

SECURITIES AND EXCHANGE BOARD OF INDIA
ORDER UNDER SECTION 11 (4) OF THE SEBI ACT, 1992
IN THE MATTER OF SANJAY KHEMANI, MEMBER OF CALCUTTA STOCK
EXCHANGE

CO/ /2003/IES/FUTP

- 1.1 Sanjay Khemani was a member of the Calcutta Stock Exchange and was registered with SEBI as a stock broker with Registration No. INB030693921.
- 1.2 The Securities and Exchange Board of India (hereinafter referred to as SEBI) initiated investigation against Shri Ketan Parekh and some entities associated with him (hereinafter referred to as KP Group) and also some brokers of the Calcutta Stock Exchange (hereinafter referred to as the CSE) including M/s Sanjay Khemani (hereinafter referred to as the broker) for alleged market manipulation. During the course of investigation, SEBI prima facie found that several lapses and violations have been found committed by the broker, which resulted in market manipulation.
- 2.1 A show cause notice dated November 7, 2002 was issued to the broker, stating the alleged lapses and violations, to show cause as to why appropriate directions should not be issued under sections 11 and 11B of the SEBI Act, 1992 restraining him from trading or dealing in securities market pending completion of investigations.
- 2.2 The main allegations in the Show cause notice are interalia as under :
 - 2.2.1 That the broker was transacting in huge volumes of “off-the-floor” transactions, and thereby organizing a parallel stock exchange for the purpose of assisting in, entering into or performing contracts in Securities and concealing these off the floor transactions, appears to have acted in violation of Section 19(1) of the Securities Contract Regulations Act, 1956.

- 2.2.2 By giving wrong declarations to CSE, thereby concealing the dealings of the clients including the KP Group the broker avoided compliance with the prudential exposure limits and margin requirements of CSE prevailing during the relevant period and thereby, interfered with the fair and smooth functioning of the market in violation of Regulation 4(b) of SEBI (Prohibition of Fraudulent & Unfair Trade Practices) relating to Securities market Regulations, 1995.
- 2.2.3 Violation of Regulation 7 of SEBI (Stock brokers & sub brokers)Regulation, 1992 read with Clause A (1,4 &5) of Code of Conduct stipulated in Schedule II of the said Regulations.
- 2.3 The broker vide letter dated November 18, 2002 replied to the aforesaid show cause notice. An opportunity of hearing was given to the broker on 30.11.2002. As the broker failed to appear, vide letter dated 5.12.02, one more opportunity of hearing was given to the broker on 18.12.2002. The broker failed to avail the second opportunity of hearing also. The broker made his further submissions vide letter dated December 17, 2002 in reply to letter dated 5.12.02. The broker or his representatives failed to attend the hearing on the said day also. Therefore, I am satisfied that the ends of justice would be met if I proceed further on the basis of material available on record.
- 3.0 The broker made the following submissions in his said reply:-
- 3.1 That all the alleged off market transactions are fully reported to CSE. Once they are reported to the Stock Exchange the provision of Section 19 of the S(C)R, Act is not at all applicable and therefore there is no default.
- 3.2 That he has requested that he be provided the basis of the figures of buying and selling, including trading with NSE members, how the off market transactions have been worked out and the working of the same which has inclined SEBI to believe that the turnover of Rs. 12,639.64 crores represented the off the floor transaction. Further, the data given by SEBI must be inclusive of compulsory carry forward positions of shares with their values and market Badla done in CSE of shares with their values and which are not accountable in the off market deals

and also the Bad deliveries and Bad deliveries returned received from the clients and Brokers and returned to them after rectification and after due rectified shares received from CSE, other Brokers which are submitted to them for rectification. That in the absence of the requisite information/details it is impossible to submit reply in rebuttal. The broker stated that on perusal of the same would reveal that Rs. 1,57,17,000 representing value of 65000 shares of HFCL being compulsory carry forward because of Book closure in settlement No. 99/00124. The broker requested to clarify that whether Rs. 1,57,17,000 representing value of 65000 shares of HFCL being compulsory carry forward because of Book closure in settlement No. 99/00124 dated 27.08.2000 to 2.9.2000 is included in total turnover of the alleged off the floor transactions of Rs. 12639.64 crores. He stated that the basis of charges suffers from serious infirmity then the same would be the case of non application of mind to the relevant material.

- 3.3 That with respect to the allegation that by transacting such huge volumes of off-the-floor transactions he along with other brokers had organised a parallel stock exchange for the purpose of assisting in, entering into or performing contracts in securities, the broker has stated that in this regard the names of such other brokers and the volume of such transactions have not been mentioned or provided with.
- 3.4 As regard to the alleged violation of SEBI (prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 particularly referring to regulation 4(b) it is stated without conceding that if the transactions are off the floor transaction then it cannot be said to be in the nature of false or misleading appearance of trading on the securities market because if they are on the securities market they are not off the market deals. The transactions were duly reported to the stock exchange and all the transactions were duly accounted for in the regular books of accounts and the audited copies of which were duly accounted for in the regular books of accounts and the audited copies of which have been submitted to the concerned authorities as and when required.
- 3.5 That in the impugned show cause notice no evidence had been furnished to the effect that he had created a false market either singly or in concert with others or

indulge in any act detrimental to the investors interest or which leads to interference with the fair and smooth functioning of the market.

3.6 That all the alleged off the floor transactions were duly reported to the Stock Exchange and having regard to other material facts/defects pointed out in the preceding paragraphs, there is no interference with the fair and smooth functioning of the market.

3.7 That the involvement of the broker as pointed in the impugned show cause notice are for the years 1999-2000 and 2000-2001. There is no question of taking any preventive measure against him for the past deals alleged to have been done during the relevant period. He submitted that even as on today he is not conducting the business and he is prepared to give an undertaking that he shall not carry any business activities as a member of Kolkatta Stock Exchange either directly or indirectly, if the present proceedings are dropped.

3.8 That the actions proposed are against a member of Stock Exchange and not against some other entity. Any action against the member Broker of any Exchange can only be taken after procedure enquiries are conducted which are mandatory. No action under Section 11 or 11B of the Act can be taken to bypass the procedure of normal set enquiry. Any preventive order passed under these regulations tantamount to penalty therefore would not have any legal backing.

3.9 That the whole proceedings are in violations of principles of natural justice and equity.

4.0 I have carefully considered the allegations in the Show cause notice and the replies of the broker. Before considering the issues, it has to be borne in mind that the present proceedings are interim measures taken as preventive step. The following issues are therefore considered to find out a prima facie case.

4.1 Whether the broker indulged in organizing a parallel stock exchange in violation of Section 19(1) of SC (R) Act

4.1.1 It has been alleged that the broker was running a parallel stock exchange with other brokers. The broker has not given the exact figure of off-the floor transactions he had reported to the Exchange. As per CSE's letter dated January 3, 2003, the broker had reported only Rs.301.02 crores during the year 2000-2001 whereas as per the findings of the investigations, at present stage, the value of off market transactions of the broker during the year 2000-2001 is around Rs.12,047 crores. In view of above, the broker had not reported all his off market transactions. The broker has not denied that he had dealt with brokers outside the Stock Exchange trading system. The broker has also not given any explanation for wrong declarations of client's trades as proprietary trades.

As per Section 19 (1) of SC (R) Act " no person shall, except with the permission of the Central Government, organize or assist in organizing or be a member of any stock exchange (other than a recognized stock exchange) for the purpose of assisting in, entering into or performing contracts in securities." This prohibition is applicable inter alia within the municipal limits of Calcutta.

Section 2(j) defines Stock Exchange as meaning " Any body of individuals, whether incorporated or not , constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities."

Therefore, it prima facie appears that, by transacting such huge volumes of off-the-floor transactions, the broker has organized a parallel stock exchange for the purpose of assisting in, entering into or performing contracts in securities and concealing these off the floor transactions. The total amount of the off the floor transactions entered into by the broker reveals that it is even higher to the total turnover of several regional Stock exchanges in India.

4.2 Whether the broker has interfered in the fair and smooth functioning of the market in violation of Regulation 4(b) of SEBI (Prohibition of Fraudulent &

Unfair Trade Practices relating to Securities Market) Regulation 1995 and Regulation 7 of SEBI (Stock brokers and Sub-brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations.

- 4.2.1 It is mentioned in the show cause notice that giving wrong declarations to the CSE and thereby concealing the dealings of the clients including KP Group, the broker avoided compliance with the prudential exposure limits and margin requirements of CSE prevailing during the relevant period and the broker had thereby, interfered with the fair and smooth functioning of the market. The broker has not denied that he had dealt with brokers outside the Stock Exchange trading system. The broker has also not given any explanation for wrong declarations of client's trades as proprietary trades.
- 4.2.2 The broker has not given the exact figure of off-the floor transactions that he had reported to the Exchange and he has enclosed to his reply dated December 17, 2002 only the copies of off-the floor transactions reports purportedly submitted to CSE during the year 2000-2001. However, these copies do not bear any acknowledgement of receipt from the CSE. As per CSE, the broker reported only Rs.301.02 crores during the year 2000-2001 whereas as per the findings of the investigations, at present stage, the value of off market transactions of the broker during the year 2000-2001 is around Rs.12, 047 crores.
- 4.2.3 The broker has not produced any evidence that he had reported his off-the floor transactions during the year 1999-2000.
- 4.2.4 Two alleged compulsory carry forward transactions of 65,000 shares of HFCL and 41,561 shares of Ranbaxy which are stated by broker in his Exhibit-1 of the said reply letter, have now found to be included in the above calculations of off-the floor transactions (which are valued only around Rs.4.36 crores). The broker has not given this explanation earlier. Shri Sanjay Khemani did not provide all the informations required for investigation and he could not be contacted over telephone and was also not available in his office when the

investigation team visited Khemani group's office located at No 16, India Exchange Place, Kolkata 700001 on January 30, 2002. Therefore, necessary explanations and informations could not be obtained from Shri Sanjay Khemani on the findings of the investigation. As explained to the investigation team by broker's office staff, when the investigation team visited to broker's office, these transactions are treated as off-the floor transactions since they do not have trade ID and trade time.

4.2.5 Even if it is assumed that the broker's total carry forward transaction of around Rs.2207 crores (1999-00: 1554 + 2000-01 : 653 as per investigation report), the maximum possibility of compulsory carry forward transactions and are included in the above calculations of brokers' off-the floor transactions, the remaining off-the floor transaction will be of Rs.10,432 crores (12,639 – 2207). The unreported off-the floor transactions of Rs.10,130.98 crores (10,432-301.02) are still a large volume and lead to a prima facie conclusion that it is in violation of Regulation 4(b) of SEBI FUTP Regulations and Regulation 7 of SEBI (Stock brokers and Sub-brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations considering the fact that the broker has not given any explanation for his wrong declaration of client trades (including KP group) as proprietary trades.

4.3 Whether the present proceedings are in violation of principles of natural justice and equity.

4.3.1 The broker has vehemently contended that the proceedings are in violation of principles of natural justice for the following reasons :-

4.3.2 The working which leads SEBI to believe that the turnover of Rs.12639.64 crores is representing the alleged off the floor transaction was not furnished. It is also not made known how the figures of buying value and sale value of the alleged off the floor transaction have been worked out nor is the same communicated.

- 4.3.3 The copies of details requisitioned from CSE and the information supplied by CSE in response to it to SEBI was not furnished. Non supply of this material information would vitiate the proceedings.
- 4.3.4 Inspection of the case record as maintained by SEBI was not given.
- 4.3.5 Without supplying him with the basis as requested without allowing the inspection he has been asked to remain present for personal hearing on December 18, 2002. On one hand it has been stated that from the data furnished by him it has been observed that he has indulged in the alleged huge volume of off the floor transactions for the period April 1999 to March 2001 and the particulars of the same has been worked out by SEBI from it and even though the said details are not supplied to him.
- 4.3.6 That the data was furnished by him in response to SEBI's investigation/queries but no clarifications has been sought from him on such data and therefore the figures worked out by SEBI are not correct and hence wrong.
- 4.3.7 That SEBI should supply him with the details/information sought, to comply with the issues raised and to allow an inspection of the referred record. A reasonable and sufficient time may also be allowed to submit his reply in rebuttal. A personal hearing may also be granted to him afterwards.
- 4.3.8 That if SEBI is not agreeable with the brokers above views then the same should be distinctively brought to his notice in writing with elaborate reasons and also by adducing sufficient evidences. In such an eventuality he may be afforded another opportunity to submit further to substantiate his case.
- 4.3.9 As already stated, the figures are arrived at by SEBI are based on the data provided by the broker. The broker has been provided with all the data collected from him in soft format based on which the off the floor transaction amount of Rs.12,639.64 crores has been arrived at. As the said data are the broker's own data, he should be aware of the names of the brokers with whom he entered in off-the floor transactions. The broker had not reported all his off market transactions

since as per CSE, the broker reported only Rs.301.02 crores during the year 2000-2001 whereas as per the findings of the on going investigations, at present stage, the value of off market transactions of the broker during the year 2000-2001 is around Rs.12,047 crores. The broker has not denied that he had dealt with brokers outside the Stock Exchange trading system.

4.3.10 Though the broker had submitted a written statement on 14.5.01, he did not provide all the informations required for investigation and he could not be contacted over telephone by the investigation team and was also not available in his office when the investigation team visited the brokers group office located at No 16, India Exchange Place, Kolkata 700001 on January 30, 2002. The broker has been provided with all the data collected from him in soft format based on which the investigation findings have been arrived. As the said data are the broker's own data, no inspection is felt necessary at the interim stage. The broker has already been granted two personal hearing which he failed to attend.

4.3.11 In view of the above, another hearing may not be required to be given as ample opportunity has been given to the broker which he failed to avail. Further, the proposed actions are not penal actions and are only preventive actions pending Enquiry. I, therefore hold that the principles of natural justice are scrupulously followed since the facts available on record are sufficient to take a prima facie view.

4.4 With respect to the remaining contentions raised by the broker, the findings are as under:

4.4.1 The statement of the broker that he is not conducting any business and that he would be prepared to give an undertaking that he would not carry any business activities as a member of CSE either directly or indirectly, if the normal procedure of the enquiry is followed by dropping the present proceedings is not tenable. When it is prima facie found by a regulator that an entity is violating law, what is required is a regulatory sanction and a specific measure to restore the confidence of the investors. The undertaking therefore is of no use when it will not help to

restore the lost confidence of the investors. In any manner, the undertaking is not enforceable under the present circumstances.

4.4.2. The contention of the broker that no action under Section 11 or 11B of the Act can be taken to by pass the procedure of normal set enquiry and any preventive order passed under these regulation tantamount to penalty without any legal backing, is also not tenable. This is only a preventive action pending investigation and Enquiry based on the prima facie findings. Section 11 and 11B of SEBI Act, 1992 empower SEBI to take preventive action pending Enquiry. The proceedings against the broker are therefore in consonance with the provisions of SEBI Act and the Rules and Regulations framed thereunder. This is also perfectly in consonance with the ratio of law as laid down by Hon'ble Bombay High Court in Anand Rathi's case.

4.4.3 There is also no merit in the contentions of the Broker that if a preventive action is taken, the same would amount to double Jeopardy as the CSE has by an order dated 8.8.2002 imposed a fine of Rs.10 lakhs, suspended the broker from trading on the exchange for six months and also warned him not to deviate in future the various rules of SEBI and Bye laws of the exchange in his transaction. The said action taken by CSE further confirms that broker had indulged in off-the floor transactions in violation of SEBI and CSE circulars and notices etc. The action taken by CSE is under its Bye-Laws, Rules and Regulations. It is also not clear at this point of time whether the broker had challenged the said order of the exchange. The stock exchange is a statutory body. The action taken by SEBI would be under the SC(R) Act, 1956 and SEBI Act, 1992, the Rules and Regulations framed thereunder. Therefore, this would not amount to Double Jeopardy. Further, these are only a preventive action pending Enquiry based on the prima facie findings of the investigation.

5.0 In light of the above submissions raised by the broker and the findings on the same, I am of the view that indulging in off the floor transactions at huge volumes and not reporting the said transactions to the exchange amounts to creating a parallel market outside the recognized stock exchange mechanism. Such

transactions are against the transparency requirements, do not contribute to the price discovery and deprive many investors of the benefit of the best possible price. It also militates against the basic concept of the stock exchanges which is meant to bring together a large number of buyers and sellers in an open manner. These trades also avoid the prudent regulatory controls and market safety measures like payment of margins, intra-day turnover, exposure limits etc. It is possible that by avoiding margins and exposure limits, broker has involved in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness. Further, by not reporting these off-the-floor transactions, the broker prima facie avoided compliance with the prudential exposure limits and margin requirements of CSE prevailing during the relevant period. It also prima facie amounts to violation of the SEBI circular dated 14.9.1999 which mandates that all deals should be executed on the screens of the exchanges. CSE also vide its notice dated 16.9.99 reaffirmed the above mandate.

Further, by giving wrong declarations to CSE, the broker prima facie avoided compliance with the prudential exposure limits and margin requirements of CSE, and thereby, prima facie interfered with the fair and smooth functioning of the market and prima facie violated Regulation 7 of SEBI (Stock brokers and sub brokers) Regulations, 1992 read with Clause A (1,4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations.

- 5.1 As per Regulation 7 of SEBI (Stock brokers and sub brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations, the stock brokers

“shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business,”

“shall not create false market either singly or in concert with others or indulge in any act detrimental to the investors interest or which leads to interference with the fair and smooth functioning of the market. A stock broker shall not involve himself in

excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness” and

“shall abide by all the provisions of the Act and Rules, Regulations, Regulations issued by the Government, the board and the Stock Exchange from time to time as may be applicable to him.”

6.0 Therefore, I am of the prima facie view that the brokers actions and conduct as elaborated above is against the interest of genuine investors and detrimental to the orderly development of securities market and appears to be in violation of Section 19 (1) of Securities Contracts (Regulation) Act, 1956, Regulation 4 (b) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 and Regulation 7 of SEBI (Stock brokers and Sub-brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations.

6.1 The said prima facie commissions and omissions of the broker are against the interest of genuine investors. Hence some preventive action is urgently required to be taken by SEBI against him in order to ensure that the investors in the securities market do not in any way suffer any losses and are not put to any harm and that the safety and integrity of the market remain unimpaired. It is more so when the broker is not properly cooperating with the investigation. It is felt that preventive action is necessary in order to prevent Sanjay Khemani from dealing in the securities market pending completion of the investigation.

During the said period, Sanjay Khemani is directed not to buy, sell or deal in the securities market directly or indirectly.

6.2 It should also be not lost sight of the fact that these proceedings are for the limited purpose of preventing the said broker from carrying out a similar manipulation pending completion of the investigation, under sections 11 and 11B of the SEBI Act. They are not for the conclusive determination of all facts, which may be possible only after completion of the investigation. The Bombay High Court has

upheld SEBI's power under sections 11 and 11B to pass preventive orders pending completion of investigation in *Anand Rathi v. SEBI*, [2001] 32 SCL 227.

Therefore any further proceeding in the matter by SEBI would be conducted uninfluenced by any observation or finding made in this interim order.

- 6.3 In view of the emergent situation, it is necessary to ensure that no further harm or detriment is caused to the market and that investors confidence is restored. Hence after taking into consideration the above mentioned facts and circumstances of the case, in exercise of the powers conferred upon me under section 4(3) of the SEBI Act, 1992, read with Sections 11(4) of the SEBI Act, 1992, I hereby debar Sanjay Khemani from associating with securities market activities and dealing in securities market till the completion of investigation and enquiry.

Date: January 21, 2003

Place: MUMBAI

G. N BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA