

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

AGAINST M/s JAYANTHILAL KHANDWALA AND SONS PVT LTD., MEMBER BOMBAY STOCK EXCHANGE, SEBI REGISTRATION NO. INB010998038 UNDER REGULATION 13(4) SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 IN THE SCRIP OF DSQ SOFTWARE LTD.

WTM/GA/85/ISD/08/06

1.0 **BACK GROUND**

- 1.1 M/s Jayanthilal Khandwala & Sons Private Ltd (hereinafter referred to as the 'broker') is a member of the Bombay Stock Exchange (hereinafter referred to as 'BSE') and is registered with the Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a Stock broker under Section 12 of SEBI Act, 1992 with Registration Number INB010998038.
- 1.2 The broker is having his Registered Office at 201, Stock Exchange Tower, Dalal Street, Fort, Mumbai - 400 001. SEBI conducted investigation into the buying, selling and dealings by the broker in the scrip of DSQ Software Limited (hereinafter referred as "DSQS") for the period October 1999 and March 2001.
- 1.3 DSQS scrip was listed in NSE and BSE. It was alleged that the promoters/ directors of DSQS generated funds by trading in the shares of DSQS through their associates. Large quantities of DSQS shares were sold by the associates of DSQS through a set of brokers in NSE and BSE. These shares were bought by the associates at the same time through different set of brokers. It was alleged that these trades were artificial and synchronized - there was close matching of buy and sell order time, order quantity and order price.
- 1.4 The Investigation, inter alia, revealed that the Broker had contravened the provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 (hereinafter referred to as the 'FUTP Regulations') and Code of Conduct for the brokers under SEBI (Stock Broker and Sub-broker) Regulations, 1992.

2.0 **APPOINTMENT OF ENQUIRY OFFICER**

- 2.1 On completion of investigation, Enquiry Officer was appointed vide order dated 04.08.2003 under Regulation 5(1) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred as the 'said regulations') read with Regulation 12 of FUTP Regulations, 1995 to enquire into the alleged irregular transactions of the broker in the scrip of DSQ Software Limited..
- 2.2 A Show Cause Notice dated 15.06.2004 was issued to the Broker under Regulation 6 (1) of the said regulations. The broker submitted his reply and appeared for an oral hearing. The enquiry officer conducted the enquiry in terms of the said Regulations and the broker was given a fair and reasonable opportunity to make his submissions.
- 2.3 The broker made the following submissions during the course of Enquiry proceedings;
 1. The broker had exercised due skill and care in the conduct of the business by obtaining proper KYC forms containing client address, etc. and that he had obtained proper margins.
 2. The broker denied that he had funded the client for the execution of the trades
 3. The transactions were executed on behalf of the client in the normal course of business and the broker was not aware of the identity of the counterparty broker as there were no means to know the same.
 4. The client DSQ Holdings had authorized the broker to take orders from S.Shri Soumyan (employee of DSQ group), Govind (PA to Dinesh Dalmia, Director of DSQ) and Annamalai (employee, DSQ Group).
 5. The broker's transactions for two days for 2.5 lac shares cannot be termed as calculated to create false appearance of trading and in the absence of any knowledge of the counterparty client or broker it cannot be treated as manipulative transaction.
- 2.4 After considering the reply and the submissions made, the Enquiry Officer vide his report dated 30.10.2004 concluded that the allegations as made out in the show cause notice were established and recommended a major penalty of 'suspension of certificate of registration for a period of four months' under the said Regulations. The Enquiry Officer found as follows;
- 2.5 The details of broker's trades executed in the scrip of DSQS during the relevant period are as follows:

	Buy	Sell
Trades executed for DSQ Holdings	33,84,037	33,34,037

Settlement # 52 (1999-01) to 50 (2000-01)		
Total trades done by DSQ Holdings in BSE	36,29,037	54,49,037

2.6 The settlement wise trading details of the broker for the client DSQ Holdings Ltd in the scrip of DSQS in BSE are as under:

Client	Broker	Sett. No.	Year	B/F Qty	Gross Purchases	Gross Sales	Net Qty.	C/F Qty	Qty De/ Rec	Exchange	%
DSQ Holdings Ltd	Jayantilal Khandwala & Sons	52	1999-00		50000		50000		50000	681761	7.33
		7	2000-01		4000	4000	0		0	746713	0
		9	2000-01		10000	10000	0		0	305536	0
		22	2000-01		50000	50000	0		0	443763	0
		34	2000-01		100000	100000	0		0	1066941	0
		35	2000-01		230000	230000	0		0	480925	0
		36	2000-01		100000	100000	0		0	442038	0
		38	2000-01		25000	25000	0		0	856443	0
		40	2000-01		100000	100000	0		0	394311	0
		41	2000-01		25000	25000	0		0	587659	0
		42	2000-01		560310	560310	0		0	705156	0
		43	2000-01		1050000	1050000	0		0	574073	0
		44	2000-01		300000	300000	0		0	508553	0
		46	2000-01		139863	139863	0		0	561339	0
		47	2000-01		49864	49864	0		0	615676	0
		48	2000-01		140000	140000	0		0	454098	0
		49	2000-01		50000	50000	0		0	668390	0
		50	2000-01		400000	400000	0		0	2738727	0

2.7 From the above table, it can be seen that all the transactions enumerated above were squared off and did not result in deliveries. These large transactions appear to be excessive speculation with an intention to create artificial volumes in the scrip. Remarkably the client was none other than DSQ Holdings Ltd which is an associate of the scrip that is been traded, i.e. DSQS.

Taking into account of the submissions of the broker it is also to be noted that the client DSQ Holdings is an Associate of DSQ Software. It was admitted by the broker that the orders were placed from the Office of Mr Dinesh Dalmia, Director, DSQ and by Mr Annamalai, employee of DSQ Group. The same should have aroused the suspicion of the broker as regards the intention of the client who had placed huge buy orders.

2.8 In a situation where the clients were none other than DSQ Holdings and Khandwala Securities (a group entity of the broker and a client as well) who traded in large volumes in the scrip of DSQS, the evidence of connected circumstances and preponderance of probabilities, common course of natural events and combination of facts creating network gives rise to a reasonable inference that the broker did not act in good faith and without negligence when he had traded for these clients in the scrip of DSQS and ought to have been aware that these clients were simultaneously placing sell orders either by themselves or by their associates through the counter party broker.

The standard of proof required in a proceeding of this nature is at variance with the standard of proof required in criminal cases. It is sufficient if the preponderance of probabilities suggests towards the indulgence of the delinquent in the misconduct. The strict rules of Evidence Act and proof beyond reasonable doubt are not applicable to a proceeding of this

nature. The Supreme Court's decision in *Gulabchand vs Kudilal AIR, 1966, SC 1734* and the decision of the Special Court for trial of offences relating to transactions in securities in the matter of *National Housing Bank versus ANZ Grindlays Bank, 1998 (2) LJ 153* is relied upon in this regard.

- 2.9 In this connection, it would be relevant to refer to the order of the Hon'ble SAT in *Madhukar Sheth Vs SEBI* (Appeal No.46 of 2002). The following is extracted from the said order dated 18th September 2003:

"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."

- 2.10 Details of the trades which were matched or synchronized in terms of time, price, order quantity, etc. wherein the buying clients of the broker were DSQ Holdings and Khandwala Securities, are as under:

Trade Date	Buy Order Number	Buy Time	Buy Price	Buy Qty	Trade Time	Buying Client	Sell Member	Sell Order No.	Sell Time	Sell Price	Sell Qty	Selling Client
04-Jul-00	32900100000001428	11:23:59	975.00	250000	11:24:02	Khandwala Sec-200000 & DSQ Holding - 50000	DKB	27600200000006571	11:24:02	975	250000	DSQ Holding
16-Nov-00	32900100010003067	10:23:24	441.90	100000	10:23:24	DSQ H	DKB	27600200010015652	10:23:22	441.9	100000	DSQ Holding

Both the buyer and the seller were DSQ Holdings. The value and volume of such trades were also quite high as both the transactions together account for the purchase of 3.5 lac shares. The price per share on 4th July 2000 was Rs,975/- and the value of the transaction for 2.5 lac shares comes to Rs. 24,37,50,000/- Similarly, the price per share on 16th November 2000 was Rs.441.90 and the value of the transaction for 1 lac shares comes to Rs.4,41,90,000/-.

- 2.11 It is seen that the broker had placed buy orders as above for clients DSQ Holdings and Khandwala Securities who had simultaneously placed sell orders through broker Dresdner Kleinwort (DKB). There were complete matching of buy and sell order quantity and order price and very close matching of order time which was less than a few seconds. In both instances, the gap between the order placement and its matching is too narrow, while the complete order quantities got matched. In view of the close proximity of the order time punched by both the parties in the system, these transactions between the broker and counterparty broker DKB will be synchronized transactions. It also shows that the rates and the quantity were predetermined. The trade dated 16th November 2000 was artificial in nature, which were calculated to create false appearance of trading in the market since effectively there was no transfer of beneficial ownership as both the buyer and seller were the same.

3.0 CONSIDERATION OF THE ENQUIRY REPORT

- 3.1 Based upon the Enquiry report and recommendations, a Show Cause Notice dated 9.11.2004 under Regulation 13(2) of the said Regulations was issued to the broker enclosing therewith a copy of the Enquiry Report. The said broker submitted his reply vide letter dated 23.12.2004.

- 3.2 The broker vide his reply dated 23.12.2004 submitted as follows;

1. Enquiry proceedings are void ab initio since the said regulations were notified in the year 2002 whereas the violations were committed during 1999 and 2001.

2. Complete records relied upon by the enquiry officer were not furnished to the broker.
3. The broker was not aware whether the promoters or directors of DSQS generated funds by trading through their associates. The broker further stated that the Enquiry report did not reveal the identity of the said promoters and directors.
4. The broker was ignorant about the alleged synchronized transactions as described in the Enquiry Report and the show cause notice. Besides, Enquiry Report did not refer to the stock exchange in which the said transactions took place. The broker was not aware as to whether the selling brokers directly made payments to clients without waiting for pay-out from the stock exchange and also whether such payments gave the said transactions the colour of funding transactions.
5. Trades described in page 7 of the Enquiry report are admitted though these cannot be termed as excessively speculative or done with the intentions to create artificial volumes. The enquiry report does not say whether the broker was aware of the malafide intentions of his clients and the manner of association of DSQ Holdings with DSQS.
6. The conclusion of the enquiry officer as to the association between DSQ Holdings Limited and DSQS is incorrect and the broker was executing the trades as per the instructions of his clients.
7. The enquiry officer failed to point out the common course of natural events and combination of facts creating network, etc, in order to prove that the broker did not act in good faith. Further, the enquiry officer has not set out how the broker came to know about the identity of the counter party broker when the trading system of the exchange maintains anonymity of trading parties.
8. The facts of the case quoted by the enquiry officer i.e. Madhukar Seth v SEBI was not similar to the present case and the enquiry officer has failed to prove that the broker had not exercised due diligence while executing the trades.
9. The basis of finding of the synchronized transactions between DKB and the broker was that the trades were matched, which was not correct, when the matching was done by the stock exchange mechanism and not by the broker. Allegation of synchronization will not stand where the ultimate client buying is not a single party.
10. The enquiry Officer had not found any violation of any provision of the FUTP regulation by the broker rather he had come to a finding that there was lack of due diligence.
11. In the absence of any finding of manipulative practices by the broker the penalty recommended is disproportionate and SEBI had given minor penalties like warning etc in similar cases.

4.0 PERSONAL HEARING

- 4.1 The broker was given an opportunity of personal hearing.
- 4.2 During the personal hearing before the WTM, the broker submitted that he had no malafides while executing the trades for his clients. His trades resulted in deliveries and the counterparty made payments promptly on the next day though there had been a 15 days payment period. Similarly DSQ Holdings made payments within 24 hours. He further submitted that there were no past record of irregularity by the broker and no investor complaints. He held that the penalty was excessive and prayed for leniency. The broker was permitted to file additional written submissions and the same was submitted later whereby he reiterated that he was buying broker for the client who bought shares and for which the broker received substantial monies on the same day or a day in advance.

5.0 CONSIDERATION OF THE ISSUES

- 5.1 I have carefully considered the findings of investigation, enquiry and the submissions made by the broker. The broker contended that complete records which were relied by the Enquiry Officer were not furnished to him. I find that the said contention is incorrect since the findings of investigation and the material relied upon in the enquiry were given to him vide show cause notice dated 15.06.2003. Further, during the time of personal hearing before enquiry officer the broker was informed of the charges and evidences against him.
- 5.2 Broker further contended that the Enquiry proceedings are void ab initio since the said regulations were notified in the year 2002 whereas the violations were committed during 1999 and 2001. This contention of the broker cannot be accepted as Regulation 23 of the said regulations provides for 'Saving of actions'. Accordingly, notwithstanding the amendment of the SEBI (Stock Broker and Sub Broker) Regulations, 1992 anything done or any action taken including any proceeding for inspections or investigations or enquiry commenced or any notice issued under the SEBI (Stock Broker and Sub Broker) Regulations, 1992 is deemed to have been taken under the said regulations. Therefore, the contention of the broker is devoid of merit. The Enquiry Officer has also extensively dealt with this issue in his enquiry report.

5.3 Similarly, the broker's claim that he was not aware about the relationship between DSQS and DSQ Holdings Limited is equally unacceptable as the name itself reveals the relation. Further, the broker himself stated in his reply to the Enquiry Officer that DSQ Holdings had authorized the broker to take orders from the employees of DSQ Group. An associate trading for the scrip itself presents an unlikely situation which should have made the broker suspicious. The broker has stated that he was ignorant about the synchronized transactions as described in the enquiry report. An analysis of the above transactions reveals that in the first transaction the sell order was placed 3 seconds after the buy order of the broker. Here, it is relevant to note that the time gap was negligible and the quantity of shares ordered was huge, while one of the buying clients was broker's associate. In the second synchronized transaction, sell order was placed only 2 seconds before the broker's buy order. Here also the quantity of shares traded is huge and time gap is negligible. The broker admitted the existence of both the above transactions in his additional reply dated 22.03.2005.

5.4 Under these circumstances, squaring off transactions and transactions wherein the buy and sell orders were entered and matched in terms of order quantity, price and time, are highly irregular and defeat the purpose of normal order matching system in the price discovery process of the exchanges and would also be in violation of Regulation of 4(b) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to securities market) 1995 which reads as under:-

Prohibition against market manipulation.

4 No persons shall

(b) Indulge in any act, which is calculated to create a false or misleading appearance of trading on the securities markets;

5.5 In respect of trades dated 4th July 2000 and 16th November 2000, the scrip, quantity and price for these orders had been synchronized by the counter party brokers, which were highly irregular in nature and violative of all prudential and transparent norms of trading in securities and principals of screen based trading where anonymity of the counter party is sought to be maintained. The very purpose of impersonal trading in which sellers and buyers without knowing each other put their trades in the trading system of the exchanges and which in turn ensured 'best price' was defeated through synchronized trades put by the broker and counter party broker of their respective clients. The proximity of timing of putting buy and sell orders, making trades in more than one occasion coupled with exact matching of price and quantity of shares between buying and selling broker clearly show that deals were actually negotiated deals put through the trading system in a synchronized manner to circumvent the prohibition of SEBI on negotiated deals.

5.6 In appeal No.54 of 2002 – *Nirmal Bang Securities Pvt. Ltd v SEBI*, the Hon'ble Securities Appellate Tribunal has held as under with regard to synchronized deals

"I find the scrip, quantity and price for these orders had been synchronized by the counter party brokers. Such transactions undoubtedly create an artificial market to mislead the genuine investors. Synchronized trading is violative of all prudential and transparent norms of trading in securities. Synchronized trading on a large scale can create false volumes. The argument that the parties had no means of knowing whether any entity controlled by the client is simultaneously entering any *contra* order elsewhere for the reason that in the online trading system, confidentiality of counter parties is ensured, is untenable. It was submitted by the Appellants that it was not possible for the broker to know who the counter party broker is and that trades were not synchronized but it was only a coincidence in some cases. Theoretically this is OK. But when parties decide to synchronize the transaction the story is different."

5.7 A seven Judge Bench of the Honourable Supreme Court in *R S Joshi, STO Vs. Ajit Mills Ltd. AIR 1977 SC 2279* held that it is not necessary that penalty should be confined only to willful acts of omission and commission in contravention of the provisions of the enactment. For proper enforcement of provisions of Law, it is common knowledge that absolute liability is imposed and the acts without mens rea are made punishable.

In para 19 of the Judgement, the Honourable Apex Court observed as under:-

"The notion that a penalty or a punishment cannot be cast in the form of an absolute or no fault liability but must be preceded by mens rea must be rejected. The classical view that "no mens rea, no crime" has long ago been eroded especially regarding economic crimes".

5.8 In view of the above observations of the apex court, what is to be seen in such a situation is whether there is a factum of breach of the Regulations and not the mental element of the violating party. In the case of SEBI v/s Cabot International Capital Corporation in Appeal No 7 of 2001 in SEBI Appeal No 24 of 2000, the Hon'ble High Court of Bombay, the following was observed.

"The SEBI Act and the Regulations, are intended to regulate the security market and the related aspects, the imposition of penalty, in the given

facts and circumstances of the case, cannot be tested on the ground of "no mens rea, no penalty". For breaches of provisions of SEBI Act and Regulations, according to us, which are civil in nature, mens rea is not essential."

- 5.9 Therefore, it cannot be said that the broker had exercised due care and caution and acted with due diligence while transacting in the scrip of DSQS for DSQ Holdings and Khandwala Securities. The conduct of the broker in executing squaring off transactions and synchronized trades for high value wherein the order quantity, price and timings had matched, is highly irregular and interferes with the normal price discovery process in the exchange. Thereby the broker has violated Regulation of 4(b) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) 1995. In view of the above, the broker has also violated the Clauses A1 to A5 of Code of Conduct prescribed for Stock brokers.

6.0 ORDER

- 6.1 Having regard to the gravity of the charges established, I agree with the findings of the enquiry officer. However, in the facts and circumstances of the case, I am of the view that a penalty of suspension of certificate of registration of the broker for a period of one month is sufficient. Now, therefore, in exercise of the powers conferred under SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby impose a penalty of 'suspension of certificate of Registration for a period of one month' in terms of Regulation 13(1) of SEBI Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 on M/s Jayanthilal Khandwala and Sons Private Limited (INB010998038), member Bombay Stock Exchange.

- 6.2 This order shall come into force on the expiry of 21 days from the date of this order.

Place: Mumbai
Date: September 07, 2006

G. Anantharaman
Whole Time Member

Securities and Exchange Board of India