

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

ORDER UNDER REGULATION 13(4) OF THE SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY), 2002 AGAINST M/S. VIKASH SOMANI SECURITIES PVT. LTD., MEMBER CALCUTTA STOCK EXCHANGE

MO/69/IVD/3/04

1. Background

1. M/s. Vikash Somani Securities Pvt. Ltd. (hereinafter referred to as "the said broker") is a member of Calcutta Stock Exchange (hereinafter referred to as "CSE") and a stock broker registered with Securities and Exchange Board of India (hereinafter referred to as "SEBI") under Certificate of Registration bearing No. INB 030878935 (formerly INB 030076410).
2. An inspection of the books of account and other records of the said broker was conducted by SEBI on 12.06.2002. In the course of inspection, it was observed that the said broker had carried out transactions with Shri Sanjay Khemani, member CSE, outside the price and order matching mechanism of the exchange and that the said broker had received funds and made payments to the said Sanjay Khemani without corresponding transactions in securities. It was therefore alleged that the said broker had indulged in transactions that were in violation of the Code of conduct prescribed for stock brokers under the SEBI (Stock Broker & Sub Broker) Regulations, 1992 (hereinafter referred to as "the broker regulations") and in violation of Securities & Exchange Board Of India (Prohibition of Fraudulent & Unfair Trade Practices relating to Securities Market) Regulations, 1995 (hereinafter referred to as "FUTP Regulations"). It was also alleged that the said broker by lending moneys had carried out business other than that in securities and thereby violated Rule 8(1)(f) of the Securities Contracts (Regulation) Rules, 1957. A copy of the inspection report was forwarded to the said broker and he submitted his reply vide letter dated 19.7.2002. Since his reply was found to be unsatisfactory, Chairman, SEBI vide Order dated 8.8.2002 directed that an enquiry be made into the matter and in this regard appointed an Enquiry Officer.

2.0 Enquiry Proceedings

2.1 The Enquiry Officer issued show cause notice on 30.4.2003 alleging that:

- i. the said broker had carried out transactions with Sanjay Khemani, member CSE, outside the price and order matching mechanism of CSE and that such transactions were irregular and prohibited under Regulation 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to securities market) Regulations, 1995 and in violation of Clause A(1) (4) & (5) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub Broker) Regulations, 1992 and Rule 4(b) of SEBI (Stock Brokers and Sub Broker) Regulations, 1992.
- ii. the said broker had made payments / received funds from Sanjay Khemani, member CSE without corresponding transactions in securities and that such activity being prohibited under Rule 8(1)(f) of SC (R) Rules, 1957, the said broker had violated the same.

In his submissions before the enquiry officer, the said broker requested that his submissions in respect of the findings of the inspection may be treated as part and parcel of his reply. The said broker further submitted as under:

1. In so far as the allegation of off the market transactions with Sanjay Khemani another broker of CSE is concerned, the said broker denied that these transactions as enumerated in Annexure 1 to the show cause notice are off market transactions in contravention of SEBI Circular dated 14.9.99. He submitted that all these transactions were spot delivery transactions as permissible under SCR Act 1956. The said broker further submitted that they did not result in delivery because the transactions were netted off at the end of the day. He further submitted that all these transactions were on proprietary a/c and contract notes in form B were issued. The said broker also submitted copies of the contract notes along with different statements and stated that he had obtained the consent of Sanjay Khemani for contracts on principal to principal basis.
 2. The said broker submitted that these transactions were reported to CSE. The said broker also filed copies of letters written to CSE informing about certain transactions. These copies are enclosed with his letter dated 19.7.2002.
 3. The said broker denied that these transactions were in any way violative of Regulation 4 of FUTP Regulations.
 4. In so far as the allegation that he had received funds and made available funds to Shri Sanjay Khemani without corresponding transactions in securities thereby violating Rule 8(1)(f) of SC(R) Rules, 1957, the said broker replied that for the money he received from Shri Khemani, he did not pay interest to him and similarly he did not charge any interest on funds that were given to Shri Khemani. He further submitted that he was all along carrying on his business with utmost devotion and there had been no complaints from the investors on any of the transactions carried out.
1. The Enquiry Officer after considering the submissions of the said broker submitted his report to SEBI on 29.8.2003. In his report, the Enquiry Officer has come to a finding that the said broker had indulged in transactions involving large amounts outside the stock exchange trading system and thereby violated the directives of SEBI vide Circular dated 14.9.99. He also found that in view of the large volumes traded and the high price involved, these transactions did not represent a true and fair discovery of the price. Therefore, the actions of the said broker constituted the violations of Regulation 4(a) & 4(b) of the FUTP Regulations. The Enquiry Officer also came to a finding that the said broker had indulged in lending of funds and had therefore violated Rule 8(1)(f) of the Securities Contracts (Regulation) Rules,

1957. In view of the above, he recommended a penalty of suspension of certificate of registration for a period of 6 months.

3.0 Show cause notice and hearing

3.1 A show cause notice dated 8.9.2003 was issued to the said broker and he submitted his reply vide letter dated 23.9.2003. The submissions of the said broker in his reply were as under:

1. The enquiry officer has relied on the interpretation of a "spot delivery contract" and has stated that since the exchange of securities for funds allegedly did not occur within forty eight hours, the transactions did not qualify as spot delivery transactions, and therefore, were necessarily violative of the aforesaid Circular dated September 14, 1999. It is submitted that where there is a netting between two willing transacting parties, of various outstanding obligations to each other, there is a deemed delivery of securities and deemed delivery of cash. Therefore, in such instances, the transaction is indeed completed when the netting of obligations occurs and it ought not to be argued that shares and funds ought to physically change hands in order to constitute delivery as required for spot delivery transactions. Therefore, it is submitted that these transactions were indeed spot delivery transactions, effected on a principal-to-principal basis and in respect of which Form B contracts were duly issued.
2. In order for an allegation relating to concealment of price and volume from the price discovery mechanism on stock exchanges to sustain, there ought to have been suppression of information from the stock exchange. However, in the instant case, the transactions were actually reported to the CSE and therefore, there was no question of hiding any of the transactions from the market. Therefore, the allegation of any intention to subvert the price discovery mechanism is unsustainable and no penalty of the nature recommended by the enquiry Officer ought to be levied.
3. A consent letter from the counter-party confirming that these transactions were indeed on a principal-to-principal basis was also submitted to the Enquiry Officer. The Enquiry Officer has merely stated that a transaction can either be a spot delivery transaction or a trade on the screen of a stock exchange. However, the Enquiry Officer has accepted the legal position that when the obligations arising out of a spot delivery transaction are netted or adjusted between the parties or replaced by other obligations between the same two private transacting parties, the obligation with regard to payment and/or delivery are deemed to have been discharged. Therefore, in our respectful submission, no penalty is sustainable and the recommendation made by the Enquiry Officer in this regard ought to be set aside.
4. The Enquiry Officer has suggested that principal-to-principal transactions may be executed on the screen of the exchange. However, it is submitted that for a principal-to-principal transaction to be executed on the floor of the exchange, the order price, quantity and time would have to be synchronized, which itself could expose the transacting parties to an allegation that they were indulging in manipulative and fictitious transactions executed on a synchronized basis. In fact, it is for this reason alone, that we execute our transaction on a spot delivery basis and, square off and/or net our mutual obligations arising out of such contracts. It is respectfully submitted that constructive payment and delivery is indeed deemed to have been concluded and therefore, it is submitted that no penalty of the nature suggested by the Enquiry Officer is attracted in the facts of these case.
5. The Enquiry Officer has stated that the value of the transaction is high and since they were off-market, the investors would be unaware of such transactions having taken place. It is submitted that the law relating to spot delivery transactions does not distinguish between transactions on the basis of the volume of the transactions concerned.
6. The Enquiry Officer has not given any reasoning for making a plain statement that the transactions also attract Regulation 4(a) and (b) of the FUTP Regulations. It is submitted that such an allegation cannot be leveled. On the one hand, the report states that market did not know of the trades, while, on other it states that, the transactions wrongly influenced the market price. Since we have not effected or participated in any transaction with the intention of artificially raising or depressing prices, nor have we indulged in any act calculated to create a false or misleading impression of trading, it is respectfully submitted that neither Regulation 4(a) or 4(b) of the FUTP Regulations would be attracted in the facts of our case.
7. The Enquiry Officer's Report alleges that two receipts of funds and three payments of funds were made by us without there being corresponding securities transactions. Totally, Rs.2.58 crores was received and Rs.2.3 crore was paid. The Enquiry Officer has merely stated that it can be reasonably concluded that such cash flows demonstrate transactions that are not permissible under the law for a broker and that Regulation 891(f) of the Securities Contracts (Regulation) Rules, 1957 has been violated.
8. As stated earlier, we are involved in the business of trading in securities. We had regular principal-to-principal transactions with the counter-party from whom shares and/or money were receivable or payable/deliverable. On the basis of such running account of mutual obligations, it is indeed possible that two such parties can mutually settle their differences in the form of payment of cash or that they may discharge their respective obligations by payment of such cash. Therefore, unless any other material is relied upon by SEBI, it cannot merely be stated that five cash entries, all of which were received transparently through the banking system, would constitute fund-based articles in violation of securities laws.
9. The Enquiry Officer has also not set out any reasoning, criteria or rationale to demonstrate why a major penalty is appropriate in the facts and circumstances of this case. It is submitted that none of the grounds on which a major penalty may be imposed exist in the facts and circumstances of the instant case. Therefore, it is submitted that the findings of the Enquiry Officer and the recommendation made thereby be set aside and no penalty be fastened on us.

1. Upon request of the said broker, he was granted a personal hearing before me on 18.11.2003. In the course of hearing, the said broker /his representative made the following submissions :

1. The said broker submitted that he was a member of CSE and counter party brokers in respect of the off market transactions were also members of CSE. Therefore, there was no question of being outside the purview of the stock exchange.
2. The said broker submitted that the alleged off market transactions were in fact spot delivery principal-to-principal transactions. The said broker further submitted that the deals were squared off and so there were no shares to deliver /take delivery of and payment to be received / paid and these transactions were therefore spot deliveries and not off the market transactions. The said broker argued that the stock exchange was informed in writing of the details of the transaction at the end of each day.
3. The said broker contended that they violated, assuming that these were violations, only the circular of SEBI and directions of CSE and not the Regulations or the Act and therefore the penalty recommended is disproportionate.
4. In respect of the moneys lent to Shri Sanjay Khemani, the said broker submitted that these were only borrowings among families that had long associations with each other and not fund based dealings as sort to be made out in the inspection / enquiry. These moneys have been returned.
5. The said broker submitted that he had made no gains from the above transactions and had no reason to believe that he acted in breach of any law. The said broker stated that his actions, if any, only constituted a technical offence and a penalty of suspension of certificate for 6 months would be very harsh. The said broker also submitted that they were ready to undergo suspension for a lesser period and requested that they may not be equated with large offenders.

4. Consideration of issues

I have considered the facts of the matter, the written and oral submissions of the said broker. The following issues arise for consideration:

4.1 Whether the said broker has indulged in off the floor transactions in violation of SEBI's Circular dated 14.9.1999.

1. I note that as per the inspection report the said broker had the following transactions with Shri Sanjay Khemani, member CSE

Settl. No.	Name of scrip	Purchase				Sales			
		Date		Qty.	Rate (Rs.)	Date		Qty.	Rate (Rs.)
2001140-F	ITC	1/1/01		4500	890.00	1/1/01		4500	908.00
--do--	--do--	2/1/01		4500	899.00	2/1/01		4500	909.00
--do--	--do--	3/1/01		4500	903.00	3/1/01		4500	949.00
--do--	--do--	4/1/01		4500	921.00	4/1/01		4500	954.00
--do--	TISCO	1/1/01		580000	131.00	1/1/01		580000	134.70
--do--	--do--	2/1/01		575000	133.60	2/1/01		575000	135.60
--do--	--do--	3/1/01		575000	133.60	3/1/01		575000	137.50
--do--	--do--	4/1/01		575000	132.70	4/1/01		575000	139.00
--do--	L&T	1/1/01		400000	195.70	1/1/01		400000	200.00
--do--	--do--	2/1/01		395000	199.00	2/1/01		395000	214.00
--do--	--do--	3/1/01		385000	214.00	3/1/01		385000	219.00

--do--	--do--	4/1/01		385000	203.00	4/1/01		385000	220.00	
--do--	ACC	1/1/01		290000	158.50	1/1/01		290000	163.00	
--do--	--do--	2/1/01		280000	158.50	2/1/01		280000	163.20	
--do--	--do--	3/1/01		285000	164.10	3/1/01		285000	167.50	
--do--	--do--	4/1/01		285000	161.00	4/1/01		285000	168.80	
--do--	RIL	1/1/01		175000	340.00	1/1/01		175000	344.00	
--do--	--do--	2/1/01		170000	341.00	2/1/01		170000	359.00	
--do--	--do--	3/1/01		160000	355.00	3/1/01		160000	360.50	
--do--	--do--	4/1/01		175000	355.80	4/1/01		175000	365.60	

Sett. No.	Name of scrip	Purchases				Sales			
		Date	Buy/Sell	Qty.	Rate	Date	Buy/Sell	Qty.	Rate (Rs.)
2001143-F	Tisco	19.01.01	B	260000	153.50	19.01.01	S	260000	158.50
- do -	- do -	22.01.01	B	255000	154.25	22.01.01	S	255000	158.75
- do -	L & T	19.01.01	B	50000	222.00	19.01.01	S	50000	233.00
- do -	- do -	22.01.01	B	50000	227.50	22.01.01	S	50000	239.50
- do -	- do -	23.01.01	B	50000	231.50	23.01.01	S	50000	241.25
Amount receivable from Sanjay Khemani as per difference bill								Rs.40,85,000/-	

Sett. No.	Name of scrip	Purchases				Sales			
		Date	Buy/Sell	Qty.	Rate	Date	Buy/Sell	Qty.	Rate (Rs.)
2001147 - F	Tisco	20.02.01	B	25000	157.00	20.02.01	S	250000	159.00
- do -	ACC	16.02.01	B	65000	184.00	16.02.01	S	65000	192.25
- do -	- do -	19.02.01	B	65000	182.00	19.02.01	S	65000	189.10
Amount receivable from Sanjay Khemani as per difference bill								Rs.14,97,750/-	

I note that SEBI vide Circular No.SMDRP/POLICY/CIR-32/99 dated 14.9.99 directed that all negotiated deals including cross deals shall not hence forth be permitted and all such deals shall be executed only on the screens of the exchange on price and order matching mechanism of the exchange like in ordinary trades. The said Circular further stated that this measure was being taken as negotiated deals lack transparency, do not contribute to price discovery, deny investors the benefits of the best possible price and militate against the basic concept of the stock exchange.

- The said broker in his submissions has stated that the said transactions were spot delivery transactions which were permitted under the Securities Contracts (Regulation) Act, 1956. They submitted that these were principal – to –principal transactions which were done on proprietary accounts and contract notes in Form B were issued. They have

also submitted that these contracts did not result in delivery because the transactions were netted off at the end of the day.

3. I am unable to accept the contentions of the said broker. On the one hand, the said broker contends that these transactions were spot delivery transactions between them and Shri Sanjay Khemani, acting as individuals / principals. If that was so, there was no need for the said broker or Shri Sanjay Khemani to report these transactions to the stock exchange since these were not within the purview of the exchange. Further section 2(i) of SC(R) Act, 1956 does not provide for a deemed delivery of Securities and a deemed delivery of cash in case of spot delivery contracts. Secondly, contract notes in Form B were issued by both the said broker and Sanjay Khemani. These would go to show that both the said broker and Sanjay Khemani considered these transactions as taking place within the stock exchange system but outside the price and order matching mechanism i.e. off the floor transactions. The circular dated 14.9.1999 sought to prevent these transactions and hence it is apparent that the said broker has acted in violation of the said circular.

5. Whether the said broker has indulged in transactions in violation of Rule 8(1)(f) of the Securities Contracts (Regulation) Rules, 1957.

1. I note that the said broker has received amounts to the extent of Rs.2.58 crores from Shri Sanjay Khemani and also paid amounts to the extent of Rs.2.21 crore without corresponding transactions in securities. Details of these transactions are as under :

Sr. No.	Broker	Date	Paid / Recd	Amount (Rs.)
1.	Sanjay Khemani	17.4.2000	Recd.	2,00,00,000
2.	Sanjay Khemani	7.7.2000	Recd.	58,00,000
3.	Sanjay Khemani	22.8.2000	Paid	25,00,000
4.	Sanjay Khemani	13.9.2000	Paid	1,04,50,000
5.	Sanjay Khemani	14.9.2000	Paid	91,50,000

2. I note that in his submissions the said broker has submitted that these were transactions done on the basis of mutual obligations arising out of regular principal-to-principal transactions in securities. They also submitted that these only amounted to borrowings and repayments among families that had long association with each other and were not fund based dealings as alleged in the inspection / enquiry report.
3. I note that although the said broker has stated that this flow of funds between them and Shri Sanjay Khemani was to meet obligations in respect of principal-to-principal transactions between themselves, the said broker has not provided any details regarding the same. These details would have established a corresponding transaction in securities and in the absence of the same, pre-ponderance of probability suggests that these transactions were in the nature of lending and borrowing.
4. Rule 8(1)(f) of Securities Contracts (Regulations) Rules, 1957 provides that:

"Qualifications for membership of a recognized stock exchange:

1. The rules relating to admission of members of a stock exchange seeking recognition shall inter alia provide that :
1. No person shall be eligible to be elected as a member if –
- a. ...
- b. ...
- c. ...
- d. ...
- e. ...
- f. he is engaged as principal or employee in any business other than that of securities except as a broker or agent not involving any personal financial liability unless he undertakes on admission to sever his connection with such business:

Provided that the Securities and Exchange Board of India may, for reasons sufficient in the opinion of the said Board, permit a recognized stock exchange to suspend the enforcement of this clause for a specified period on condition that the applicant is not associated with or is a member of or subscriber to or shareholder or debenture holder in or connected through a partner or employee with any other organization, institution, association, company or corporation in India where forward business of any kind whether in goods or commodities or otherwise is carried on or is not engaged as a principal or employee in any such business.

1. From the above, I note that in addition to business as a stock broker, the said broker was also carrying on the business of lending funds. Therefore, I find that the said broker has acted in violation of Rule 8(1)(f) of Securities Contracts (Regulation) Rules, 1957. I also note that this rule relates to the qualification of a person to be admitted as a member of a stock exchange. The said broker has violated this condition.

1. *Whether the penalty recommended by the Enquiry Officer is commensurate with the violations committed by the said broker?*

1. I note that the Enquiry Officer has recommended a penalty of suspension of the certificate of registration for a period of 6 months.
2. As found above, the said broker has indulged in off the floor transactions in violation of the directives of SEBI vide Circular dated 14.9.1999. The said Circular banned transactions done outside the price and order matching mechanism of the stock exchange on the ground that such transactions were not transparent, did not contribute to price discovery and did not give investors the benefit of the best price; in short such transactions were not beneficial to investors and the securities market. By indulging in such transactions, and that too for substantial amounts to the tune of Rs.4.35 crores, the said broker has violated the directions given by SEBI and thereby violated the code of conduct specified for stock brokers and the Broker Regulations.

4.4 In view of the above, I find that the said broker has violated Regulation 7 of the Broker Regulations and the Code of Conduct for stock brokers and is therefore liable for imposition of a penalty under Regulation 13 of the enquiry regulations. The said broker has also by violating Rule 8(1)(f) of the SCR Rules, violated one of the conditions subject to which registration was granted to him. In the light of the finding that the said broker has violated one of the conditions of registration, the said broker is also liable for a major penalty to be imposed upon him. I, therefore, find that the penalty recommended by the enquiry officer is commensurate with the violation committed by the said broker.

4. Order

5.1 Therefore, I, in exercise of powers conferred on me under Section 19 of the SEBI Act read with Regulation 13 (4) of the enquiry regulations, do hereby suspend the certificate of registration bearing No. INB 030878935 granted to M/s. Vikash Somani Securities Pvt Ltd for a period of 6 months.

This order shall come into effect from 21 days of the date of the order.

Date: 3rd March 2004

Place: Mumbai

A K BATRA

Member

Securities and Exchange Board of India