

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. Varun Stock Broking, Sub-broker INS231049912, to M/s. Suresh Rathi Securities Pvt. Ltd, (Member, The National Stock Exchange, Mumbai), in the matter of M/s. Morepen Hotels Ltd

1.0 Background

- 1.1 In December 1995, Morepen Hotels Limited (hereinafter referred to as MHL) came out with a public issue at a premium of Rs.20/- per share. The scrip was listed at Jaipur Stock Exchange, Ludhiana Stock Exchange, Delhi Stock Exchange, National Stock Exchange (hereinafter referred to as "NSE") and The Stock Exchange, Mumbai (hereinafter referred to as "BSE"). There was a major spurt in the total volume in the scrip of MHL. From 29, 400 shares during January 2000 including nil volume for the entire month of July 2000, the volume of scrip of MHL shot up to 11,34,200 shares during the period August to November 2000. Further, the percentage of net quantity delivered to gross quantity traded during the period 11th September 2000 to 17th November 2000 was less than 1% of the total traded volume on the exchange. The same trend was accompanied by the price, the price of shares of MHL touched a 52-week high at Rs.285/- on 11th September 2000 and was followed by a fall in price of Rs.154.65 on 15th November 2000 touching a 52-week low.
- 1.2 In view of the above, Securities and Exchange Board of India (hereinafter referred to as "SEBI") conducted an investigation into the trading of the scrip of MHL for the period June 2000 to December 2000 (hereinafter referred to as "investigation period"). During the investigation it was observed that the scrip of MHL was traded only at NSE and BSE.
- 1.3 It was observed that the P/E ratio of MHL was not in synchronisation with the rest of the hotel industry. The rise in volumes observed during the period June 2000 to December 2000 did not appear to be justified based on its fundamentals. SEBI's investigation into the matter found that 80% of the total quantity traded during the period June 2000 – December 2000 was contributed by few brokers of BSE and NSE. It was found that the ultimate clients had acted in concert through selected members and thus were involved in creating artificial trade in the scrip of MHL.
- 1.4 The gross quantity traded i.e. buy and sell in the scrip at BSE and NSE during the period June 2000 to December 2000 was 77,01,773 shares. During the course of investigation, it was observed that most of the clients trading in the scrip were linked to each other.
- 1.5 The total quantity traded by these entities as per the information gathered during investigation is given as under:

Sr.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.	M/s. Prashant Investment	66, 300	66, 300	1, 32, 600
5.	M/s. K. P Investment	5, 94, 900	5, 95, 300	11, 90, 200
6.	M/s. S. M. Investment	3, 04, 000	3, 04, 000	6, 08, 000
7.	M/s. N. N. Investment	3, 65, 500	3, 65, 500	7, 31, 000
8.	M/s. Hakeem Auto Ltd.	6, 610	4, 100	10, 710
	Total	38, 56, 136	38, 45, 627	77, 01, 763

- 1.6 During investigation as per the statement of Shri Vishal Mashewari, authorized signatory of M/s. Varun Stock Broking (hereinafter referred to as "Sub-broker"), a SEBI registered sub-broker to M/s. Suresh Rathi Securities Pvt. Ltd., had traded in the scrip of MHL on behalf of its client M/s. Jem Fiscal Ltd (hereinafter referred to as "the client"). Sub-broker did not know the client through any known source. The only introduction the Sub-broker had was that the Director of the client met the Sub-broker at a party. It was observed from the records that the Sub-broker had not collected any deposit towards initial margin from the client. The sub-broker further informed the investigating team that the net outstanding position of the client generally used to be either nil or negligible however, the client was regular in pay-in obligations.
- 1.7 It has been alleged that Sub-broker by not showing due skill, care and diligence in its dealings with the client was alleged to be in violation of Code of Conduct as given under Schedule II read with regulation 15 of Securities and Exchange Board of India (Stockbrokers and sub-brokers) Regulations, 1992 (hereinafter referred to as "Brokers Regulations"). Further, trading done by Sub-broker on behalf of the client was alleged to be in violation of Securities and Exchange Board of India (Prohibition of

Fraudulent and Unfair trade practices relating to securities market) Regulations, 1995 (hereinafter referred to as "PFUTP Regulations").

2.0 Enquiry Proceedings

2.1 In view of the alleged irregularities committed by Sub-broker, Chairman, SEBI, vide order dated 18th February 2002 appointed an Enquiry Officer (hereinafter referred to as "Enquiry Officer") to enquire into the affairs of Sub-broker. The Enquiry Officer after conducting the enquiry submitted a report dated 30th April 2004 finding the Sub-broker guilty of violating Clause A (2) of Code of Conduct laid down under Schedule II of Broker Regulations and recommended that a minor penalty of suspension of certificate of registration of Sub-broker for a period of two months be imposed on the Sub-broker.

3.0 Show cause notice and reply

3.1 Subsequent to the submission of the said Enquiry Report, a show cause notice dated 6th May 2004 was issued to Sub-broker under regulation 13 (1) of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing penalty) Regulations, 2002.

3.2 Sub-broker vide letter dated 12th July 2004 responded to the said show cause notice, which is extracted as follows;

- "1) At the outset we had stressed that we had closed down business with M/s. Jem Fiscal Ltd., on our own, prior to any SEBI investigation in January 2001. (Para 5.3.6) i.e., within 3 months of Jem Fiscal becoming our client. Hence, if we had not been diligent enough M/s. Jem Fiscal Ltd would have continued to build up artificial volumes in Morepen Hotels Ltd., thereby trapping innocent investors also.
- 2) Hence the contention that we had not been prudent enough to doubt the intentions of our client M/s. Jem Fiscal Ltd (Para 7.6) is not true. We would again like to stress that we had stopped executing orders on behalf of M/s. Jem Fiscal Ltd., on our own.
- 3) Till date Varun Stock Broking has had no other complaints against them and we have honoured all our commitments with reference to our broker and our clients.
- 4) In the light of above, we request you to be lenient with us. We assure you that we will be more cautious in the future.

4.0 Consideration of Issues

4.1 I have carefully considered findings of investigation, the Enquiry Report, show cause notice issued to Sub-broker and the submissions made in response to the show cause notice.

4.2 I observe that the P/E ratio of MHL was not in synchronization with the rest of the hotel industry. Hence, neither the scrip price of MHL was justified based on the fundamentals of the company nor the rise in volumes observed during the period June 2000 to December 2000 is justified on any grounds. I note from investigation that 80% of the total quantity traded during the period June 2000 – December 2000 was contributed by few brokers of the exchange and that the ultimate clients had acted in concert through selected members and thus were involved in creating artificial trading.

4.3 From trading details collected from brokers of BSE and NSE, it was seen that some of the clients, who were linked/connected to each other in some way or the other were trading in the scrip both at BSE and NSE. They had enrolled as clients to both BSE and NSE members and traded simultaneously in the scrip of MHL during the investigation period. From the records obtained from different brokers of both the exchanges, it was observed that most of these clients had not paid any margin to the brokers for the trades executed by them. Further, they were squaring off their positions not only at the end of settlement but almost on the same day.

4.4 From the trading details supplied by the exchange, I observe that delivery based business in the scrip during the period 1st June 2000 to 31st December 2000 was less than 1% of the total trading volume on the exchange. I find that during the period of investigations the total volume at both the exchanges BSE and NSE 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. I note that during the investigation period these related entities had purchased 38, 56, 138 shares and sold 38, 45, 627 totaling to 77, 01, 763 shares.

4.5 The contention of the sub-broker that the sub-broker was unaware of trading done by its client is not convincing. I find that the client had shown no inclination of picking up or giving delivery and was trading in illiquid scrip. The sub-broker should have been more diligent in its dealing especially when a client is trading in illiquid scrip and squaring off the position on the same day without much profit or loss. I note that during settlement Nos. 29 to 38 the client had brought 1,80,300 shares and sold as many shares resulting in its net position becoming 300 which clearly indicates that the clients had no intention in genuine trading. Whatever trading was done by the client was for the purpose of creating artificial trade in the scrip of MHL and creating a misleading appearance of trading in the scrip of MHL.

- 4.6 When the client is trading only in one scrip that too in illiquid scrip, sub-broker has reasonable ground to suspect the intentions of the client. I note that only few clients connected to each other were able to indulge in circular trading i.e., buy and sell transactions with each other, squaring off positions and reversing trades either on the same day or same settlement, making the net receivables and deliverable positions either nil or in negligible quantities and created a false and misleading appearance of trading on the securities in the scrip of MHL. These clients had traded through certain brokers while indulging in manipulative practices and Sub-broker was one of them.
- 4.7 The scrip had been made liquid by putting artificial volumes and price by certain connected clients including the client of Sub-broker. Sub-broker has allowed a new client to trade in such scrip that too even without collecting margins. The client had entered into speculative transactions without any genuine interest in giving or taking delivery of shares. Any prudent broker can doubt the intentions of the client and stop trading for it. Unsuspected 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.
- 4.8 Being a registered intermediary, Sub-broker is under positive obligation to be more diligent while dealing with clients, which Sub-broker failed to in the instant case resulting in violation of Brokers Regulations. The trading pattern of the client should have alerted Sub-broker and he ought to have taken adequate steps to mitigate the trading strategy of the client. Functioning of Sub-broker calls into question the exercise of due diligence by him and more so the intention of Sub-broker to comply with Broker Regulations in respect of due diligence, which is observed from the hands-off attitude of Sub-broker. I find that Sub-broker failed to exercise due skill and care in terms of Clause A (2) of the Code of Conduct prescribed for sub brokers, in Schedule II in terms of Regulation 7 of Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 which resulted in the client indulging in manipulative activities in violation of provisions of PFUTP Regulations.
- 5.0 Order
- 5.1 In the light of the above, I agree with the recommendation of the enquiry officer. Therefore, I in exercise of the 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 minor penalty of suspension of certificate of registration of M/s. Varun Stock Broking as Sub-broker with SEBI Registration No. INS 010359912, for a period of two months.
- 5.2 This order shall come into force after the expiry of three weeks from the date of this order.

Place: Mumbai
Date: 27 December 2005

MADHUKAR
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA