
MOOT PROBLEM

IN THE SUPREME COURT OF INDIA

APPELLATE JURISDICTION

Appeal No. 1

The Securities and Exchange Board of India ... Appellant

v.

Zero-Cubed FinTech Limited
Directors of Zero-Cubed FinTech Limited
Skylight Capital Partners
Jack D'Souza
Moses Soares
Janesh Shah

....

Respondents

Appeal No. 2

Investor Protection Association of India
105 Investors of Zero-Cubed FinTech Limited ... Appellants

v.

Zero-Cubed FinTech Limited
Directors of Zero-Cubed FinTech Limited
Skylight Capital Partners
Jack D'Souza
Moses Soares
Janesh Shah
Grant Stanley Investment Bank Company

....

Respondents

1. Ram and Girija Diwan have earned the moniker of the “serial startup couple”. Being technology aficionados, over the last 20 years they have set up several businesses in the field that they have subsequently either taken public or sold to suitors such as acquirers or private equity investors. With a robust track record of success in their ventures, they have been a popular draw with potential investors who have all been keen to invest in their ventures.

2. Sometime in 2011, the Diwans were introduced at a social event to Jack D’Souza, a Mumbai-based banker, who had just then stepped down from his position as the India head of a prominent multinational bank. Jack was looking to establish a new venture in the FinTech space, which is entirely understandable given his extensive experience in the banking and finance sector. A casual conversation led to more extensive discussions, and the Diwans and Jack came up with a business proposal to establish a venture that will provide technological solutions to the banking industry, including establishing and servicing e-payment systems, which had been witnessing a lot of demand in India. After weeks of brainstorming, they shook hands on a deal that then needed to be put in place as soon as possible. The idea was to develop a solution called “Z-Cube”, which would operate as a back-end platform for e-payment systems being used by banks.
3. Accordingly, in July 2011, the parties negotiated and executed a Shareholders’ Agreement, pursuant to which they made investments into a new company Zero-Cubed FinTech Limited (“ZCFL”). The paid-up capital of ZCFL was INR 10 crore, with the company having issued only one type of security, i.e. equity shares. 75% of the shares of ZCFL were held by Diwan Family Office Private Limited, a company owned equally by Ram and Girija. At the time of establishment, 24% of ZCFL’s shares were held by Jack D’Souza, with the remaining 1% being held in equal proportion by five of the initial employees of ZCFL. Girija was the chairperson and managing director of ZCFL, with Ram being the Director (Operations) and Jack, the Director (Marketing and Customer Relations). They were also joined on the Board of Directors by Mr. Sharan Misra, a seasoned venture capitalist.
4. The company was off to a promising start. It steadily built up a healthy clientele over a couple of years and clocked an annual revenue of INR 150 crore by the Financial Year 2012-13. Given the exponential growth demonstrated, as well as further prospects for the future, the company’s expansion plan needed to be accompanied by a significant capital infusion. One option was for the company to embark upon the path of obtaining private equity funding, but the management resisted that option on the ground that private equity financiers would normally seek extensive control rights over the company that the current shareholders were unwilling to cede. Hence, the management decided that the company ought to undertake an initial public offering (“IPO”) of equity shares.
5. In May 2013, ZCFL kick-started the IPO process by appointing leading investment banks and law firms, who duly prepared a draft red herring prospectus, which was filed with the Securities and Exchange Board of India (“SEBI”) for comments. After obtaining SEBI’s comments and completing other formalities, the IPO successfully closed in November that year. The company issued 25% new equity shares in the IPO

for a total value of INR 250 crore, which in turn resulted in a proportionate dilution of the founders' stake. In preparation for the IPO, the Board of Directors and other governance structures of ZCFL were revamped to comply with the requirements mandated for listed companies. Accordingly, four additional directors were inducted into the company and were treated as independent directors for purposes of compliance with corporate governance norms.

6. Following the listing of its shares, ZCFL continued to progress on its growth trajectory, which in turn gave rise to a further need for capital injection into the company. During the press briefing while announcing the results for the second quarter of the Financial Year 2014-15, Girija had stated that the company is actively scouting for further funding opportunities and will be exploring potential options. This time, ZCFL's management decided against a follow-on public offering or a rights offering, which were not only costly, but also time consuming. It decided instead to go in for a PIPE (Private Investment in Public Equity) deal, with negligible control rights being offered to prospective investors. ZCFL appointed Grant Stanley Investment Bank Company ("GSIBC") to advise on the potential deal. GSIBC prepared an Investment Memorandum ("IM") and, in April 2015, scouted for investors by distributing the IM to about 20 potential suitors. The IM contained information that was already in the public domain. For this reason, neither ZCFL nor GSIBC required the recipients of the IM to sign any confidentiality agreement.
7. Before ZCFL began approaching potential investors, it had applied to SEBI to seek a no-action letter in relation to the process it proposed to undertake. This it did so because it wanted to preempt any legal risks relating to the transaction. In an informal guidance issued on March 31, 2015, SEBI stated that the proposed transaction involving the issue of IM by ZCFL to potential investors was in compliance with the relevant laws and regulations pertaining to SEBI. Neither did ZCFL mention in its request for no-action about confidentiality requirements, nor did SEBI impose any condition in its no-action letter relating to matters of confidentiality and non-disclosure. However, two days after the issue of the letter to ZCFL, SEBI issued another informal guidance to Asian Bearings Limited, also a client of GSIBC, which was undertaking a similar transaction to ZCFL, that the issue of an IM has to be preceded by "appropriate confidentiality and standstill arrangements." While GSIBC immediately brought this to the attention of ZCFL, the company's management decided to disregard SEBI's no-action letter to Asian Bearings Limited as that was of no concern to ZCFL.
8. One of the recipients of the IM was Skylight Capital Partners ("Skylight"), a Silicon Valley-based technology investment fund with a strong focus on South Asia. Skylight's managing partner, Mr. Kamil Merchant, was incredibly excited about the potential investment opportunity in ZCFL and was willing to stretch Skylight's financial limits

to bag the investment in the company, so long as the terms were acceptable. Based on the prevailing trading price of INR 250 per share on the National Stock Exchange of India Limited (“NSE”), Kamil calculated that any deal at a premium of 40% to the trading price was a steal. He was keen to obtain the ZCFL investment at any cost, especially because he truly believed that the market had undervalued the company’s business. Within a couple of days of receiving the IM and making these back-of-the-envelope calculations, Kamil was on the phone with Girija to seek to persuade her to offer the investment to Skylight. Girija in turn was reticent in her conversation, and simply mentioned that she and her management would have to follow the strict process set out by GSIBC in choosing the ultimate investor, especially because ZCFL is a listed company and had to ensure compliance with proper norms that were above board and were in the best interest of the shareholders. She instead prevailed upon Kamil to wait to hear formally from GSIBC.

9. In his keenness to bag the deal, Kamil felt that it would be helpful to apply pressure on both ZCFL as well as the other potential bidders for the company’s stake if Skylight adopted measures to strengthen its position. Its own investment bank advised that Skylight would be in a position of strength if it were to obtain a “toehold” in ZCFL, which would confer it an advance over other bidders. Accordingly, Skylight instructed its stock broker in India to place buy orders for up to 0.1% shares in ZCFL. The broker duly complied with the instructions and, over the period between May 1, 2015 and May 14, 2015, Skylight acquired 30,000 shares constituting 0.1% shares of ZCFL through the NSE in small trades from several hundred investors at an average price of Rs. 290 per share. During this period, there was a sudden spike in the share price of ZCFL which, during one trading session, went up to Rs. 350 per share to eventually close at Rs. 300 on May 14, 2015. Upon Skylight’s acquisition of a toehold, Kamil addressed an email dated May 17, 2015 to Girija informing her of the acquisition of the stake and explaining: “You may note how serious we are about the investment in your company and that we have put our money where our mouth is. I hope this will not only demonstrate our keenness to enter into an investment arrangement with your company, but also persuade you to consider us as your preferred partner.” Pat came Girija’s nonchalant and noncommittal reply: “Noted. You will hear from us on our decision soon.”
10. By the end of May 2015, ZCFL completed its pre-screening exercise, and narrowed its options to two investors who were informed that they could proceed to the next stage of conducting due diligence as well as negotiation of definitive terms. To Kamil’s relief, Skylight was shortlisted. But, to his dismay, he was pitted against ThreeCent Ventures (“ThreeCent”), a Cayman Islands-based private equity firm owned by Chinese investors, with a hard-nosed investment strategy that was supplemented by an almost inexhaustible pool of cash. Kamil realized he had a tough battle on his hands.

11. The due diligence process began in early June 2015 after both Skylight and ThreeCent signed a confidentiality agreement with ZCFL that required the short-listed investor to not disclose the fact of a potential investment transaction, the terms thereof, or any confidential information received by them during due diligence. In addition, the investors undertook not to use the information for any purpose other than the proposed transaction, and also not to trade in the shares of ZCFL when in possession of any confidential information. As part of the due diligence, each of the investors was provided access to a virtual data room for a period of five days from June 6, 2015 to June 10, 2015. They were also provided with a draft Investment Agreement. The process required that by June 15, 2015, each of the investors should make a firm bid (including price) for the transaction, which was now confirmed to take the shape of ZCFL issuing 5% of its shares (on a post-diluted basis) to the successful bidder.
12. While the due diligence process was relatively smooth, one particular issue caused some wrinkles. Among the documents disclosed in due diligence was a proposed contract of significant proportions that ZCFL was to enter into with Raider Banking Company, Inc. (“**Raider**”), which would constitute 60% of the total business of ZCFL. The negotiations with Raider were nearly complete, and the deal was expected to be signed and announced to the stock market on June 15, 2015. Given the material nature of the transaction, ZCFL disclosed the draft agreement with Raider as part of the due diligence to Skylight and ThreeCent, but it redacted certain key information, including the price of the transaction and the tenure of the proposed arrangement, as they were not only confidential, but could be subject to minor adjustments during the final round of negotiation. While news reports had been doing the rounds that ZCFL was in the course of snaring a new mega-deal, the details of the transaction as well as the identities of possible counter-parties were sparse, and were a subject of great speculation in the markets. In any event, on June 15, 2015, a services agreement was signed between ZCFL and Raider, after which ZCFL’s company’s secretary informed the stock exchange within 15 minutes of the signing. The Raider relationship was viewed very favourably by the market, and the ZCFL stock soared on a steep upward trajectory, reaching Rs. 400 per share by the end of June 2015. Aside from the market perception, the Raider deal has benefited ZCFL immensely as it has considerably added to the revenue and profitability of the company and significantly enhanced shareholder value.
13. In the meanwhile, the negotiations for the investment into ZCFL were on in full swing. The company had set a deadline of June 30, 2015 to complete the choice of the successful bidder. It was a tough call as there was little to choose between Skylight and ThreeCent as their strengths and weaknesses were largely comparable. ZCFL’s management went into a huddle for three full days and, in the end, decided to invite Skylight as the investor into the company by proposing to issue 5% shares in the company at a price of INR 460 per share (which was at some premium to the prevailing

market price). ThreeCent failed in its bid as it had quoted its final price at a marginally lower price of INR 450 per share. Kamil was thrilled with this development and began to foresee the tremendous returns Skylight would receive in the long term from its investment in ZCFL. On July 15, 2015, the Investment Agreement was signed between Skylight and ZCFL. On August 17, 2015, a shareholders' meeting was convened to approve the issue of shares to Skylight, at which the resolution therefor was passed with the requisite majority. On August 25, 2015, the issue of shares to Skylight was complete, and necessary filings were thereafter made with the relevant regulatory authorities.

14. Buoyed by Skylight's investment, the management of ZCFL continued with its relentless pursuit of growth and was poised for another year of record financial results. But, in January 2016, ZCFL, its directors as well as Skylight received a show-cause notice ("**First Show-Cause Notice**") from SEBI alleging breach of the provisions of the Securities and Exchange Board of India Act, 1992 ("**SEBI Act**") and relevant regulations issued pursuant to that legislation. In particular, the allegations pertained to the disclosure of information by ZCFL and its management to Skylight in violation of SEBI regulations, as also the acquisition of shares by Skylight from the market in May 2015. It transpired that based on certain complaints filed by the Investor Protection Association of India ("**IPAI**"), a SEBI-recognised investor association, SEBI had initiated an investigation of the transactions surrounding the issue of shares by ZCFL pursuant to the IM. Along with this and surveillance reports from the NSE, SEBI had reason to believe that the transaction specified in its First Show-Cause Notice contravened legal provisions, and it threatened to take appropriate action against ZCFL, its directors and Skylight, including debarring them from the capital markets for a period of three years.
15. Reacting rapidly to a bolt from the blue, the noticees assembled their legal teams and prepared their response to SEBI's allegations. While they were in the process, ZCFL and its management were struck by another SEBI show-cause notice ("**Second Show-Cause Notice**"), this time addressed to ZCFL, Jack D'Souza and two persons named Moses Soares and Janesh Shah. The Second Show-Cause Notice detailed a set of transactions and events that led to possible violations of the SEBI Act and the regulations issued thereunder. Moses Soares was an investment analyst employed by Goreman Bushing Investment Company ("**Goreman Bushing**"), an investment banking firm that was hired in 2015 by ThreeCent to advise it on its potential investment in ZCFL. Moses was neither staffed on the ZCFL transaction on behalf of ThreeCent, nor did he take part in any of the financial due diligence, valuation analysis or other aspects of the deal. SEBI has also acknowledged that Goreman Bushing had what the market popularly refers to as "Chinese walls", namely strict isolation of client information among various departments within the organization.

16. However, it turned out that Moses was the brother-in-law of Jack D'Souza. During a family gathering on June 11, 2015, Jack had received a telephone call from Girija to discuss certain matters pertaining to the Raider contract. Jack was seated on the inside chair of a large table and did not want to disturb other family members by stepping out. Hence, he had a brief discussion with Girija from amidst the company of his family members, although he was conscious not to speak in terms that would be obvious to the others. He referred to "The Lost Ark" (which was the code word for the Raider transaction), although it was clear he was referring to an aspect relating to a customer contract. After dinner that night, Moses confronted Jack about the conversation and intended to seek further information. However, Jack stuck to his guns and did not disclose any details and simply stated that his professional commitment and confidentiality obligations prevented him from speaking further. At the same time, Jack feared that he may have let the cat out of the bag since Moses seemed to have a strong inkling of the goings on within ZCFL. Jack did not wish to precipitate matters given the sensitivity in the negotiations in progress with Raider, and hence did not mention this turn of events with any of the other members of ZCFL's management.
17. It is SEBI's case that Moses immediately contacted his close friend, Janesh Shah, who is a technology investment analyst at Manohar Das Stock Broking Limited. Being someone who has specialized in the field for over 15 years, Moses believed that he may be onto something if he can enlist Janesh's help to suss out more details regarding the transaction. After some brainstorming overnight and reviewing the details of various companies who could be possible future customers of ZCFL, Moses and Janesh zeroed in on Raider as being the possible counter-party with whom ZCFL was carrying out discussions for a possible deal. The next step was to try and construct some details around the transaction to examine whether it would be a valuable deal for ZCFL or not. Here, the deal value (based on the pricing of the transaction) was crucial. Janesh felt, based on his analysis and experience, that the deal size would be anywhere between INR 150 crore and INR 175 crore. That's when Moses recalled Jack's telephonic conversation where he had overheard a mention of "1.6", which the two of them then took to mean a value of Rs. 160 crore. Similarly, they arrived at a ballpark tenure of 5 years for the contract, based on Moses overhearing "20 qua.... periods" from Jack's telephonic conversation.
18. Soon enough, around noon on June 12, 2015, Janesh created a WhatsApp group which he titled "Goldmine", which included Moses and seven other stock brokers known to Janesh, wherein Janesh conveyed this information regarding the potential contract between ZCFL and Raider at a value of INR 160 crore for a term of 5 years. There was considerable excitement on the WhatsApp group as the participants knew that this would catapult ZCFL into the major league and substantially enhance its financial position and future prospects. There was unanimity on the group in their conclusion

that it would be a great investment opportunity to buy some ZCFL stock. As it happens, none of them (except Moses) had previously traded in ZCFL stock. Between June 12, 2015 and June 14, 2015, the members of the Goldmine WhatsApp group all engaged in fervent purchases of ZCFL stock in more than a hundred small trades. They acquired several thousand shares of ZCFL at an average price of Rs. 300 per share. It was further ascertained that by mid-July, they had all liquidated their shareholding at an average price of Rs. 375 per share, thereby earning a total profit of INR 25 Lakh. Moses, however, liquidated only half of the shares he acquired during the relevant period as he was more bullish about the long term prospects of the company and wished to stay in the investment.

19. The circumstances in which SEBI got whiff of the matter are rather peculiar. Due to his inadvertence, Janesh forwarded some of the relevant messages (that he intended to post on the Goldmine WhatsApp group) to Jayesh Joshi, who was on his WhatsApp contact list. Jayesh, being an active member of the IPAI, brought this to the notice of the association, which then provided the details to SEBI along with its complaint. Although Moses and Janesh are known to be members of the “Goldmine” WhatsApp group, the identity of the others is not yet available with SEBI. Upon receipt of the notice from SEBI, all members of the group (apart from Moses and Janesh) “left” the group and it might very well be that they may have deleted the messages from their WhatsApp. In this background, SEBI in its Second Show-Cause Notice threatened to take appropriate action against ZCFL, Jack, Moses and Janesh, including by debarring them from the capital markets for a period of three years. SEBI also required Moses and Janesh to provide transcripts of the WhatsApp conversations on the Goldmine group, but they flatly refused. In response, SEBI seized the smartphones belonging to Moses and Janesh, but that was of no avail as the two noticees remained steadfast in their refusal to help unlock their phones.
20. The noticees in both the First Show-Cause Notice and the Second Show-Cause Notice vehemently contested the allegations, arguing that they had not committed a violation of either the SEBI Act or any of the regulations issued thereunder. They also made a similar representation before the whole-time member of SEBI. After considering all the contentions, the SEBI Whole-Time Member passed orders on July 15, 2016 by which ZCFL, its directors and Skylight (under the First Show-Cause Notice) and ZCFL, Jack, Moses and Janesh (under the Second Show-Cause Notice) were debarred from the capital markets for a period of three years commencing that date. Separately, adjudication proceedings were also commenced in respect of both the matters, and the Adjudicating Officers respectively imposed a penalty of INR 1 Crore in relation to the transactions covered by the First Show-Cause Notice and INR 50 Lakh in respect of those covered by the Second Show-Cause Notice.

21. Against all of the SEBI orders, the affected parties filed appeals before the Securities Appellate Tribunal (“SAT”). After hearing all the parties concerned, on June 7, 2017, SAT ruled against SEBI on all the appeals, and held that none of the parties had indulged in a violation of either the SEBI Act or any of the regulations relevant to the case. Against the SAT orders, SEBI has preferred appeals before the Supreme Court of India (referred to in the aggregate as “**Appeal No. 1**”).

22. In the meanwhile, immediately after the issue of the Show-Cause Notices by SEBI, IPAI initiated an action before the National Company Law Tribunal (“NCLT”) in Mumbai (where the registered office of ZCFL is located) under Section 245 of the Companies Act, 2013 seeking damages from ZCFL, its directors, Skylight and GSIBC for wrongful conduct on their part that resulted in a loss caused to various investors who sold their shares during the period May 1, 2015 and May 14, 2015 (related to the First Show-Cause Notice) and June 12, 2015 and June 14, 2015 (related to the Second Show-Cause Notice). IPAI’s petition received the support of 105 investors of ZCFL who had sold their shares during the relevant periods. They sought compensation on behalf of all investors who may have sold to the respondents during the relevant period for the loss they suffered due to the suppression of information on the part of the respondents, due to which they sold shares at a value less than the true value of the shares (which would have been discovered if the information was available to the market). In other words, they sought to recover from the parties the difference between the price at which they sold their shares (with the average being INR 290 and INR 300 per share respectively under the First and Second Show-Cause Notices) and the price that prevailed in the market after the information came to light. On this basis, they claimed a total of INR 2 Crore in compensation.

23. The NCLT admitted the IPAI’s petition and, after hearing the parties, ordered that that the petitioners be given compensation of INR 2 Crore, with the detailed process and individual distribution of amounts to be determined by Justice Barua, a retired judge of the Bombay High Court. Against this, the respondents appealed to the National Company Law Appellate Tribunal (“NCLAT”), which set aside the NCLT order and ruled that circumstances did not exist for payment of compensation to the affected investors under Section 245 of the Companies Act, 2013. In turn, IPAI (and the other petitioners) appealed to the Supreme Court (“**Appeal No. 2**”), which is seized of the matter.

24. Since the two appeals arise out of the same set of transactions, the Supreme Court has decided to hear them together.
