction which lead to the shareholders receiving an amount much higher than the then ruling market price of the equity shares of the Company. Subsequently, the share price of the Company rose substantially i.e. ₹ 16.80 to ₹ 42.15 registering thereby an increase of 135% in forty four (44) trading days on NSE.

During the course of investigation, SEBI observed that the CMD and two (2) others were the persons privy to the 'slump sale of software solutions business to Kewill group'. The CMD was also privy to the information about the declaration of dividend. Therefore, the CMD being the connected person within the meaning of Regulation 2(c)(i) of the SEBI (PIT) Regulations and having access to the Unpublished Price Sensitive Information ("**UPSI**"), was alleged to be an 'insider' in terms of the Regulation 2(e) read with Regulation 2(c) of the SEBI (PIT) Regulations. The other fifteen (15) entities were also found to be connected through mutual friends on 'Facebook'.

WHO IS AN INSIDER?

Insider means any person who is:

- (i) A connected person; or
- (ii) in possession of or having access to unpublished price sensitive information

WHAT IS UPSI?

UPSI is a piece of information which is yet to be made public by a company but which, if published, would materially affect the market price of the shares of a company. In the present case, (i) the slump sale of the business of the Company; (ii) the proposed special dividend; and (iii) the buy-back of shares were known well in advance leading to do Insider Trading.

WHO ARE CONNECTED PERSONS IN THE PRESENT CASE?



In the aforesaid matter, connections between the parties were established on several grounds.

- (a) The CMD of the Company along with two (2) other persons were privy to the UPSI in relation to the slump sale and special dividend;
- (b) Further, SEBI observed and noted that Mr. Pirani Aryn Abdul Aziz is also found to be connected to Mr. Ameen Khwaja through mutual friends on Facebook. Mr. Aziz was employed with Deloitte Tax Services, a group company of Deloitte Touche Tohmatsu India Pvt. Ltd which had conducted the due diligence of the Company during its slump sale transaction;
- (c) Mr. Ameen Khwaja, one of the other connected person was found to be common director/promoter with the Chairman on another company (which was to be merged with the Company) which incidentally had also provided services to the Company;
- (d) Several family members of Mr. Ameen Khwajahad dealt in the shares of the Company and not Mr. Ameen Khwaja himself, though the same was construed as "Insider Trading" by SEBI.

FACEBOOK – CONNECTING PEOPLE..!!!

This is for the first time that SEBI has treated Facebook as a relevant factor to establish connection between persons. In this present case, SEBI has dealt and concluded that having "mutual friends" on Facebook will form the basis of determination of connection. Facebook is an open social media networking website connecting people where friends are made/ deleted even at times without knowing detailed background of the parties. In fact, there are times where people on Facebook may not be connected in any manner to the person concerned or may not be even offline contact with such person. However, it is pertinent to note that pursuant to the aforementioned order, SEBI has made it quite evident that it may



resort to and go to any extent to protect the interest of investors even if that takes in intruding into a "*so called*" private space of individuals viz. the social media platforms (*facebook, twitter, linkedin, etc*) to establish 'connection' for investigation purposes of insider trading violations.

The definition of the term "**connected person**" under the new SEBI (PIT) Regulations has been widened to include any person who has a connection with the company that has given him access to or is in possession of UPSI. Therefore, a banker or immediate relative of a banker or an official of a stock exchange or of clearing house or corporation who may not apparently be in occupation of any position in the company but are in regular touch with the company and its officers are all included under the definition of connected person since, these persons are presumed to know of the company's operations. Thus, in other words, irrespective of the fact whether or not a person is deployed in the company in a position to have an access to UPSI or through whatever connection is possible, if a person is in a position to access UPSI about any company or class of companies, then he would be construed as a "connected person".



OUR VIEW

It can be observed from this SEBI Order that SEBI is using technology and social media to establish relationships between persons who may be involved in securities markets violations. Though, this measure by SEBI is certainly innovative and unprecedented to establish a securities law violation, a Facebook connection itself maybe insufficient to establish that two persons are "Connected Persons" under SEBI (PIT) Regulations merely because they are connected *via* Facebook, although such connections could well provide a lead to SEBI to investigate in the right direction to establish connections on the basis of further evidence. This Order though issued by SEBI at its level, is yet to be tested before judicial forums like the Securities Appellate Tribunal (SAT) and the Courts to enable SEBI and even other regulatory authorities to rely upon such connections on social media to indict persons for violations of law.

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