

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

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

IN THE MATTER OF M/S. SHREEPATI HOLDINGS & FINANCE PVT. LTD., MEMBER OF NATIONAL STOCK EXCHANGE INDIA LIMITED,
INB 230639031

Date of hearing : 26th September 2006

Appearances :

For noticee : Mrs. Kanan Sheth, Director, Shreepati Holdings &
Finance Pvt. Ltd.

Shri Pramod Goyal, Executive, Shreepati Holdings & Finance Pvt. Ltd.

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

Shri Atul Agrawal, Manager

Ms. Kshama J. 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. SHREEPATI HOLDINGS & FINANCE PVT. LTD, INB 230639031, MEMBER, NATIONAL STOCK EXCHANGE IN THE MATTER OF TRADING OF THE SCRIP 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 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 Shreepati Holdings and Finance Pvt. Ltd. (hereinafter referred to as "Shreepati") corporate member of National Stock Exchange India Limited (hereinafter referred to as "NSE") has traded in the scrip of MHL on behalf of M/s. F T Traders and K. N. Traders. 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, thereby upsetting the market equilibrium in the scrip.
- 2.0 Enquiry Proceedings
- 2.1 In view of the alleged irregularities committed by Shreepati, Chairman, SEBI, vide order dated February 18, 2002 appointed an Enquiry Officer to enquire into the affairs of Shreepati. Enquiry Officer issued a show cause notice dated March 20, 2002 to Shreepati for the alleged irregularities.
- 2.2 Shreepati vide letter dated April 12, 2002 replied to aforesaid show cause notice. An opportunity of personal hearing before the Enquiry Officer was given to Shreepati on September 16, 2002. Pursuant to the personal hearing Shreepati submitted written submissions dated September 25, 2002 before the Enquiry Officer.
- 2.2 On completion of enquiry, Enquiry Officer submitted a report dated May 31, 2004 to SEBI recommending a minor penalty of suspension of certificate of registration of the broker for a period of two months.
- 3.0 Show cause notice and reply
- 3.1 Subsequent to the submission of the said Enquiry Report, a show cause notice dated June 3, 2004 was issued to Shreepati to show cause as to why appropriate penalty including penalty as recommended by Enquiry Officer should not be imposed upon it. 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 (Stockbrokers 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 In response to the said show cause notice, a reply dated July 2, 2004 was received from Shreepati submitting inter alia as under:
- (i) *Shreepati was not aware of the dealings of their constituents in the scrip of MHL with other brokers of the exchange. Shreepati submitted that their constituents never informed them of their dealings with the other brokers viz. Ceekay Holdings Pvt. Ltd.*
- (ii) *As regards the allegation that Shreepati has allowed new clients to trade without collecting requisite margins it is submitted that during the investigation period, only two clients traded viz., FT Traders and KN Traders. As far as M/s. KN Traders are concerned margin of Rs. 15,000 was initially collected from them which was more than adequate in view of the nature and extent of transactions being executed through their clients. In addition to this, KN Traders held a credit of Rs. 1,23,000. Therefore, the allegation against KN traders does not survive. As far as FT traders are concerned they had given margin cheques as security to be deposited only if pay-in/pay-out was not met by them which was margin itself. Therefore the question of collecting margin did not arise and cheques were handed over only on net positions.*

- (iii) *It is denied that the clients have entered into continuous speculative transactions without any genuine interest in giving or taking delivery of shares which resulted in creation of artificial volumes and price rise in the scrip. It is submitted that the proportion of their clients' turnover and the turnover on the exchange was very low.*
- (iv) *There was no question of interest being aroused in general investors through such artificial trades since the holding in the scrip was very low i.e. less than 4% i.e. 1 lac floating shares.*
- (v) *Shirpati has acted as broker on behalf of their clients and carried out their instructions, issued contract notes raised bills as required by law and have discharged all their obligation as required by them as a broker. Therefore, it is denied that there was a lack of due diligence on the part of their clients.*
- (vi) *It is submitted that on September 11, 2000, the price was at its peak i.e. Rs. 285 and fell to Rs. 154 on November 15, 2000. It is seen that if there was a circular trading or occasion to manipulate the market, then parties would have ensured that the price would be dropped or if there was genuine dispute, the same would be with a view to make profits. In the present case their clients, M/s. FT Traders have made net loss of Rs.51,461 where as M/s. KN Traders have gained a negligible profit of approx. Rs.18000. In these circumstances in the fact of negligible figure such allegation cannot be sustainable.*

4.0 Personal Hearing

- 4.1 An opportunity of hearing was granted to Shreepati before me on September 26, 2006 wherein Mrs. Kanan Sheth, Director, and Shri Pramod Goyal, Executive were present and made submissions as under :
- 4.2 Vide letter dated September 26, 2006, the broker made the following submissions:
 - (i) *Out of 9 entities, Shreepati dealt with 2 entities viz., M/s. K N Traders and M/s. F T Traders and no money was receivable by them inspite of big volumes in shares like TISCO, Satyam, Sterlite, Himachal Global Tele etc. which shows the financial strength of the clients.*
 - (ii) *It is difficult to know the other brokers positions for particular scrips, past future volumes, past / future price, clients position with other brokers.*
 - (iii) *They have daily turnover of Rs.100 crores and the turnover of MHL is approx. Rs.20 to 30 lakhs which is below 1% of our daily turnover.*
 - (iv) *Their client M/s. F T Traders has lost Rs.51,461 in jobbing and M/s. KN Traders have made profit of Rs.18,998.*
 - (v) *There was neither any profit nor loss made by the clients, nor major debit or credit in their account. Further no default was made by the clients and regular cheques were received from their client viz., M/s. F T Traders and credit balance in account of M/s. K N traders.*
 - (vi) *They do not have any connection with the client and that how they are supposed to know if client hides facts and misrepresents things. Further it stated that with regard to allowing the clients to deal in illiquid scrip, there are no guidelines in place which guide a broker in what conditions they should accept the order from the clients or reject for illiquid scrip. If brokers refuse to enter sauda for illiquid scrip, they feel that this may be against the interest of the investors.*
 - (vii) *There are no guidelines in place which guide a broker in what conditions they should accept order from the clients or reject for illiquid scrip. If brokers refuse to enter sauda for illiquid scrip, then that is against the interest of the investors.*

5.0 Consideration of issues and findings

- 5.1 I have carefully considered findings of investigation, the Enquiry Report, show cause notice issued to Shreepati and the submissions made by Shreepati in response to the show cause notice and my findings are as under:-
- 5.2 I find that the price of MHL was not justified either based on fundamentals of MHL or on price earning ratio of the rest of the hotel industry. Besides the rise in volumes observed during the investigation period was not justified on any grounds. I have noted that 80% of the total quantity traded during the period of June 2000 to December 2000 was contributed by few brokers of the exchange and that their ultimate clients had acted in concert indulging in circular trading.
- 5.3 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 at both 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 found 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 on the same day.
- 5.4 From the trading details supplied by the exchanges, I find that during the period of investigation the delivery based trading in the scrip of MHL was less than 1% of the total trading volume. Further, the total volume at both the exchanges, BSE and NSE were almost the same and had 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. Further I agree with the finding of the Enquiry Officer that almost all the transactions were squared off with negligible portion of the purchases resulting in delivery and that the client was squaring off the positions at the end of each settlement.
- 5.5 I note that Shreepati in its reply dated July 2, 2004 submitted that it was unaware of trading done by the clients which had resulted in circular trading. The submission of Shreepati is not convincing, as its client along with the associates / entities connected with the client was 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. Shreepati should have been more diligent in its dealing especially when the clients were 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.

5.6 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 creating 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 Shreepati was one of them.

5.7 The clients had traded in the scrip of MHL which was illiquid scrip. The scrip had been made to appear liquid by putting artificial trades by certain connected clients including the clients of Shreepati. Shreepati has allowed new client to trade in such scrip that too even without collecting requisite 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 would have been more diligent. Unsuspected innocent gullible 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.

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

5.9 However I note that Shreepati did not have any proprietary trades in the share of MHL. I also note that Shreepati had submitted that it had no connection with the clients, were not aware about their act and were only executing trades as placed by their clients. Given the above context, I am of the view that suspension of certificate of registration granted to Shreepati, 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 Shreepati Holdings & Finance Pvt. Ltd., Member of NSE. I also direct Shreepati to note that any instances of violations or non-compliance of the provisions 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