

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER AGAINST M/S GAYATHRI & CO., MEMBER, BANGALORE STOCK EXCHANGE LTD., SEBI REGISTRATION NO.INB080169817, UNDER REGULATION 13(4) SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 FOR THE IRREGULAR TRANSACTIONS IN THE SCRIP OF HOME TRADE LTD.

WTM/GA/83/ISD/08/06

1.0 BACKGROUND

- 1.1 M/s Gayathri & Co (hereinafter referred to as the Broker) is a member of the Bangalore Stock Exchange Ltd. (hereinafter referred to as BgSE) and is registered with the Securities and Exchange Board of India (hereinafter referred to as SEBI) as a stock broker under section 12 of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the Act) with registration number INB080169817.
- 1.2 The scrip of Home Trade Ltd. (hereinafter referred to as HTL) was listed at PSE on November 15, 1999 at Rs 250/- and at Bangalore Stock Exchange Ltd. (hereinafter referred to as BgSE) on November 16, 1999 at Rs.275/-. There was a very sharp rise in the price of the scrip of HTL both at PSE and BgSE. The price of the scrip of HTL reached Rs.315/- within two weeks of its listing i.e. by December 06, 1999. The subsequent rise in the price of the scrip of HTL is as detailed below:

1.3	The maximum rise in the price of the scrip of HTL took place between November 16, 1999 and March 31, 2000, when it moved from Rs.275/- to Rs.815/-.	Date	Price (Rs.)
		December 30, 1999	525.00
		January 31, 2000	735.00
		March 31, 2000	809.00
		May 5, 2000	874.00

- 1.4 SEBI conducted an investigation into the buying, selling and dealings in the scrip of HTL inter alia by the members of BgSE including the Broker for alleged circular trading and price manipulation, thereby contravening the provisions of SEBI (Prohibition of Fraudulent and Unfair Trade practices Relating to Securities Markets) Regulations, 1995 (hereinafter referred to as FUTP Regulations) and SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as the Broker Regulations).
- 1.5 Upon investigation, SEBI inter alia found that the Broker along with some other members of BgSE had contributed for significant volume of trading in the scrip of HTL at BgSE, which were not genuine and made only for the purpose of creating artificial price and volume. The trades executed by the Broker in the scrip of HTL are as follows:

Period	Gross Purchase (shares)	% to the total buy volume at BgSE	Gross Sales (shares)	% to the total sell volume at BgSE
November 16, 1999 to March 31, 2000	4,700	2.46%	4,600	2.41%
April 01, 2000 to March 31, 2001	99,600	13.01%	99,800	13.03%
April 01, 2001 to December 31, 2001	14,600	5.01%	14,600	5.01%

- 1.6 The clients of the Broker were Shri Sudhakar Dani, Ms Radhika Dani , D.S Investments and Shri Sanath Kumar. It was also alleged that the Broker had traded in his own account in the scrip of HTL, mainly as per the instructions of Shri Rajneesh Karanpuria of HTL.

2.0 APPOINTMENT OF ENQUIRY OFFICER

- 2.1 On completion of the said investigation, SEBI appointed an Enquiry Officer, vide order dated November 27, 2002, under regulation 5(1) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as the 2002 Regulations) to enquire into the alleged irregular transactions made by the Broker in the scrip of HTL.
- 2.2 A show cause notice was also issued to the Broker in which the following allegations were leveled against the him:

"1) The broker had not maintained client registration form and broker client agreement which is in violation SEBI Circular No. SMD/POLICY/CIRCULAR/5-97 dated 11.04.1997.

2) It is alleged that the broker had actively traded in the scrip of HTL and resorted to circular trading with other brokers of BgSE wherein the shares were traded amongst themselves and rigged up the prices by trades which were not genuine and created artificial price and volumes. It is, therefore, alleged that the broker had contravened provisions of the Regulation 4(a)(b)(c)(d) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 and violated Clause A(3-4) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI (SB&SB) Regulations 1992".

- 2.3 Pursuant to the show cause notice, the Broker was also granted a fair and reasonable opportunity to make his submissions. The Broker inter alia submitted before the Enquiry Officer that one Shri Rajneesh approached him and started placing orders on behalf of Shri Sudhakar Dani, Ms Radhika Dani, D S Investments and Shri Sanath Kumar. The Broker further submitted that the client registration forms in respect of the clients namely, Shri Sudhakar Dani, Ms Radhika Dani, D S Investments and Shri Sanath Kumar were misplaced at the time of shifting of the office and therefore, they were not traceable. It was admitted by the Broker that the said Rajneesh had taken deliveries on behalf of the clients and that the payments were received by post from Mumbai through Shri Rajneesh. The Broker further admitted before the Enquiry Officer that the trades in the scrip of HTL were undertaken with a view to make some profits.
- 2.4 After considering the submissions of the Broker, the Enquiry Officer vide his report dated October 21, 2004, recommended for the imposition of a minor penalty of suspension of certificate of registration (granted by SEBI) of the Broker for a period one month, in terms of 2002 Regulations. The Enquiry Officer observed that the Broker had traded in the scrip of HTL on behalf of his clients viz. Shri Sudhakar Dani, Ms. Radhika Dani, D S Investments and Shri Sanath Kumar, who were new and introduced by Shri. Rajneesh of HTL. It was also established that the order on behalf of those clients were placed by Shri. Rajneesh and the delivery was also taken by him.
- 2.5 The Enquiry Officer has also observed that the Broker had traded substantially (for 1,05,600 shares) in the scrip of HTL in his proprietary account and the said transaction attracted regulation 4 (c) of the FUTP Regulations. Further, the Enquiry Officer noted that the Broker did not act in good faith and without negligence when he had traded for his clients in the scrip of HTL. It was also observed by the Enquiry Officer that the Broker could not produce any evidence to suggest that he had obtained KYC forms and verified the financial capabilities, net worth etc. of his clients before commencing trades on their behalf. The Enquiry Officer had also observed that the Broker had not produced the broker client agreement.

3.0 CONSIDERATION OF ISSUES AND FINDINGS

- 3.1 Based upon the recommendation of the Enquiry Officer, a show cause notice dated October 29, 2004 was issued to the Broker under regulation 13(2) of the 2002 Regulations asking him to show cause as to why the penalty as considered appropriate should not be imposed upon him. A copy of the Enquiry Report was also forwarded to the Broker with the said show cause notice.
- 3.2 The Broker, vide letter dated November 12, 2004 submitted his reply to the aforesaid show cause notice and stated that the mistakes and lapses which had occurred were not with deliberate intentions and that the traders had misused his innocence and lack of professional knowledge in handling such traders. The Broker in the said reply has agreed with the findings of the Enquiry Report in respect of his mistakes that happened for not strictly complying with the general requirements of proper introduction of a new client, proper client registration along with photo identity. The Broker further stated that the penalty imposed by the Adjudicating Officer of SEBI was already paid by him and therefore, the suspension of the certificate of registration for a period of one month would become a double punishment. In view of the above, the Broker has requested to close the matter with the fine that has already been paid by him and further assured that the mistakes would not happen in future.
- 3.3 I have perused the recommendations of the Enquiry Officer, show cause notice issued by SEBI, reply filed by the Broker and other relevant material available on record. I note that the Broker, vide his reply dated November 12, 2004 raised a preliminary objection that the proposed penalty would become a double punishment, as the Adjudicating Officer of SEBI had already imposed a monetary penalty of Rs. 15,000/- and the same was remitted by him.
- 3.4 I note that the adjudication proceedings were initiated against the Broker for the alleged violation of the provisions of section 15A(b) of the Act. The allegation leveled against the Broker in the said proceedings was that, he had failed to submit the client registration forms and broker client agreement to the investigating authority of SEBI during the investigation into the price manipulation in the scrip of HTL. The said violation is one of the charges leveled against the Broker in the present proceedings. I have noted that, in the adjudication proceedings, the Broker had inter alia admitted that he had not submitted the relevant information, as sought by the investigating authority of SEBI. The Adjudicating Officer after considering the submissions of the Broker had imposed a penalty of Rs.15,000/-
- 3.5 I note that the purpose of adjudication proceedings and the present proceedings are different and therefore, there is no overlapping. The former is for non production of documents called for, as per the provisions of the Act, while the present proceedings which is initiated under 2002 Regulation are for violations of the provisions of the Broker Regulations and FUTP

Regulations. Hence, any penalty under the present proceedings can not constitute double punishment. In view of the above, I reject the contention of the Broker that any penalty imposed under the present proceedings would become as a double punishment. The nature, object and scope of both the proceedings are different and it does not amount to double jeopardy.

- 3.6 Coming to the allegations leveled against the Broker, I note that the Broker has not denied the fact that he had transacted substantially by executing trades on behalf of his clients and on proprietary account, in the scrip of HTL during the period from November 16, 1999 to December 31, 2001. I note that the Broker had admitted that his clients were introduced by Shri Rajneesh. In terms of the Broker Regulations, it is the duty of the stock broker to enter into a member client agreement and the same has to be entered in the format specified in SEBI Circular dated April 11, 1997, pertaining to 'Know Your Client' (KYC) norms. In the said circular, it was also advised that the brokers might seek additional information, if any, so as to satisfy themselves about the antecedents of the client and that it would be the responsibility of the stock brokers to provide for clients' details as and when need arises. It was also observed by the Enquiry Officer that the clients themselves were not properly introduced to the Broker and therefore, the Broker should have exercised care and caution for the said clients, who were trading only in the scrip of HTL. It is also noted from the admission of the Broker that Shri Rajneesh was giving orders and taking deliveries, although the clients were different persons.
- 3.7 The Broker could not give a convincing reply for his failure to obtain the member client agreement, except a vague submission to the effect that the client registration forms and the broker client agreement forms were not traceable. The said reply made by the Broker can not be accepted and in the absence of any sufficient materials to corroborate the case of the Broker, it is presumed that the Broker had failed to enter into the broker client agreement and thereby violated the SEBI Circular April 11, 1997.
- 3.8 It is further established that the majority of the transactions of the Broker during the period from April 01, 2000 to March 31, 2001 and all the trades done during the April 01, 2001 to December 31, 2001 were done on the proprietary account. In this regard, on the admission of the Broker himself, his proprietary trades had accounted for the bulk of the volume, about 13% to the total volume at BgSE during the year 2000-2001. This has to be appraised in the context that the Broker executed the remaining trades on the instructions of Shri Rajneesh of HTL without proper KYC.
- 3.9 It is the primary requirement that a stock broker has to compulsorily ensure that his client is personally known to him or has been introduced to him by a person known to him for the purpose of satisfying that his clients are genuine. The very purpose of client registration form is to provide various details of the clients so as to enable the stock broker to evaluate the client before the broker takes up trading for him. A stock broker has to verify the financial capacity of his clients before executing the trades on their behalf. Such assessment of financial capacity of the client is necessary in order to avoid the risk. When a stock broker fails to perform the above primary requirements and if he is transacting on behalf of such unknown clients without knowing their details and financial capacity, he is putting the entire system in jeopardy. The Broker could not adduce any evidence to suggest that he had assessed the financial capacity of his clients, as required under the KYC norms.
- 3.10 It is pertinent to note that the clients on behalf of whom the Broker had transacted in the scrip of HTL were new to him and they were residing in Mumbai and admittedly the orders on behalf of them were placed by Shri Rajneesh and the delivery was also taken by Shri Rajneesh. Further, the Broker could not adduce any material to suggest that the clients had authorized Shri Rajneesh to trade on their behalf with the Broker in the scrip of HTL or to accept delivery of securities. In the light of the admitted facts that his clients were new to him and the orders were placed by Shri Rajneesh, it would transpire that the transactions were executed with a view to make some profits, in total disregard of the duties cast upon him.
- 3.11 The Enquiry Officer in his report has referred to the admission of the Broker that the deliveries with respect to the transactions made in the scrip of HTL on behalf the clients were sent to Shri Rajneesh who was stationed in Mumbai. It is pertinent to note that the Broker had delivered the securities by courier to Shri Rajneesh in Mumbai when his clients were also residing in Mumbai. This clearly shows that the Broker did not have an intention to deliver the securities to his clients and the same is in violation of SEBI Circular dated November 18, 1993 which inter alia stipulates the delivery of securities to the clients within a stipulated time. Further, the Broker could not adduce any material to suggest that the clients had specifically authorized Shri Rajneesh to take the delivery from the Broker on their behalf. Though the Enquiry Officer discussed the admission of the Broker regarding the non delivery of securities to the clients he has not made a specific finding with respect to the violation of the above circular committed by the Broker. In the context of the admission by the Broker on non delivery of securities and coupled with the fact that the Broker has not given any submission with respect to his admission as stated above, in his reply dated November 12, 2004, it is fairly established that the Broker has violated the provisions of SEBI Circular dated November 18, 1993.
- 3.12 Further, the trades executed by the Broker for his clients were voluminous and also they appear to be not innocuous transactions but one meant to create artificial volumes in the scrip of HTL as would be evident from the concentrated volume and sharp movement of price in the said scrip and also in view of the admissions made by the Broker, it would give

a reasonable inference that the Broker did not act in good faith and without negligence when he had traded for his clients in the scrip of HTL.

- 3.13 In this connection, it would be relevant to refer the following extracts of the order dated September 18, 2003 of the Hon'ble Securities Appellate Tribunal in Madhukar Sheth Vs SEBI (Appeal No.46 of 2002):

"Before executing series of transactions for his client, any prudent broker would have gone a bit far to ascertain the goings around and also would have normally assessed the financial capability of the person for whom he was trading....."

.....The Appellant's submission that he had taken client registration form, entered into agreement etc. by itself was not sufficient. Exercise of due diligence in ongoing transactions is a continuous process and it is not a one time measure to be adhered to while taking up the first transaction. The appellant's submission that it was B's dishonesty that created the problem did not absolve him of his failure to discharge his duties as a prudent broker....."

.....On the basis of the material available on record, it was difficult to conclude that the appellant had exercised due skill and care in dealing with 'B'. It was not that the appellant had carried on only few trade transactions for 'B' for a short period. He had transacted in huge volumes for 'B' and the association dated back to August 2000. If the appellant could not see any design or pattern in the transactions which 'B' was executing through the appellant during the period, then the appellant certainly deserved to be blamed for being indifferent and unconcerned and for that reason he was at fault for the failure to exercise due skill and diligence....."

.....It is true that a broker cannot act of his own against the instructions of the client. But no one can compel him to be a party to manipulate the market. No doubt a broker is supposed to protect the interest of his client, but he is also expected to protect the interest of the securities market in which he operates. It is his duty to ensure not to be a party to any market manipulation and that the market in which he operates is run on a health and non-manipulative basis."

- 3.14 From the materials on record, it emerges that all the clients were new and hailed from a distant place like Mumbai. It is not disputed that the said clients substantially traded only in the scrip of HTL (except the client Ms Radhika Dani, who had also traded in the scrip of Reliance for a meager 300 shares) and thereby contributed significantly to the volume of the said scrip traded at BgSE. It can be seen that the Broker was fully aware of the transactions in the scrip of HTL and the manner in which the clients from Mumbai were planted by the employee of HTL.
- 3.15 The trades by the Broker constituted a significant percentage of the volumes at BgSE immediately after listing and during the period when there was unusual price rise in the scrip without change in economic fundamentals of HTL. In the totality of the circumstances, the transactions executed by the Broker at the behest of HTL employees, without following the mandated requirements of KYC norms, without following due diligence, without the verification of financial capabilities and net worth of clients together with the highly objectionable conduct of effecting delivery to third party without necessary authorization or instruction from the client which are meant for imparting transparency, need to be viewed seriously.
- 3.16 The above facts and circumstances will prove that the Broker did not act in good faith and without negligence when he had traded for his clients in the scrip of HTL. In view of the above established and admitted facts, I find that the Broker has violated the provisions of SEBI Circular dated April 11, 1997 pertaining to the member client agreement and the SEBI Circular dated November 18, 1993 with respect to the delivery of securities to the clients and the said violations call for penalty. However, I note that there is no evidence to suggest that the Broker had violated the provisions of FUTP Regulations. I also note that the Broker has given an assurance that such mistakes would not happen in future. Having regard to the same, I find that the quantum of penalty as recommended by the Enquiry Officer is excessive.

4.0 ORDER

In view of the forgoing and taking into account the mitigating circumstances as stated above, I, in exercise of the powers conferred vide regulation 13(4) of (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, hereby impose a minor penalty of suspension on the certificate of registration (granted by SEBI) of M/s Gayathri & Co (INB080169817), Member, Bangalore Stock Exchange Ltd. for a period of fifteen days in terms of regulation 13(1)(a)(iv) thereof.

This order shall come into effect on expiry of 21 days from the date of this order.

G.ANANTHARAMAN

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai

Date: 30-08-06