

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER AGAINST M/S UDAY STOCKS & SECURITIES PRIVATE LIMITED MEMBER, BANGALORE STOCK EXCHANGE LTD., UNDER REGULATION 13(4) OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 FOR THE IRREGULAR TRANSACTIONS IN THE SHARES OF HOME TRADE LTD.

WTM/GA/102/ISD/11/06

1.0 BACKGROUND

- 1.1 M/s Uday Stocks & Securities Private Limited (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 said Act) with registration number INB 081033837.
- 1.2 The shares of Home Trade Ltd. (hereinafter referred to as HTL) were 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 shares of HTL both at PSE and BgSE and it reached Rs. 315/- within two weeks of its listing, i.e. by December 06, 1999. Thereafter, the price of the said shares reached Rs.874/- on May 05, 2000. The maximum rise in the price of the shares of HTL took place between November 16, 1999 and March 31, 2000, when it moved from Rs.275/- to Rs.815/-.
- 1.3 SEBI conducted an investigation into the buying, selling and dealings in the shares of HTL inter alia by the members of BgSE including the Broker for the alleged circular trading and price manipulation thereby contravening the provisions of Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995 (hereinafter referred to as the FUTP Regulations) and Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as the Broker Regulations).
- 1.4 The investigation conducted by SEBI found that the Broker had traded in the shares of HTL on behalf of his clients, Ms Priyadarshini Bhati and Ms Chandra Bai. It was also alleged that the Broker had traded on his own account in the shares of HTL at BgSE. The transaction details of the Broker in the shares of HTL are mentioned below:

Period	Gross Purchase (shares)	% to the total buy volume at BgSE	Gross Sales (shares)	% to the total sell volume at BgSE
April 01, 2000 to March 31, 2001	30,500	4.11%	31,400	4.17%

- 1.5 The client /proprietary wise trade details made by the Broker in the shares of HTL are as under :

Name	Buy quantity	Sell quantity
Ms. Priyadarshini Bhati	27,500	28,400
Ms. Chandra Bai	1500	1500
Trading a/c	1500	1500

- 1.6 The investigation conducted by SEBI inter alia revealed that the Broker had resorted to circular trading with other members of BgSE, wherein the shares of HTL were traded amongst themselves, creating artificial volumes in the shares of HTL.

2.0 APPOINTMENT OF ENQUIRY OFFICER

- 2.1 SEBI appointed an Enquiry Officer, vide order dated May 28, 2003, under regulation 5(1) of Securities and Exchange Board of India (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 of the Broker in the shares of HTL.
- 2.2 It was alleged that the Broker had no knowledge of his clients, as required in terms of the concept of "Know Your Client" as per SEBI Guidelines and that the orders on behalf of the clients were placed by Shri Rakesh Karanpuria of HTL, at successively higher rates. It was further alleged that the Broker had resorted to circular trading with other members of BgSE wherein the shares were traded amongst themselves thereby rigging up the prices by trades which were not genuine besides creating artificial price and volume in violation of the provisions of the FUTP Regulations. It was also alleged that the Broker had not obtained the counter foils of the contract notes issued to the clients.

- 3.3 The Broker had furnished his reply and made his submissions before the Enquiry Officer. The Enquiry Officer conducted the enquiry in terms of the 2002 Regulations and vide report dated November 29, 2004, the Enquiry Officer recommended for the imposition of a minor penalty of censure against the Broker. The Enquiry Officer inter alia observed that the Broker did not exercise due diligence to ascertain the financial capability of the client before executing trades on behalf of his clients. The Enquiry Officer had also observed that the Broker had violated Clause B (1) of the Code of Conduct as specified in Schedule II read with Regulation 7 of the Broker Regulations and SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993.

3.0 CONSIDERATION OF ISSUES AND FINDINGS.

- 3.1 Based upon the recommendations of the Enquiry Officer, a notice dated December 20, 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. The said show cause notice was delivered to the Broker through BgSE. Though sufficient time was given to the Broker, he had failed to file his reply to the said show cause notice.
- 3.2 While considering the Enquiry Report, I noticed that the Broker had prima facie violated the allegations specified at pages 2 and 3 of the Enquiry Report and the said violations called for a penalty higher than that recommended by the Enquiry Officer. Accordingly, a notice dated August 31, 2006 was issued to the Broker to show cause as to why a penalty of suspension of the certificate of registration for a period of 15 days should not be imposed upon him. The Broker was also advised to file his reply within 7 days of the receipt of the said notice. The Broker, vide his reply dated September 07, 2006 inter alia submitted that during the period of maximum price rise in the shares of HTL (between November 16, 1999 and May 15, 2000), the volume traded in the shares of HTL was only 3000 shares and with such a low volume, it was not possible for anyone to rig the price of an actively traded shares on the floor of BgSE. The Broker added that its total volume during the period April 01, 2000 to March 31, 2001 had constituted roughly 4% of the total volume at BgSE.
- 3.3 It was further stated that, Shri Padam Porwal, a respectable person in the locality had introduced his brother in law Shri Rakesh Porwal (who was a practicing advocate) to the Broker and the said Shri Rakesh Porwal had further expressed his desire to trade through the Broker in the name of his wife, Smt. Chandra Bai. The Broker further stated that, since the clients were residing in Udaipur, it was not possible to obtain their signature on the counterfoils. The Broker contended that, the contract notes were sent either by post or by courier to their respective addresses within 24 hours of the trades and they had never sent back the signed contract notes. The Broker had also stated that 200 shares were delivered to Shri Rakesh Porwal in good faith as he was the one who had introduced Ms Priyadarshini Bhati to him. The Broker added that knowingly, he had never flouted any of the guidelines or rules laid down by SEBI. The Broker also assured that he would not do so in future.
- 3.4 The Broker was also granted an opportunity of hearing before me on October 27, 2006 wherein Shri B Nirmal Kumar Jain, the Director of the Broker appeared before me and reiterated the submissions made by the Broker vide its reply dated September 07, 2006. It was submitted that the copy of the Know Your Client (KYC) form, copy of the member client agreement and the authorization letter from the client with respect to the transactions and delivery of shares of HTL to Shri Rakesh Porwal, were produced before the Enquiry Officer. The Broker was advised to produce the copy of the said documents and the same were forwarded by the Broker vide letter dated October 27, 2006. The Broker further assured that he would comply with the Rules, Regulations etc. without any failure.
- 3.5 I have perused the Enquiry Report, show cause notices issued to the Broker, his reply dated September 07, 2006, the submissions made at the time of the hearing, the copies of the documents submitted by the Broker vide his letter dated October 27, 2006 and other relevant materials available on record. As the Enquiry Officer had 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.
- 3.6 In the context of the trades executed by the Broker on behalf of the aforesaid clients, the first issue to be examined is whether the clients of the Broker were properly introduced to him. In this regard, I note from the submissions made by the Broker before Enquiry Officer that Shri Rakesh Karanpuria was introduced to the Broker by one Shri Padam Porwal, a well known person in the locality. The said Shri Rakesh Karanpuria was introduced as Shri Rakesh Porwal (as the brother-in-law of Shri Padam Porwal). Further Shri Rakesh Karanpuria had traded in the shares of HTL, in the name of the clients of the Broker. In terms of SEBI Circular dated February 11, 1997, the stock brokers were advised to maintain a database [pertaining to 'Know Your Client' (KYC) norms/ guidelines] 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 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.
- 3.7 I have perused the copy of the member client agreement and the client registration agreement of both the clients (now produced) by the Broker vide his letter dated October 27, 2006. The Broker has also produced the copy of the letter

received from the aforesaid clients authorising Shri Rakesh Porwal to place orders and to accept delivery of shares on their behalf, with the letter dated October 27, 2006. In the facts and circumstances, there is nothing to suggest that the clients were not properly introduced to the Broker, before the execution of trades in the shares of HTL.

- 3.8 However, I note that, it is one of the precautionary measures of a stock broker to verify the financial capacity of his clients before executing the trades on their behalf, which is one of the checks under the Know Your Client norms/guidelines. When a stock broker fails to perform the said primary requirement 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. In this regard, I note that the Broker had submitted before the Enquiry Officer that since there was no payment default from the clients, the question of verifying the financial worthiness did not arise. The aforesaid contention can not be acceptable, as the Broker has got a duty to ensure that his clients were capable of fulfilling the payment obligations for the trades which were executed on their behalf. The assessment of financial capacity of the client can not be taken as irrelevant even when the trades were squared off. The Broker could not establish that he had assessed the financial network of his clients before executing trades on behalf of his clients. The Broker should have exercised due care and skill while trading on behalf of his clients in the above circumstances. The above acts of the Broker clearly establish that the Broker had failed to assess the financial capacity of the clients before executing trades on behalf of them in the shares of HTL.
- 3.9 I note that the Enquiry Officer had observed in his report that non obtaining of the acknowledgement copies of the contract notes might be treated as a procedural irregularity under regulation 17(1)(i) of the Broker Regulations. In terms of the provisions of the Broker Regulations, a stock broker, without any delay shall issue the contract note to his client and in terms of regulation 17(1) (i) of the Broker Regulations, he has to maintain the counterfoils or duplicates of such contract notes. In the present matter, the Broker had traded substantially in the shares of HTL on behalf of his clients. However, he had failed to submit the copy of acknowledgment of counterfoils of contract notes. It can be seen from the trading details, that the Broker had executed several transactions of significant volume in the shares of HTL on behalf his clients. Despite of executing large transactions, the Broker had failed to obtain the acknowledgement copy of contract notes. The above act of the Broker does not appear to be a simple omission considering the trades (volume of the shares) executed by the Broker on behalf of his clients. Therefore, it is established that the Broker had violated regulation 17(1) (i) of the Broker Regulations.
- 3.10 I further note that some of the shares were delivered by the Broker to Shri Rakesh. Though the Broker produced the copy of the authorisation letter as stated hereinabove, and contended that the shares were delivered as per the instruction of the clients, it was observed by the Enquiry Officer that the same were not delivered within 48 hours of the pay out, as specified in the SEBI Circular dated November 18, 1993. Therefore, it is fairly established that the Broker had failed to deliver the shares within the stipulated time prescribed under the aforesaid circular.
- 3.11 In the facts and circumstances as detailed above, the Broker deserve for a penalty under the provisions of 2002 Regulations. As the Broker has now produced the copy of the member client agreement and the client registration form it is seen that the clients were introduced to the Broker before the execution of the trades in the shares of HTL. The Broker has also produced the authorisation letter in respect of his clients regarding the placement of orders and delivery of shares. Taking into account the above circumstances and also in view of the assurance given by the Broker that he would comply the rules, regulations etc. without any failure, I do not consider this as a fit case for imposing a higher penalty than recommended by the Enquiry Officer and in the facts and circumstances of the case.

4.0 ORDER

In view of the foregoing, 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 censure on the certificate of registration of M/s Uday Stocks & Securities Private Limited , Member, Bangalore Stock Exchange Ltd. (Registration number INB 081033837).

G. ANANTHARAMAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place : Mumbai
Date : 24-11-06