

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. Mangla Capital Services Pvt. Ltd. INB.230675838, Member, The National Stock Exchange in the matter of trading of the scrip of M/s. Cyberspace Infosys Ltd.

1.0 BACKGROUND

- 1.1 M/s. Century International Finance Ltd formerly known as M/s. Greenfield Leasing and Holdings Limited was incorporated in 1984 and was renamed as M/s. Century International Finance Limited in 1994. The name was further changed to M/s. Cyberspace Infosys Ltd in 1998 (hereinafter referred to as "Cyberspace"). Cyberspace came out with a public issue in December 1994 and listed its total equity of Rs.5. 74 crores which was divided into 57, 40, 000 equity shares of Rs.10 each. Shares of Cyberspace were listed on The Stock Exchange, Mumbai (hereinafter referred to as "BSE"), The National Stock Exchange (hereinafter referred to as "NSE"), The Delhi Stock Exchange and Uttar Pradesh Stock Exchange.
- 1.2 Securities and Exchange Board of India (hereinafter referred to as "SEBI") had conducted an investigation into the trading of the scrip of Cyberspace and violation inter-alia of provisions of Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995, (hereinafter referred to as "FUTP Regulations").
- 1.3 During the investigation it was observed that the trading of Cyberspace in BSE and NSE from January to March 2001 showed a high trading volume till middle of March 2001. It was observed that on BSE the trading volume on 16th March 2001 was 4, 93, 238 shares and on the next trading day i.e., 19th March 2001, trading volume in the scrip of Cyberspace was only 2 shares. It was further observed that the price at the start of the year was at around Rs.170/- and it dropped down to around Rs.150/- in the next two months. In March 2001, this price slipped further to bottom within next fortnight or so. The volume which was around two lacs shares per day / settlement in the first two months i.e. January and February went up to three and half to four lacs per day in the first half of March 2001.
- 1.4 Investigation report observed that Cyberspace, M/s. Century Consultants Ltd., promoters of Cyberspace, M/s. Century Consultants Ltd and a group of 20 entities have traded in the scrip of Cyberspace and were related / associated with each other. It was found M/s. Mangla Capital Services Ltd (hereinafter referred to as "MCSL"), Member, NSE was one of the brokers through whom the said trading was done.
- 1.5 In the above background Chairman, SEBI vide orders dated 20th July 2001 and 29th November 2002 appointed an Enquiry Officer to conduct an enquiry into the alleged violations by MCSL of the provisions of Securities and Exchange Board of India (Stock brokers and sub-brokers) Regulations, 1992 (hereinafter referred to as "Broker Regulations") and FUTP Regulations. Enquiry Officer had issued a show cause notice dated 11th September 2001 to MCSL for which MCSL replied vide its letter dated 10th October 2001. On 12th August 2003 an opportunity of personal hearing before Enquiry Officer was also given to MCSL. Shri. Vinod Gupta, Director of MCSL and Shri. Bharat B Merchant, Advocate & Solicitor appeared on behalf of MCSL and made submissions.
- 1.6 Meanwhile, MCSL surrendered its certificate of registration as stock broker vide letter dated 18th August 2003 and sought for a "No dues" certificate from SEBI so that MCSL's membership with NSE can also be surrendered and the deposit lying with NSE can be taken back from NSE. However in view of the pending enquiry against MCSL, SEBI vide letter dated 2nd April 2004 refused to accept the surrender of certificate of registration of MCSL as stock broker.
- 1.7 In view of SEBI refusing to accept the surrender of certificate of registration, MCSL filed an appeal before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "SAT"), Appeal No. 85 of 2005 submitting that SEBI has refused to accept surrender of certificate of registration of MCSL as stock broker and issue a "No dues" certificate in view of pending enquiry. MCSL further submitted that by virtue of regulation 27 of Broker Regulations, no enquiry can be conducted against person who ceases to be stock broker. MCSL prayed that SEBI be ordered to complete the enquiry and issue a "No dues" certificate to MCSL. The Hon'ble SAT vide its order dated 15th June 2005 directed SEBI to complete the enquiry against MCSL and dispose off the matter within 10 weeks from the date of the order i.e., by 25th August 2005.
- 1.8 Pursuant to the aforesaid order passed by the Hon'ble SAT, Enquiry Officer submitted a report dated 29th July 2005 recommending that in view of MCSL surrendering its certificate of registration as stock broker on 18th August 2003, a minor penalty of Censure be considered to be imposed against MCSL in terms of Regulation 13 (1) (a) (i) of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.

2.0 SHOW CAUSE NOTICE AND REPLY

- 2.1 A show cause notice dated 17th August 2005 was issued to MCSL enclosing a copy of Enquiry report mentioned above requiring MCSL to show cause as to why penalty as recommended by the Enquiry officer or any other penalty as deemed appropriate should be imposed on MCSL. MCSL vide letter dated 22nd August 2005 responded to the said show cause notice asking for final investigation report and names of clients who traded through MCSL but made the statement that they did not trade through MCSL nor did they identify MCSL. In response to the request made by MCSL, SEBI vide letter dated 31st August 2005 informed MCSL that since there were no fresh allegations even after the completion of enquiry, it was not possible to provide copy of final investigation report however, SEBI provided names of clients as sought by MCSL. After receipt of SEBI letter dated 31st August 2005, instead of replying to the show cause notice, MCSL sought for further statements and submitted that since the transactions in question were that of 2001, Securities and Exchange Board of India Act as amended subsequently does not apply. MCSL further submitted that since the certificate of registration has been surrendered, no enquiry can be held against MCSL as barred by regulation 27 (a) of Broker Regulations. MCSL also denied allegation of manipulation and malpractice. SEBI vide letter dated 12th September 2005 forwarded copies of those statements that were sought by MCSL vide its letter dated 7th September 2005. Even after the receipt of all the documents as sought by MCSL and provided by SEBI, MCSL did not reply to the show cause notice, instead vide letter dated 15th September 2005 sought for a personal hearing and stated that reply would be made at the time of personal hearing. SEBI vide letter dated 16th September 2005 informed MCSL that since the penalty of censure as recommended by Enquiry Officer is only minor penalty, personal hearing, as requested by MCSL, may be given only if such penalty is proposed to be enhanced. Further it was advised that MCSL should file its reply in order to facilitate early disposal of the matter. MCSL vide its letter dated 19th September 2005 finally responded to the show cause notice extract of which is as follows

"The statements of the clients appear to be made under pressure to save their own skin. We have been denied the right to cross-examine these clients. May we point out here that we taken all possible care while dealing with them? The know your client procedure was followed; all payments were effected only after receipt of shares directly from the client account. Shares were sold on receipt of written instructions and on receipt of shares. Payment for the same was also effected directly by account payee cheques. It is surprising how SEBI registered sub brokers can make statements like "used our name and account", all the statements, if read closely are identical in nature and contradictory. The remark made in the show cause "specially Mangla" on Pg-2 is wrong and misleading, none of the clients have said it in that fashion or implied so.

We deny role played by Binod Agarwal was that of a sub broker. He has simply acted as an introducer; no bill, sale or payment has been routed through him. All sales and payments were direct in the name of the clients.

We also deny the allegation that we abetted fraudulent and unfair trade practice. We have acted as only brokers. The Insta-cash facility was also a back to back facility. We fail to understand how the scenario would have been any different if the rolling settlement payment would have been received by the clients 4 days later. (We enclose a newspaper article, which speaks for itself). Had we to introduce the clients to HDFC, they would have done the same, only we would have lost the business. The fault in fact was and lies in the scheme floated by HDFC. (Which was supposed to have been cleared by SEBI and the Exchange before being introduced as market Intermediary). Our act has not resulted in as loss to any investor, nor has anyone complained against us from the date of commencement of business till the date of surrender. This show cause notice was the first^t and last one received by us as brokers from any authority.

We therefore in light of the above request you to give us a clean chit in the matter and drop the charges levied. We also request that the proposed minor penalty of Censure should not be imposed."

- 2.2 SEBI vide letter dated 3rd November 2005 informed MCSL that as requested by MCSL an opportunity of personal hearing was being given to MCSL on 29th November 2005. On the scheduled date of hearing before me Shri. Vinod Gupta appeared on behalf of MCSL and reiterated submissions made in earlier letters written to SEBI. Shri. Gupta sought 15 days time to submit written submissions, which was granted. Accordingly MCSL made written submissions dated 9th December 2005 detailing how MCSL had started to avail Insta-cash facility provided by HDFC bank and how the facility operated.

3.0 CONSIDERATION OF ISSUES AND FINDINGS

- 3.1 I have carefully examined the enquiry report, show cause notice issued to MCSL and subsequent communication between SEBI and MCSL.
- 3.2 I note that MCSL had admitted that MCSL made two contract notes for the same trade, one in the name of the client and the other in the name of Shri. Vinod Gupta, Director of MCSL. Shri. Gupta availed the Insta cash facility of HDFC Bank and placed himself as the client for these trades and the payments were routed to the clients, who were none other than the fronts of Century Consultants, for spot payments for the purchases made through market. The amount so released by the trading member to the clients during March 2001 was about Rs.15 crores. During this period these clients were only sellers

and together account for nearly 49% of the total market sell of the scrip of Cyberspace. As per Broker Regulations, a broker shall not issue contract notes in any other name than in the name of the client for whom the trade was executed. However, as brought out above MCSL made two contract notes and raised money from HDFC Bank. The activity of MCSL facilitated its clients to receive immediate cash for the sales made and use that money to purchase the same shares through other brokers and thereby indulge in manipulation of market. The submission of MCSL that HDFC accepted two contracts being issued is not acceptable since MCSL as a registered stock broker is under positive obligation to follow procedures laid down by SEBI. As per the Code of Conduct laid down under Broker Regulations, a stock-broker shall issue "a" contract note, which means only one contract note shall be issued. Whereas in the instant case MCSL, by showing Shri. Gupta as client on the duplicate contract notes provided to HDFC, created a second contract note in violation of Code of Conduct as laid down under Broker Regulations. Further, HDFC accepting issuance of two contract notes does not override the procedure laid down by SEBI. MCSL therefore, aided and abetted fraudulent and unfair trade practices and is guilty of manipulation and malpractices and therefore, violated A (3) and (4) of Code of Conduct as laid down under Schedule II read with Regulation 7 of Brokers Regulations.

- 3.3 With regard to the charge that MCSL acted through Shri. Binod Agarwal who was not a SEBI registered sub-broker, I do not accept the submission of MCSL that Shri. Agarwal had only introduced clients since the investigation report clearly brought out 19 clients whose transaction were routed through Shri. Agarwal on his instructions and if Shri. Agarwal had only introduced clients, he should not have instructed on their behalf. MCSL, acting through Shri. Binod Agarwal who is not a registered sub-broker is contravention of Securities and Exchange Board of India circular, Circular No. SMD / POLICY / CIRCULAR / 3-97 dated 31st March 1997. I further note that these clients who were introduced by Shri. Agarwal have dealt only in the scrip of Cyberspace and were one way or the other related to M/s. Century Consultants or Cyberspace or Shri. Arvind Johari. None of the clients had directly dealt with MCSL but through Shri. Agarwal. Though the clients contributed to large proportion of the total sale transaction in the scrip of Cyberspace, MCSL did not check the proper identity of the client thereby not exercising due skill and care. Therefore, MCSL has violated A (2) of Schedule II read with regulation 7 of Brokers Regulations.
- 3.4 I note that MCSL has contended that Broker Regulations as they were in 2001 would be applicable in the instant case since the transactions were that of 2001. The contention of MCSL does not hold good since in this context what is made applicable is only the procedure as saved during the amendment and not penalties as amended. I further note that MCSL had contended that in view of surrender of certificate of registration, no enquiry can be conducted by virtue of regulation 27 of Broker Regulations. What is to be seen is the spirit of the statute. The said provision is to facilitate those situations where it may not be necessary to conduct investigation or enquiry when termination of certificate of registration is a mere formality. The provision does not provide any protection to those brokers against whom action is pending. In the instant case MCSL had surrendered the certificate of registration after initiation of enquiry by SEBI. The surrender of certificate of registration after initiation of enquiry appears to be a tactic adopted by MCSL to surpass the pending enquiry and subsequent action that might follow after the completion of enquiry.

4.0 ORDER

- 4.1 In view of the above, I agree with the recommendation of the Enquiry Officer that a minor penalty of Censure be considered to be imposed against MCSL. I do not find any substantial ground to differ with the recommendation of Enquiry Officer. Therefore, in terms of Section 19 of 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 Censure on M/s. Mangla Capital Services Pvt. Ltd. INB.230675838, Member, The National Stock Exchange.

Date: 31 January 2006
Place: Mumbai

Madhukar
Whole Time Member
Securities and Exchange Board of India