

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

Coram: T.C. NAIR, WHOLE TIME MEMBER

**Against Kaushik Shah Shares and Securities Pvt. Ltd. in the matter of
M/s. ORIENT INFORMATION TECHNOLOGY LTD.**

WTM/TCN/IVD ID1/ 49,

Date of hearing : 31-05-2006

Appearance

For Noticee: Mr. Kaushik Shah, M.D., M/s. Kaushik Shah Shares & Securities Pvt. Ltd.

Mr. Ravi Kumar Varanasi, Advocate.

For SEBI: Mr. P.K. Nagpal, Chief General Manager.

ORDER

(Under Regulation 13(4) of SEBI (Procedure of Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002)

- 1.1** M/s Kaushik Shah Shares and Securities Pvt. Ltd. (hereinafter referred to as KSL or broker), a company incorporated under the Companies Act, 1956, is a member of the Bombay Stock Exchange (hereinafter referred to as BSE) registered with Securities and Exchange Board of India (hereinafter referred to as SEBI) as Stock Broker, bearing registration no. INB 010939732. KSL was also a subsidiary of M/s Arcadia Share and Stock Brokers Private Ltd. (hereinafter referred to as ASL) who is a member of National Stock Exchange (NSE) registered with SEBI bearing Registration No. INS 2308709 January 02, 2001 to March 28, 2003.
- 1.2** SEBI conducted an investigation into the buying, selling or dealings in the scrip Orient Information Technology Ltd. (hereinafter referred to as Orient) *inter alia*, to ascertain possible violations of provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 (hereinafter referred to as FUTP Regulations) and SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as Broker Regulations). The scrip of Orient was listed on NSE, Stock Exchange, Mumbai, and the Delhi Stock Exchange at the time of investigation. Trading details of the persons who had traded in the scrip were collected and analyzed along with the data of the volumes contributed by these entities. From these details it was found that Nirjay Securities Pvt. Ltd. (hereinafter referred to as NSL) and KSL along with ASL had actively traded in the shares of Orient during the relevant period. Investigations *prima facie* revealed that the above entities contributed to an unusual spurt in the traded volumes in the scrip.
- 1.3** The investigations further found that KSL was found to have traded in the scrip of Orient on the NSE and on BSE it was found to have executed proprietary trades as well as trades for their clients. Investigations found KSL guilty of violating the provisions of Clause A (1), A (3) and A (4) of the Code of Conduct specified in Schedule II read with Regulation 7 of Broker Regulations and Regulation 7(c) and (d) of FUTP Regulations as applicable at the time when the alleged acts were committed. It was therefore, alleged that KSL and NSL traded to create artificial market in the scrip which resulted in transactions which were not genuine trade transactions. The maximum volume traded in the scrip was of 3,70,870 shares (as on 31-01-2001) to lowest of 36,042 shares (as on 07-12-2000).
- 1.4** In view of the above, an enquiry officer was appointed under Regulation 5(1) of SEBI (Procedure for Holding enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as the Enquiry Regulations) to enquire into the alleged acts of commissions and omissions of KSL while transacting in the above mentioned scrip.

Enquiry Report and Recommendation

- 2.1** The Enquiry Officer, issued a Show Cause Notice (hereinafter referred to as SCN) dated April 30, 2004 under Regulation 6 (1) of Enquiry Regulations to KSL communicating thereby the allegations in respect of the transactions in the scrip of Orient. After considering the replies dated June 08, 2004 and January 18, 2005 from KSL, the Enquiry Officer had conducted the enquiry as per the procedure laid down in Enquiry Regulations and submitted a report dated March 29, 2005. The Enquiry Officer found that KSL had indulged in transactions which were manipulative and fraudulent in nature. The Enquiry Officer had recommended the suspension of certificate of registration granted to ASL for a period of ten days.
- 2.2** A SCN dated April 12, 2005 was issued to the broker along with a copy of Enquiry Report in terms of Regulation 13 (2) of Enquiry Regulations, calling upon it to show cause as to why it should not be recommended by the Enquiry Officer should not be taken against it. The broker had replied to the said SCN vide its letter dated May 13, 2005.
- 2.3** The broker was also given an opportunity of personal hearing before me on May 30, 2006. On the designated day Mr. Kaushik Shah and Mr. Ravi Kumar Varanasi appeared and made submissions on behalf of KSL. Documents showing details of price fluctuations in the scrip on dates when no transactions executed were submitted by them and in addition to this they had also relied on oral arguments and a large reiteration of written reply dated May 13, 2005. In addition to this the broker had also submitted written submissions dated June 15, 2006.

Consideration of Issues

- 3.1** I have carefully considered the facts of the case, the findings of the Enquiry Officer and the reply of the Broker including the documents and submissions made during the personal hearing and the written submissions submitted after the hearing. My findings are as under;
 - a.** With regard to the finding that the trades executed by KSL were cross deals and these transactions were structured and synchronized, the broker submitted that it had executed these transactions on the exchange terminal in the nature of cross deals and by doing this it had not violated the provisions prescribed by SEBI and Stock Exchanges.

It was found that NSL used to sell shares through the member KSL at BSE on last day of settlement, which were purchased by KSL by acting as a client and the same shares were sold by it through ASL and these shares were purchased by NSL. Further it has been alleged that on the last day of settlement of NSE, the transactions were reversed i.e. NSL sold shares through ASL which were brought by KSL as a client and then KSL sold the shares through its broking firm at BSE which were purchased by NSL. KSL submitted that this practice was prevalent in the market. It further submitted that the purpose of these transactions was not to manipulate the prices or the volumes. The reply of KSL is not convincing as the manner in which the trades were executed is not proper and it resulted in creation of false market in the scrip. The said conduct defeats the objective of screen based trading.

Further the Enquiry Officer found that ASL had executed 35 deals involving a total of around 28 lakhs shares for both KSL and NSL. KSL the trading member on the BSE, was the counter party in the same trades on the NSE, in furtherance both KSL and NSL had taken counter positions at both the exchanges. The quantity ordered, price quoted and time at which order was entered matched at both the exchanges i.e. NSE and BSE exactly matched. An inference can easily be drawn that these transactions were structured and synchronized as the proximity of timing of putting buy and sell orders, exact matching of price and quantity of shares and matching of trades almost on every occasion between themselves. The Enquiry Officer had rightly stated that these trades were said to be a mere coincidence as these had happened on a continuous basis. KSL also contended that the trades entered by it are cross deals and these deals are valid in terms of SEBI Circular SMDRP/POLICY/CIR-32/99 dated September 14, 1999. KSL had executed cross trades on NEAT system of NSE at the prevailing market price, which were in accordance with the said circular. In my view that the deals entered by KSL may be cross deals but the manner in which these deals have been entered is not proper and resulted in creation of false market. These deals were structured in a manner that the trade matched there and then only. The time difference in these deals is of a few seconds only.

I appreciate the findings of the Enquiry Officer about the benefits of screen based trading. She has rightly stated that this enables investors to transact in a fair and transparent manner. This mechanism is to ensure matching of the orders through screen, on the basis of best offer price, wherein the sellers would realize the best price of their securities within the circuit filters prescribed by SEBI in the light of the above cited circular. I am of the view that broker might have technically not violated the abovesaid circular but the manner in which the trades were entered would defeat the objective of the said circular and the trading system.
 - b.** With regard to the finding that the transactions entered by KSL are synchronized transactions the broker submitted that this is only a presumption of the Enquiry Officer. The Enquiry Officer found that these synchronized trades were executed on the screen of the exchange by KSL and NSL, because these were arranged deals with a prior understanding. The Enquiry Officer had rightly disregarded the argument of the broker that the identity of the other trading client is not known to each other, by saying that the frequency of trades and the perfect matching of the time, order and price to the nearest of two decimal places in one scrip only cannot be a mere co-incidence. The details of transactions are as follows:

Details of buy and sell of client		Order Execution on NSE				Data revealing synchronized nature of trade executed					
Buy client	Sell client	Date	Time	Qty	Traded Price	Buy Order Time	Sell Order Time	Buy Order Qty	Sell Order Qty	Buy Order Rate	Sell order Rate
Nirjay	KSL	06.12.00	14:03:38	74900	167.35	14:03:38	14:03:38	75000	75000	167.35	167.35
Nirjay	KSL	06.12.00	14:39:07	25000	167.25	14:39:06	14:39:07	25000	25000	167.25	167.25

	05.01.01(fri)	100000	134307	74.46%	100000	237169	42.16%	200000	371476	53.84%
	09.01.01(tue)	100000	167525	59.69%	100000	204636	48.87%	200000	372161	53.74%
	12.01.01(fri)	100000	171056	58.46%	100000	195422	51.17%	200000	366478	54.57%
	16.01.01(tue)	100000	204168	48.98%	100000	229670	43.54%	200000	433838	46.10%
	19.01.01(fri)	100000	196571	50.87%	100000	370649	26.98%	200000	567220	35.26%
	23.01.01(fri)	100000	168420	59.38%	100000	241762	41.36%	200000	410182	48.76%

I find from the above, the trades entered by KSL in the scrip of Orient, generated considerable volumes and this fact has not been denied by the broker. At this juncture it is relevant to observe the observation of the U.S Courts in *Hyne's Case* that "proof of manipulation is generally not based on a single activity but rather on a course of conduct showing an intentional interference with the functioning of the market for a security. Indeed the manipulation is usually the result of acts, practices and course of conduct that deceive the market place.....".

- d. With regard to the findings of Enquiry Officer that KSL was not engaged in genuine arbitrage, the broker replied vide letter dated May 13, 2005 that it was not engaged in the arbitrage transaction was doing genuine trades. KSL again in its written submissions dated June 15, 2006 i.e after availing the opportunity of hearing has submitted, contrary to its previous stance that it was engaged in arbitrage transactions. I have also considered the reply of the broker to SCN under regulation 6 (1) of Enquiry Regulations dated January 18, 2005, where it had submitted that it was engaged in a transactions.

Taking the above replies into consideration it makes clear that the broker itself is not sure of the nature of its transactions and is trying to change its stands. KSL in letter dated May 13, 2005 that it has no co-relationship with NSL. It further submits that it was taking the rate difference prevailing on the closing days of the settlement and shifting its position and taking advantage prevailing on two exchanges, it was always holding the delivery of the scrip of Orient and shifting the position from one market to another market on the closing days of the settlement in the re Stock Exchanges. In addition KSL submitted that it never had a naked position in the market and always there was delivery in hand. The fact that KSL is changing its defense once by saying that doing arbitrage and again shifting its stand to by saying that it was not engaged in arbitrage. By this KSL is trying to confuse its behavior on transactions undertaken.

Enquiry Officer found in its enquiry that KSL had earned profits from these transactions to the extent of Rs. 7,75,866.60/- and Nirjay admittedly incurred losses. ASL had also lost Rs. 9 lakhs by b from Nirjay and that their arbitration case is pending before NSE against Nirjay. From this it becomes clear that orders were placed by KSL and NSL at BSE and NSE in the same scrip, which res generation of large volumes. The orders were placed in such a manner that trades matched with each other time and again. The observations that these orders were entered into by both the p around the same time, for the same quantity and at the same price, clearly indicate that the counter parties were aware of these transactions in advance. The co-ordinated and synchronized m which these trades were executed prove that there was a tacit understanding between KSL and NSL to manipulate the scrip of Orient.

- e. With regard to the finding that trades of the KSL had misled the investors while making their investment decisions, the broker submitted that these transactions were carried out on the closing day settlement on the two stock exchanges and not everyday. The broker further submitted that by doing this there was no question of unusual fluctuation in the volumes of each day. I agree with the the Enquiry Officer that the creation of volumes and liquidity in a particular scrip is an important criterion and this is capable of misleading the investors while making their investment decisio volumes in particular scrip create artificial demand inducing innocent investors, not well versed with the market practices. They can be carried away by the unusual fluctuations in the volumes and c induced into investing their hard earned money in the scrip and loose out their invested amount.

The trades of KSL during the period of investigation had led to volume generation. Volumes in a particular scrip raise demand for the scrip in the securities market. The greater the liquidity, high investor's attraction towards investing in such a scrip. Another contention raised by the broker is that the Enquiry Officer has not produced any evidence on record to prove that the investors ha losses due to the transactions carried out by it on behalf of the clients. I find that there is no such requirement and in any case it is not possible to quantify loss to investors in the instant case.

The broker has also referred to the order of SEBI in the matter of JM Morgan Stanley Retail Services Pvt. Ltd. The Enquiry Officer has rightly found that the case referred to is not based on th facts. In the present case action is initiated upon a detailed investigation into the irregularities in the trading of the scrip of Orient, which involves larger public interest. The conduct of KSL is detri to the interest of investors and the safety and integrity of the securities market.

- f. With regard to the professional relationship between these three entities, the Enquiry Officer has very carefully brought out it with the help of the data of disciplinary proceedings against ASL in I taking this into consideration it becomes clear that all of them would have consensus of making profit by doing these type of trades.
- g. As regards the contention of the broker that it had no intention to manipulate the market, I find from the above discussion, that KSL had acted in concert with NSL and ASL, to create an artific market in the scrip of Orient. As per the Enquiry Report KSL had traded in the scrip of Orient during the period under investigation by carrying out substantial transactions in this particular scr cannot be genuine as these were meant to serve purposes other than that of ordinary trading in the market.

- 4.1** In view of the above factual conclusions arrived at by me, I find that the broker has violated Regulations 4 (b) (c) and (d) of FUTP Regulations as applicable at the time when the act was commit Clause A (1), A (3) and A (4) of the Code of Conduct specified in Schedule II read with Regulation 7 of Broker Regulations.
- 4.2** From the aforesaid, I find that the broker has failed to explain the necessity of executing structured trades within the same exchange or in two exchanges. In the facts and circumstances of the cas therefore, not inclined to differ with the enquiry officer.

Order

- 5.1** In view of the above and in exercise of the powers conferred to upon me by Section 19, of SEBI Act, 1992 read with Regulation 13 (4) of the said Regulations, I hereby impose a penalty of suspe Certificate of Registration of Kaushik Shah Shares & Securities Pvt. Ltd., member, BSE Ltd., bearing SEBI Registration No. INB 010939732 for a period of seven days.
- 5.2** This order shall come into force immediately after the expiry of 21 days from the date of this order.

Mumbai **T.1**

Date: 1.11.2006 **Whole Time M**

Securities and Exchange Board of India