BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.39 of 2007

Date of decision: 18.8.2010

SMIFS Securities Limited
Vaibhav (5F), 4 Lee Road,
Kolkatta. ….. Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No.C-4A,
G Block, Bandra Kurla Complex,
Mumbai. ….. .Respondent

Mr. P.N. Modi, Advocate with Mr. N.P. Lashkari, Advocate for the Appellant.

Mr. Shiraz Rustomjee, Advocate with Mr. Kersi Dastoor, Advocate for the Respondent.

CORAM : Justice N.K. Sodhi, Presiding Officer
Samar Ray, Member
P.K. Malhotra, Member

Per : Justice N.K. Sodhi, Presiding Officer (Oral)

This appeal under section 15 T of the Securities and Exchange Board of India Act, 1992 (for short the Act) is directed against the order dated February 15, 2007 passed by the whole time member of the Securities and Exchange Board of India (hereinafter called the Board) imposing a major penalty of suspension for six months of the certificate of registration of the appellant which is a member broker of the Calcutta Stock Exchange Association Limited (hereinafter referred to as the exchange).

2. The Board carried out investigations into the trading in the scrip of DSQ Industries Ltd. (for short the company) whose shares are listed on the exchange. Investigations revealed that the appellant as a broker had executed one trade each on 5 days on behalf of its clients on December 20 and 21, 2000 and on January 9, February 13 and March 1, 2001 and it is alleged that the appellant through these trades had indulged in circular trading and created artificial market and raised the price artificially giving a misleading appearance of trades on the screen of the exchange. On conclusion of the investigations, the appellant was served with a show cause notice dated November 28, 2003 calling upon it to show cause why action be not taken against it for the acts of commission and omission referred

to in the investigation report the relevant portions of which were summarized in the annexure appended to the notice. The trades executed by the appellant on the aforesaid five dates were mentioned and it was alleged that the trades executed on December 21, 2000 and January 9, 2001 appeared to be non genuine and could have been executed for the purpose of funding and that they showed promoter broker nexus. It was also alleged that the trades indicated linkages between the Biyani group of companies and the appellant's group of companies since the appellant was a common broker on both sides in the aforesaid trades. On receipt of the show cause notice the appellant filed its reply and explained as to how each trade was executed and it was emphatically denied that the trades were fictitious, non genuine or were executed for purposes of funding. The enquiry officer considered the material on the record including the explanation furnished by the appellant and agreed with the latter that no trade had been executed on December 20, 2000. He examined in detail the trades executed by the appellant on December 21, 2000 and January 9, 2001 and came to the conclusion that the cross deals executed by the appellant on behalf of its clients could not be said to be non genuine or that they had been executed for the purpose of funding only. On the basis of the material available on the record he accepted the plea of the appellant and gave it the benefit of doubt. As regards the trades executed on February 13, 2001, the enquiry officer was of the view that there were no linkages between the appellant's group of companies and the Biyani group as alleged in the summary of allegations annexed to the show cause notice. He accepted the explanation of the appellant and gave it the benefit of doubt on this count as well. The enquiry officer then examined in detail the trade executed on March 1, 2001. It was a cross deal by which 1,50,000 shares were traded in which Maya Trade Links Ltd. (Maya) was the buyer and Hulda Properties and Trades Ltd. (hereinafter referred to as Hulda Properties) was the seller. The enquiry officer found that this trade had been expunged by the exchange on March 14, 2001 on the ground that it was in the nature of fund accommodation. In view of the fact that the trade had been annulled by the exchange, the enquiry officer recommended that the appellant be warned on this count. The enquiry report dated July 22, 2004 was then considered by the whole time member. By notice dated July 30, 2004 the enquiry report was furnished to the appellant calling upon it to show cause why penalty as considered appropriate be not imposed on it. A reply was again filed by the appellant furnishing a

detailed explanation in regard to the trades executed by it, particularly the one on March 1, 2001 in regard to which the enquiry officer had recommended a warning. Since the recommendation of the enquiry officer was based on the decision of the exchange to annul the transaction on the ground that it was in the nature of funding, the appellant pointed out that it was the broker on both sides and that it had nil obligations to the exchange in respect of those transactions. It was also pleaded that the appellant had not made any advance payment to the selling client i.e. Hulda Properties and, as per the order of the exchange, the transaction had been cancelled. The whole time member considered the enquiry report alongwith the other material on the record including the explanation furnished by the appellant in regard to all the aforesaid trades and disagreed with the findings recorded by the enquiry officer on the trades executed on December 21, 2000, January 9 and February 13, 2001. The whole time member did not advert to the details of the trade executed on March 1, 2001 nor did he consider the findings of the enquiry officer or the explanation furnished by the appellant in regard to this trade and found that the other trades executed by the appellant violated the provisions of Regulations 4(a) to (d) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 (hereinafter referred to as the regulations). Accordingly, by his order of February 15, 2007 he suspended the certificate of registration of the appellant for a period of six months. Hence this appeal.

3. We have heard the learned counsel for the parties. As already noticed above, the enquiry officer did not find fault with any of the trades executed by the appellant except the one executed on March 1, 2001 and the whole time member has disagreed with those findings. He has not dealt with the trade executed on March 1, 2001 at all. There is no gainsaying the fact that the whole time member is entitled to disagree with the findings of the enquiry officer but in that event it is incumbent upon him to record his reasons for dissent and those reasons must be communicated to the delinquent to enable him to represent, if he wants to, that the findings recorded by the enquiry officer were correct and that there was no good reason to differ with those findings. We find that this procedure was not followed in the instant case. This, in our opinion, violates the principles of natural justice. The appellant in whose favour the findings have been recorded by the enquiry officer should have known the grounds on which the whole time member wanted to

disagree. It is not that the whole time member after considering the arguments can disagree with the findings for the first time in the final order that he passes. Such a procedure is not in accordance with the principles of natural justice as it deprives the delinquent of his right to represent that the findings of the enquiry officer ought to be upheld. In this view of the matter, we were inclined to set aside the impugned order and remand the case to the whole time member for a fresh decision after communicating to the appellant the reasons for dissent. Mr. P.N. Modi, learned counsel for the appellant strenuously urged that he does not want the case to be sent back for a rehearing and that on the basis of the material that is on the record we should look into the details of the aforesaid trades which had been called in question and decide the case on merits. Since the impugned trades were executed almost a decade back and the proceedings against the appellant were initiated in the year 2003 and the sword of Damocles has been hanging since then, we have accepted the plea of Mr. Modi and are examining the validity of the trades ourselves.

4. Nothing much needs to be said in regard to the trade allegedly executed by the appellant on December 20, 2000. The enquiry officer agreed with the appellant that it had not executed any such trade on that day and the whole time member does not hold to the contrary. We shall first examine the trade of December 21, 2000. This transaction was executed for an aggregate quantity of 4,48,000 shares of the company. Hulda Properties was the seller and SMIFS Capital Markets Ltd. (hereinafter referred to Capital Markets) and Dhanavaridhi Concerns Limited (hereinafter referred to Dhanavaridhi) were the two buyers and the appellant was the common broker for both sides. The trade was executed on the online trading terminals of the exchange. The seller i.e. Hulda Properties delivered 62,000 shares against their sale obligation for 4,48,000 shares. Out of the 62,000 shares 50,000 shares were delivered to Capital Markets and 12,000 shares to Dhanavaridhi. By letter dated December 23, 2000 the seller informed the appellant that it was unable to deliver the balance quantity and requested for the cancellation of the contract in regard to the undelivered quantity. This request was communicated by the appellant to the counter party i.e. Capital Markets who consented to the same in writing. Since the appellant as a broker had bought and sold 4,48,000 shares on the trading screen, its obligation to the clearing house of the exchange was nil. As already observed, the enquiry officer found

nothing wrong with the cancellation of the contract in regard to the undelivered quantity but the whole time member found the entire trade to be questionable and recorded his findings in paragraphs 4.4 and 4.5 of the impugned order which read as under:-

> "4.4 In the first instance, it is a cross deal wherein the Broker was present on both the sides, by which the anonymity of the trading system was breached, crediting the Broker with the necessary knowledge as to the true purport of the transaction. Further the cross deal resulted in pushing up the price by 8% and thereby impacting the price and volume (by 41.10%). Definitely, these artificial developments generated investor interest. Further, in addition, the fact that SMIFS Capital Markets Ltd. (promoter of the Broking company) had given its consent to square off the purchase transaction for the balance 3,86,000 deliverable to SMIFS Capital Markets Ltd. at purchase rate itself instead of close-out the short delivery as per SEBI's Circular dated December 09, 1996 and thereby foregoing around Rs.2.62 crores as auction proceeds profit being 20% more than the closing price is clearly an accommodation, thereby establishing a strong community of interlacing interest of the Broker and the promoter companies in the cross deals relating to DSQ.
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> 4.5 Definitely it is a clear case of accommodation having congruence of interest and such an act could not be anything but compatible with a scheme of manipulation, to which the Broker is a privy."

Having examined the findings, we cannot agree with the whole time member. No doubt the transaction was a cross deal because the appellant was a common broker for the buyer as well as the seller but such trades are lawful and recognized by the market and also by the Board as a regulator. Since the screen based trading system permits a cross deal, it cannot be said that such deals breach the anonymity of the system. He records a finding that the deal resulted in pushing up the price by 8 per cent and volumes by 41. 10%. There is no charge in the show cause notice that the appellant had manipulated or pushed the price of the scrip upwards though it was mentioned as a fact that the trade was 8% higher than the last traded price. Neither the show cause notice nor the impugned order points out as to what the last traded price was and whether there were other orders at a lower price pending in the system when the trade was executed. These pending orders can tell us whether the appellant or its client were pushing the price upwards. In the absence of this material, it cannot be said that the appellant by executing the trade at 8 per cent higher was trying to raise the price upwards. It is pointed out by the learned counsel for the Board that the appellant did not ask for this information at any stage of the proceedings. This is so because there was no such charge in the show cause notice. The only charge in regard to this trade was that it was non genuine because it had been executed for the purpose of funding only. The enquiry report also does not point out that the price of the scrip was

sought to be pushed up by the appellant. The whole time member observes that the Capital Market had foregone a sum of Rs.2.62 crores by agreeing to cancel the contract in regard to the undelivered quantity instead of closing out the trade on the trading screen of the exchange. He has referred to the Board's circular of December 9, 1996 and concludes that the transaction executed by the appellant was in the form of an accommodation given by the buyer to the seller. He also concluded that this accommodation was compatible with the scheme of manipulation. We cannot agree with him. The circular referred to in paragraph 4.4 of the impugned order is the one issued by the Board to the stock exchanges requiring them to amend their bye laws so as to provide a procedure for close out of the trades as referred to in the circular. It is the appellant's case which could not be refuted by the respondent that the Calcutta Stock Exchange had not amended its bye laws to incorporate the procedure atleast till the time when the impugned trade was executed. The whole time member has also observed that this trade generated investor interest. We have on record the price volume data of the scrip of the company which clearly indicates that no trade took place after December 21 till December 31, 2000. We wonder how the impugned trade generated investor interest. At this stage we may notice the argument of the learned counsel for the Board. He argued that instead of the parties cancelling the contract for the undelivered quantity, the trade should have been squared off on the trading screen of the exchange and since that was not done the appellant is guilty of violating the procedure prescribed in this regard. No such charge has been laid in the show cause notice and, therefore, we cannot accept this plea on behalf of the Board.

5. The next trade that has been called in question is the one that had been executed on January 9, 2001. This is also a cross deal where the appellant was a broker for the buyer and the seller. Capital Markets and Dhanavaridhi are the sellers who sold 62,000 shares and Maya was the buyer. The charge in regard to this trade is also that it was executed for the purpose of funding and shows promoter broker nexus. It is alleged that one Deepak Shah was the authorised signatory for Maya who was operating its bank account with Indus Ind Bank and the same Deepak Shah had signed the client agreement form on behalf of Capital Markets. From this it is sought to be inferred that there was a link between Maya and Capital Markets and the appellant. In our view this inference is farfetched but even if one were to assume that there was such a link, we fail to understand as to how it

vitiates the transaction in question. As already noticed, the gravamen of the charge is that this trade was executed for the purpose of funding. We have perused the allegation in the annexure to the show cause notice and find that it is as vague as it could be. Who has funded whom has not been pointed out. There is not even an iota of material on the record to show that the appellant or any of its group companies including Capital Markets had at any point of time given funds to either party on the basis of which it could be said that it was a funding transaction. The enquiry officer was right in observing that no fault could be found with this trade. The whole time member has really gone on a tangent in recording a finding against the appellant in paragraph 4.6 of the impugned order. He observes that the cross deal executed by the appellant pushed the price of the scrip from Rs.339 to Rs.450. What he does not appreciate is that the price of the scrip was Rs.339 on December 21, 2000 and that the impugned transaction was executed on January 9, 2001. On that day the opening price of the scrip was Rs.452 and what wrong did the appellant do when it executed a trade at the rate of Rs.450.50 (wrongly mentioned as Rs.450 in the impugned order). We fail to understand how this trade could have pushed the price up. In any case, this is not even the charge in the show cause notice. It has been repeatedly observed that the price and volumes had been manipulated but we see no evidence of this in the absence of any material. The price volume data which is on the record indicates that this trade was executed around the prevailing market price on that day. On January 9, 2001, 2,62,000 shares were traded which means another 2,00,000 shares had also been traded where the appellant was not the broker. In this background, the trade executed by the appellant on behalf of its clients could not be said to have artificially increased the volumes or the price.

6. This brings us to the trade executed by the appellant on February 13, 2001 which has also been called in question. The allegation is that the appellant sold 3,25,000 shares on behalf of its clients Hulda Properties and Biyani Securities Pvt. Ltd. (Biyani) and Harish C. Biyani (H.B) was the counter party broker and that the appellant delivered 1,55,000 shares directly to Biyani and 1,70,000 shares to H.B. The charge is that this trade was synchronized and that the appellant by directly delivering the shares to the counter party brokers without going through the clearing house of the exchange had violated the regulations. It is also alleged that the appellant transferred 4,15,000 shares of DSQ Holdings Ltd. on February 27, 2001 to Biyani which in turn sold the shares to Stock

Holding Corporation of India Ltd. From this it is concluded that there were linkages among the Biyani group (Biyani and H.B.), the DSQ group and the appellant. As regards the charge of synchronization, we find that it cannot bear scrutiny even for a moment. No details of synchronization have been furnished either in the show cause notice or in the enquiry report and even the whole time member has not referred to the same in his order. In the absence of order and trade logs, it cannot be said that the trade executed by the appellant as a broker was synchronized with a view to manipulate. The explanation furnished by the appellant in its reply makes the position clear. It is true that 3,25,000 shares in the pool account of the appellant came from Biyani on behalf of Hulda Properties which were sold through the trading system of the exchange. The system being anonymous, it could not be known at the time of the trade as to who the counter party broker was. Having sold the shares on the exchange, the appellant deposited these shares with the exchange towards early pay in. On the following day the appellant received 4,15,000 shares from DSQ Holdings pending sale instructions. While these shares were lying in the pool account of the appellant, the exchange issued delivery instructions to the appellant requiring it to deliver the shares directly to the counter party brokers and the instructions contained the names of Biyani and H.B. The appellant was required to deliver the shares by February 22, 2001. The exchange had made it clear that the appellant should produce confirmation of delivery from the counter party broker and only then would it be given the pay out for the shares delivered on February 13, 2001. Since the appellant had not received the shares from the exchange and was required to deliver the same to the counter party brokers, it utilized the shares transferred to it by DSQ Holdings with its consent for meeting the delivery obligations. The shares were actually delivered on February 21, 2001 and the delivery confirmation was furnished with the exchange and it was thereafter that the appellant received 3,25,000 shares back from the clearing house of the exchange. Having received the shares, the appellant then on instructions from DSQ Holdings transferred the same to Biyani’s account with the Stock Holding Corporation of India Ltd as per the written instructions. As already noticed, the enquiry officer accepted the explanation furnished by the appellant and found no fault with the trade though he was not clear as to why DSQ Holdings transferred 4,15,000 shares to the pool account of the appellant without giving any sell order and why it allowed the shares to be used towards

the obligation of Hulda Properties. He, however, did not record any finding against the appellant. In this background, he gave the benefit of doubt to the appellant though he specifically recorded a finding that there was no link between the appellant and the DSQ group of companies or Biyani group. The whole time member curiously records a finding that the shares were diverted by the appellant to meet its margin obligations and this, according to him, was a clear violation of the code of conduct prescribed for stock brokers. He did not appreciate that there was no charge of violation of the code of conduct in the show cause notice. We have already noticed that the only charge on the basis of different trades executed by the appellant was that it violated Regulations 4(a) to (d) of the regulations. In the light of the explanation furnished by the appellant which has not been rejected in the impugned order, it is clear that the appellant had deposited the shares with the exchange towards early pay in to meet the margin obligations of the client which was the requirement of the circular dated November 18, 1993 issued by the Board. In this view of the matter, we cannot uphold the finding of the whole time member that the shares had been diverted by the appellant.

7. We are now left with only one transaction executed by the appellant on March 1, 2001. This trade had also been called in question in the show cause notice and the enquiry officer in his report found that since it had been annulled by the exchange, the appellant should be given a warning on this ground. The whole time member did not advert to this trade at all in the impugned order and the learned counsel for the Board does not dispute this position.

For the reasons stated above, we allow the appeal and set aside the impugned order with no order as to costs.

Sd/-
Justice N.K.Sodhi
Presiding Officer

Sd/-
Samar Ray
Member

Sd/-
P.K. Malhotra
Member

18.8.2010
Prepared and compared by:
ptm