

**SECURITIES AND EXCHANGE BOARD OF INDIA****ORDER**

**UNDER REGULATION 13(4) OF THE SEBI (PROCEDURE FOR HOLDING INQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTIES) REGULATIONS, 2002.**

**AGAINST AMITABH SONTHALIA, MEMBER, CALCUTTA STOCK EXCHANGE ASSOCIATION LIMITED, HAVING SEBI REGISTRATION NO. INB030966517.**

**BACKGROUND**

1. M/s Amitabh Sonthalia (hereinafter referred to as 'the said broker') is a member of the Calcutta Stock Exchange (hereinafter referred to as "CSE") and a stock broker registered with the Securities and Exchange Board of India (hereinafter referred to as "SEBI") under Certificate of Registration No. INB 030966517.
2. An inspection of the books of accounts and other records of the said broker was conducted by the Securities and Exchange Board of India, on 27.05.2002. A copy of the inspection report was forwarded to the said broker on 21.6.2002 and the said broker submitted his comments on the same. Since the comments of the said broker were found to be unsatisfactory, an enquiry officer was appointed under Regulation 5(1) of the SEBI (Procedure for Holding Inquiry by Enquiry Officer and imposing penalties) Regulations, 2002(hereinafter referred to as 'enquiry regulations'), in order to enquire into the irregularities observed during the inspection.

**ENQUIRY PROCEEDINGS**

3. The enquiry officer issued show cause notice to the said broker on 30.04.2003, under Regulation 6(1) of the enquiry regulations, setting  
out the following allegations:
  - a. That the said broker had carried out transactions with Sanjay Khemani, another member of CSE, outside the price and order matching mechanism of the Exchange and that by doing so the said broker had violated the directions of SEBI given vide Circular dated 14.09.1999.
  - b. That the said transactions prevented CSE from monitoring the risks taken by the said broker and Sanjay Khemani.
  - c. That the said transactions were irregular and were prohibited under Regulation 4 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 (hereinafter referred to as "FUTP Regulations").
  - d. That by indulging in the above transactions, the said broker had also violated sub clauses (1), (4) and (5) of Clause A of the Code of Conduct of Stock Brokers specified in Schedule II of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as "the Broker Regulations").
1. The said broker submitted his reply to the show cause notice, vide his letter dated 02.06.2003. The said broker also appeared before the enquiry officer and made the following submissions:
  - i. That the transactions mentioned in the show cause notice were genuine trades with the concerned broker, at the market rates prevailing at the relevant time.
  - ii. That SEBI circular dated 14.09.99 containing restrictions on negotiated deals were not being followed by many members due to lack of knowledge or excess work load. It was the general practice amongst the entire stock brokers of CSE at that time and therefore these off market trades cannot be viewed in isolation.
  - iii. That these transactions were settled for the difference of amount with the concerned broker. It was denied that there was any unfair trade practice or fraudulent practice in such transactions and all the transactions have been accounted for and commitments arising there from have been honoured.
  - iv. Though the transactions were reported on an aggregate basis to the CSE, the acknowledgement copies were not available. It was further submitted that all the transactions were proprietary trades and no client was involved.
  - v. That violation, if any, of SEBI regulations, was due to inadequate knowledge and understanding of provisions on the part of the broker and requested to view leniently.
1. The enquiry officer considered the reply and submissions of the said broker and the facts on record and came to the following findings:
  - a. That the said broker was not in order in executing transactions otherwise than through trading mechanism of the stock exchange and that the same was in violation of SEBI Circular SMDRP/POLICY/CIR-32/99 dated 14.09.99.
  - b. That the value of each of the transactions entered into by the said broker was above Rs. 1 crore and that given the said value, since the above transactions were entered outside the screen based trading system, they did not lend transparency to and distorted the price discovery process in the stock market. Therefore, the above transactions were also in violation of Regulation 4(a) and (b) of the FUTP Regulations.

1. In view of the above findings, the enquiry officer, in his report dated 31.07.2003, recommended that the certificate of registration of the said broker may be suspended for a period of 4 months.

### **SHOW CAUSE NOTICE AND HEARING**

2. Pursuant to the submission of the enquiry report, show cause notice dated 07.08.2003 was issued to the said broker, advising him to show cause as to why the penalty recommended by the enquiry officer should not be imposed on them.
3. The said broker submitted his reply to the said show cause vide letter dated 22.09.2003, in which he made the following submissions:

- i. The said broker submitted that the entire basis of the charge against him was that he entered into certain transactions outside the market, which were alleged to have been banned by SEBI, vide its circular dated 14.09.99. The said broker argued that the matter is governed by Section 13 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "SC(R) Act"), which specifically bars transactions other than by or through members of a recognized stock exchange i.e it permits transactions through or with a member. Consequently, any circular, which purports to declare illegal transactions which were specifically declared by the statute to be legal, is ultra vires, illegal and void. He therefore contended that the very basis of the charge is incorrect and therefore, the imposition of penalty does not arise.
- ii. The said broker further contended that the charge regarding violation of Regulations 4 (a) and (b) of the FUTP Regulations was wrong since:
  - a. these transactions were transactions whose genuineness was never questioned;
  - b. the transaction did not affect the market or the prices.

He argued further that "In fact, the adverse finding seems to be that they did not affect the market or the prices and would have impacted prices, had they been executed on the market. Consequently, they did not affect prices in any manner. Since, they were admittedly off market transactions they could never have created any appearance of trading on the market. There was no allegation that any person was induced to buy or sell any scrip. On the contrary, the grievance appears to be that the others (on the exchange) were not induced or affected by the transactions and thereby lost a purported opportunity. Hence, none of the ingredients of Regulations 4(a) and (b) were met."

- i. The said broker contended that the use of the word 'with the intention of', 'calculated to create' or 'inducing' etc. in the text of the said Regulation 4 of the FUTP Regulations clearly indicates that *mens rea* was a critical and necessary ingredient of any offence or alleged contravention of Regulation 4. The SAT, while referring to the use of 'fraudulent' and 'unfair' used in the very heading of the chapter, had held that "The caption of Chapter II referred to above is a pointer in this regard. On a careful perusal of the regulation it is clear ..... that element of deceit is an underlying factor in the transaction. A genuine transaction by itself cannot attract the regulation, though such a transaction had resulted in market price variation".
- ii. The said broker further submitted that in order for any charge of violation of any of sub regulations to Regulation 4 to be upheld, it must first be proved that the impugned act has been committed and further, that such act was committed with the requisite mala fide intention. In other words, both *actus reus* and *mens rea* must necessarily be proved and such proof cannot merely be in the nature of a surmise or conjecture. Nor would it be enough to merely adduce evidence alleging a preponderance of probabilities.
- iii. The said broker further submitted that even though the report sought to establish the *actus reus*, it cannot be said to have succeeded in demonstrating any mala fide intention or *mens rea* on the part of the broker.
- iv. The said broker contended that they cannot be said to have contravened sub regulation 4(a) and (b) of FUTP Regulations as claimed in the report, since, firstly, none of the ingredients of Regulation 4(a) and (b) were met and secondly, they did not have any fraudulent or deceitful intentions and the said report did not prove the existence of such intention. In view of the above, the broker submitted that there was no ground for imposition of any penalty against them and that their registration should not be suspended for 4 months or any other duration.
- v. The said broker submitted that the report did not specifically establish that any of the impugned trades resulted in "artificially raising or depressing" of prices of the securities in question. He submitted that lacking in definite details and further, not being backed by evidence, the said statements in the report were purely of a speculative and conjectural nature. He stated that nowhere did the report mention a specific instance or provide evidence which demonstrated that the trade in question caused prices of the relevant security to increase or decrease. He contended that the report did not even attempt a quantification of any increase or decrease. The broker drew attention to the rulings of SAT wherein it was held that mere surmise, conjecture or suspicion cannot sustain the finding of guilt and further that preponderance of probabilities is not sufficient to establish such a serious offence of market manipulation.
- vi. The said broker contended that the report failed to even allege that the trades in question resulted in any inducement of the sale or purchase of securities by any person and that the report did not mention even a single instance of such inducement or allude to any proof in that behalf.
- vii. The said broker argued that since the above showed that the trades mentioned in the report did not attract the provisions of sub regulation 4(a) of the FUTP Regulations, he cannot be said to have violated the same and should not be penalized as recommended in the report.

viii. The said broker submitted that a contravention of sub regulation 4(b) can only be said to have occurred if the given act caused the creation of "a false or misleading appearance of trading on the securities market". He argued that the report did not establish with any degree of specificity how, if at all, a false or misleading impression of trading in the securities market was created as a consequence of the trades in question. The said broker submitted that being genuine trades between two parties, there was no question of the same creating a false or misleading appearance of any kind. The said broker contended that the report did not contain any evidence that the impugned trades had any particular effect on a given person in relation to the securities to which such trades pertained. He therefore argued that it cannot be said that there was a breach of sub-regulation 4 (b) of the FUTP Regulations as a consequence of the trades in question and it would not therefore be proper to impose penalties on him in that respect.

1. The said broker was granted an opportunity of personal hearing on 19.11.2003, wherein he appeared through his Counsel and made the following submissions:

- i. That the transactions in securities contemplated under Regulation 4(a) must necessarily induce the sale or purchase of securities by any other person. Similarly the transactions which are contemplated by Regulation 4(b) must be calculated to create a false or misleading appearance of trading on the security market.
- ii. That the charge against him is that he entered into off market transactions in securities outside of the price and order matching system of the CSE. These transactions, by their very nature, are not known to other investors, who were only aware of transactions within the said order matching system and therefore cannot result in any other party being induced to sell or purchase any security. So also, these transactions cannot possibly result in any misleading appearance of trading in the security market.
- iii. That SEBI, in its report, states that "These off market deals do not lend transparency and distort the true price discovery process in the regular market since the investor would not be aware of the large scale transactions taking place outside the market system, which if executed on screen based system, would have an impact on the demand and supply of the shares and consequently on the price". The broker submitted that SEBI has therefore categorically acknowledged that such off market transactions do not have any impact on the demand and supply of shares and consequently on the prices.
- iv. That it is now a well established that SEBI is required to prove the mens rea of a party charged under Regulation 4 of the FUTP Regulations. The broker submits that the mens rea of a party is essential ingredient of the offences under Regulation 4(a) and (b). This is evident from Regulation 4(a) itself, which proscribes transactions in security entered into "with the intention of artificially raising or depressing the prices of securities". Similarly, Regulation 4(b) proscribes any person from indulging in any act "which is calculated" to create a false or misleading appearance of trading in the security market.
- v. That, in Nirmal Bang Securities Pvt. Ltd. v/s Chairman SEBI (Appeal No.54/2002), SAT held that it was absolutely necessary to prove intention under Regulation 4. The broker submitted that it is also well established that the standard of proof required to be met by SEBI in proving such intention is high when the offences alleged is of such a nature and the fall out of the same is multifarious.
- vi. That it also a well settled that the Burden of Proof in all such matters is squarely upon SEBI. The said broker further submitted that the burden of proving the intention of the broker in entering into the said off-market-transaction is upon SEBI. Further, since the charges levied against the broker were of serious nature, the standard of proof required to be discharged by SEBI was reasonably high one. The said broker submitted that if SEBI failed to discharge this burden, he must necessarily be acquitted of any charge under Regulation 4 of FUTP Regulations.
- vii. That there was no evidence whatsoever that he had any intention to commit an offence under Regulation 4. Further SEBI's Inspection Report and Notice under Enquiry Regulations and the Show Cause Notice do not state any evidence collected by SEBI in this regard. The broker submitted that SEBI had not even considered the question of proof of such intention.
- viii. That the show cause notice has not charged him with any offence other than having violated the provisions of Regulation 4(a) and (b) of FUTP Regulation. He therefore argued that the charge recommend in the Enquiry Report of violating Clause A (1), (4) and (5) of Code of Conduct, Regulation 7 of the Stock Broker Regulations and Regulation 4 of the Stock Broker Rules be dropped. The broker submitted that it is well established that no charge can be confirmed against them to which they had not been called upon to show cause.
- ix. That they had not in any way created a false market either singly or in concert with others, or indulged in any act which was detrimental to the investors' interest or which lead to interference with the fair and smooth functioning of the market. He had not involved himself in any speculative business whatsoever. Accordingly, it was submitted that they had not, in any manner, breached Clause A of the Code of Conduct. Similarly, the broker submitted that they had not, in any manner, committed breaches of Clause A (1) & (5) of the Code of Conduct or Rule 4(b) of the Stock broker Rules or Regulation 7 of the stock broker regulations.
- x. That the violations of SEBI circular dated 14.09.99 were a technical breach. The broker also submitted that it was well established that no penalty should be imposed when a mere technical breach has been committed and when the person has acted in the bonafide of belief that he is not liable to act in the manner prescribed.

## **CONSIDERATION OF ISSUES**

1. I have considered the facts and circumstances of the case, the reply and submissions made by the said broker and other material on record. The following issues arise for consideration:

11. Whether the said broker had entered into transactions that were in violation of the directions contained in circular dated 14.09.99 and consequently, the bye laws of CSE?

1. I note that the said broker had entered into transactions with Shri Sanjay Khemani outside the price and order matching mechanism of CSE. In respect of the transactions mentioned in para 1.2 supra, the volume and value of the said transactions in quite high, as summarized hereunder:

| Date    | Purchase / Sale | Scrip           | Quantity        | Value               |
|---------|-----------------|-----------------|-----------------|---------------------|
| 3.1.01  | Sale            | Satyam Infotech | 1,50,000        | 4,69,50,000         |
| 4.1.01  | Purchase        | Satyam Infotech | 1,50,000        | 5,44,50,000         |
| 2.2.01  | Sale            | Satyam Infotech | 90,000          | 3,41,10,000         |
| 7.2.01  | Purchase        | Satyam Infotech | 90,000          | 3,79,80,000         |
|         |                 | <b>Total</b>    | <b>4,80,000</b> | <b>17,34,90,000</b> |
|         |                 |                 |                 |                     |
| 1.1.01  | Sale            | Telco           | 1,50,000        | 1,35,00,000         |
| 4.1.01  | Purchase        | Telco           | 1,50,000        | 1,59,00,000         |
|         |                 | <b>Total</b>    | <b>3,00,000</b> | <b>2,94,00,000</b>  |
|         |                 |                 |                 |                     |
| 3.1.01  | Sale            | Tata Tea        | 90,000          | 2,00,70,000         |
| 4.1.01  | Purchase        | Tata Tea        | 90,000          | 2,32,20,000         |
| 5.1.01  | Sale            | Tata Tea        | 90,000          | 2,20,50,000         |
| 10.1.01 | Purchase        | Tata Tea        | 90,000          | 2,61,00,000         |
|         |                 | <b>Total</b>    | <b>3,60,000</b> | <b>9,14,40,000</b>  |
|         |                 |                 |                 |                     |
| 19.1.01 | Sale            | Global Tele     | 25,000          | 1,67,50,000         |
| 24.1.01 | Purchase        | Global Tele     | 25,000          | 1,93,90,000         |
|         |                 | <b>Total</b>    | <b>50,000</b>   | <b>3,61,40,000</b>  |
|         |                 |                 |                 |                     |
| 9.2.01  | Sale            | RIL Ltd.        | 90,000          | 3,57,30,000         |
| 9.2.01  | Sale            | RIL             | 50,000          | 1,99,00,000         |
| 15.2.01 | Purchase        | RIL Ltd.        | 90,000          | 3,80,70,000         |
| 15.2.01 | Purchase        | RIL Ltd.        | 50,000          | 2,12,00,000         |
|         |                 | <b>Total</b>    | <b>2,80,000</b> | <b>11,49,00,000</b> |
|         |                 |                 |                 |                     |

|        |          |              |                 |                    |
|--------|----------|--------------|-----------------|--------------------|
| 6.2.01 | Sale     | ITC Ltd.     | 50,000          | 3,90,00,000        |
| 7.2.01 | Purchase | ITC Ltd.     | 50,000          | 4,47,50,000        |
|        |          | <b>Total</b> | <b>1,00,000</b> | <b>8,37,50,000</b> |

11.2 SEBI vide circular dated 14.09.99 had stipulated that all the negotiated deals (including cross deals) shall be executed only on the screens of the Exchanges in the price and order matching mechanism of the Exchanges just like any other normal trade.

11.3 I note that the above transactions have not been executed on price and order matching mechanism of CSE. In this regard, the said broker has, in his reply to show cause notice, claimed that the matter is governed by Section 13 of the SC (R) Act 1956 which permits transactions through or with the member/s of recognized stock exchanges, whether on or off the floor of the exchange.

11.4 I note that Section 13 of SC (R) Act, 1956 reads as under:

*"13. Contracts in notified areas illegal in certain circumstances*

*If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or area, that it is necessary so to do, it may, by notification in the Official Gazette, declare this section to apply to such State or area, and thereupon every contract in such State or area which is entered into after date of the notification otherwise than between members of a recognized stock exchange in such State or area or through or with such member shall be illegal."*

I note from the above that the said transactions could be entered into only between members of stock exchange and when it is stated that a transaction should be between members, it should be done through members, on the exchange mechanism.

5. I find that Section 11 of the SEBI Act confers powers on SEBI to regulate the business in stock exchanges. The same section also empowers SEBI to take measures in the interest of investors and orderly development of Securities market. Hence, the circular cited above is not in violation of the SC(R) Act, 1956, as claimed by the member.
6. The said broker has further submitted that the genuineness of these transactions was never questioned nor did they affect the market. He further submitted that since the said transactions were admittedly off the floor transactions and hence they could not have created an appearance of trading in the market. Further, in their submissions before me on 19.11.2003, the said broker has submitted that the said transactions by their very nature are not known to other investors and hence they cannot possibly result in misleading appearance of trading in the securities market. In this regard, I find that the issue is whether the member indulged in off-market transactions in violation of the circular cited above. It is not relevant for the purpose of this issue to ascertain whether the said transactions resulted in a misleading appearance of trading in the securities market.
7. I also note that the said transactions are not spot transactions, falling under Section 18 of SC(R) Act, which are exempted from the purview of Section 13 of the said act and which are permitted to be undertaken outside the stock exchange mechanism; the said broker has also failed to bring on record any proof to the contrary.
8. In view of the above, I find that the said broker has admittedly entered into the impugned transactions outside the price and order matching mechanism of the stock exchange and has therefore violated the directions given by SEBI under the circular dated 14.09.99.

*12. Whether the transactions by the said broker amounted to violation of the prohibition under the FUTP Regulations?*

1. I note that the impugned transactions involved large quantities of various scrips and large value. In this regard I note that the enquiry officer in his report has mentioned that the objective of the prohibition vide circular dated 14.09.99 was to bring in the transparency in negotiated deals, cross deals and other off-market deals. It was also necessary that negotiated deals, as a class of transactions, contribute to price discovery on the exchange and that investors are not denied the benefit of best possible price by the said deals. The Enquiry Officer has noted that having regard to large value of transactions, their execution outside the price and order matching mechanism of the Exchange attracted Regulation 4(a) and (b) of the SEBI (FUTP) Regulations.
2. In their submissions before me the said broker has submitted that in order to attract the prohibition under Regulation 4(a) of SEBI (FUTP) Regulations, the said transactions must necessarily induce the sale or purchase by any other person. Since, the impugned transactions were off market transactions, they are not known to other investors and hence there cannot be any inducement to sell or purchase securities.
3. In this regard I am of the view that transactions involving such large quantities and large values do impact the price of securities over a period of time. I find that the impugned transactions were not spot transactions, nor were they transactions permitted under the said circular; in fact these transactions were fraudulent transactions intended to circumvent the directions of SEBI to ensure transparency in transactions and to ensure proper price discovery. I further find that the transactions were of such nature that there was no change of beneficial ownership. Thus I find these transactions were intended only to operate as fraud on investors and not to effect any change in beneficial ownership or to contribute towards price discovery.

*13. Whether in the light of the above, the said broker had violated the condition subject to which registration was granted to him?*

1. I note that Rule 4 of the SEBI (Stock Broker and Sub Broker) Rules, 1992 provides that one of the conditions subject to which a Certificate of Registration may be granted to a stock broker is that he shall abide by the Rules, Regulations and Bye Laws of the stock exchange or stock exchanges of which he is a member.
2. CSE had brought the stipulations regarding negotiated deals contained in SEBI Circular dated 14.09.99 to the notice of its members vide notice dated 16.09.99. I find that by failing to inform the stock exchange of the said transactions, and entering into negotiated deals in contravention of the stipulations in the SEBI Circular and the notice of CSE, the said broker has violated the rules and bye-laws of CSE and thereby one of the conditions subject to which registration was granted to him.

*13. Whether the penalty recommended by the Enquiry Officer should be imposed on the said broker?*

1. In view of the above and in view of my earlier findings that the broker has violated Regulation 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 1995 and Sub clauses (1), (4) and (5) of Clause A of the Code of Conduct of Stock Brokers specified in Schedule II of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992, I find that the penalty recommended by the enquiry officer is adequate.

### **ORDER**

13. Therefore, I, in exercise of powers conferred on me vide Section 19 of the Securities and Exchange Board of India Act and Regulation 13 (4) of the SEBI (Procedure for Holding Inquiry by Enquiry Officer and Imposing Penalties) Regulations, 2002, do hereby suspend the Certificate of Registration INB No. 030966517 granted to M/s Amitabh Sonthalia, for a period of 4 (four) months.

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

**A K BATRA**

**Place: Mumbai**

**Whole Time Member**

**Date : July 21<sup>st</sup>, 2004**

**Securities and Exchange Board of India**