

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 SHILPA STOCK BROKER PVT. LTD., MEMBER, THE STOCK EXCHANGE, MUMBAI, IN THE MATTER OF MOREPEN HOTELS LTD.

Background

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

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, the details of whose trades are as follows:

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

3. SSB 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 SSB who acted in the scrip of MHL, 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 imposed on SSB.

SHOW CAUSE NOTICE

5. Pursuant to the receipt of the Enquiry report, a show cause notice dated 02.06.04 was issued to SSB, 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. SSB submitted its reply to the said show cause notice, vide letter dated 17.06.04, wherein they had submitted that :

- "1. At the outset, we appreciate the finding of the learned enquiry officer that the total volume traded by the client was mainly in the other A group scrips i.e. more than 85% volumes were in the normal scrips such as TISCO, Infosys, Global Tele, Zee etc. and therefore, we could not suspect.
2. The BSE has sent us the letter about the investigation into the transaction of MHL and we have stopped doing the business and discontinued the terminal immediately.
3. We have not done any single transaction in our proprietary account or in any personal account of the directors.

However, after going through the SEBI and BSE, we have taken various steps to improve our vigilance and we assure you that we are taking all necessary steps so that such thing doesn't occur in future."

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 SSB are as under.

7. I note that SSB had traded in the scrip of Morepen Hotels Ltd. on behalf of M/s K N Traders and M/s Hakeem Auto Ltd. The trading details of M/s K N Traders with the SSB are as under:

Settl. No.	Gross Purchases	Gross Sales	Net
Demat	3,79,026	3,79,026	
22	2,000	2,000	0
23	10,300	10,300	0
24	13,900	13,900	0
25	14,200	14,200	0
26	14,400	14,400	0
27	16,700	16,700	0
28	13,500	13,500	0
29	1,600	1,600	0
Total	4,65,626	4,65,626	0

I also note that the trading details of M/s Hakeem Auto Ltd. with the SSB are as under:

Settl. No.	Gross Purchases	Gross Sales	Net
22	10	100	-90
23	300	300	0
24	1,600	0	1,600
25	3,700	3,700	0
28	1,000	0	1,000
Total	6,610	4,100	2,510

8. From the trading pattern of the clients, it is evident that the clients were mostly squaring off their positions at the end of each settlement. It is seen from the records submitted by SSB that they had not collected Initial Margin. However, SSB stated that they had collected carry forward margins in cash for the trades executed in A group shares. During the enquiry, SSB stated that the clients were trading in various scrips including A1 group scrips, which constituted 85% of their volumes. The total volume in the scrip of Morepen Hotels Ltd. was about 15% of their total volume with SSB. Hence, they did not find any abnormality in their clients trading in the scrip of MHL. SSB informed the investigating team that they were not aware about the dealings of their clients in the same scrip with other brokers of the exchange.

9. I have observed that SSB's clients, along with associates/entities connected with them, had traded in the scrip and more than 90% trading in the scrip was done by these entities, resulting in the creation of artificial volumes in the scrip of MHL. I have observed that the clients, especially K N Traders, had traded in significant quantities through SSB. I have also observed that the said client had mostly squared off its positions, taking delivery of insignificant quantities of shares, if at all.

10. A prudent stock broker ought to have questioned the motives of the client and stopped trading for them, considering that the volumes in the scrip shot up only from August and the client was trading in significant quantities, without taking delivery of the shares. Instead, SSB continued trading for the client across several 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 would be detrimental to the interest of investors and the orderly development of the securities market.

11. In view of the above, I am convinced that SSB is guilty of violating the provisions of clause A(2) of the code of conduct of schedule II read with Regulation 7 of the said regulations. I do not see any valid reason to differ with the detailed findings of the enquiry officer.

12. As regards the quantum of penalty, I have noted the findings of the Enquiry Officer and the detailed submissions of the broker, wherein it was stated that :

- i. The said clients had been dealing with them since November, 1999,
- ii. The said clients had dealt mainly in A group scrips like TISCO, HFCL, Infosys, Zee etc and the volumes of the client in MHL were only 15% of their total volumes.
- iii. The volumes of the said clients in the shares of MHL accounted for only 0.2% of the total volume of the broker.
- iv. The said broker had stopped dealing with the said clients in September 2000 itself, on the basis investigations investigated by BSE against the said clients in Eonour Software, even before BSE intimated them regarding the suspicious trades of the clients in MHL.
- v. The broker did not have any proprietary trades in the said scrip.

13. 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.

14. Given the above context, and considering also that the majority of the clients' trade were in other A group scrips and that the clients' total volume was a mere 0.2% of the broker's total volume, 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 inclined to accept the recommendation of the Enquiry Officer that a warning may be issued to SSB in this regard, with the advice that they be careful in future.

ORDER

15. 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 pass an order issuing a warning to M/s Shilpa Stock Broker Pvt 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 : 28th October, 2004

WHOLE TIME MEMBER

PLACE : MUMBAI

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