

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

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

AGAINST M/S PRAMOD KUMAR JAIN SECURITIES PVT. LTD., MEMBER, THE STOCK EXCHANGE, MUMBAI, IN THE MATTER OF MOREPEN HOTELS LTD.

Background

1. M/s. Pramod Kumar Jain Securities Pvt Ltd (hereinafter referred to as 'PKJS') is a member of The Stock Exchange, Mumbai (hereinafter referred to as 'BSE') and is registered with the Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a stock broker.

2. The shares of Morepen Hotels Ltd. (hereinafter referred to as 'MHL') were listed for trading on BSE and National Stock Exchange of India Ltd. (hereinafter referred to as 'NSE'). There was a major spurt in price and volumes traded at these exchanges during the period August to December, 2000 ('said period'). It was observed that :

i. During the one year period of August, 1999 to July, 2000, the total volume traded at BSE was 74,700 shares, as against which, approximately 19 lac shares were traded in the period august-December, 2000. The average quantity traded during the one year preceding the said period was in the range of 100-2800 shares per day, as against which, the average quantity traded during the investigation period was in the range of 18,000 to 25,000 shares per day.

ii. Similarly, at NSE, the volumes in the scrip during May-August, 2000, were in the range of 200 to 500 shares. However, after August 25, 2000, the volumes went up manifold and were in the range of 18,000 to 25,000 shares per day.

iii. The price of the share at BSE, which was Rs. 193.30 as on 25.08.2000, rose to Rs. 264.25 on 09.09.2000 and fell to Rs. 138.95 on 27.11.2000. A similar pattern was noticed at BSE.

iv. The delivery volumes during the said period were less than 1% of the total traded volume on the exchanges.

v. The P/E ratio of MHL was not on par with the rest of the hotel Industry and hence the shares price did not appear to be justified, on the basis of fundamentals.

vi. SEBI's investigation revealed that 80% of the volumes traded during the period June-December, 2000 were contributed by a handful of brokers of the exchange. It was found that the clients of these brokers, who were linked/connected to each other, had acted in concert through selected members of the exchanges and were involved in circular trading in the shares of MHL.

vii. It was further observed that most of these clients had squared off their positions; not only at the end of the settlement, but also at the end of each day. It was found that the spurt in volumes was entirely contributed by the said "clients", as more than 90% of the trades were done by these entities, by entering into transactions which were "circular" in nature.

3. One of the brokers who had traded extensively in the shares of MHL, for one of the "clients" during the said period was PKJS. An enquiry officer was appointed vide order dated 18.02.2002, to conduct an enquiry into the contravention/s alleged to have been committed by the broker while dealing in the scrip of MHL and for possible violations of the provisions of the SEBI (Stock Brokers and Sub-Brokers) Rules and Regulations, 1992 (hereinafter referred to as 'the said Regulations') and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 (hereinafter referred to as 'the PFUTP Regulations') and Rules, Bye laws and Regulations of the Stock Exchange, Mumbai.

4. The Enquiry Officer, after conducting an enquiry in accordance with the provisions of regulation 13 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 Enquiry Regulations'), submitted a report dated 28.05.04 and recommended that a minor penalty of warning be issued to the broker.

SHOW CAUSE NOTICE

5. Pursuant to the above, a show cause notice dated 02.06.04 was issued to the broker along with a copy of the enquiry report. In response to the said show cause notice, PKJS submitted its reply vide letter dated 19.6.04, wherein inter alia it was submitted that :

- a. the said scrip was in the 'A' group and generally a group scrips are considered good for trading.
- b. There is no provision to limit transaction (of a client/sub-broker) in a particular scrip; only a general ad valorem limit, based on the margin provided by the broker

FINDINGS

6. I have considered the contents of the Enquiry Report, the show cause notice, the replies and submissions of the broker. My findings with respect to the allegations leveled against PKJS are as under.

7. I have noted that the trades in MHL were carried out by PKJS, on behalf of its sub-broker, M/s Shailee Securities, who had in turn traded for M/s N N Investment, who was one of the 8 clients that had accounted for the circular trading and increase in volumes in the share of MHL, during the investigation period. The trading details of M/s N N Investment through sub-broker Shailee Securities at BSE are given as under:

Settl. No.	Gross Purchases	Gross Sales	Net
29	17,100	17,100	0
30	14,700	14,700	0
31	10,900	10,900	0
32	8,000	8,000	0
33	21,800	21,800	0
34	20,200	20,200	0
35	22,700	22,700	0
36	21,000	21,000	0
37	20,300	20,300	0
38	18,800	18,800	0
	1,76,100	1,76,400	0

8. It is evident from above that the client was squaring off his positions at the end of settlements. The details submitted by the broker/client showed that the client had squared off its position on a daily basis. At the time of recording the statement, PKJS had informed the investigating team that as per the information provided by their sub-broker, M/s Shailee Securities had started trading with the said client from October 2000, whereas M/s. Shailee Securities was trading with PKJS since April 1996. It was further stated by PKJS that the volumes in all the scrips were very high during the period under investigation and their sub-broker was trading in many scrips for its clients. Further, the total volume in the scrip at their terminal was in the range of 8000 – 10000 shares per settlement, which may not be considered as “eye-catching”. PKJS also stated that sometime in November, 2000, they received a letter from BSE asking them to furnish the trading details in the scrip of MHL. Subsequently, in December 2000, BSE informed them that M/s N N Investment had been dealing in the shares of MHL with their sub-broker, which has led to circular trading in the scrip. PKJS further submitted that (a) it is difficult for them to know the ultimate client and it was not possible to control their action as to whether the client was acting in concert with other brokers; (b) they were totally innocent in this matter; (c) they were neither connected nor had any interest in the scrip; and (d) their sub-broker was working with them for last 5 years and perhaps they are also not involved in the matter.

9. I observe that BSE had imposed a penalty on them. On being asked to give reasons for penalty by stock exchange and whether they had contested the penalty levied by the exchange, PKJS had stated that BSE had directly debited their General Charges a/c and communicated the same to them. However, they had explained their position to BSE by writing a letter to them.

10. I find that PKJS had traded in the scrip of MHL for its registered sub broker, M/s Shailee Securities for total purchases of 1,75,500 shares in Settlement no.29 to 38. All these purchases were squared off without any trade resulting in delivery of shares.

11. I find that certain connected clients, including M/s N N Investments, client of the sub-broker of PKJS, had traded in the scrip in a concerted manner. These clients had entered into continuous speculative transactions without any genuine interest in giving or taking delivery of shares. These transactions had resulted in creation of artificial volumes and price rise in the scrip, which had otherwise not attracted any interest from the general investors.

12. I have noted the submissions of the broker to the effect that :

(a) They had earned Rs. 23,122 as brokerage from the transactions in MHL; that they would not have put more than 13 years standing in the exchange at stake by consenting to circular transactions,

(b) They had observed that trading pattern of the client M/s N N Investments and had stopped trading for them w.e.f. 18.12.200, even before they received the letter from BSE regarding suspicious trades in MHL. Hence, they can not be alleged to not have exercised due care and skill.

13. In this regard, I have also noted the findings of the Enquiry Officer that :

i. PKJS had not dealt with the clients directly, but through its registered sub-broker.

ii. There is no evidence to suggest that it was aware of the ultimate client or that some connected clients were trading in the scrip in a concerted manner.

iii. PKJS had provided a trading terminal to M/s Shailee Securities via lease line with one end connected to BSE and the other end to their office. The orders were punched by the sub broker at the said terminal with their client codes.

iv. Required margins were collected by PKJS from its sub-broker, M/s Shailee Securities.

v. PKJS did not have proprietary trading in the scrip.

14. In view of the above findings, although I agree with the findings of the Enquiry Officer that PKJS can not be held guilty of having aided or abetted the clients in creating artificial market in the scrip, I am of the view that the broker should have exercised greater control over the trades of its sub-broker, especially considering that the scrip was illiquid for a large part of the year before the sudden spurt in price and volumes. PKJS ought to have asked its sub-broker to refrain from trading in an illiquid counter like MHL, instead of allowing it to trade in significant quantities, over the duration of 10 settlements.

15. Hence, I am of the view that PKJS ought to be cautioned to be more vigilant in future.

ORDER

16. Therefore, in exercise of the powers conferred upon me by virtue of Section 19 of the SEBI Act, 1992, read with Regulation 13(4) of SEBI (Procedure For Holding Enquiry By Enquiry Officer And Imposing Penalty) Regulations, 2002, I hereby advise M/s. Pramod Kumar Jain Securities Pvt Ltd., member, BSE to be more careful in future and I also direct the broker to note that any instances of violations or non-compliance of the Securities and Exchange Board of India Act and the Rules and Regulations, in future, shall be dealt with stringently.

A K Batra

DATED : 25th October, 2004

WHOLE TIME MEMBER

PLACE : MUMBAI

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