

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 SURESH RATHI SECURITIES PVT. LTD., MEMBER, THE STOCK EXCHANGE, MUMBAI AND MEMBER, NATIONAL STOCK EXCHANGE OF INDIA LTD., IN THE MATTER OF MOREPEN HOTELS LTD.

Background

1. M/s. Suresh Rathi Securities Pvt Ltd. (hereinafter referred to as 'the said broker'), a member of The Stock Exchange, Mumbai (BSE) and National Stock Exchange of India Ltd. (NSE), 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. 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. The said broker was one of the brokers who had traded extensively in the shares of MHL, for one of the "clients" during the said period. An enquiry officer was appointed vide Order dated 18th February 2002 to conduct an enquiry into the contravention/s alleged to have been committed by the said 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 BSE and NSE.

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 31.05.04 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 03.06.04 was issued to the broker, along with a copy of the enquiry report. The broker submitted his reply to the said show cause notice, vide letter dated 16.6.04, wherein they had stated that :

- "i. There were more than 6000 scrips in BSE/NSE put together and it would be extremely difficult to know the liquidity of the various scrips. Moreover, the scrip of MHL had been fairly liquid during the relevant period.
- ii. They did not have any means to know the transactions of their clients with other brokers."

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 observed that the said broker had dealt in the shares of MHL for its sub-broker M/s Varun Stock Broking, who had in turn executed all the trades for M/s Jem Fiscal Ltd., 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. Jem Fiscal Ltd. at BSE during the period under consideration are as follows:

Settl. No.	Gross Purchases	Gross Sales	Net
27	15,500	15,500	0
28	13,800	13,800	0
29	17,100	17,100	0
30	18,300	18,300	0
31	11,200	10,900	300
32	7,500	7,600	-100
33	22,100	21,800	300
34	20,200	20,200	0
35	21,000	21,200	-200
36	22,700	22,700	0
37	21,400	21,400	0
38	18,800	18,800	0
39	22,300	22,300	0
Total	2,31,900	2,31,600	300

[The broker has submitted details till Settlement No.39 of BSE. However, as per the details collected from the exchange, the broker had purchased 2,33,000 shares and sold 2,32,500 till December 31, 2000.] The trading details of Jem Fiscal Ltd. at NSE are as follows:

Settl. No.	Gross Purchases	Gross Sales	Net
37	6,000	6,000	0
38	14,200	14,200	0
39	17,400	17,400	0
40	11,800	11,800	0
41	15,400	15,400	0
42	19,100	19,100	0
43	15,800	15,800	0
44	4,700	4,700	0
45	8,000	8,000	0
46	15,400	15,900	-500
47	20,700	20,200	500
48	18,800	18,800	0
49	19,800	19,800	0
Total	1,87,100	1,87,100	0

[The Broker has submitted details till Settlement No.49. However, as per the details collected from the exchange, the broker has purchased 2,33,000 shares and sold 2,32,500 till December 31, 2000.]

8. It is evident that the client was squaring off his positions at the end of settlements. The daily details submitted by the broker shows that the client used to square off his position on a daily basis most of the time. There was negligible delivery of shares. At the time of recording the statement, the said broker informed the investigating team that as per the information provided by their sub-broker, M/s. Varun Stock Broking, M/s. Jem Fiscal Ltd. was their ultimate client. On being asked as to why they had allowed trading as above, in an illiquid scrip, the broker had stated that they used to monitor the net outstanding position of their sub-broker at the end of the day. As the trading details suggest, the client used to square off his position at the end of the day and the net position of the client on almost all the days was nil and they therefore had not noticed any abnormality in the trading pattern as they were more concerned about the net exposure of the sub-broker.

9. I find that M/s Jem Fiscal Ltd., client of the sub-broker of the said broker, along with entities acting in concert, was the pre-dominant trader in the scrip during the period under consideration. The volumes in the scrip started going up from the last week of August 2000 and the sub-broker of the said broker had traded for M/s Jem Fiscal Ltd. during the said period, when M/s Jem Fiscal Ltd., along with entities acting in concert, was trading in the scrip and creating artificial volumes.

10. However, I also find that the said broker had not dealt with the clients directly, but through its registered sub-broker. I have also noted that the said broker basically operates through a large network of sub brokers, who are all registered with SEBI. The said broker has client business through a network of around 35 sub-brokers. There is no evidence to suggest that it was aware of the ultimate clients or that some connected clients are trading in the scrip in a concerted manner. I have noted that the broker did not have any

proprietary position in the shares of MHL and also that the turnover of the broker in the shares of MHL was insignificant compared to its overall turnover.

11. I have observed that the said broker had provided a trading terminal to its sub-broker Varun Stockbroking via lease line with one end connected to BSE and the other end to their office; that the orders were punched by the sub broker at the said terminal with their client codes. The said broker had also collected required margins from its sub-broker.

12. In view of the above, I agree with the findings of the Enquiry Officer that it cannot be held that the said broker had aided and/or abetted the clients in creating artificial market in the scrip of MHL. However, I also tend to agree with the Enquiry Officer that in view of the fact that the scrip has been considerably illiquid and that there were unusual movements in the volumes and the price of the scrip, SRSL should have exercised extra caution and not allowed its sub broker to trade substantial volumes in an illiquid scrip, on both exchange, over an extended period, as it gives misleading impression of trading and might induce innocent investors into trading in the scrip.

13. In view of above, I do not see any valid reason to differ with the detailed findings of the enquiry officer. I am fully convinced that the said broker should have exercised due care and caution while dealing in the shares of MHL and therefore, I feel that the said broker ought to be cautioned to be more vigilant in future.

ORDER

14. 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 Suresh Rathi Securities Pvt. Ltd, member, BSE and NSE, 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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