

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 GSB CAPITAL MARKETS LTD., MEMBER, THE STOCK EXCHANGE, MUMBAI, IN THE CASE OF MOREPEN HOTELS LIMITED.

Background

1. GSB Capital Markets Limited (hereinafter referred to as "the said broker") is a member of Bombay Stock Exchange (hereinafter referred to as "BSE") and is registered with Securities and Exchange Board of India (hereinafter referred to as 'SEBI').

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. The public holding in MHL including other Body Corporates not in the group is approximately 37% of the paid up capital of MHL i.e. approximately 24,10,360 shares are with the public. Out of which less than 5% of the paid up equity capital is with Individual shareholders and the remaining shareholding i.e. approx. 32% with body corporates. Further, out of a total 772 shareholders, only 47 shareholders hold approximately 96.35% of the equity capital. This clearly shows that the shares of MHL are concentrated in limited hands.

vii. Trading in the scrip was very infrequent, as is evident from the following table:

Month & Year	No. of Trades	No. of days traded	Avg. trades per day	Total Qnty. Traded	Avg. Qnty. Per day
Aug 99	115	22	5	31,000	1,409
Sept 99	59	19	3	7,700	405
Oct 99	11	8	1	2,300	288
Nov 99	6	5	1	700	140
Dec 99	34	11	3	3,600	327
Jan 00	4	4	1	400	100
Feb 00	4	6	1	700	117
Mar 00	26	13	3	4700	362
Apr 00	1	1	1	100	100
May 00	31	8	4	22,400	2,800
June 00	11	6	2	1,100	183
July 00	NIL	NIL	NIL	NIL	NIL
Aug 00*	Not. Available.	5	Not Available.	85,400	17,080
Sept 00*	-do-	20	-do-	4,64,200	23,210
Oct 00*	“	19	“	3,47,400	18,285
Nov 00*	“	20	“	4,76,500	23,825
Dec 00*	N. A.	20	N. A.	5,08,700	25,435

* The sudden spurt in Volume has been shown in Bold and Italics.

viii. As is observed from the above table, w.e.f August 2000, the volumes started going up and were in the range of 20,000 to 25,000 shares per day till December 2000. Thereafter, the volumes in the scrip started declining and after January 15, 2001 the volumes came down to around 5,000 shares per day. The volume spurt was observed mainly during the five month period viz. August 2000, September 2000, October 2000 , November 2000 and December 2000. During the period August 1999 - July 2000 (one year) the total volume traded at The Stock Exchange, Mumbai was just 74,700 shares . However, during the period August 2000 to December 2000, approx. 19 lac shares were traded at the exchange.

ix. 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.

x. 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

xi. As stated above, delivery based business in the scrip, during the period June 01, 2000 to December 31, 2000, was less than 1% of the total trading volume on the exchange. It was also observed that during the period of investigations the total volume at both the exchanges mentioned above were almost same and had great degree of similarity both in prices and total number of shares traded per day. It was also observed that the same set of clients was trading at both the exchanges. The total quantity traded by these entities is given as under:

Settl. No.	Name of the Entity	Purchases	Sales	Gross
1.	M/s. Jem Fiscal Ltd.	10,37,800	10,32,001	20,69,801
2.	M/s. F. T. Traders	8,54,800	8,52,200	17,07,000
3.	M/s. K. N. Traders	6,26,226	6,26,226	12,52,452
4.	Prashant Investment	66,300	66,300	1,32,600
5.	K. P Investment	5,94,900	5,95,300	11,90,200
6.	S. M. Investment	3,04,000	3,04,000	6,08,000
7.	N. N. Investment	3,65,500	3,65,500	7,31,000
8.	Hakeem Auto Ltd.	6,610	4,100	10,710
	Total	38,56,136	38,45,627	77,01,763

xii. The combined quantity traded in the scrip at BSE and NSE during the period June 2000 to December 2000 was approx. 38 lac shares, out of which approx. 90% of the shares were traded by the above mentioned entities at both the exchanges taken together.

3. The "clients" mentioned at 2(xi) above were linked to each other. The the exact relationship/link of all the clients mentioned above are as under:

3.1 Jem Fiscal Ltd -

a) It is /was the employer of Ketan Shah (K. N. traders), Prashant Shah (Prashant Investment), Kisan Parwad (K. P. Investment), Shamshad Sheikh (S. M. Investment), Narendra Navale (N. N. Investment).

b) The Director of the firm, Shri Nazir Hakeem is also a Director with Hakeem Auto Ltd.

c) Shri Nazir Hakeem introduced the bank a/c of F. T. Traders (Prop. Fakruddin Moyiandi) with United Bank of India, Fort Branch. d) Shri Prashant Shah (Prashant Investments) placed orders on behalf of Jem Fiscal with Toss Financial Services, member NSE and Varun Stock Brokers, (Sub-broker to Suresh Rathi Securities)

3.2 Hakeem Auto Ltd

a) The Director, Shri Nazir Hakeem is also a director of Jem Fiscal Ltd.

b) Introduced the bank account of F. T. Traders with United Bank of India.

3.3 N. N. Investment

a) The proprietor of the firm, Shri Narendra Navale, is an employee of Jem Fiscal Ltd.

b) He stated that he has traded on the recommendation of his employer's website.

c) Shri Prashant Shah (Prop: Prashant Investment), who also in employment with Jem Fiscal Ltd. placed the orders on behalf of N. N. Investment with Toss Financial, member NSE.

3.4 S. M. Investment

a) The proprietor, Shri Shamshad Sheikh, is an employee of Jem Fiscal Ltd.

b) The account of the firm with United Bank of India was introduced by Shri Fakruddin Moiyaddi of F. T. Traders.

c) He had traded in the scrip because his employer, M/s. Jem Fiscal Ltd. was also trading in the scrip.

3.5 K N Traders

a) The proprietor, Shri Ketan Shah was employed with Jem Fiscal Ltd. as Manager (Research).

b) As per information provided by Shilpa Stock Brokers, he was trading on the terminal provided to Hakeem Auto Ltd.

c) He had given recommendation on the web site of Jem Fiscal Ltd.

d) He had also recommended the scrip for trading to Prashant Shah (Prashant Investment)

3.6 Prashant Investment

a) The proprietor, Shri Prashant Shah, is an employee of Jem Fiscal Ltd.

b) He had traded in the scrip based on the recommendation on the website of his employer.

c) Had discussed the matter with Ketan Shah (K. N. Traders) before he started trading in the scrip.

d) He had placed orders for Jem Fiscal Ltd. with Varun Stock Brokers (sub-broker of Suresh Rathi Securities Pvt. Ltd.).

e) He had also placed orders for Jem Fiscal Ltd. with Toss Financial, Member NSE.

f) He had placed orders for N. N. Investment with Toss Financial, member NSE.

3.7 K P Investment

a) He is employed with Jem Fiscal Ltd.

b) Has traded mainly because his employer, Jem Fiscal Ltd. was also trading/investing in the scrip.

3.8 F T Traders

a) Shri Fakruddin Moiyadi, Prop. F. T. Traders, had given the office address of Jem Fiscal Ltd. as his correspondence address.

b) The BOLT terminal provided by Bhupendra M. Bheda to F. T. Traders was installed at the office address of Jem Fiscal Ltd.

c) The account of F. T. Traders with United Bank of India, Fort Branch was introduced by Shri Nazir Hakeem, who is a Director of Jem Fiscal Ltd. and Hakeem Auto Ltd.

d) Shri Fakruddin Moiyadi had introduced the account of S. M. Investment (Proprietor: Shri Shamshad Sheikh, an employee of Jem Fiscal Ltd.) with United Bank of India.

3.9 The other indicators showing the connections of the clients are as under:

3.9.1 FT Traders (Shri Fakruddin Moiyandi) had dealt through three members of BSE simultaneously viz. Bhupendra Bheda, Dinesh J Shah and Anantrai A Parekh.

3.9.2 Jem Fiscal Ltd dealt through two members of BSE simultaneously namely, Suresh Rathi Securities and GSB Capital Markets.

3.9.3 Prashant Investments (Prashant Shah) and KP Investments (Kisan Parwad) have dealt in the scrip of MHL simultaneously through two BSE members viz. Joinder Capital and MJ Doshi.

3.9.4 Hakeem Auto shared the same address as that of FT Traders and KN Traders.

3.9.5 Both FT Traders and KN Traders have accounts with United Bank of India and their account numbers were close to each other i.e 4664 and 4667.

3.9.6 The fax no. 2818179 given by Prashant investments (Prashant Shah) is the same as that of Hakeem Auto and KN Traders.

3.9.7 The telephone numbers provided by FT Traders in the client registration form to BSE member M/s D J Shah are standing in the name of Hakeem Zohra who is one of the directors of Jem Fiscals Ltd.

3.9.8 The telephone numbers provided by KP investments and Prashant Investments in their client forms were matching with the telephone nos of Hakeem Zohra who is a director of Jem Fiscals Ltd.

3.9.9 Both Pramod Navale of NN Investments and Kisan Parwad of KN Traders shared the same address viz. Ganesh Nagar, Pump House, Andheri East.

3.10 It was observed from the trading pattern that these clients were involved in Circular Trading in the scrip. These clients have entered into buy and sell transactions with each other, squaring up positions and reversing trades either on the same day or during the same settlements, making the net receivable/deliverable positions as either nil or shares of negligible quantities i.e about 100 to 200 shares. Thus, all the aforesaid clients had done transactions of fictitious nature, through different members of NSE and BSE and established /created artificial volumes in the scrip, thereby upsetting the market equilibrium in the scrip.

4. The said broker had dealt in the shares of MHL for one such client, namely, M/s Jem Fiscal Ltd. An enquiry officer was appointed 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.

ENQUIRY REPORT AND RECOMMENDATION

5. The enquiry officer, after conducting the enquiry as per the procedure laid down under SEBI (Procedure for Holding Enquiry By Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as "the said regulations") submitted a report dated 31.05.2004, with the recommendation that the registration of the member be suspended for a period of two months.

SHOW CAUSE NOTICE AND REPLY

6. Pursuant to the receipt of the Enquiry report, a show cause notice dated 03.06.04 was issued to the said broker, along with a copy of the enquiry report, advising them to show cause as to why the penalty, as recommended by the Enquiry Officer, should not be imposed on them. The said broker submitted his reply to the said show cause notice, vide letter dated 21.06.04, wherein it was inter alia submitted that :

i. the scrip of MHL was liquid at least from August 2000 onwards on the BSE and the finding of the Enquiry Officer that the scrip of MHL was illiquid was erroneous.

ii. they had no knowledge at all of the purported associates / connected entities of Jem Fiscal or their trading activities.

iii. The impugned transactions were executed from August to December, 2000. Jem Fiscal was their client since September 1999, and had not committed any default till then, hence, there was nothing wrong in allowing Jem Fiscal to trade in the scrip of MHL.

iv. Since the margin recoverable from Jem Fiscal was less than Rs.1 lac, by virtue of the said Notice No.40609/2000 of the BSE, it was not mandatory for them to collect the margin and consequently did not do so and contended that they did not violate any rule or regulation by not collecting margin.

v. there was nothing unusual about a client squaring of his position at the end of the trading session. Every client has his own motives and objectives and accordingly he executes transactions to achieve the desired results. The broker also submitted they do not concern themselves with the motives and objectives of clients and they simply execute the orders and it was the practice of Jem Fiscal to square off their transactions.

vi. They did not notice this pattern of trading by Jem Fiscal, in any event, it was perfectly legal and permissible for Jem Fiscal to square off their transactions.

vii. They did not execute a single trade for the alleged associates of Jem Fiscal and there was no question of doubting the intentions of their client, i.e. Jem Fiscal, therefore, Enquiry officer's suggestion that they should have stopped trading for Jem Fiscal and their associates is absurd, since, they had no connection with the so-called associates of Jem Fiscal.

FINDINGS

7. 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 the said broker are as under.

8. Shri Ramakant Biyani, director of M/s G S B Securities Pvt. Ltd., had stated that they had traded in the scrip of Morepen Hotels Ltd. on behalf of M/s Jem Fiscal Ltd., who started trading with him since August 2000. The trading details of M/s Jem Fiscal Ltd., at BSE, with the broker are as under:

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

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Settl. No.	Gross Purchases	Gross Sales	Net

22	1,000	1,000	0
23	8,700	8,700	0
24	10,500	10,500	0
25	14,300	14,300	0
26	14,300	14,300	0
27	17,600	17,600	0
28	13,300	13,300	0
29	18,800	18,800	0
30	16,800	16,800	0
33	21,800	21,800	0
34	22,500	22,500	300
35	12,200	12,200	0
37	11,300	11,300	0
38	18,800	18,800	0
39	22,100	22,100	0
40	20,000	20,000	0
	2,44,000	2,43,700	300

9. It is evident that the client of GSB was mostly squaring off its positions at the end of each settlement. The details submitted by the broker suggest that the client used to square off its positions within the same settlement. It was also seen from the records submitted by the broker that it had not collected anything towards Initial Margin. The same was confirmed by Shri Biyani in his sworn statement. I have noted that BSE had imposed penalty on the broker. On being queried about the same, Shri Ramakant Biyani submitted that the penalty was imposed by way of a debit to their account and that they had written to BSE clarifying their position. He further added that they then stopped trading with the client from January 2001.

10. I have observed that the client of GSB was one of the eight entities who were responsible for 90% of the transactions in the shares of MHL during the investigation period, transactions which resulted in creation of artificial volumes in the shares of MHL. I have further observed that the client had traded in significant quantity of shares, across 16 settlements and also that the client had squared off the transactions in all settlements except one, with the result that even after having transacted in a total of 4,87,700 shares, the net position at the end of 19 settlements was a mere 300 shares.

11. The volumes in the scrip started going up from the last week of August 2000 and the broker has traded for the client during the period when his client, along with entities acting in concert, was trading in the scrip and creating artificial volumes.

12. I have also noted the finding of the Enquiry Officer that the client of GSB had traded only in two scrips through the said broker, namely MHL and Veronica Labs, with major volumes in the shares of MHL, as stated at para 8 above. I do not agree with the contention of the said broker that the shares of MHL were liquid during the investigation period and that they did not have any cause to notice anything unusual with respect to the transactions of their client. As stated at para 2 above, the shares of MHL were infrequently traded prior to August, 2000 and the volumes spurted only after August 25, 2000, when 8 entities, including the client of GSB, indulged in circular trades and created artificial volume in the scrip. The client has entered into continuous speculative transactions in big quantities without any genuine interest in giving or taking delivery of shares, which has resulted in artificial volumes and price rise in the scrip, a scrip which had otherwise not attracted much interest from the general investors.

13. The broker continued trading for their clients for a number of settlements, which resulted in building up of artificial volumes and price in the scrip of MHL. Unsuspecting innocent investors would be trapped by such false appearance of trading in securities. This is also detrimental to the interest of investors and the orderly development of the securities market. I am of the view that the said broker ought to have noticed the trading pattern of the client. It is possible that the reckless trading by the clients involved in generating artificial volumes in the shares of MHL could have been arrested, had the said broker been careful in his dealing in the shares of MHL, given that :

- the shares were infrequently traded and the volumes had spurted only from August onwards,
- there was no fundamental reason for the share prices to go up as they did, during the investigation period,
- the client was entering into continuous speculative transactions in big quantities, without taking delivery of shares.
- By the broker's own admission, the client had traded predominantly in the scrip of MHL, accounting for Rs. 9.14 crores in the scrip of MHL alone, against its total transaction value of Rs. 24.27 crores.

14. In view of the above, I am convinced that the broker has failed to exercise due skill and care in terms of Clause A(2) of the Code of Conduct prescribed for stock brokers, in Schedule II in terms of Regulation 7 of Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 which enabled the client in indulging acts calculated to create a false and misleading appearance of trading in the scrip of MHL in violation of Regulation 4(b) of the said regulations.

15. Clause A(2) of the Broker Regulations reads as :

"A. General

(1)

(2) Exercise of due skill and care: A stock-broker shall act with due skill, care and diligence in the conduct of all his business.”

16. However, I have also noted that :

- a. They have held the membership of BSE for nearly 50 years and have never been penalized for any infraction.
- b. The turnover in MHL was insignificant compared to the total turnover of the broker.
- c. They did not have any proprietary trades in the shares of MHL.
- d. They stopped doing business with the client in January, 2001, immediately on learning from BSE that the said client may be involved in market manipulation.

17. Taking an overall view of the case, I find that the crux of the matter really lies in whether it can be realistically and fairly maintained that the broker, in the normal course of his business and working with normal diligence, would have quickly detected the “taint” attaching to the above group of transactions. It is true that, as stated above, going by the highest standards of prudence, the broker should have been more diligent in questioning his client/s about the nature of business being placed by them. For the purpose of determining what the appropriate and fair penalty is, however, it would be inequitable to wholly disregard the ground level practical constraints, the total business volumes handled by the broker, whether the pattern of trading was patently suspicious, and other related issues. Hindsight clarity of vision should not override due consideration of these facts and circumstances.

18. Given the above context, and considering also that the turnover of the client in MHL was insignificant as compared to the total turnover of the broker, it does not appear to be fair to assume that the broker, without undue difficulty and with ordinary diligence, would have been in a position to readily zero-in on or segregate the transactions of the said clients and quickly establish their suspicious nature. Hence, I am of the view that suspension of certificate of registration granted to the said broker, for a period of two months, would be excessive. Considering the circumstances, imposition of penalty of warning, would be adequate to meet the ends of justice.

ORDER

19. Therefore, in exercise of the powers conferred upon me by virtue of Section 19 read with Regulation 13(4) of SEBI (Procedure For Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby pass an order issuing a warning to M/s GSB Capital Markets Ltd., member, BSE, to the effect that the broker should be careful in future and exercise due care and diligence in the conduct of its affairs as a capital market intermediary. 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

SECURITIES AND EXCHANGE BOARD OF INDIA