

SECURITIES AND EXCHANGE BOARD OF INDIA

Order under Regulation 13(4) of SEBI (Procedure for Holding Inquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 against M/s. K & A Securities Pvt. Ltd., Member, The National Stock Exchange, in the matter of Morepen Laboratories Ltd.

Background

- Investigations were conducted by Securities and Exchange Board of India (hereinafter referred to as SEBI), pursuant to an order of the Chairman dated 24.04.00, into the buying, selling and dealing in the scrip of M/s. Morepen Laboratories Ltd. (hereinafter referred to as MLL) and more particularly to ascertain whether any provisions of the SEBI Act, 1992 and various Rules and Regulations made thereunder have been violated.
- The scrip which had been quoting at around Rs. 125 in January 1999 had gone up to around Rs. 176 in March, 1999 and further to about Rs. 567 in June 1999. At the BSE, the scrip was trading at Rs. 157 on 16.02.99 and increased over the period to close at Rs. 766 on 29.10.99. The volumes also shot up from 50,000 shares on 17.04.99 to 1,54,850 shares on 10.05.99. Steady volumes were witnessed thereafter except for three days between 20.08.99 and 24.08.99 when an aggregate of 6,32,775 shares were traded. At the NSE, the price increased from Rs. 165 on 03.03.99 to close at Rs. 753 on 29.10.99. A substantial rise in the price and volume was noticed during the period January to October 1999. BSE imposed a special margin on the scrip of Rs. 150 from 13.05.99, which was increased from time to time and removed when the scrip was transferred to rolling settlement from January 10, 2000.
- Investigations revealed that there were matching trades executed on NSE between Alpic BBK Finance Ltd. and K & A Securities Pvt. Ltd. (hereinafter referred to as KASPL). The transactions carried out by M/s. Alpic BBK Finance Ltd. (hereinafter referred to as Alpic) was for and on behalf of its client, M/s. Jem Fiscal Ltd. (hereinafter referred to as JFL). The transactions carried out by KASPL was for and on behalf of its client, M/s. Prajay Investments (hereinafter referred to as Prajay). Prajay had acted on behalf of M/s. KN Traders, represented by Shri Ketan Shah. The following is the list of matching trades noticed during the investigation:

Date	Time	Trade No.	Rate	Qty	Buy TM	Buy Client	Sell TM	Sell Client
2-Jul-99	10:21:23	199907020021722	503.50	10000	Alpic	J0080	K&A	K053
2-Jul-99	10:22:23	199907020022633	510.50	10000	K&A	K053	Alpic	J0080
5-Jul-99	10:56:36	199907050076368	503.50	10000	Alpic	J0080	K&A	K053
5-Jul-99	10:57:46	199907050077659	501.00	10000	K&A	K053	AIDic	J0080
6-Jul-99	14:11:43	199907060231726	500.75	10000	K&A	K053	Alpic	J0080
6-Jul-99	14:15:54	199907060234443	502.50	10000	Alpic	J0080	K&A	K053
9-Jul-99	12:39:04	199907090190618	501.00	10000	Alpic	J0080	K&A	K053
9-Jul-99	12:52:02	19990790202418	501.00	10000	K&A	K053	Alpic	J0080
12-Jul-99	10:15:29	199907120029950	501.50	10000	Alpic	J0080	K&A	K053
12-Jul-99	10:44:40	199907120083137	505.50	10000	K&A	K053	Alpic	J0080
14-Jul-99	13:19:22	199907140259559	514.00	10000	Alpic	J0080	K&A	K053
14-Jul-99	13:22:29	199907140263889	512.50	10000	K&A	K053	Alpic	J0080
16-Jul-99	11:08:55	199907160078070	524.00	10000	Alpic	J0080	K&A	K053
16-Jul-99	11:09:33	199907160078728	523.00	10000	K&A	K053	Alpic	J0080
20-Jul-99	10:23:21	199907200029353	557.50	10000	K&A	K053	Alpic	J0080
20-Jul-99	10:24:11	199907200030429	557.40	10000	Alpic	J0080	K&A	K053
23-Jul-99	11:06:43	199907230083402	605.00	10000	K&A	K053	Alpic	J0080
23-Jul-99	11:19:39	199907230095412	604.00	10000	Alpic	J0080	K&A	K053
26-Jul-99	10:30:16	199907260041464	595.00	10000	Alpic	J0080	K&A	K053
26-Jul-99	10:41:48	199907260055988	594.25	10000	K&A	K053	Alpic	J0080
27-Jul-99	11:19:54	199907270094710	596.00	10000	AIDic	J0080	K&A	K053
27-Jul-99	11:28:16	199907270103343	595.25	10000	K&A	K053	Alpic	J0080
28-Jul-99	10:47:08	199907280073266	587.00	10000	K&A	K053	Alpic	J0080
28-Jul-99	11:07:09	199907280095139	587.50	10000	Alpic	J0080	K&A	K053
28-Jul-99	12:16:19	199907280165118	587.50	10000	Alpic	J0080	K&A	K053
28-Jul-99	12:22:04	199907280169996	586.50	10000	K&A	K053	Alpic	J0080
29-Jul-99	10:03:08	199907290003758	600.00	10000	Alpic	J0080	K&A	K053
29-Jul-99	10:14:06	199907290021168	598.00	20000	K&A	K053	Alpic	J0080
2-Aug-99	10:12:27	199908020017356	597.00	20000	Alpic	J0080	K&A	K053
2-Aug-99	10:19:21	199908020026638	596.25	20000	K&A	K053	Alpic	J0080

- Investigations also revealed that the trades of Shri Ketan Shah were put through the terminal of Prajay, installed at the office of M/s. Pramod Kumar Jain Securities, member of BSE (hereinafter referred to as PKJS). Prajay is an associate of PKJS. PKJS had dealt on behalf of JFL at the BSE in the scrip of MLL. Alpic traded on behalf of JFL at the NSE in the scrip of MLL.

5. Based on the above findings of investigation it was alleged that KASPL had not exercised proper control over the trades executed by the agent Prajay, which facilitated entering the structured deals at NSE. Prajay, which is an unregistered entity, aided and abetted in the creation of artificial liquidity and entering into non-genuine trades. Also the negligence on the part of KASPL enabled Shri Ketan Shah to enter into structured deals based on information of the trades he had received from PKJS and Alpic.

Enquiry Report and findings:

6. Based on the above findings of the investigation, a show cause notice dated 28.11.03 was issued to KASPL alleging that the member had failed to exercise due skill and care in the conduct of its dealings and thereby had violated the provisions of Clause A-2 of the Code of Conduct for stock brokers specified in Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992. KASPL was asked to submit its reply, if any before the Enquiry Officer. A reply dated 23.12.03 was received by the Enquiry Officer. KASPL was offered a hearing by the Enquiry Officer on 04.02.04, when the member appeared and made its submissions.
7. Subsequently, the Enquiry Officer submitted a report dated 19.01.05 concluding the following:
 - a. KASPL stated that the transactions were executed for Prajay Investments in the capacity of a client. The relationship between KN Traders and Prajay Investments Pvt. Ltd. was not known to them till the time SEBI investigation was initiated. But, from the records of the trades executed it is observed that, trades have been executed and reversed immediately within a span of seconds. In the instant case, as the trades have been squared off immediately, such transactions cause suspicion and the member is bound to exercise caution in such cases.
 - b. Further, the member has stated that when they became aware of these transactions, they had asked the client to stop trading at least in the scrip of MLL. But these transactions have been repeatedly executed for a month before which the member became aware of them. In reply to a question posed during the personal hearing KAS, in the matter, has stated that the delay in taking steps to stop trading was because he was out of station till 22nd of July 1999. Such negligence on the part of the trading member for long period, to exercise due skill, care and diligence cannot be ignored.
 - c. As per SEBI circular dated 31.03.1997, all brokers should ensure that none of their clients deals as unregistered sub-broker. In the instant case, Prajay Investment who entered with KAS a member constituent agreement had dealt as unregistered sub-broker by allowing KN traders to deal through them. Hence, I am constrained to believe that KAS has failed in taking due care and diligence and has allowed Prajay Investment to deal as an unregistered sub-broker.
 - d. I find that KAS has violated the provisions of Clause A-2 of the Code of Conduct for stock brokers specified in Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992.
8. In view of the above, the Enquiry Officer had recommended a minor penalty of one month suspension of registration of KASPL in terms of Regulation 13 of SEBI (Procedure for holding Inquiry by an Enquiry Officer and Imposing Penalty), 2002.

Show cause notice, reply and hearing

9. Pursuant to the submission of the enquiry report, a notice dated 28.01.05 was issued to the member asking it to show cause as to why the penalty recommended by the Enquiry Officer should not be imposed upon it. A reply dated 15.02.05 was received from the member submitting the following:
 - a. At the end of July 1999, KASPL noticed that the transactions conducted in the MLL scrip by Prajay were unusual in quantity with respect to both number of shares and the repetitive nature of the transactions. Hence KASPL informed Prajay to discontinue dealing in the scrip at the end of July. Prajay consequently stopped dealing in the scrip from August 02, 1999.
 - b. In February 15, 2000 KASPL received a letter from the NSE inquiring about the trades in the MLL scrip and asking KASPL to furnish the requisite information about them. When KASPL enquired into the matter it realised that its client Prajay had been dealing as a sub-broker on behalf of KN Traders and that all its trades in MLL had been done for and on behalf of KN Traders. KASPL immediately told Prajay to stop dealing as a sub-broker and subsequently in March 2000 stopped dealing with Prajay altogether.
 - c. It is pertinent to note that KASPL asked Prajay to stop dealing in the MLL scrip at the end of July 1999 when it became uncomfortable with the nature of the transactions. Further, as soon as it came to the knowledge of KASPL that Prajay was acting as sub-broker, KASPL immediately told them to discontinue the activity and subsequently terminated the member-client agreement as well.
 - d. It is pertinent to note that SEBI concluded the investigation against Mr. Pramod Kumar Jain in January 2003 and as a final direction issued them a warning not to repeat the conduct and maintain confidentiality of client dealings. It is clear from the facts narrated that it was KN Traders that indulged in the activity of fraudulent and unfair trade practices. It is also clear that it was Prajay that acted contrary to the SEBI Act and the Stock Brokers Rules and Regulations in acting as a sub-broker without being duly registered with SEBI. It is also clear from the facts that it was Prajay that was grossly unprofessional and in violation of the Code of Conduct in allowing Mr. Ketan Shah to have access to their trading room. SEBI has not only concluded its investigation in 2003 but also found it proper to issue a mere warning to Mr. Pramod Jain not to repeat such conduct.
 - e. Without prejudice to the above, it is submitted that there was no way for KASPL to know that the trades entered into on behalf of Prajay were of a fraudulent nature. NSE's NEAT trading system is an anonymous system and its price and order matching mechanism is not known to the stock brokers. Prajay never disclosed that the trades carried out through KASPL were on behalf of someone else or that they were going to be matched with orders of other counter parties.

f. KASPL had raised bills, contract notes and issued cheques only in the names of Prajay and all orders were executed on the NEAT system in their name and code only. KASPL did not have any doubts or suspicion that Prajay maybe acting as a sub-broker particularly when the Prajay Investments originally registered as a client, confirming that the account was being opened for the firm's transactions only.

10. An opportunity of being heard was given to KASPL, before me on 21.04.06, when it appeared through its representative and reiterated the aforesaid submissions.

Consideration of issues

11. I have considered the recommendations of the enquiry report and the submissions of the member in response to the same. I now proceed to analyse whether KASPL is guilty of violating the provisions of Clause A-2 of the Code of Conduct for stock brokers specified in Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992, by failing to exercise due care and diligence in the conduct of its business.

12. The enquiry report has concluded that the member had traded in the scrip of MLL through an unregistered sub-broker, Prajay. I have perused the Member Client Agreement entered into between KASPL and Prajay. I have also noted the submissions of KASPL that it had issued the bills, contract notes etc., in the name of Prajay only. It has also been submitted by KASPL that the payments have been made to the account of Prajay. I have also noted letters dated 23.02.00 and 31.03.00 submitted by KASPL which it had received from Prajay mentioning that the transactions in the scrip had infact been carried out on behalf of their client M/s. KN Traders, which was stopped during August 1999. The table above shows that the transactions have been put through the client code of Prajay. All these put together corroborate the statement of KASPL that it had not known of the dealings of KN Traders through Prajay, until certain information was called for by the NSE. Therefore, I am in agreement with the submission of the member that it had no means of ascertaining the fact that KN Traders was putting through the deals, at the time when the transactions were carried out.

13. I am in agreement with KASPL's submission that the transactions in the scrip as per the table above was carried out during the period July – August 1999. But the major spurt in prices had occurred during the period ending June 1999. Therefore, the aforesaid transactions had not influenced the price resulting in a major change.

14. KASPL has submitted that it had not been able to check the transactions in the scrip for their genuineness till July 22nd, 1999 due to certain practical considerations. But once the non-genuineness of the transactions was discovered, KASPL directed its client, Prajay, to stop carrying out such transactions, forthwith. The transactions have thereafter been stopped with effect from the 2nd August, 1999. There has been thus lack of control by the member as it failed to track the activities of its client on a consistent basis.

15. With proper tracking of its client's activity on a consistent basis, KASPL could have avoided the undue acts of KN Traders in the scrip of MLL. KASPL has however made amends, by issuing proper directions to Prajay, on finding something amiss about the transactions, rather than allowing the situation to go out of hand.

16. As regards the penalty, recommendation of one month suspension of the certificate of registration has been made in the enquiry report. Since the charge based on which the recommendation has been made stands mostly refuted, I feel suspension of certificate for a period of one month, would be disproportionate in the case of KASPL. Also, the other party involved in the transaction PKJS has been issued a warning, which has been pointed out by KASPL, before me. Therefore, I feel a parity of treatment needs to be accorded to the parties, and a month's suspension would be harsh on KASPL.

Order

17. In view of the aforesaid findings and conclusions, I, in exercise of powers conferred upon me under Section 19 of the SEBI Act, 1992, read with Regulation 13(4) of SEBI (Procedure for holding Inquiry by an Enquiry Officer and Imposing Penalty) Regulations, 2002, hereby direct M/s. K & A Securities Pvt. Ltd., Member, The National Stock Exchange, to 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 SEBI Act, Rules and Regulations, in future, shall be dealt with stringently.

Place: Mumbai
Date: 29.06.06

T C Nair
Whole Time Member
Securities and Exchange Board of India