

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: Dr. T. C. NAIR, WHOLE TIME MEMBER

**IN THE MATTER OF INSPECTION OF STOCK BROKER-
RELIANCE SHARES AND STOCK BROKING PRIVATE LIMITED**

Date of Hearing: April 07, 2006

Appearance:

For Noticee: Mr. D.J. Khambatta, Senior Advocate
Mrs. R.H. Khan, M/s Mulla & Mulla , Advocates
Miss. Pooja, M/s Mulla & Mulla , Advocates
Mr. Gautam Doshi, Reliance Share and Stock Broking Pvt. Ltd.
Mr. Kamal Gupta, Reliance Share and Stock Broking Pvt. Ltd.
Mr. S.M. Dandekar, Reliance Share and Stock Broking Pvt. Ltd.

For SEBI: Shri P.K. Kuriachen, General Manager
Shri J.Ranganayakulu, Joint Legal Adviser

ORDER

**[UNDER REGULATION 13 (4) OF SEBI (STOCK BROKERS & SUB-
BROKERS) REGULATIONS, 1992]**

01. M/s Reliance Shares and Stock Broking Private Limited (hereinafter referred to as the 'stock broker') is a member of the Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Ltd.(NSE), Calcutta Stock Exchange (CSE), Vadodara Stock Exchange (VSE), Bangalore Stock Exchange (Bg.SE), Ahmedabad Stock Exchange (ASE) and Over The Counter Exchange of India (OTCEI). It 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 Numbers INB010607538,

INB230607532, INB030607534, INB190607530, INB080607533, INB020634735 and INB200607538 for the respective Stock Exchanges.

02. SEBI vide its order dated October 20, 2000, under Regulation 19(1) of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as the "Stock Brokers Regulations") appointed auditors M/s Devendra Kumar & Associates (hereinafter referred to as the 'Inspecting Authority') to conduct inspection of books of accounts, documents and other records of the stock broker. The Inspecting Authority conducted an inspection of the stock broker for the period commencing from April 3, 1999 to November 26, 2000 with reference to its transactions on BSE.
03. The Inspecting Authority vide its report dated March 15, 2001, pointed out various violations. The violations were with regard to non maintenance of requisite books of accounts, documents and other records, non issuance of contract notes, undertaking of improper trades and transactions with other members of BSE, non segregation of own funds from client's funds and utilization of client's funds, non maintenance of client data base, dealing with unregistered sub-brokers etc.
04. A copy of the Inspection Report was forwarded to the stock broker on August 13, 2001. After due consideration of the reply submitted by the stock broker, vide order dated January 28, 2003, an Enquiry Officer was appointed under Regulation 5(1) of the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred as 'the said regulations') to enquire into the alleged irregularities noticed during the inspection.
05. Thereafter, a show cause notice dated May 30, 2003 was issued to the stock broker under Regulation 6(1) of the said regulations communicating the detailed charges. The stock broker submitted a reply to the charges leveled against it vide its letter dated June 22, 2003. The stock broker also appeared

for a personal hearing before the Enquiry Officer on July 31, 2003 and August 4, 2003. The Enquiry Officer conducted the enquiry in terms of the said regulations and stock broker was given a fair and reasonable opportunity to make its submissions.

06. The Enquiry Officer submitted his report dated November 18, 2003. As per the summary of findings of the Enquiry Officer, the stock broker:

- ? Failed to maintain proper accounts, sauda book and also failed to issue contract notes at the actual price at which transactions were executed;
- ? Converted his own trades into client trades in violation of SEBI (Prohibition of Fraudulent and Unfair Practices) Regulations, 1995;
- ? Issued manual contract notes in order to pass on artificial prices to clients and failed to account for missing contract notes;
- ? Did not put order number, trade number, trade time, settlement number, etc. on contract notes to facilitate artificial pricing of trades;
- ? Failed to enclose original cancelled contract notes to the office copies;
- ? Issued contract notes which were not reflected in Sauda book.
- ? Did not mention order time and number on the contract notes to facilitate artificial pricing;
- ? Failed to ensure proper segregation of clients' funds from that of its funds and also mis-utilized clients' funds;
- ? Indulged in improper dealing transactions with other brokers of the Exchange;
- ? Reported cross deals with considerable delay;
- ? Failed to take appropriate measures/precautions to avoid computer/net work system failure resulting in its absence from breakup sessions;
- ? Exceeded intra day trading limit; and

- ? Failed to keep proper proportion of cash and fixed deposits for capital adequacy, thereby violating Exchange requirements.

07. In view of the above findings, the Enquiry Officer held that the stock broker has violated the following relevant provisions of law:

1. Rule 15 of Securities Contracts (Regulation) Rules, 1957;
2. Regulation 17 of SEBI (Stock Broker and Sub Broker) Regulations, 1992;
3. Rule 4(b) and (c) of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992;
4. Circular SMD (B)/104/22775/93 dated 29.10.2003;
5. Code of Conduct A(2), A(3) and B(2) of Schedule II of SEBI (Stock Brokers and Sub- Brokers) Regulations, 1992;
6. Regulation 6(b) of the SEBI(Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market), 1995;
7. Circular SMD/Policy/IECG/1-97 dated 11.02.1997;
8. Circular SMD/MDP/Cir/043/96 dated 05.08.1996;
9. Circular SMD/Policy/Cir-29/97 dated 13.11.1997;
10. Circular SMD/Policy/4296/96 dated 04.10.1996;
11. Circular SMD/SED/93/23321 dated 18.11.1993;
12. Circular SMDRP/Policy/Cir-32-99 dated 14.09.1999;
13. Circular No. SMD/RCG/CIR(BKG)293/95 dated 14.03.1995.

08. In view of the findings as given in Para 06 above, the Enquiry Officer recommended a major penalty of suspension of Certificate of Registration of the stock broker for a period of nine months.

09. A show cause notice dated December 10, 2003 under Regulation 13(2) of the said regulations was issued to the stock broker with a copy of the Enquiry

Report thereto. The stock broker submitted its reply vide letter dated January 21, 2004¹ on each of the allegations in the show cause notice as under:

10. Failure to maintain proper books of accounts:

10.1 *Books of accounts as per rule 15 of the Securities Contracts (Regulation) Act, 1957 (hereinafter referred to as 'SCRA') and Regulation 17 of the Stock Brokers Regulations were maintained.*

10.2 *In support of the above, print outs of separate books of accounts including the Client Ledger account for each of the Exchange viz; BSE, NSE, CSE for the year 1999-2000 could be produced.*

11. Failure to maintain Sauda book:

11.1 *BRK files were downloaded everyday, and without such files it was not possible to prepare Daily Transaction Report maintained in Microsoft Excel System. Therefore, it was not correct to say that the stock broker has not downloaded the BRK files.*

11.2 *As the BRK files of a few days for the year 1999-2000 duly downloaded were misplaced, an offer was made to the Inspecting Authority that the missing records could be made available from the Exchange, if so required. The Inspecting Authority never asked for such copies at the time of inspection; had it been so directed, it could definitely have obtained the same for inspection purposes. It is, therefore, not correct to say that the stock broker did not maintain the BRK.*

12. Failure to issue contract notes at actual price at which transactions were executed:

12.1 *Only a handful of transactions, weighted average price was applied. The weighted average price was arrived at by dividing total actual market value of shares traded for orders by total number of shares traded for orders. As per records, only 25 contracts were issued in the above manner, aggregating in value to Rs.71.47 crore. The total turnover during the period under review was Rs.26,517.02 crore. Accordingly, contract notes issued at weighted average price represented a miniscule 0.27% of the total turnover, whereas in 99.73% of cases, the contract notes were duly issued at*

¹ Paragraphs from 10 to 27 contain material reproduced from the letter dated January 21, 2004 submitted by the stock broker.

actual rates for each client. The said handful of cases can not be taken as a routine practice adopted by the stock broker.

12.2 The names of the clients who have been charged such weighted average price were Reliance Capital Ltd., Reliance Industries Ltd., Florentine Trading Pvt. Ltd., Trimity Investments and Financial Services Pvt. Ltd., B.H.Kothari-Hindu Unidivided Family(HUF), Nayantara B Kothari, Arjun B Kothari, Kothari Exports Trading India Pvt. Ltd., Saumya Finance and Leasing Company Pvt. Ltd., Sanatan Textrade Pvt. Ltd., Rishiraj Merchandise Pvt. Ltd., Guruvass Textiles Pvt. Ltd., Avshesh Mercantile Pvt. Ltd., Chandragupta Traders Pvt. Ltd. and Reliance Capital Limited (RCL) is stock broker's parent company which is promoted by Reliance Industries Limited (RIL). All other companies named above are connected / related to stock broker's group. In other words, there is not a single instance where any external client was involved. As parties involved were connected / related to stock broker's group, there could not be any ulterior motive as alleged in charging weighted average price of scrips traded.

12.3 Even in the above handful of cases, the weighted average price was arrived at on the basis of actual price at which transactions were executed on the Stock Exchanges. Accordingly, there was no artificial pricing or any disturbance to market equilibrium as alleged. In the aforesaid cases, orders were received for more than one customer for the same scrip at the same time and in such a situation, it was obviously not possible to execute all the orders simultaneously. Under the circumstances a handful of contracts were issued on the basis of weighted average price as it was the only solution to be fair to all the clients.

12.4 It is also with full knowledge and consent of the clients, the weighted average price was given for all such transactions. These transactions did not represent Ware Housing Transactions as described in Circular No. SMD/Policy/CIR-29/97 dated November 13, 1997 and thus the question of violation thereof did not arise. In view of the above, there has been neither violation of Clause A (3) of the Code of Conduct nor any distortion in the transparency criteria of electronic trading.

13. Transferring/Converting 'own trades' into client trade :

13.1 From the BRK files, it can be observed that the trades done for FI are charged at the average rate of the trades done for FI as per the requirement of the Exchange. The contract notes have been duly accepted by the FI. The average rate for FI (IPCL) 4,83,760 shares worked out to Rs.111.90, and average rate for Indian Petro

Chemicals Limited (IPCL) (own) 4,27,265 shares worked out to Rs.109.89, totaling 9,11,025 shares.

13.2 The rate at which sale was executed for the client is higher than the rate at which the sale was executed for own trades. The said conduct established bonafides beyond doubt. If there was any intention of front-running as alleged, the rate charged to the client for the sale should have been lower than rate charged for own transactions, whereas, in reality, it is the other way around.

13.3 However, the INST_ID was marked inadvertently as 'CL' instead of 'OWN' for stock broker's trades. Nonetheless, there was no mixing up of transactions of the institutional client and all trades pertaining to JM Mutual Funds (JMM) were duly marked as such in the BRK files. Further, the fact that these trades pertained to own trades was amply demonstrated by the purchases of the said scrip prior to the sale. Accordingly, there was no question of any front-running and it was a mere clerical error.

13.4 As regards, the transaction of 3000 IPCL shares dated January 3, 2000, it was a Badla carried forward transaction of December 30, 1999. In support of the above, relevant BRK files of December 30, 1999 and relevant contract notes of Innovative Enterprises are produced. The factual data on the illustration regarding RIL on October 05, 1999 is that the trade of 1,41,000 shares of RIL was executed for RCL on October 05, 1999, but inadvertently the INST_ID was marked as 'OWN' instead of 'CL'. This is again a mere clerical error. Hence, there can be no question of front-running where the client involved is none other than the parent company of the stock broker i.e. RCL.

14. Non-issuance of contract notes at rates the trade was executed:

With regard to the charge that contract notes were not issued at the rate at which actual trades was executed the submission is as per reply given in paragraph 12 above.

15. Issuance of manual contract notes in order to pass on artificial prices to clients:

15.1 The allegation that manual contract notes were issued to facilitate artificial pricing is wholly unjustified. There was no prohibition against issuing of manual contract notes and this has also been confirmed by the Enquiry Officer. Contract notes bearing No.3243 to 4019 were unutilized and hence were not accounted for in the books of accounts. The said unutilized contract notes are available for verification, if required. Numbering of contract notes serially started

from the first year of operation i.e. 1994-95 and since then, the same continuous serial numbers were being used. Accordingly, the Serial No. for the first contract note was 3121 for the year 1999-2000 (not 3129 as stated in the findings) and this was the next consecutive number after the last number used for the previous year. The adverse inference in this regard is unjustified.

15.2 The only reason for issuing manual contract notes in the year 1999-2000 was that the software 'ACPLUS' developed by S.B. Management used during the year in question did not have the provision for system generated contract notes. This was a limitation of the software used and there was no ulterior motive in this regard.

16. *Failure to put order number, trade number, trade time, settlement number etc. on contract notes to facilitate artificial pricing of trades:*

Some of the above details, being voluminous in nature, were not mentioned in the contract notes, but were given separately to clients by way of attachment as was permissible under the applicable regulations. The allegation that this information was not given to facilitate artificial pricing is thus factually incorrect and unjustified as per reply given in paragraph 12 & 13 above.

17. *Contract notes not signed by authorized persons:*

The details of authorized signatories of the contract notes for the relevant period was submitted to the Exchange. No communication or complaint regarding the alleged non-compliance of this requirement was received.

18. *Failure to enclose originals of cancelled contract notes to the office copies:*

The original cancelled Contract Note No. 4401 prepared in the name of Reliance Petroleum Limited was misplaced. The genuineness of the transaction was verified by the Inspecting Authority during the inspection. It is also a matter of record that there was neither any financial transaction nor any exchange of securities in respect of the cancelled contract notes. Accordingly, no adverse inference is called for on this account.

19. *Some contract notes issued were not reflected in Sauda book:*

Contract notes mentioned in the Inspection Report were in fact cancelled and the genuineness of the same was verified by the Inspecting Authority. It is a matter of record that there is neither any financial transaction nor any exchange of securities in respect of the cancelled contract notes. Accordingly, no adverse inference is called for on this account.

20. Failure to mention order time and number on the contract notes to facilitate artificial pricing:

The circular referred to by the Enquiry Officer is one addressed to the Stock Exchanges. The Stock Exchanges have not communicated such requirements to members. In fact, the format of the contract notes as provided by the Exchanges does not provide for the time of receipt of Order from the client. A copy of format of contract note as specified by BSE is enclosed. In view thereof, there is no omission in not mentioning the order time on the contracts. Contract Note No.GA/03/6 dated April 11, 2000 referred to in the Enquiry Report is not a manual contract note and it is a system generated contract note of the following year. The question of average pricing in this case does not arise as the entire trade is pertaining to only one client i.e. RCL.

21. Failure to ensure proper segregation of client's funds from that of own funds and also mis-utilisation of client's funds:

21.1 In all such cases of non segregation of client's funds and own funds, there may be clerical issue and client's funds were never utilized for own purpose at any point of time. The Enquiry Officer has accepted that 5 payments out of 7 unauthorized transfers were not from clients' account as mentioned in Annexure XII of the Inspection Report. In respect of the two entries of Rs.1.25 crore and Rs.2.50 crore on March 14, 2000 and March 20, 2000 respectively, RCL was both a client as well as a lender to the stock broker.

21.2 The payment of Rs.1.25 crore to RCL was part repayment of Inter Corporate Deposit (ICD) from BSE client account. The payment of Rs.1.25 crore was, in fact rectifications of the earlier deposits of ICD made in BOI- BSE client Account. In support of the above, relevant bank statements and other documents are enclosed.

21.3 The client whose cheque of Rs.2.48 crore was returned on March 21, 2000 is B.H.Kothari (HUF) and supporting documents in this regard are enclosed. It can be observed that the deposit of Rs.2.48 crore was returned. All ICDs received were deposited in the Current Account No. 603581 maintained with Syndicate Bank, Fort Branch, Mumbai. It is in few instances the stock broker had deposited ICDs in client account and the same were rectified.

21.4 The ledger account for ICDs is produced for perusal. It can be seen that proper segregation of client's funds have been maintained except in a few cases. With regard to the ICD of Rs.0.36 crore received from Reliance Stock Holdings Private Limited on December 30, 1999, the Enquiry Officer desired to know who the

client was and what kind of contingency requirements were there. In this respect, it was stated that the stock broker had done Vyaj Badla transaction on behalf of his client 'Reliance Safe Vaults and Securities P. Ltd.' in settlement No. BSE/ A/40 for an amount of Rs.0.36 crore. Since, the amount due from the client was not received on due date the stock broker had availed ICD from Reliance Stock Holding Private Ltd. for meeting the client contingency and obligation towards the Exchange.

- 21.5 The amount of Rs 0.40 crore transferred from BSE Clearing Account to CSE Client A/c was towards meeting the contingency requirement for capital adequacy at CSE. Since, the amount was subsequently not found required for CSE, an amount of Rs.0.70 crore comprising the RCL ICD of Rs.0.40 crore (as mentioned above) and stock brokerage of Rs.0.30 crore earned in CSE settlement was transferred to NSE Clearing Account to meet contingency requirements i.e. capital adequacy requirements. As this was not required by NSE, the amount was further transferred to BSE Clearing Account and from there to BSE Client Account to refund the margin and ICD due to RCL aggregating to Rs.6.25 crore as the ICD was earlier credited to BSE Client Account. There could be procedural lapses on the part of staff who were new to the system. Neither the Stock Exchanges nor any client had suffered on account of such lapses. A few erroneous entries cited in the Inspection Report be viewed in the perspective of the large number of banking and Stock Exchange transactions as the stock broker had dealings in BSE, NSE and CSE during the period of inspection. The number of bank accounts maintained was 15 for these Exchanges. There has been large number of banking transactions involving issue and deposits of cheques. There are only clerical errors and the same have been rectified.*
- 21.6 The transfers of client's funds from one Exchange to another Exchange were made with the knowledge and consent of the clients. These banking transactions have been effected in order to avoid duplication and blocking of funds of clients in banks for a number of days. Some of the entries which have been cited by the Inspecting Authority as erroneous entries are not so. The Inspecting Authority was in the stock broker's office for inspection for 2-3 months intermittently but did not discuss their final observations with the stock broker. Many of the points mentioned in the Inspection Report would not have been reported had the inspectors discussed the issues/queries with the stock broker after completing the inspection.*
- 21.7 The stock broker had maintained proper segregation and separation of its own funds and client's funds and the sanctity there*

of. The deposits of own funds into the client's account was purely a clerical lapse and had not caused any loss/gain to either the client's interest or Stock Exchanges or to the company and the same have been rectified. A few clerical errors compared to the volume cannot be construed as non-maintenance of client's transactions exclusively. Further, such clerical errors are rectified thus adhering to SEBI's mandate in spirit.

22. *Indulging in improper dealings in transactions with other members of the Exchange:*

The transactions stated in this connection are rectifications of bad deliveries pertaining to the spot deal entered into between RPL and RCL through the stock broker. The relevant contract notes to support that these transactions for the year 1997 are produced. The deliveries which were received during the year 1999-2000 were bad deliveries that were made good. This is not required to be reported and this is not the spot deal in 1999-2000 as alleged. To support the same, confirmations received from RIL (erstwhile Reliance Petroleum Limited) stating that the deliveries given on August 27, 1999 and December 4, 1999 were rectification of bad deliveries are produced.

23. *Reporting cross deals after considerable delay:*

Seven instances of cross deals were executed on BSE On-line Trading (BOLT). The very fact that the cross deals have been entered in the BOLT system and the relevant Trade ID is generated itself proves that the transaction has been reported to the Exchange. The BRK files for the dates February 17, 1999, February 18, 1999, March 12, 1999 and March 26, 1999 have also been produced. The letters that have been submitted to the Exchange are only the confirmation of having settled the transactions on due dates.

24. *Failure to take appropriate measures / precautions to avoid computer/net work system failure resulting in stock broker's absence from breakup sessions:*

Vide letter dated December 29, 1999, the Exchange was intimated that it had been facing connectivity problems for the past few days and consequently facing problems in attending break-up sessions. The Exchange informed that there was a satellite (VSAT) problem since the stock broker was located at Worli. The Exchange also advised to take lease line connection. After December, 1999, the problem has been rectified. In support of the above, copies of the letters to the Exchange about measures taken to avoid / rectify computer / network system are produced.

25. Holding shares in pool account for more than 15 days:

Three hundred and fifty L&T shares were lying in the pool account for more than 15 days due to oversight. The shares were transferred to the beneficiary account later.

26. Exceeding intra day trading limit:

On January 14, 2000, the stock broker had done intra-day trade in IPCL shares for 5,35,000 worth Rs.5.67 crore. The Exchange has already levied a penalty of Rs.16,700 in the above case which has been duly paid and proof for the same is produced. With reference to the transaction dated October 11, 1999 in regard to ZEE Telefilms, the carry forward limit of Rs.6.00 crore was exceeded as a result of oversight. After taking necessary corrective action, the matter was reported to Exchange vide stock broker's letter dated October 12, 1999 and copy of the same is produced.

27. Failure to keep proper proportion of cash and fixed deposits for capital adequacy

In this connection, the Exchanges have issued clarification that all Additional Base Capital (ABC) given in the form of Cash / Fixed Deposit Receipts(FDR) (hereinafter referred to as 'cash component') should be at least 30% of the total ABC and cash margins in respect of every trading member. In case where non cash component is more than 70% of the total additional base capital, the excess non cash component shall be ignored for the purpose of exposure limits requirements and / or for margin requirements. Copy of the said Circular issued by NSE No.NSCC/M&S/384 dated March 29, 2000 is produced. In view of the above, ABC is adjusted according to the cash component that the stock broker had maintained. In other words, the excess Bank Guarantee (BG) of the stock broker is ignored. The stock broker wrote to the Exchange for confirmation of figures stated by the Inspecting Authority. The stock broker has been constantly following up the matter with the Exchange, but the Exchange has not given any confirmation of the same. The limits sanctioned by the Exchange are always in proportion to the combination of Cash/FD/BG provided for Capital Adequacy Requirements and hence there was no violation as such.

28. An opportunity of personal hearing was granted to the stock broker on March 25, 2004. On the designated day Mr. Amitabh Jhunhunwala, Director, Reliance Capital, Mr. D.H. Shah, Director, Reliance Share & Stock Brokers Pvt. Ltd., Mr. R.P. Mehta, Dealer, Reliance Share & Stock Brokers Pvt. Ltd.,

Mr. S.M. Dandekar, and Mr. G. Parameshwaran appeared and made submissions on behalf of the stock broker. The stock broker had also submitted written submissions dated April 08, 2004 and August 03, 2004. Subsequently due to change in the competent authority, a fresh opportunity of personal hearing before me was granted to the stock broker on April 07, 2006. On the designated day the stock broker had appeared through persons mentioned on the first page of the order and Mr. D.J. Khambatta, Senior Counsel made submissions on behalf of the stock broker. The submissions were by and large reiteration of written reply dated January 21, 2004 and written submissions dated April 08, 2004 and August 03, 2004. In addition to this the stock broker had also submitted written submissions dated April 21, 2006.

29. I have carefully considered the findings of the inspection, the findings of the Enquiry Officer, the reply and documents submitted by the stock broker, submissions made by the stock broker during the personal hearing and also the written submissions made available after the hearing. My findings against the stock broker are as under :

30. In connection with the findings of the Enquiry Officer that the stock broker failed to maintain proper accounts, the stock broker submitted that separate and segregated accounts in respect of each of the Stock Exchanges were maintained by it. However, I find that the said claim of the stock broker is not supported by any evidence. The stock broker failed to produce printouts of separate books of accounts, including the Client Ledger account for each of the Exchange as claimed by it in its reply. The circular dated May 14, 1993 clearly mandates that where a corporate member is a member of more than one Stock Exchange, the member has to maintain separate and segregated accounts in respect of each of the Stock Exchanges in which it is a member. This has been specifically brought out in the Inspection Report and further in the Enquiry Report where the stock broker has admitted to have been

maintaining only one set of books of accounts i.e. one General Ledger and Client Ledger for all Exchanges. Furthermore, the submission of the stock broker that it is maintaining books of account separately for each Exchange and the combined General Ledger and Client Ledger accounts were maintained in addition to the separate books lacks merit in the absence of evidence of the separate books of accounts for each Exchange. The submission of the stock broker that this was done only for clients' convenience as well as for the convenience of the stock broker is out of context as the law is not to cater to the convenience of its subjects at all the times. Therefore, I find that stock broker has violated Rule 15 of the SEBI (Stock Broker and Sub Broker) Rules, 1992 (hereinafter referred to as "the Stock Brokers Rules"), Regulation 17(1) of the Stock Brokers Regulations and SEBI Circular dated May 14, 1993.

31. The Enquiry Officer has found that the stock broker has failed to maintain Sauda book. In this regard, the stock broker in its reply has stated that it had informed the Inspecting Authority that the missing records could be made available from the Exchange, if so required. The said statement of the stock broker shows that these documents were not maintained by it at the time of inspection. Sauda book is the basic document which a stock broker is required to maintain and preserve. Therefore, its argument that it could have made arrangements to obtain Sauda book from the Exchanges is unacceptable because if that be so, no stock broker need to maintain this basic document. Further, in terms of Regulation 18 of the Stock Brokers Regulations, the stock broker is also required to preserve the books of accounts and other records for a minimum period of 5 years. Therefore, the plea of the stock broker that *"copies of a few BRK files were not available after the lapse of a considerable time period"* is not acceptable. I further note that the 'considerable time period' is one and half years only in this case and the conduct of the stock broker tantamounted to violation of Regulation 18 of the Stock Brokers Regulations. However, as the charge against the stock broker is only under Regulation 17(1) of the Stock Brokers Regulations, I find

that the stock broker has failed to maintain Sauda book and has violated aforesaid provision of the Stock Brokers Regulations.

32. The Enquiry Officer found that that the stock broker failed to issue contract notes at the actual price at which transactions were executed. In this regard, the stock broker has admitted that there were a handful of transactions in which weighted average price was applied. According to the stock broker, the weighted average price was arrived at by dividing total actual market value of shares traded for orders, by total number of shares traded for orders. Thus, the stock broker has admitted to have issued contract notes at an average price by averaging the prices, the stock broker has, in fact, failed to pass on the price at which the trade has taken place. This practice has lead to lack of transparency, especially, when done for select clients and in select scrips. The submission of the stock broker that these are a handful of transactions constituting only 0.27% of total turnover is irrelevant and misleading in the view of the fact that these transactions were valued at Rs.71.47 crore. The submission of the stock broker that all such clients to whom average rates were passed on are connected/ related to the Reliance group is not acceptable. No relaxations of whatsoever kind in this regard have been allowed to connected/ related companies. The stock broker had produced request letters for such average pricing, obtained from some of its clients and these letters were dated April 01, 1999. The Enquiry Officer has observed in this regard as under :

"From the above letters it is found that all are obtained on single date i.e. April 01, 1999. This is the first day of the period for which inspection was conducted. All are similarly worded without any exception and all the letters refer to some discussion between the member and the client. The letters further suggest that these were issued to confirm and agree to a representation made by the member to issue contract note at average price for all trades executed on their behalf with their other clients. Member has not explained what this representation was about. On a consideration of the charge and the reply and the information made available to me, I am of the view that a member cannot issue a contract note other than at a price at which a

transaction is executed. This will defeat the very purpose of electronic trading. This will also lead to some financial and accounting impropriety on the part of the clients."

I concur with the observations of the Enquiry Officer that even upon the request of its client, the stock broker cannot issue contract notes at artificial rates or at rates at which the trades were not executed. The stock broker has submitted that it had received orders from more than one customer for the same scrip at the same time. Hence, it was not possible for it to execute all the orders simultaneously and this happens all the time with all the stock brokers. In this connection, I find that even in that case, none of the stock brokers who face the same difficulty has resorted to the practice of executing orders together and issuing contract notes on average prices. As per the mandate of SEBI, orders as and when received are required to be fed into the system and should not be kept back for bunching and executing. Accordingly, I find that the stock broker has violated clause A(3) of the Code of Conduct for the stock brokers.

33. With regard to the finding of the Enquiry Officer that the stock broker failed to quote the Client ID on BOLT, I find that the stock broker has admitted that the INST_ID was marked as 'CL' instead of 'OWN' for own trades and that it was an inadvertent clerical error. I note that the stock broker had contended before the Enquiry Officer that these transactions were carry forward transactions and the rate had accordingly been charged. I also note that there were hundreds of transactions in IPCL by the stock broker on that date wherein client ID was not mentioned as per the extract of the transaction dated January 03, 2000 filed along with the stock broker's letter dated August 04, 2003. Some transactions were quoted as INST_ID as FISD and some as CL and the details of clients who placed the orders were not reflected. The irregularities committed by the stock broker here are two fold i.e. non-mentioning of Client ID in the execution of trades/contract notes and non-maintenance of record of client's orders.

34. The Enquiry Officer has found that the stock broker's sale of 3000 IPCL shares dated January 03, 2000 does not form part of the transactions that day. In this regard, I find that the claim of the stock broker that the sale of 3000 IPCL shares dated January 03, 2000 is a Badla carried forward transaction of December 30, 1999 is false and this could be observed upon verification of the BRK files and contract notes produced by the stock broker. For instance, the sale rate mentioned in the contract note No. 4687 is Rs.109.31 for the above transaction while there is no corresponding sale entry of 3000 IPCL shares at the said rate in the transaction sheet of the December 30, 1999.
35. It was found by the Enquiry Officer that the stock broker executed these trades as 'own' trades and it was showing them as 'clients' trades at the end of the day. A glaring instance of this practice is pointed out by the Enquiry Officer as under:
- "From Annexure 5 of the member's response date April 19, 2002 it is found that there are several trades of sell executed in the scrip of RIL on October 05, 1999, where the INST_ID is shown as 'own'. There were 1,41,000 shares sold and averaged at Rs.230.49. However, as per Annexure 3 of the Inspection Report, it was shown as a contract note issued to a client by name RCL for similar quantity of shares at price Rs.230.49. The member has not clarified in his reply as to how the own trade was converted to an agency trade and a contract note was issued to RCL."*
36. I find that both the trades mentioned are on the same date, time and quantity which means it's the same trade. The only difference is that while the inspection team found that the trade was in the name of the stock broker, according to the stock broker it is a client's trade. However, stock broker has submitted that the trade of 1,41,000 shares of RIL was executed for RCL on October 05, 1999, but inadvertently the INST_ID was marked as 'OWN' instead of 'CL' and this was again a mere clerical error and in this case there can be no question of front-running as the client involved was its parent company, RCL. This contention can be accepted if it were an isolated incident, but as per the Inspection Report at Annexure-3 there are huge

number of such transactions and only a few instances were noted for convenience of illustration by the Inspecting Authority.

37. It was alleged that the stock broker had indulged in the unfair trade practice of 'front running' by converting own trades to client's trades by the end of the day. Front Running is an unethical practice where stock brokers trade in equity based on information from the analysis department before their clients have been given the information. Fund manager / broker buys or sells securities in advance of a substantial client order or whereby a futures or options position is taken about an impending transaction in the same or related futures or options contract. The stock broker in this regard has submitted that the average rate for FI (IPCL) in regard to 4,837,60 shares worked out to Rs.111.90, and average rate for own (IPCL) 4,27,265 shares worked out to Rs.109.89. The fact that the rate at which sale was executed for the client is higher than the rate at which the sale was executed for own trades establishes the bonafides of the stock broker and the fact that there was no intention of front-running as alleged. If it had been otherwise, the rate charged to the client for the sale should have been lower than for own transactions. This contention of the stock broker is not sustainable, as it is clear that the stock broker's assumption of variation in price after the substantial sale of the same scrip by the client has not happened. Regulation 6(b) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 (hereinafter referred to as "PFUTP Regulations") reads as under:

"6. No person shall -

(b) on his own behalf or on behalf of any person, knowingly buy, sell or otherwise deal in securities, pending the execution of any order of his client relating to the same security for purchase, sale or other dealings in respect of securities".

The aforementioned transactions of the stock broker, therefore, are in clear violation of the Regulation 6(b) of PFUTP Regulations.

38. With regard to the finding of the Enquiry officer that contract notes were not issued at the rate for which actual trades were executed, the stock broker has relied upon its submissions referred to in Paragraph 32 above. I note that SEBI has instituted various measures like printing the trade number, time, trade price, brokerage on the contract note and issuance of contract note with 24 hours of trade execution etc. so as to bring about transparency in the dealings and to ensure that the mandate of the client is fulfilled by the stock broker. Clause B (2) of the Code of Conduct of the Stock Brokers Regulations requires the stock broker to issue a contract note in the form specified by the Exchange. As per the form prescribed by the Exchange, the stock broker has to reflect the trade number, time, quantity and rate at which the trade was executed on the contract note. Thus, by issuing a contract note at a rate which is not the rate at which the trade was executed, the stock broker has indulged in deceptive transactions which are detrimental to the interest of the client and the securities market which is in violation of Regulation 7 read with Code of Conduct as specified in schedule II of the Stock Brokers Regulations.
39. The Enquiry Officer has found that the stock broker was issuing manual contract notes in order to pass on artificial prices to clients and stock broker failed to account for missing contract notes. In this connection, Inspection Report observes that 2068 contract notes starting from number 3121 to 5188 i.e. were issued during the year 1999-2000 out of which 777 contract notes were missing and remained unaccounted for. In this regard, the Enquiry Officer made the following observation:

“The explanation of the member that some contract notes bearing numbers 3243 to 4019 were missing is not clear. Member merely stated that they were not utilized hence not accounted. When contract notes are manually numbered, it does not make sense to say that certain contract notes with specific numbers were not utilized. Without the benefit of the actual data collected by the inspection, it can only be found that these contract notes were not properly accounted for.”

I concur with the finding of the Enquiry Officer in this regard. The stock broker has not stated the reason for keeping 777 contract notes unutilized and that too after manually numbering them. The stock broker has also submitted that they were issuing manual contract notes as the software did not have the provision for system generated contract notes. Adoption of system of manual contract note is susceptible to misuse as under:

1. Issuance of backdated contract note at later date;
2. Issuance of contract note not backed by trade on the Exchange;
3. Manipulation of rates, quantity, trade time etc.

It is also not possible to ensure that the volume for which contract notes are issued tally with volume of trade on Exchange. Viewed in the context of other violations alleged such as missing contract note, contract note not reflected in Sauda book, trade time not reflected in contract note, average pricing etc., this cannot be taken on face of it; but rather raises doubt as to the motive of the stock broker in adopting this system. The stock broker has however submitted before me that it is in possession of the unutilized contract notes bearing the aforementioned numbers. In this regard, it is relevant to note that at the time of inspection these contract notes were not available with the stock broker. However, I am inclined to give a benefit of doubt to the stock broker in the absence of independent evidence that contract notes bearing the same numbers were ever executed by the stock broker.

40. Regulation 17 (h) of the Stock Brokers Regulations mandates that stock broker should maintain contract books showing details of all the contracts entered into by it with other members of the same Exchange or counterfoils or duplicates of memos of confirmation issued to such other members. I note the findings of the Enquiry Officer with regard to the failure of the stock broker to put order number, trade number, trade time, settlement number, PAN etc. on contract notes was to facilitate artificial pricing of trades.

The stock broker has replied to this finding that the details being voluminous in nature, were not mentioned in the contract notes, but were given separately to clients by way of attachment, as was permissible under the applicable regulations. I do not find the contention of the stock broker acceptable as Clause B(2) of the Code of Conduct of the Stock Brokers Regulations requires the stock broker to issue contract notes in the form specified by the Stock Exchange. In the first place, it was not in order for the stock broker to issue contract note at average prices which has already been found as an irregularity. Hence, on this basis the stock broker cannot plead that such details being voluminous were not reflected on the contract note. Thus, it can be concluded that the stock broker has not issued the contract note in the form and manner prescribed which it is required to do as per Clause B(2) of the Code of Conduct of the Stock Brokers Regulations. The said form prescribed by Stock Exchange does not provide for separate attachments as to the details of trade. Therefore, the conduct of the stock broker is in violation of Regulation 7 read with Code of Conduct as specified in schedule II Clause B(2) of the Stock Brokers Regulations.

Further, the Inspection Report observes that the PAN is not mentioned where most of the deals exceed Rs.10 lakh. The stock broker has not replied on this irregularity. The conduct of the stock broker is in violation of SEBI Circular No. SMDRP/POLICY/CIR-36 /98 dated March 12, 1998 which states that Central Board of Direct Taxes vide its notification dated October 09, 1998 made it mandatory for every person to quote his/her PAN/GIR in all documents pertaining to any contract of a value exceeding ten lakh rupees for sale or purchase of securities as defined in Clause (h) of Section 2 of the Securities Contracts Regulation Act, 1957 and hence the stock brokers have to comply with the same. This conduct of the stock broker substantiated the normal inference that the stock broker had omitted these details from the contract notes in order to facilitate artificial pricing.

41. It was found by the Enquiry Officer that stock broker has not submitted the names of the persons entitled to sign the contract notes to the Stock Exchange. The stock broker in its reply has stated that it has submitted the details of authorized signatories to the Exchange. Though the claim of the stock broker is not supported by any documentary evidence, I am inclined to give benefit of doubt to stock broker as the allegation is not substantiated by independent evidence from the Stock Exchange.
42. The Enquiry Officer found that while the stock broker cancelled some of the duplicate contract notes which it had issued, the originals of the same were not enclosed. In this regard, the stock broker stated that the original contract notes were misplaced. Upon considering the submissions and the absence of the original contract note, I find it difficult to believe that the original contract notes were not issued and no transaction was undertaken. I, therefore, hold that the explanation of the stock broker is not satisfactory. In view of the above, I find that the stock broker has violated Clause A (2) of the Code of Conduct for stock brokers.
43. It was further found by the Enquiry Officer that contract notes issued by the stock broker were not reflected in the Sauda book. Three such instances are mentioned in Annexure IX of the Inspection Report. Though, the stock broker stated that it had verified the records and these contract notes were cancelled, it failed to produce any evidence for such cancellation. From the Inspection Report, it is observed that BRK files for these days were not available to verify the genuineness of these transactions. Hence, the submission of the stock broker that genuineness of the same was verified by the Inspecting Authority is not true. Therefore, I find that stock broker has violated Regulation 7 read with Code of Conduct as specified in schedule II of the Stock Brokers Regulations.
44. The Enquiry Officer found that the stock broker did not mention order time and number on the contract notes to facilitate artificial pricing. The stock

broker has admitted that it had failed to mention trade number, order time and order number on the contract notes. However, the stock broker submitted that the format of the contract notes as prescribed by the Exchange did not provide space for the time of receipt of order from the client and in view thereof, there is no omission on the part of the stock broker in not mentioning the order time on the contract notes. Even though, the Circular dated February 11, 1997 requires the stock broker to maintain record of time when the client has placed the order and reflect the same in contract note, it is seen that the format of contract note prescribed by BSE did not have provision for reflecting the order time. It was however also found that the space for filing trade number, trade time and order number was kept blank in the case of contract note bearing No. GA 03/ 6 dated April 11, 2000 issued to RCL for purchasing on their behalf 11,212 shares of Bajaj Auto. The Enquiry Officer observed that the stock broker who was admittedly issuing manual contract notes during the said period could have entered order time manually on the contract notes. In this regard, the stock broker submitted that the said contract note is a system generated contract note of the following year. This submission of the stock broker does not make sense as the inspection was carried out in November 2000 for the transactions till then, while according to the stock broker the contract note is for the year 2001 and not for the year 2000. If admitted, it will mean that the inspection has covered even transactions of the stock broker of the relevant period or the stock broker had executed trades in advance. Therefore, I find that the stock broker has violated Regulation 7 read with Clause A (2) & B (2) of Code of Conduct as specified in schedule II of the Stock Brokers Regulations.

45. The Enquiry Officer found that stock broker failed to ensure proper segregation of client's funds from that of its funds and also mis-utilized client's funds. In this regard, the stock broker admitted that there had been failure in keeping proper segregation of client funds and own funds and has attributed the same to "*clerical issues*". It was further alleged that the stock broker has mis-utilized the client's funds and the Enquiry Officer has discussed in detail

two such instances out of seven instances mentioned in the Inspection Report. The details of the same are as under:

- a) Payment of Rs.1.25 crore as refund of Inter Corporate Deposits (ICD) to RIL on March 14, 2000.
- b) Payment of Rs.2.5 crore as refund of ICD to RIL on March 20, 2000.

The stock broker in this connection has submitted that the RIL was both a client as well as a lender to the stock broker. Stock broker has admitted that payment of Rs.1.25 crore to RCL was from BSE client account. According to the stock broker, it was rectifications of the earlier deposits of ICD made in BOI - BSE client Account. I find from the bank statement produced before me as Annexure 6 of the stock broker's reply that there are two credit entries which are ICDs as per stock broker into BOI - BSE Client Account dated January 18, 2000 and January 10, 2000 for amounts Rs.2.5 crore and Rs.1.5 crore respectively. Besides, loan receipt of the corresponding date and amounts from the RIL is also attached to prove the genuineness of these claims.

It is probable that the said payments can be rectifications of the deposits as claimed by the stock broker and the stock broker is entitled for benefit of doubt with regard to the finding of the Enquiry Officer that there was mis-utilization of client's funds in this regard. However, I find here that the stock broker has admitted payment and withdrawal of monies other than client's monies to/from the client account. SEBI Circular No. SMD/ SED/CIR/93/ 23321 dated November 18, 1993 which mandates as under:

"C] What moneys to be paid into "client's account". No money shall be paid into client's account other than -

- i. money held or received on account of clients;*
- ii. such money belonging to the Member as may be necessary for the purpose of opening or maintaining the account;*
- iii. money for replacement of any sum which may by mistake or accident have been drawn from the account in contravention of para D given below;*
- iv. a cheque or draft received by the Member representing in part money belonging to the client and in part money due to*

the Member.

D] What moneys to be withdrawn from "client's account". No money shall be drawn from clients account other than -

- i. money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the Member from clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the Member, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client;*
- ii. such money belonging to the Member as may have been paid into the client account under para 1 C [ii] or 1 C [iv] given above;*
- iii. money which may by mistake or accident have been paid into such account in contravention of para C above.*

E] Right to lien, set-off etc., not affected. Nothing in this para 1 shall deprive a Member broker of any recourse or right, whether by way of lien, set-off, counter-claim charge or otherwise against moneys standing to the credit of client's account."

I find that the number of such instances of payment and withdrawal itself establishes that these had not happened by mistake or by accident as claimed by stock broker, rather these were transactions done by the stock broker in gross disregard to the applicable laws for its own conveniences. Therefore, I find that the stock broker has violated SEBI Circular No. SMD/ SED/CIR/93/ 23321 dated November 18, 1993.

46. The Enquiry Officer found that the stock broker had indulged in improper dealing transactions with other brokers of the Exchange. The stock broker was found to be involved in spot transactions in the scrips of UTI Master Growth, SBI & UTI Gain on July 28, 1999, December 04, 1999 and December 06, 1999 and these transactions were not reported to the Stock Exchange. According to the stock broker, these transactions are rectification of bad deliveries pertaining to the spot deal entered into between RPL and RCL through stock broker. In support thereof, the stock broker has enclosed contract notes dated March 26, 1997 and further confirmation slips of the deliveries received in 2000. In view of the supporting evidence, I am inclined

to accept the submission of stock broker that these transactions were entered into during the year 1997 and the transactions pointed out in the Inspection Report are transactions where bad deliveries were rectified.

47. With regard to seven instances of cross deals mentioned in the show cause notice, the stock broker admitted that they were cross deals and that they were entered into during the year 1998-99. The Enquiry Officer found that the trades were reported to the Stock Exchange with considerable delay and transactions on February 17, 1999, February 18, 1999, March 12, 1999 and March 26, 1999 were all acknowledged by BSE on April 19, 1999. The stock broker had made several letters with prior dates of such acknowledgement, though, obviously the information was not communicated to BSE on time. As per the Circular dated SMD/RCG/CIR (BKG) 293/95 dated March 14, 1995, it is mandatory on the part of all the stock brokers to report cross deals on the same day of transaction and the stock broker has violated the said Circular. Besides, I find that only institutional trades are allowed to be settled directly in this fashion, from the BRK file and it is noted that buy-client is J. Modi & Co. who is a non-institutional client; the transactions are reportedly through BOLT and therefore, they should have been settled in the normal course through Exchange system. However, I find that these transactions were beyond the period of inspection, i.e. April 03, 1999 to November 26, 2000 and the said contention is admissible. Therefore, no adverse inference is drawn on the stock broker on behalf of these violations.
48. The Enquiry Officer found that there was a lapse on the part of the stock broker to take appropriate measures / precautions to avoid computer / network system failure and consequent difficulty in attending breakup sessions. In this regard, I note that the stock broker has produced letters addressed to BSE dated December 06, 1999, December 20, 1999, December 24, 1999 and December 29, 1999. In the last letter dated December 29, 1999, the stock broker had informed the Exchange that there was a satellite (VSAT) problem since its office was located at Worli and was advised to take lease line

connection. While appreciating the fact that the problem has not recurred after December 29, 1999, I note that there were four instances during the inspection period when stock broker failed to make the break up reporting. I find that the stock broker has failed to take appropriate measures even after the failure had occurred once and the same is evident from its four letters during a period of three weeks informing the Stock Exchange that it was unable to do the break up reporting due to system failure. I find that the conduct of the stock broker was in violation of Regulation 7 read with Clause A (2) Code of Conduct as specified in schedule II of the Stock Brokers Regulations.

49. It was found during the inspection that stock broker was holding IPCL and L&T scrips Pool account for more than 15 days. In its reply, the stock broker submitted that the IPCL scrip was under objection and hence was transferred after the clearance of objection. With regard to 350 L&T shares, stock broker submitted that these shares were lying in the pool account for more than 15 days due to oversight and the shares were later transferred to the beneficiary account. The conduct of stock broker is in violation of Regulation 7 read with Clause A (2) of Code of Conduct as specified in schedule II of the Stock Brokers Regulations.
50. It was found that the stock broker had exceeded intra day trading limits and Gross Exposure limits in 9 instances during the period covered under inspection. In the following two instances where stock broker crossed daily break up limit in single scrip of Rs.4 crore and overall limits of Rs.40 crore were found to be in violation of Regulation 7 read with Code of Conduct as specified in schedule II of the Stock Brokers Regulations by the Enquiry Officer:
 - a) 15.06.2000, SC marked to IPCL was Rs.5.67 crore - limit was exceeded of Rs.1.67 crore.

- b) 11.10.2003 set 30/99-2000, SC marked for Zee Telefilms was Rs.25.82 crore-limit exceeded by Rs.19.82 crore.

With regard to the transaction in IPCL shares, the stock broker submitted that the Exchange has already imposed a penalty of Rs.16,700 on it and the same is already paid. In the case of ZEE Telefilms, the stock broker admitted that it had exceeded the intra day limit by Rs.19.82 crore and the excessive trading was due to oversight. Imposition of penalty by the Stock Exchange does not bar SEBI from considering the matter and imposing penalty independently. However, on the transaction in IPCL shares as the Stock Exchange has already imposed a penalty a lenient view is being taken. With regard to the second transaction, I find that the stock broker exceeded the trading limit by almost Rs.20 crore which is five folds the permitted limit. I therefore find that stock broker has violated Regulation 7 read with Clause A (2) and A(5) of Code of Conduct as specified in schedule II of the Stock Brokers Regulations.

51. It was found by the Enquiry Officer that the stock broker failed to keep proper proportion of cash and fixed deposits for capital adequacy and hence violated Exchange requirements. The stock broker had failed to maintain the stipulated proportions of cash & fixed deposits in the Additional Capital to bank guarantee on February 25, 2000 as under :

Sl. No	Item Description	Amount (lakhs)	Percentage
1	Cash and Fixed Deposit	609.90	26.74
2	Bank Guarantee	1660.00	73.26
	Total Capital	2265.90	100.00

Though, the Inspection Report stated that the stipulated ratio of bank guarantee and cash/fixed deposit should be 50:50, the Enquiry Officer observed that the same should be 70:30 and going by the same the stock broker's cash/fixed Deposit proportion was below 30% in the additional capital. This is found to be in violation of SEBI Circular No. SMDRP/POLICY/CIR-19/99 dated July 02, 1999.

52. However, I do not find any stipulation that the minimum cash component of the additional capital shall be 30% in the SEBI / Stock Exchange Circulars as applicable for the year 2000. There is neither any BSE Circular nor a SEBI Circular mandating such requirement. Though there is a reference made to SEBI Circular No. SMDRP/POLICY/ CIR-19/99 dated July 02, 1999 it is silent as to the proportion of bank guarantee and cash component in additional capital. In a subsequent SEBI Circular No. SEBI/SMD/SE/Cir-22/2003/11/06 dated June 11, 2003, I find the following mandate:

“Sub :- Composition of Capital and Margins

The SEBI Circular no SMDRP/Policy/Cir-19/99 dated July 02, 1999 specifies the additional capital required to be deposited in the form of cash, fixed deposit receipts (FDRs), bank guarantees and securities. Presently the cash component of additional capital and margins is specified as 30%. The issue of composition of additional capital and margins has been discussed by the Advisory Committee on Derivatives and Market Risk Management and based on the deliberations of the Committee, it has been decided that the revised composition of additional capital and margins and the eligibility criteria for securities shall be as follows:-

1. Cash and non-cash component of additional capital and margins

- 1. The minimum cash component of the additional capital and margins shall be increased from the existing level of 30% to 50 %.*
- 2. The cash component of additional capital and margins shall be increased to 50% in a manner so that this is complied with by the member brokers of the Exchange by the end of June 2003.....”*

It could be observed that the Circular referring to 30 % is the one pertaining to the year 2003 and since the alleged irregularity was observed in the year 2001 the Enquiry Officer's finding is irrelevant in the current case. In view of the above, I am inclined to give a benefit of doubt to stock broker with regard to the aforementioned charge.

53. The stock broker vide its written submissions dated April 21, 2006, has stated that the alleged irregularities are only in respect of a few transactions of an aggregate gross turnover or approximately Rs.289 crore and the irregular

transactions therefore worked out to only 1.09% of the total turnover. The submission of the stock broker is not acceptable as it is the nature of the irregularities which is taken into account rather than the volume of the trades undertaken. The stock broker has further submitted that the subsequent BSE inspection in the financial year 2003-04 had found only four irregularities with the broker. As per the said Inspection Report of BSE dated August 19, 2004, the stock broker has committed the following irregularities:

- a) Contract notes issued were not in accordance with the format prescribed by the Exchange;
- b) In certain cases, 'OWN' trades were marked as 'CL' instead of 'OWN' and the stock broker has entered its own client code;
- c) Clients funds were not routed through designated 'Client Account';
- d) Stock broker had borrowed monies on short/long-term basis from RCL.

In this regard, I note that the stock broker had not rectified the irregularities even after three years from the date of inspection by the Inspecting Authority. Most of the irregularities observed in the BSE inspection are the same which were found by the Inspecting Authority. The broker came to know about these irregularities in 2001 itself as SEBI had forwarded the Inspection Report to the broker vide letter dated April 03, 2001. Even after taking note that SEBI has leveled these serious charges against the stock broker, it is surprising to see that the broker continued with the very same irregularities till March 2004 and until it was pointed out again by the BSE's inspection. Though, the stock broker has clarified the same to BSE, it is obvious from the conduct of the stock broker that it was overtly negligent in complying with the regulations.

54. The stock broker has contended that during the relevant time it was apparently a wholly owned subsidiary of RCL which was an inhouse broking firm and several transactions alleged to be irregular are on behalf of or concerning RCL. If the said contention of the stock broker is considered, it will have the colour of proprietary trades of the stock broker and the same will go

against the stock broker where most of the trades are in the shares of Reliance group itself. The fact that the irregular transactions are on behalf of the holding company, trades are in the shares of its own group companies and irregular transactions leading to a finding of violation under PFUTP Regulations will have a new dimension to the case. Therefore, I find the same as an irrelevant consideration as far as the findings of the present case are concerned.

55. The stock broker has submitted that no loss or prejudice to any client has been caused and no profit, gain or advantage is accrued to the stock broker. These submissions of the broker are irrelevant considerations in the present case as the aforesaid factors constitute a violation of the applicable provisions of law.

56. The stock broker has contended that the violation of Regulation 6(b) of the PFUTP Regulations is not reasonably established.

I have gone through the above regulation 6 (b) which provides as under:

*“6. No person shall –
(b) On his own behalf or on behalf of any person, knowingly buy, sell or otherwise deal in securities, pending the execution of any order of his client relating to the same security for purchase, sale or other dealings in respect of securities.
Nothing contained in this clause shall apply where according to the clients instruction, the transaction for the client is to be affected only under specified conditions or in specified circumstances;”*

Whenever, the stock broker bunches orders for sale or purchase of securities the following factors are implicit:

- i) There is an already existing order by a client;
- ii) There is a subsequent order in the same scrip by another client or by same client;
- iii) The stock broker is fully aware of the fact that there is an order already pending and the subsequent order is in the same scrip

and the said information enables the stock broker to bunch the orders;

- iv) The order which is prior in time is pending execution compared to the order later in time;
- iv) The order which is prior in time was pending execution.

There are two interpretations possible: one is that the order was pending execution where 'time' is taken as the deciding factor. In the alternate, if 'actual execution' is taken as the deciding factor, the order was not pending execution where the order which is prior in time and which is later in time are executed simultaneously. However, there is a mandate that the broker has to execute the order 'as and when' it is received which makes 'time' the deciding factor rather than actual execution of the order. Therefore, the last requirement of regulation, i.e. pending execution of the order is met and the stock broker is guilty of violation of Regulation 6(b) of the PFUTP Regulations.

57. The stock broker has admitted that there are seventeen such instances where an average rate for day was charged to clients for whom transaction in any one scrip had been carried on that day. In this regard, the contention of the stock broker that there is no scope for invoking Clause A (3) of the Code of Conduct is unacceptable. Clause A (3) reads as under:

“(3) Manipulation: A stock broker shall not indulge in any manipulative, fraudulent or deceptive transaction or schemes or spread rumors with a view to distorting market equilibrium or making personal gains.”

As already referred in paragraph 32 above, there is detailed finding of the Enquiry Officer with regard to the infringement of Clause A(3). I find the following relevant points which establish the violation of Clause A(3) :

- a) *It defies the normal price discovery system of the exchange since each order, its time and the volume are crucial factors in deciding the demography of the market when collectively taken, and therefore the conduct of the stock broker had distorted the market equilibrium. Though, the same is not evident apparently, beyond doubt it is obvious that the price of the scrip will be distinct if ten sell or purchase orders are executed for 100 shares at different points of time in a day compared to sale or purchase of 1000 shares of the same scrip at a single point in a day;*
- b) *Clients are charged with higher or lesser prices than the market price and also the order 'price';*
- c) *non-use of client ID makes the transaction fraudulent as there is a chance that the broker can make it his proprietary trade if found profitable, and in such a case transaction is deceptive. There is no necessity to show that the actual deceit has occurred as per the language of Clause A(3);*
- d) *Contract notes issued by the stock broker do not show the actual price at which the trade was executed and it obliterates the very purpose of a contract note.*

58. The stock broker has contended that imposing a major penalty, 6 years after the irregularities are alleged to have taken place and several years after the procedural lapses have been corrected is meaningless and not in the interest of securities market. With regard to this contention, I find that the period of inspection was April 03, 1999 to November 26, 2000 and the show cause notice for the stock broker's comments was issued on April 03, 2001. However, as the stock broker held that it had not received the Inspection Report, the Inspection Report was sent to it again on August 13, 2001. I find that the stock broker had requested SEBI to provide extension of time to comment on the Inspection Report till end of September 2001 and certain circulars which were available at SEBI website during the relevant period. I note that the stock broker submitted its comments on the findings of the

Inspection Report only in April 19, 2002 i.e. almost one year after it was asked for the comments. On analysis of the comments of the stock broker an Enquiry Officer was appointed. The Enquiry Officer issued a show cause notice dated May 30, 2003 and stock broker replied to the SCN on June 22, 2003. The Enquiry Officer submitted his report on November 18, 2003. Subsequently, a show cause notice under Regulation 13(2) of the said regulations was issued to the stock broker on December 10, 2003. The stock broker sought an extension of time to reply to the said show cause notice on January 14, 2004 and submitted its reply on January 21, 2004. Further, as per the request of the stock broker, personal hearing was granted to it before the then Whole Time Member on March 25, 2004. The stock broker filed written submission on August 19, 2004 and September 13, 2004. However, due to the change in the competent authority, the order could not be passed. Therefore, in accordance with the principles of natural justice, the stock broker was given another opportunity of hearing before me on April 07, 2006 and it filed written submissions on April 27, 2006. Going by the process indicated above and the dates mentioned above, I do not find any inordinate delay in passing the order though it is true that the order is being passed after a period of 6 years of the actual event. Delay in passing the order cannot be however considered as a mitigating factor where no interim sanction is imposed on the stock broker's activities during the pendency of proceedings.

59. The stock broker has further relied upon the judgment of the Hon'ble Securities Appellate Tribunal in UBS Securities Asia Ltd Vs SEBI, where the stress was on sections 11B & 11(4) of the SEBI Act, 1992 . However, the proceedings here are under Regulation 13(4) of the said regulations. Section 11 read with Section 11(4) is normally interim in nature as against intermediaries, but in the regulations envisage a specific penalty upon detailed enquiry and conclusive finding of guilt of the intermediary. Similarly, the stock broker has contended that the Section 15 J factors are applicable to the instant proceedings. I do not find any merit in the said contention of the stock broker due to reason that adjudication proceedings under Section 15-I

of the SEBI Act, 1992 does not prohibit any person's recognised right to operate in the securities market whereas the said regulations restrict or take away such right. Likewise, finding of guilt in adjudication proceedings results in a monetary liability on the defaulter where as finding of guilt results in imposition of minor or major penalty under the said regulations. Apart from this, Section 15 J is meant for the purposes of Chapter VIA of the SEBI Act, 1992 as it is clear from the language of the said section which is as under :

"15J.Factors to be taken into account by the adjudicating officer :

While adjudging quantum of penalty under section 15, the adjudicating officer shall have due regard to the following factors, namely:

- a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;*
- (b) the amount of loss caused to an investor or group of investors as a result of the default;*
- (c) the repetitive nature of the default."*

60. I find from the above that the stock broker is guilty of most of the violations alleged against it in the show cause notice. As per the submissions made by the stock broker some of the irregularities have been rectified. However, I find that the stock broker has committed some serious violations such as, artificial pricing of trades, omission in mentioning relevant entries in contract notes, conversion of own trades to client trades, omission in mentioning of client ID for execution of trades, consolidation of client orders, unfair trade practices in violation of Regulation 6(b) of PFUTP Regulations, etc. Artificial pricing of the trades, for example, has destroyed the sanctity of the contract notes, the prime evidence of transactions in the secondary market. Besides, the fact that most of the relevant entries in the contract notes have been omitted defies the purpose of Stock Exchange trading wherein price of the scrip is determined by the market forces. Whereas, in this case the stock broker himself decided what price it should pass on to its clients on the basis of contract notes prepared to suit its conveniences. This kind of unfair trade

practices cannot be in normal course viewed with any leniency where stock broker took over the role of Stock Exchange in determining the price of the scrip. In view of the above, I find that this is a fit case for imposition of a penalty.

61. Taking into consideration the facts and circumstances of the case, and considering that there are a few violations which are technical in nature where some of them have been rectified, I am inclined to reduce the penalty from nine months to four months. I, therefore, in exercise of powers conferred under upon me in terms of Section 19 of SEBI Act, 1992 read with Regulation 13(4) of the said regulations, hereby impose a major penalty of Suspension of Certificate of Registration on Reliance Share and Stock Broking Private Limited, Member of BSE, NSE, CSE, VSE, Bg.SE, ASE and OTCEI having Registration Numbers INB010607538, INB230607532, INB030607534, INB190607530, INB080607533, INB020634735 and INB200607538 respectively in the aforesaid Stock Exchanges for a period of four months.
62. This order shall come into force on the expiry of twenty one days from the date of this order.

Place: Mumbai

Date: December 11, 2006

T.C. Nair

Whole Time Member

Securities and Exchange Board of India