

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002.

AGAINST M/S RAJESH N JHAVERI, MEMBER, AHMEDABAD STOCK EXCHANGE, IN THE MATTER OF TRADING IN THE SCRIP OF SAWACA BUSINESS MACHINES LTD.

BACKGROUND

1. The shares of Sawaca Business Machines Ltd (earlier known as 'Sawaca Finance Ltd' and hereinafter referred to as 'SFL') were listed on The Stock Exchange, Bombay (hereinafter referred to as 'BSE') and Ahmedabad Stock Exchange.
2. Securities and Exchange Board of India (hereinafter referred to as 'SEBI') conducted an investigation into the alleged price manipulation in the scrip of SFL, during the period October – December, 1999. It was seen that there was unusual upward price movement in the shares of SFL during this period, the price having moved up from Rs. 8 to a high of Rs. 38. Similarly, it was also seen that the volumes in the shares, which were traded a total of 7 times in the whole year, prior to 26.10.99, went up significantly during the investigation period.
3. Investigations revealed that one Shri Mahendra Shah, who was subsequently appointed the Managing Director of the company, was the

largest seller during the investigation period. It was observed that Shri Shah, along with M/s Rajesh N Jhaveri (hereinafter referred to as 'Rajesh'), among others, had created artificial volumes in the shares of SFL and had then offloaded a large quantity of shares in the market. It was also seen that Shri Shah had put in large buy orders to influence the price of the scrip and had created false/misleading appearance of demand/interest in the shares of SFL, thereby influencing the share price of the scrip.

4. Rajesh, a member of Ahmedabad Stock Exchange, had traded in the scrip of SFL, for their client, Shri Shah. Investigations also revealed that Rajesh, while trading in the shares of SFL, had acted as sub-broker to M/s Shrikanth G Mantri (hereinafter referred to as "SGM"), Member of BSE and had also traded through the entity Shri Parshwa Finance, who had acted as client to M/s Jyotish Bhogilal Stock Brokers Pvt. Ltd.
5. In view of the above, it was alleged that Rajesh had acted as an unregistered sub-broker, had failed to submit full information to SEBI and had hence failed to exercise proper skill and diligence which is a violation of clause A (2) of Code of Conduct given in Schedule II read with regulation 7 of Securities and Exchange Board of India (Stockbrokers and sub-brokers) Regulations, 1992 (hereinafter referred to as "Broker Regulations").
6. It was further alleged that Rajesh had aided and abetted the ultimate client, Shri Mahendra A Shah, in creation of false market in the shares of SFL, which is a violation of regulations 4 (a), (b) and (d) of Securities and Exchange Board of India (Prohibition of Fraudulent

and Unfair Trade Practices relating to Securities Market) Regulations, 1995.

ENQUIRY PROCEEDINGS

7. Having considered the investigation report, Chairman, SEBI, vide order dated 24th July 2003, appointed an Enquiry Officer to inquire into the alleged violations committed by the Broker, in accordance with the provisions of the Securities and Exchange Board of India (Procedure for holding Enquiry by Enquiry Officer and imposing penalty) Regulations, 2002 (hereinafter referred to as “the Regulations”).
8. The Enquiry Officer, having granted an opportunity of hearing to Rajesh, submitted his report dated 5th March 2004, to SEBI, with the recommendation that a major penalty of cancellation of certificate of registration be imposed on Rajesh.

SHOW CAUSE NOTICE AND REPLY

9. On receipt of the enquiry report, a show cause notice dated 16th March 2004 was issued to Rajesh. Rajesh, vide letter dated 20th April 2004, replied to the said show cause notice inter-alia submitting as follows:

- 9.1 Rajesh contended that they were not provided with copies of documents relied upon by SEBI and that they were not allowed to cross examine people, based on whose

statements, charges against them were framed. Further, Rajesh contended that the enquiry was conducted after two years of completion of transactions and hence suffers great delay. In view of the above, Rajesh submitted that show cause notice issued to him needs to be suspended and all the further proceedings against him need to be dropped.

- 9.2 Rajesh submitted that Enquiry Officer had come to conclusions based on vague facts, without specific instances to show how they had actually violated any provisions.
- 9.3 Rajesh submitted that they had not failed to exercise due diligence, care and skill while dealing on behalf of clients. In support of this statement, they stated that they had duly filled in the client registration form. Rajesh added that they had only a business relationship with Shri Shah. They submitted that they had traded only 54 lac shares of SFL, which amounts to 2% of total equity and 19% of total volume, averaging just 2800 shares per day during the transaction period.
- 9.4 Rajesh submitted that they maintained high standard of integrity, promptitude and fairness in the conduct of all investment business. Since the allegation was not regarding their being involved in price manipulation, they submitted that there was no violation of code of conduct, as alleged.
- 9.5 Rajesh submitted that they had no intention of aiding and abetting Shri Shah in market manipulation and that they had not helped clients to off load shares in the market. Further, they submitted that neither they nor their family has traded in the scrip of SFL. Rajesh further submitted that they did not have the knowledge of Shri Shah manipulating the price of the

scrip of SFL, if any and that they has no say in the business activities of Shri Shah.

- 9.6 In addition, Rajesh submitted that it was not established that they had knowledge that Shah was acting for persons connected with promoters of SFL. Rajesh denied that he was allotted any shares by SFL.
- 9.7 Rajesh submitted that in an online system of trading it was not possible to know who the counter party client was or who the counter party broker was. Broker contended that the charge of market manipulation is not fully proved, based on good evidence, by Enquiry Officer, as required under by law.
- 9.8 Rajesh also contended that the law did not require a registered stock broker to get a separate registration as sub-broker, for dealing on another exchange through member of that exchange. Further, they submitted that as per rule 2 (f) of Securities and Exchange Board of India (Stock Broker and Sub-brokers) Rules, 1992, a stock broker is disqualified from getting registered as sub-broker.
- 9.9 In view of this, Rajesh contended that the SEBI circular which he had allegedly violated, was ultra vires the Rules and hence could not be the basis of the current proceedings.
- 9.10 Rajesh also submitted that the dealing in shares undertaken by them through SGM and Parshwa Finance, were in essence, the same sphere of activity done by them as members of ASE. Hence, Rajesh submitted that requirement of obtaining separate registration for same activity would therefore seem to be unreasonable and that there is no bar on an intermediary not to act as another entity under Rules and

Regulations. Rajesh submitted that thus he had not violated any provisions of the Rules & Regulations of SEBI.

- 9.11 Rajesh contended that not obtaining sub-broker registration had no co-relation with the purpose for which the investigation was started by SEBI. The alleged irregularity observed by SEBI was stumbled upon incidentally and that initiation of proceedings on this count was contrary to rules of fair play, equity and natural justice.

CONSIDERATION OF ISSUES

10. I have considered the facts of the case, the findings of the Enquiry Officer, the reply of Rajesh in response to the show cause notice. My findings with respect to the allegations against Rajesh are as under.
11. As stated elsewhere, the share price of SFL went up from Rs. 8/- to Rs 38/- during the period October-December, 1999. The scrip was practically illiquid before October 1999, having been traded a total of 7 times before 26.10.99. Investigations revealed that Shri Mahendra Shah, along with some other entities, had traded extensively in the shares of SFL and their trading had contributed to the initial price rise in the shares. Once these entities had created investor interest in the shares, they had offloaded the shares held by them.
13. I have also noted that Rajesh is shown as a promoter group entity of Sawaca Communications, a related company of SFL and also that Shri Gautam Jhaveri, proprietor of RNJ was one of the allottees in the preferential allotment made by SFL in January 2000 and had

received 2 lac shares of SFL. Thus, it appears that RNJ was known to the management of SFL.

14. I have observed that Rajesh had admitted to having dealt for Shri Shah, acting as a “client” to the following entities :
 - i. M/s Shrikant G Mantri, member, BSE, and
 - ii. M/s Parshwa Finance, a client to M/s Jyotish Bhogilal Stock Brokers Pvt. Ltd., an unregistered sub-broker to M/s Prabhudas Liladhar Pvt. Ltd., member, BSE.
15. Rajesh had contended, inter alia, that a registered stock broker does not need a separate registration to act as sub-broker. In this regard, I note that a stock broker is granted a certificate of registration to act only as stock broker and not as a sub-broker. Existence of registration as a stock broker does not automatically confer upon the broker a right to act as a sub-broker. The two registrations are mutually exclusive and a clear distinction is made to this effect in both, the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Rules, 1992 and the Broker Regulations, wherein the functions, duties, responsibilities of both entities are defined. A stock broker is a principal whereas a sub-broker is an agent to the principal. When a stock broker trades through another stock broker for his clients, he becomes a sub-broker to the stock broker, through whom he is trading for his own clients. The circulars issued by SEBI in this regard supplement the principles stated above and are not contrary, as sought to be projected by Rajesh. Hence, the contention of Broker that the law does not require a stock broker to get a separate registration as sub-broker is not only not acceptable, but also calls into question the exercise of due diligence by the Broker

and more so the intention of the Broker to comply with Broker Regulations in respect of due diligence, which is observed from the attitude of the Broker. I find that Rajesh, having dealt as an unregistered sub-broker, has violated SEBI Circular and Clause A (2) of Schedule II read with regulation 7 of Brokers Regulations. The violation is further compounded in the latter case, where Rajesh has dealt through the “client” of an unregistered sub-broker.

16. I have observed that RNJ had dealt as under for Shri Shah:

Name of the entity	Sett./Date	Purchases	Sales	Gross	Net
Shrikant G. Mantri(SGM)	22.11.99	0	43,500	43,500	-43,500
	30.11.99	0	28,600	28,600	-28,600
	22.12.99	0	30,000	30,000	-30,000
Parshwa Finance(the client of JBS)	38	9,100	9,100	18,200	0
	39	0	18,200	18,200	-18,200
	40	700	0	700	700
	41	0	1,500	1,500	-1,500

17. Further, RNJ had also put large orders on behalf of Shri Shah and other clients. The relevant extracts of Order Log of BSE are as under:

Broker	B/S	Rate	Quantity	Discl		Date	Time	Order No.	Client
738	S	19.4	26500	26500	A	22-11-99	10:44:25	738040014	R0038
738	S	19.4	7000	7000	A	22-11-99	13:43:32	738040026	R0038
738	S	19.4	10000	10000	A	22-11-99	15:26:02	738040053	R0038
738	S	27.15	20000	2000	A	30-11-99	10:18:05	738040101	R0038
738	S	27.15	20000	2000	A	30-11-99	12:59:22	738040142	R0038
738	B	24.5	20000	20000	A	01-12-99	11:53:04	738040219	R0038
738	B	24.55	20000	20000	A	01-12-99	11:53:30	738040220	R0038
738	B	24.8	20000	20000	A	01-12-99	11:57:38	738040223	R0038
738	B	24.9	20000	20000	A	01-12-99	11:57:46	738040224	R0038
738	B	24.95	20000	20000	A	01-12-99	11:57:50	738040225	R0038
738	B	25	8900	8900	A	01-12-99	11:58:21	738040226	R0038

738	B	24	25000	25000	A	02-12-99	10:44:00	738020076	R0038
738	B	24.25	25000	25000	A	02-12-99	10:44:08	738020077	R0038
738	B	24.5	25000	25000	A	02-12-99	10:44:14	738020078	R0038
738	B	0	24800	24800	D	02-12-99	14:09:34	738020078	
738	B	22.7	25000	2500	A	03-12-99	11:01:09	738040406	R0038

18. It is clear from the above that Rajesh had dealt in high volumes on behalf of Shri Shah, particularly considering that SFL was an illiquid scrip prior to October, 1999 and the volumes had increased only after Shri Shah started dealing in these shares. The large orders placed by Rajesh created false impression of demand in the shares of SFL, which in turn influenced the price of the scrip.
19. I have also observed that Shri Gautam Jhaveri, proprietor, RNJ is shown to have been allotted 2 lac shares in the preferential issue of shares by SFL in January 2000. RNJ has claimed that they had neither made any application nor received any shares in the said allotment. However, no evidence has been produced to substantiate this claim, apart from a mere denial, particularly as the allottee list of SFL contains his name. It also seems unlikely that a company would show name of a person as allottee, without there being an adequate explanation for the same, the most obvious being that the persons was indeed an allottee.
20. RNJ has claimed that there was no default in any of their transactions for Shri Shah and manipulation, if any, would be attributable to the client, not the broker. I have observed that RNJ had a gross position 140700 shares during the period under consideration. I have also noted that they had put major buy orders, as reproduced at para 17 above. Taking into consideration the low liquidity in the scrip and lack of fundamental reasons for any interest in the scrip, it can be assumed

that such large orders would have influenced the price of the scrip. I have also observed that the transactions done by RNJ for Shri Shah constituted a major chunk of the transactions of Shri Shah.

21. I have noted that the shares of SFL were illiquid prior to the investigation period, having been traded a total of 7 times in the year, before 26.10.03. The trading increased only after Shri Shah and other entities started transacting in these shares. Considering the weak fundamentals of SFL and the lack of trading interest prior to October 1999, the transactions done by RNJ on behalf of Shri Shah would have definitely contributed to the creation of artificial/false market in the shares of SFL. I do not accept the submissions of RNJ that manipulation, if any, is attributable to the client. Given the circumstances, any prudent broker would have doubted the intentions of the client and stopped trading for them. Unsuspecting innocent investors would be trapped by such false appearance of trading in securities. This is detrimental to the interest of investors and the orderly development of the securities market. RNJ ought to have been more careful while dealing as above for Shri Shah. Shri Shah had entered into continuous speculative transactions without any genuine interest in giving or taking delivery of shares, an act which had resulted in creation of artificial volumes and price rise in the scrip, which otherwise had no interest from the general investors. RNJ should have been more diligent in his dealing, especially when his client was trading in an illiquid scrip. Thus, I find that RNJ has facilitated, aided and abetted Shri Shah in creation of false market in the shares of SFL and hence, I hold RNJ guilty of having violated the provisions of Regulation 4(b) of the FUTP Regulations.

22. In view of the above findings, I do not have any hesitation in agreeing with the recommendations of the Enquiry Officer.

ORDER

21. Therefore, in exercise of powers conferred upon me in terms of Section 19 of the Securities and Exchange Board of India Act, 1992, read with regulation 13 (4) of Securities and Exchange Board of India (Procedure for holding Enquiry by Enquiry Officer and imposing penalty) Regulations, 2002, I hereby impose a penalty of cancellation of certificate of registration of M/s Rajesh N Jhaveri, member, Ahmedabad Stock Exchange, having SEBI registration number INB020123415.
22. This order shall come into effect on the expiry of three weeks from the date of this order.

Place: Mumbai	A K Batra
Date: October 08 , 2004	Whole Time Member Securities and Exchange Board of India