

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER AGAINST M/S SAKRUTHI FINVEST PVT LTD., MEMBER, BANGALORE STOCK EXCHANGE LTD., SEBI REGISTRATION NO. INB 081009439, 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/84/ISD/08/06

1.0 BACKGROUND

1.1 M/s Sakruthi Finvest Pvt. Ltd. (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 INB 081009439.

1.2 The scrip of Home Trade Ltd. (hereinafter referred to as HTL) was listed at Pune Stock Exchange Ltd. (hereinafter referred to as PSE) on November 15, 1999 at Rs 250/- and at 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 detailed below:

1.4 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
	April 30, 2000	825.25

1.5 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).

1.6 The transaction details of the Broker in the scrip of HTL at BgSE 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	46,800	24.50%	48,200	25.24%
April 01, 2000 to March 31, 2001	1,37,200	17.31%	1,32,950	16.85%
April 01, 2001 to December 31, 2001	16,985	5.83%	14,650	5.03%

1.7 The main clients of the Broker were Modi family (comprising Shri. Chandrakant Ratilal Modi, Shri. Ajay Chandrakant Modi and Ms. Heta Ajay Modi), Porwal group {comprising Shri Himmat Singh Porwal, Porwal & Co., Shri Vimal Mishra (employee of Shri Himmat Singh Porwal)}, Taleshra family (comprising Shri Hemendra Taleshra and his wife Ms. Pratibha Taleshra), Ms Sharmila Bachawat, Ms Lata KB, Navoday Agencies Ltd, DTC Securities and Shri. Dhiren C

1.8 The trading details of the above clients are shown below:

a) for the period from November 16, 1999 to March 31, 2000:

Client	Gross buy	%gross buy to the total buy position of the broker	Gross sell	% gross sell to the total sell position of the broker
Porwal Group	12100	25.85%	12300	25.52%
Modi Family	19600	41.88%	19000	39.42%
Taleshra family	10300	22.00%	11100	23.03%

Total	42000	89.74%	42400	87.97%
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b) for the period from April 01, 2000 to March 31, 2001:

Name of the client	Buy qty.	Sell qty
Hemendra Taleshra	43600	43700
Pratibha Taleshra	39800	39800
Sharmila Bachawat	26500	26500
Lata KB	9600	9600
Navoday Agencies	7600	0
Porwal & Co	6600	8350
Vimal Mishra	2200	2400
Himmat Singh Porwal	1200	2200

c) for the period from April 01, 2001 to December 31, 2001:

Name of the client	Buy qty.	Sell qty
DTC Securities	10450	10950
Dhiren C	3000	2500
Porwal & Co	1235	0
Sharmila Bachawat	1200	1200
Navoday Agencies	1000	0

- 1.9 The investigation conducted by SEBI revealed that inter alia the members of BgSE including the Broker were involved in creation of abnormally high volumes in the scrip of HTL and had resorted to circular trading with other members of BgSE, wherein the shares of HTL were traded amongst themselves, thereby rigging up the price of the scrip of HTL by executing a number of trades, which appeared to be not genuine, for various clients introduced by the employees of HTL.

2.0 APPOINTMENT OF ENQUIRY OFFICER

- 2.1 Based on 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 issued to the Broker in which the following allegations were leveled against him :
- "1) The broker did not receive any margin money as security deposit on the purchase and sale transactions done on behalf of any of the clients. This is in violation of SEBI Circular No. SMD/SED/CIR/93/23321 dated 18.11.1993 .
 - 2) All the clients were not known and Shri Rajneesh or Shri Veerkar (as in the case of Shri Himmat Singh Porwal) used to place orders on behalf of the clients which is in violation of SEBI Circular No. SMD/POLICY/IECG/1-97 dated 11.02.97.
 - 3) Not obtained acknowledgement of the clients on the counterfoils of the contract notes issued to them and is in violation of Regulation 17(1)(i) of SEBI (SB&SB) Regulations, 1992.
 - 4) Did not give deliveries to clients but were given to Shri Rajneesh or Shri Veerkar of HTL which is in violation of B(1) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI (SB&SB) Regulations, 1992 .
 5. It is alleged that the broker has actively traded in the scrip of HTL and artificially created higher price and volumes in the scrip of HTL. The broker has entered into transactions that are not genuine trade transactions. It is alleged that the broker had contravened provisions of the Regulation 4(a)(b)(c) 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 The Broker submitted his reply to the said show cause notice. Pursuant to this, the Broker was also granted a fair and reasonable opportunity to make his submissions. The Broker inter alia submitted before the Enquiry Officer that he had traded in the scrip of HTL on behalf his clients belonging to Talesara family, Modi and Porwal family. The Broker, in his letter dated June 24, 2004 addressed to the Enquiry Officer submitted the copies of the client registration forms, member client agreement, courier slips etc. The Broker further submitted that his clients namely, Porwal & Co, Shri. Vimal Mishra, Ms. Heta Ajay Modi, Shri. Himmat Singh Porwal and Shri. Chandrakanth Modi were introduced by Shri Rajneesh of HTL. Further it was also stated that the counterfoils of the contract notes were not maintained in respect of out- station clients.
- 2.4 The Enquiry Officer vide his report dated October 30, 2004 recommended for the imposition of a major penalty of suspension of the certificate of registration granted to the Broker for a period of 4 months under regulation 13(1) (b) (ii) of the 2002 Regulations. The Enquiry Officer has observed that the Broker had failed to maintain the counterfoils of the contract notes with acknowledgement of his clients, as contemplated under regulation 17(1)(i) of the Broker Regulations. The Enquiry Officer has also observed that the Broker did not act in good faith and without negligence while dealing in the scrip of HTL on

behalf of his clients. The Enquiry Officer further observed that the said trades executed by the Broker constituted a significant percentage of the volumes of HTL (24.50%) at BgSE immediately after its listing and during the period when there was unusual price rise in the scrip of HTL without any change in its economic fundamentals.

3.0 CONSIDERATION OF ISSUES AND FINDINGS

- 3.1 Based upon the recommendation of the Enquiry Officer, a show cause notice dated November 04, 2004 under regulation 13(2) of the 2002 Regulations was issued to the Broker 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. The Broker, vide letter dated November 24, 2004, submitted his reply to the said show cause notice. The Broker stated that he was not involved in the rigging of the price of the scrip of HTL and further stated that he had no knowledge that his clients were trading in the scrip of HTL on behalf of the employees of HTL. In view of the above, the Broker requested SEBI to let him off with a warning instead of four months suspension. SEBI, further vide letter dated February 13, 2006 inter alia advised the Broker to inform whether he was desirous of attending a personal hearing before SEBI. Though sufficient time was given to the Broker to file his reply, he has not filed any reply, till date. In the circumstances, it is observed that the Broker is not interested in availing any personal hearing.
- 3.2 I have perused the Enquiry Report, the show cause notice issued by SEBI, the reply filed by the Broker and other relevant materials available on record. As the Enquiry Officer has not recorded any specific findings in respect of the violation of the provisions of FUTP Regulations, I deal with the other alleged violations attributed to the Broker. I note that the transactions of the Broker in the scrip of HTL at BgSE during the period November 1999 – March 2000, along with other members of BgSE had contributed for more than 85% of the total volume in the said scrip at BgSE. It is relevant to mention that the price of the scrip of HTL reached its maximum of Rs. 815/- from Rs. 275/- during the said period and the Broker has executed 24.50% of transaction in the said scrip during the said period.
- 3.3 At the first instance, it needs to be examined as to whether the clients of the Broker were properly introduced to him and whether the Broker had carried out the 'Know Your Clients' (KYC) checks for his clients. In this regard, I note that the Enquiry Officer in his report had discussed in detail about various deficiencies in the KYC forms obtained by the Broker, such as:-
- a) forms without introducer (in the case of the client, Shri. Vimal Mishra.)
 - b) forms without the details of the introducer (in the case of clients, Shri Himmat Singh Porwal and Porwal &Co, Ms. Heta Ajay Modi, Shri. Ajay Chandrakant Modi, Navoday Agencies and Ms Sharmila Bhachawat.)
 - c) forms without the details of the introducer and the date of signing the client registration form (in the case of the client , Shri Dhiren Champklal Shah)
 - d) forms without the details of the introducer and without the photograph(in the case of clients, Shri Hemendra Taleshara, Ms Pratibha Taleshara and Shri Chandrakant Ratilal Modi) .
- 3.4 The above deficiencies have to be viewed seriously, as the Broker could not adduce any evidence to show that his clients (except Shri Hemendra Taleshara, Ms Anjali Bhuva, Ms Pratibha Taleshara and Shri Radheyshyam) were known to him and that they were dealing in scrips other than HTL during the same period, through the Broker. In this context, it has to be noted that the clients of the Broker namely, Porwal & Co, Vimal Mishra, Heta Ajay Modi, Himmat Singh Porwal and Chandrakant Modi were from Mumbai and they were admittedly introduced by Shri. Rajneesh of HTL.
- 3.5 I note that the Broker had admitted before the investigating authority of SEBI that, Shri Rajneesh used to place orders on behalf of the Modi family and sometimes on behalf of Shri Porwal. The statement of the Broker further suggests that Shri. Rajneesh used to arrange funds on behalf of his clients. This statement of the Broker has been further corroborated by the statement made by one of his clients namely, Shri Himmat Singh Porwal made to the investigating authority. He stated before the investigating authority that the funds were received from one Maniram Consultants, an associate of HTL, to meet the pay- in obligations to the Broker and that the securities were also arranged by Shri Rajneesh. The importance of the compliance of KYC form assumes great significance in view of the fact that a large number of transactions (about 24% to the total volume at BgSE) on behalf of such clients was executed by the Broker when the price of the scrip of HTL was at its maximum.
- 3.6 It is to be mentioned here that, SEBI by its circular dated February 11, 1997 advised the stock brokers to maintain a database of their clients. SEBI, vide Circular dated April 11, 1997, had once again advised the stock brokers to follow the circular dated February 11, 1997 and further advised that the stock brokers might seek additional information, if any, so as to satisfy themselves about the antecedents of clients and that it would be the responsibility of the brokers to provide for client details as and when need arises. The various shortcomings in complying with KYC norms which have been spelt out above in detail coupled with the fact that the Broker had not disputed the said allegations, would establish that the Broker had failed to comply with the aforesaid circulars. It is one of the primary duties of a stock broker to ensure that his client is personally known to him or has been introduced to him by a person known to him so as to satisfy that his clients are

genuine. The very purpose of such practice is to enable the stock brokers to evaluate the client before the broker takes up trading for him. Though some of the clients claims to have been introduced by Shri Rajneesh, in the absence of vital information in the KYC forms as detailed above, I hold that the clients have not been properly introduced to the Broker with the concomitant violation of the above circulars.

- 3.7 Secondly, it has to be seen as to whether the Broker had assessed the financial capacity of his clients before executing trades on their behalf. It is one of the mandatory duties of a stock broker 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 said primary requirements and further, if he happens to be transacting on behalf of such clients without knowing their antecedents and financial capacity, he is putting the entire system in jeopardy.
- 3.8 In the present matter, on a perusal of the KYC forms, it can be seen that the Broker had traded for his clients in the scrip of HTL disproportionate to their income. For instance, in the case of the client, Porwal & Co, the annual income as reported in the KYC form was Rs.1,00,000/-, whereas the said client made the payment of Rs.6,00,000/- on February 25, 2000 and Rs 1,99,600/- on March 21, 2000 to the Broker which was much higher than its annual income. Further the annual income of Shri Himmat Singh Porwal, as per the KYC form was Rs. 70,000/-. However, the Broker had purchased substantial number of shares of HTL on behalf of the said client. The Porwal & Co had purchased 6,600 shares of HTL and Shri Himmat Singh Porwal had purchased 1,200 shares of HTL during the period April 01, 2000 to March 31, 2001. The Broker could not have undertaken such substantial transactions on behalf of the above clients, when it was borne out from the record (KYC form) that the aforesaid clients were not having sufficient financial capacity to fulfill their payment obligations, especially when the price of the scrip of HTL was high during the above period. The income and net worth of the clients as reflected in the KYC forms do not support the volumes of trades done by them which involves huge commitment of resources in terms of funds or securities. The volumes traded were disproportionate to the networth and income levels declared in the KYC forms, entailing the inference of outside funding. As a matter of fact, in the case of the client, Shri Himmat Singh Porwal, as admitted by the client, the funds came from Maniram Consultants, an associate of HTL.
- 3.9 I further note that one of the clients of the Broker, namely Shri Himmat Singh Porwal stated before the investigating authority that he knew Shri Veerkar of HTL and upon the instructions from the Shri Veerkar, he had supplied the names of himself and his family members including that of his employee, Shri. Vimal Mishra. He further stated that the orders regarding price, quantity, etc were placed with the Broker as per the directions of Shri Rajneesh. Shri Himmat Singh Porwal further stated that the payments received from the Broker were deposited in his account and thereafter cheques were issued in favour of the above Maniram Consultants. This will further show that the broker had failed to assess the financial capacity of his clients, when the funds were received from third party. This clearly establishes that the said clients who were men of straw were used by HTL to ramp up the price of the stock and this could have been avoided, had the Broker exercised proper care and carried out the verification as per SEBI circulars.
- 3.10 Therefore, in view of the above facts, it is established that the Broker did not act in good faith and without negligence while executing large number of transactions on behalf of his clients in the scrip of HTL, at BgSE immediately after its listing and during the period when the price of the scrip of HTL was maximum.
- 3.11 The third issue is whether the Broker had collected margin from his clients before executing transactions on behalf of his clients. The Enquiry Officer has inter alia noted that most of the clients had first sold the shares and the proceeds were retained by the Broker towards the margin as per his submissions and further observed that in the absence of certain details, it would be difficult to conclude that he had transacted for the clients without collecting margin. Therefore, I note that there is no sufficient evidence to indicate that the Broker had failed to comply with margin requirements.
- 3.12 Fourthly, it has to be examined as to whether the Broker had maintained the copies of acknowledgments of the contract notes issued to his clients. In terms of regulation 17(1) (i) of the Broker Regulations, a stock broker, has to maintain the counterfoils or duplicates of contract notes issued to his clients. In the present case, one of the clients of the Broker, DTC Securities stated that he had purchased and sold 500 shares of HTL through the Broker, whereas the Broker had stated before the investigating officer that he had purchased 10,450 shares and sold 10,950 shares of HTL on behalf of the said client. The Broker himself had submitted two letters written by the aforesaid client to the Broker which mentions the purchase of only 500 shares of HTL, by the said client. The trading details as per BgSE show that the client had purchased 10,450 shares and sold 10,950 shares during April 01, 2001 and December 31, 2001.
- 3.13 The Broker could not give any substantial evidence with respect to the details of the balance shares of HTL purchased on behalf of the said client. Had the Broker maintained the counter foils of the contract notes with acknowledgment of the clients, the said discrepancy would not have arisen at all. In that view it transpires that the Broker had violated regulation 17(1)(i) of the broker Regulations while dealing in the scrip of HTL on behalf of his client, DTC Securities.
- 3.14 As regards, the delivery of securities, I note the observation of the Enquiry Officer that the documents produced by the Broker, vide letter dated January 24, 2004 suggest that the shares were received into his pool account or were transferred to the account of the clients. Therefore, it is presumed that the Broker had delivered the securities to the clients' account.

- 3.15 In a situation where all the clients were relatively new and hailed from far off places like Mumbai and traded only in the scrip of HTL, without proper KYC check as evident from the serious deficiencies in the KYC forms with particular reference to lack of introduction, financial capabilities, networth, etc., it would be evident that the Broker did not act in good faith and without negligence while executing large number of transactions on behalf of his clients in the scrip of HTL during the above periods.
- 3.16 In this connection, it would be relevant to refer the following extracts of the order dated September 18, 2003 passed by the Hon'ble Securities Appellate Tribunal in the matter of 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."

- 3.17 In view of the above established and admitted facts, I agree with the findings of the Enquiry Officer and it is proved that the Broker has violated the SEBI Circular dated February 11, 1997, the provisions of regulation 17(1) (i) of the Broker Regulations and the said violations call for penalty. However, in the present matter, I note that there is no evidence to suggest that the Broker had violated the provisions of FUTP Regulations. Also there is nothing to suggest that the Broker had failed to collect the margin money from the clients. Further the Enquiry Report indicates that shares were received into the pool account of the Broker or were transferred to the clients' account, suggesting payment and delivery. 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 foregoing 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 Sakruthi Finvest Pvt. Ltd (INB081009439), 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 : August 31, 2006