

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA**CORAM: Dr. T.C.NAIR, WHOLE TIME MEMBER****IN THE MATTER OF M/S. TOSS FINANCIAL SERVICES PVT. LTD. MEMBER OF NATIONAL STOCK EXCHANGE, INB
230760236**Date of hearing : 26th September 2006*Appearances :*

For Noticee : Shri M.Z. Rehman, Managing Director, Toss Financial Services Pvt. Ltd.

For SEBI : Shri P.K.Bindlish, General Manager

Shri Atul Agrawal, Manager

Ms. Kshama Chavan, Legal Officer

ORDER**(UNDER REGULATION 13(4) OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 AGAINST M/S. TOSS FINANCIAL SERVICES PVT. LTD. INB 230902537, MEMBER, NATIONAL STOCK EXCHANGE INDIA LIMITED IN THE MATTER OF M/S MOREPEN HOTELS LIMITED.****1.0 Background**

- 1.1 Morepen Hotels Ltd. (hereinafter referred to as "MHL") came out with a public issue at a premium of Rs. 20/- per share in December 1995. The scrip was listed at Jaipur Stock Exchange, Ludhiana Stock Exchange, (LSE), Delhi Stock Exchange, (DSE), National Stock Exchange (NSE) and Bombay Stock Exchange Limited, (BSE).
- 1.2 Securities and Exchange Board of India (hereinafter referred to as "SEBI") conducted an investigation into the trading of the scrip of MHL for the period June 2000 to December 2000 (hereinafter referred to as "investigation period"). During the period of investigation, it was observed that the scrip of MHL was traded only at NSE and BSE.
- 1.3 There was a spurt in the total volume of the scrip of MHL at BSE. It was observed that during the one year period of August, 1999 to July, 2000, the total volume traded at BSE was 74,700 shares, as against 18,82,200 shares during the period August-December, 2000. The average quantity traded during August 1999 – July 2000 was in the range of 100-2800 shares per day, as against which the average quantity traded during August-December, 2000 was in the range of 18,000 to 25,000 shares per day.
- 1.4 Similarly, at NSE, the volume of the scrip during May-August, 2000, were in the range of 200 to 500 shares and the scrip was infrequently traded. However, after August 25, 2000, the volume in the scrip went up manifold and was in the range of 18,000 to 25,000 shares per day. During the period August 2000 – December 2000, the average trading volume at NSE was approximately 22,000 shares per day.
- 1.5 The price of the share at BSE, which was Rs.193.30 as on August 25, 2000, rose to Rs. 264.25 on September 8, 2000 and fell to Rs. 138.95 on November 27, 2000. A similar pattern was noticed at NSE also.
- 1.6 It was observed that the P/E ratio of MHL was not in synchronisation with the rest of the hotel industry. The rise in price and volumes observed during the investigation period did not appear to be justified based on fundamentals of the company. Further, investigation revealed that 80% of the total quantity traded during the investigation period was on account of a few brokers of BSE and NSE. It was found that ultimate clients had acted in concert through selected members and engaging themselves in circular trading in the scrip of MHL.
- 1.7 The investigation further revealed that most of these clients had not paid any margin to the brokers for the trades executed by them. Further they were squaring off their positions not only at the end of the settlement but almost on the same day. The delivery based business in the scrip during the investigation period was less than 1% of the total trading volume on the exchange. It was also observed that the same set of clients was trading at both the exchanges.
- 1.8 The combined quantity traded in the scrip of BSE and NSE by the clients mentioned in the table below during the period June 2000 to December 2000 was approximately 90% of the shares traded at both the exchanges taken together. The total quantity traded by these entities as per the information gathered during investigation is as under :

Sr.No.	Name of the Entity	Purchase	Sale	Gross
1.	M/s The Jem Fiscal Ltd.	10,37,800	10,32,001	20,69,801

2	M/s F.T.Trades	8,54,800	8,52,200	17,07,000
3.	M/s K.N. Trades	6,26,226	6,26,226	12,52,452
4.	M/s Prashant Investment	66,300	66,300	1,32,,600
5.	M/s K.P. Investment	5,94,900	5,95,300	11,90,200
6.	M/s S.M. Investment	3,04,000	3,04,000	6,08,000
7.	M/s N.N. Investment	3,65,500	3,65,500	7,31,000
8.	M/s Hakeem Auto Ltd	6,610	4,150	10,710
	Total	38,56,136	38,45,627	77,01,783

1.9 During the course of investigation, it was observed that most of the clients trading in the scrip were linked to each other. It was observed from the trading pattern that these clients were involved in circular trading in the scrip. These clients have entered into buy and sell transactions with each other, squaring up positions and reversing trades either on the same day or during the same settlements, making the net receivable/deliverable positions as either nil or shares of negligible quantities i.e about 100 to 200 shares. Thus, all the aforesaid clients had done transactions of fictitious nature, through different members of NSE and BSE and established /created artificial volumes in the scrip.

1.10 Toss Financial Services Pvt. Ltd. (hereinafter referred to as "Toss") is a member of NSE. Investigations revealed that Toss had traded in the scrip of MHL on behalf of M/s. Jem Fiscal Ltd., M/s. Prashant Investments and M/s. N. N. Investments from August 2000. All the aforesaid clients (masterminded by Jem Fiscals and Nazir Hakeem) have done transactions of fictitious nature through different members of NSE and BSE and established/created artificial volumes in the scrip thereby upsetting the market equilibrium industry.

2.0 Enquiry Proceedings

2.1 In view of the alleged irregularities committed by Toss, Chairman, SEBI vide order dated February 18, 2002 appointed an Enquiry Officer to enquire into the contravention/s alleged to have been committed by Toss while dealing the scrip of MHL. The Enquiry Officer issued a show cause notice vide letter dated March 20, 2002 to Toss for alleged irregularities.

2.2 Toss vide its letter dated May 6, 2002 replied to the show cause notice. An opportunity of personal hearing before the Enquiry Officer was given to Toss on November 28, 2002. On completion of the enquiry, the Enquiry Officer submitted the report dated April 30, 2004 to the Board recommending a minor penalty of suspension of certificate of registration of Toss for a period of two months.

3.0 Show Cause Notice and Reply

3.1 Subsequent to the submissions of the Enquiry Report, a show cause notice dated May 6, 2004 under Regulation 13 (2) of the SEBI (Procedure for holding Enquiry by the Enquiry Officer and Imposing Penalty) Regulations 2002 (hereinafter referred to as "Enquiry Regulations") was issued to Toss to show cause as to why appropriate penalty including penalty as recommended by Enquiry Officer should not be imposed on Toss. It has been alleged that the broker had failed to exercise due skill, care and diligence in its dealings with the clients therefore violated clause A (2) of Code of Conduct as laid down under Schedule II read with regulation 7 of Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as "Brokers Regulations"), which enabled the clients in indulging acts calculated to create a false and misleading appearance of trading in the scrip of MHL in violation of Regulation 4(b) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 (hereinafter referred to as "FUTP Regulations").

3.2 Toss vide its letter dated June 25, 2004 responded to the said show cause notice and *inter alia* made following submissions:

- (a) *Without prejudice to the findings of the Enquiry Officer, it is submitted that Regulation 13 (1) of Enquiry Regulations, 2002 came into force from September 27, 2002. The said provisions are not applicable to the present enquiry. The said Regulations under which Toss is directed to show cause is not maintainable as the said Regulations were not in force at the time when the said transactions were executed by Toss on behalf of their clients.*
- (b) *Toss had from the inception exercised due skill and care while dealing with their clients. The clients viz., Jem Fiscal Ltd., N.N. Investments & Prashant Investments were introduced by Shri Mayur Kadakia, Asst. Vice President, Enam Securities Ltd., who was personally known to Shri M. Z. Rehman, Director of Toss. Based on the introduction of Shri Kadakia, Toss had permitted the said three clients to commence trading in the securities. Further, all necessary documents were obtained by Toss from the said three clients.*
- (c) *It is submitted that Toss received the orders from their clients from time to time, it is pursuant to the aforesaid instructions, Toss had executed orders placed by the aforesaid clients in the normal course of their business.*
- (d) *Toss had earned a brokerage by executing transaction for the aforesaid clients which is the main activity of the company.*

- (e) The trades executed by Toss on behalf of the aforesaid clients works out to be insignificant i.e. around 15.5% when compared to the total volume of NSE.
- (f) Toss had earned the following brokerage over a period of six months of the trades done by the three clients in respect of MHL:

Clients Name	Amount
M/s Jem Fiscal Ltd.	Rs. 13036.00
M/s Prashant Investment	Rs. 696.80
M/s N.N. Investment	Rs. 30868.00

- (g) The orders were received by Toss from the representatives of the said clients. Toss was not obliged to know the association of Shri Prashant Shah with Jem Fiscal and M/s N.N Investment as observed by the Enquiry Officer. Toss was required to implement the instructions received from Jem Fiscal and M/s N.N. Investment in their usual course of business. Toss submits that there was no occasion for us to be suspicious of the dealings of the clients when they were regular in their pay-in obligations.
- (h) The clients were dealing in other scrips as well as such as Reliance Industries, TISCO and Morpen Laboratories. There was nothing suspicious in the conduct of the clients.
- (i) The clients promptly made payments and cleared their outstanding positions hence there was no occasion or any grievance with regard to the financial inability of the clients.
- (j) All the transactions put through by Toss were on behalf of the clients and there was no proprietary trading in respect of MHL. The occasion for requiring margin money to be deposited did not arise because the clients were squaring up the position between the settlements and were regularly clearing their dues. The issue about the initial margin money also did not arise having regard to the introduction made and the relatively small volumes in which the clients were initially dealing.
- (k) There were no problems with respect to pay-in or delivery of shares as such there was no occasion to be suspicious of the dealings of the clients.
- (l) Toss had no knowledge about any wrongful conduct of the clients and was not even aware whether Mr. Prashant Shah of M/s. Pranshant Investments and Mr. Narendra Navale of M/s. N N Investment were the employees of M/s. Jem Fiscal Ltd. Mr. Nazir Hakeem, Director, M/s. Jem Fiscal Ltd had instructed Toss to accept instructions form Mr. Prashant Shah for the purpose of executing transactions in securities. Mr. Narendra Navale of M/s. N N Investment had instructed Toss to accept orders from Mr. Prashant Shah for the purpose of executing trades in the account of M/s. N N Investment.

4.0 Personal Hearing

- 4.1 Due to change in competent authority, an opportunity of hearing was granted to Toss before me on September 26, 2006, wherein Shri M.Z. Rehman appeared before me and made submissions in brief.

5.1 Consideration of Issues

- 5.1 I have carefully considered findings of investigation, the Enquiry Report, show cause notice issued to Toss and the submissions made by it in response to the show cause notice.
- 5.2 At the outset, I have noted the contention raised by Toss regarding non applicability of provisions of the Enquiry Regulations as the same were not in force at the time when the transactions were executed by Toss on behalf of their clients. In this regard, it is to be noted that Regulation 23 of the Enquiry Regulations states as under:

"23(1) Notwithstanding amendment of the regulations as specified in regulation 21, anything done or any action taken including any proceeding for inspections or investigation or enquiry commenced or any notice issued under the said regulations before the commencement of these regulations shall be deemed to have been done or taken under the corresponding provisions of these regulations.

(2) In particular without prejudice to the generality of the provisions of sub regulation (1) :-

- (i) *an enquiry proceedings initiated by the Board under the relevant regulations and pending before the Board before the commencement of these regulations shall be conducted and completed under the relevant regulations as if those are not amended as specified in Regulation 21.*
- (ii) *any order appointing an enquiry officer under the relevant Regulations and pending before such enquiry officer immediately before the commencement of these regulations shall be deemed to have been ordered under the corresponding provisions of these regulations.*

The provision clearly states that anything done or any action taken including any proceeding commenced or any notice issued under the said Regulations before the commencement of these regulations shall be deemed to have been done or taken under the corresponding provisions of these regulations. The contention raised by Toss is devoid of merit and is therefore not maintainable.

- 5.3 I observe that the P/E ratio of MHL was not in synchronization with the rest of the hotel industry. Hence, neither the scrip price of MHL was justified based on the fundamentals of MHL nor the rise in volumes observed during investigation period is justified on any grounds. I note from investigation report that 80% of the total quantity traded during the period June 2000

- December 2000 was contributed by few brokers of the exchange and that the ultimate clients had acted in concert through selected members and thus were involved in circular trading.

5.4 From trading details collected from brokers of BSE and NSE, it was seen that some of the clients, who were linked/connected to each other in some way or the other were trading in the scrip both at BSE and NSE. They had enrolled as clients to both BSE and NSE members and traded simultaneously in the scrip of MHL during the investigation period. From the records obtained from different brokers of both the exchanges, it was observed that most of these clients had not paid any margin to the brokers for the trades executed by them. Further, they were squaring off their positions not only at the end of settlement but almost on the same day.

5.5 From the trading details supplied by the exchange, I observe that during the period 1st June 2000 and 31st December 2000 delivery based trading in the scrip of MHL was less than 1% of the total trading volume on the exchange. I find that during the period of investigations the total volume at both the exchanges BSE and NSE were almost same and had great degree of similarity both in prices and total number of shares traded per day. It was also observed that the same set of clients was trading at both the exchanges. I note that during the investigation period these related entities had purchased 2,82, 400 shares and sold 2,83, 000 totaling to 5,65, 400 shares details of which are given as follows in Table -2

Sr. No	Name of the client	Purchase	Sale	Net	Gross
1.	M/s. Jem Fiscal	84, 200	84, 200	0	1, 68, 400
2.	M/s. Prashant Investment	8, 200	8, 200	0	16, 400
3.	M/s. N N Investment	1, 90, 000	1, 90, 600	-600	3, 80, 000

As can be seen from Table -2, the clients together had purchased 2,82,400 shares, sold 2,83,000 shares which amounts to net of -600 shares and gross of 5,65,400 shares, which clearly shows that the clients were squaring off their position and thus did not have any genuine interest in the trading of the scrip of MHL. However, in the process of trading as shown in Table -2, the clients have created artificial volumes in the scrip of MHL.

5.6 I note that Toss in its reply dated June 25, 2004 submitted that it was unaware of trading done by their clients which had resulted in circular trade. The submission of Toss is not convincing, as its client along with the associates / entities connected with the client were trading in the scrip and more than 90% trading in the scrip was done by the clients along with the entities acting in concert. Further, the clients had shown no inclination of picking up or giving delivery and were trading in illiquid scrip. Toss should have been more diligent in its dealing especially when the clients was trading in illiquid scrip and squaring off positions on the same day without much profit or loss. Whatever trading was done by the clients, it was for the purpose of creating artificial trade in the scrip of MHL thus creating a misleading appearance of trading in the scrip of MHL.

5.7 I note that only few clients connected to each other were able to buy and sell with each other, squaring off positions and reversing trades either on the same day or same settlement, making the net receivables and deliverable positions either nil or in negligible quantities and created a false and misleading appearance of trading on the securities in the scrip of MHL. These clients had traded through certain brokers while indulging in manipulative practices and Toss was one of them.

5.8 The clients had traded only in the scrip of MHL which was illiquid scrip. The scrip had been made to appear liquid by putting artificial volumes and price by certain connected clients including the clients of the broker. Toss had allowed new client to trade in such scrip that too even without collecting margins. The clients had entered into speculative transactions without any genuine interest in giving or taking delivery of shares. Any prudent broker in such cases should doubt the intention of the clients and stop trading on its behalf. Unsuspected innocent investors would be trapped by such false appearance of trading in securities. This is detrimental to the interest of investors and the orderly development of the securities market.

5.9 From the reply of Toss, I note that, on the one hand Toss submitted that it did not have knowledge of the clients being related to each other and on the other hand submitted that Mr. Nazir Hakeem, Director, M/s. Jem Fiscal Ltd had instructed the broker to accept instructions from Mr. Prashant Shah for the purpose of executing transactions in securities. Mr. Narendra Navale of M/s. N N Investment had instructed Toss to accept orders from Mr. Prashant Shah for the purpose of executing trades in the account of M/s. N N Investment. This shows that Toss was aware that the clients were related to each other. Toss ought to have become suspicious as to why one entity authorizing someone else to place orders on their behalf and should have taken a look at the trading that was being done by the clients. Toss however, did not bother to do so which shows Toss had not shown due skill and care while dealing on behalf of the clients.

5.10 Being a registered intermediary, Toss is under obligation to be more diligent while dealing with clients, in which the broker failed in the instant case resulting in violation of Stock Brokers Regulations. The trading pattern of the clients should have alerted Toss and it ought to have taken adequate steps to defeat the trading strategy of the clients. Functioning of Toss calls into question the exercise of due diligence and more so its intention to comply with Stock Brokers Regulations in respect of due diligence, which is observed from the hands-off attitude of Toss.

- 5.11 I note that Toss submitted that the trading done by the clients was only 15.5% which was insignificant compared to the turnover of NSE. For illiquid scrip like MHL, it is substantial volume. It does have an impact on market creating artificial illusionary volumes. I also note that Toss submitted that it was only executing trades as placed by the clients. While I agree that the agent has to place order as per instructions of the clients, the question is what the broker did in its capacity as intermediary responsible in its own way for integrity of the market. Intermediaries which operate in the market are required to maintain high standards of integrity, promptitude and fairness in the conduct of the business dealings, which in this case Toss failed to do.
- 5.12 I note that the scrip of MHL has been made to appear liquid by creating artificial volumes and price by certain connected clients including that of the clients of the broker. These clients have entered into continuous speculative transactions without any genuine interest in giving or taking delivery of shares. This has resulted in creation of artificial volumes and price rise in the scrip which otherwise had no interest from the general investors. Toss should have been more diligent in its dealing especially when the clients were trading in illiquid scrip and squaring off their position on the same day without much profit or loss.
- 5.13 In view of the above, I am convinced that the broker has failed to exercise due skill and care in terms of Clause A(2) of the Code of Conduct prescribed for stock brokers, in Schedule II in terms of Regulation 7 of Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 which enabled the clients in indulging acts calculated to create a false and misleading appearance of trading in the scrip of MHL in violation of Regulation 4(b) of the said regulations.
- 5.14 However, I have also noted that Toss did not have any proprietary trades in the shares of MHL and there was no connection with the clients. Given the above context, I am of the view that suspension of certificate of registration granted to the said broker, for a period of two months, would be excessive. Considering the circumstances, imposition of penalty of censure, would be adequate to meet the ends of justice.

6.0 Order

Therefore, in exercise of the powers conferred upon me by virtue of Section 19 read with Regulation 13(4) of SEBI (Procedure For Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby "Censure" M/s Toss Financial Services Pvt. Ltd., Member of NSE. I also direct Toss to note that any instances of violations or non-compliance of the provisions of Securities and Exchange Board of India Act and the Rules and Regulations framed thereunder, in future, shall be dealt with stringently.

Date: 21.05.2007

Place: Mumbai

T.C. Nair
Whole Time Member
Securities and Exchange Board of India