

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 28(2) OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATION, 2008 AGAINST M/S. P.K. KHANNA & CO. IN RESPECT OF ITS DEALING IN THE SHARES OF CLASSIC GLOBAL IMPEX LIMITED (NOW KNOWN AS DEVINE IMPEX LIMITED)

Date of Hearing: November 26, 2009

Appearance:

For M/s. P.K. Khanna & Co.: Mr. Pardeep Kumar Khanna, Proprietor

For Securities and Exchange Board of India: Mr. Amarjeet Singh, Chief General Manager
Mr. Vijayakrishnan G., Deputy Legal Adviser
Mr. Rakesh Bhanot, Assistant General Manager
Mr. T. Vinay Rajneesh, Legal Officer

1. The Securities and Exchange Board of India (hereinafter referred to as SEBI) had conducted investigations into the dealing in the shares of Classic Global Impex Limited, now known as Devine Impex Limited (hereinafter referred to as the company) for the period 1997-1999 pursuant to an appraisal report from the Income Tax Department in respect of their 'search and seize' operation on June 24, 1999 at the premises of the company, its Managing Director, Mr. Nagesh Agarwal and other related entities including M/s. Neeraj Agarwal & Co. (now known as M/s. Aniket N Agarwal). The said report from the Income Tax Department mainly focused on ascertaining capital gains/losses engineered by various entities through certain members of The Ludhiana Stock Exchange Limited (hereinafter referred to as LSE) while transacting in the shares of the company. The findings of SEBI revealed that the shares of the company were

illiquid at LSE during 1997 to 1999 and that, few stock brokers including M/s. P.K. Khanna & Co. (hereinafter referred to as the Broker) had contributed significant volumes in the shares of the company during the investigation period. It was found that shares shown to have bought at Rs.2/- to Rs.3/- were then shown to have been sold at Rs.30/- to Rs.35/- indicating capital gains which were used by the trading clients to set off losses. The stock brokers including the Broker were alleged of providing dummy contract notes with distinctive numbers without any trades actually entered into by them, against commission from the clients. It was also alleged that such fictitious contract notes were used by the clients to claim capital gains/losses from the Income Tax Department. On the basis of the findings of the investigation, it was alleged that the Broker facilitated the clients by issuing fictitious contract notes and thereby failed to maintain high standards of integrity and fairness in the conduct of its business, *prima facie* in violation of Clause A(1) of the Code of Conduct for stock brokers specified under Schedule II of Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 (hereinafter referred to as the Stock Brokers Regulations). In view of the above, SEBI, vide order dated June 17, 2004 read with subsequent orders dated July 19, 2007, January 30, 2008 and August 7, 2009 appointed an Enquiry Officer under the provisions of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (since repealed) to enquire into the alleged violations committed by the Broker. The Enquiry Officer submitted his report dated October 30, 2009 in terms of the provisions of Securities and Exchange Board of India (Intermediaries) Regulations, 2008 and while finding the Broker guilty of contravening Clause A(1) of the Code of Conduct for stock brokers prescribed under Schedule II of the Stock Brokers Regulations, recommended that the certificate of registration of the Broker be suspended for a period of one month.

2. Thereafter, SEBI, vide notice dated November 10, 2009 advised the Broker to show cause as to why the penalty as recommended by the Enquiry Officer should not be imposed against it. A copy of the Enquiry Report was also forwarded to the Broker along with the show cause notice. However, the Broker failed to submit its reply. An opportunity of hearing was also granted to the Broker by SEBI on November 26, 2009. Mr. Pardeep Kumar Khanna, Proprietor of the Broker appeared before me and submitted that the Broker had issued the contract notes in exchange for commission. He further submitted that the proceedings before the Income Tax Department has been disposed of and requested to take a lenient view in respect of the violations committed by the Broker.

3. I have considered the Enquiry Report, the show cause notice issued to the Broker, the submissions made on behalf of the Broker and other material available on record. The only charge against the Broker is that it had failed to maintain high standards of integrity and fairness in the conduct of its business while dealing in the shares of the company and thereby violated Clause A(1) of the Code of Conduct for stock brokers specified under Schedule II of the Stock Brokers Regulations. It was alleged that some of the stock brokers (including the Broker) had issued contract notes for fictitious entries to enable certain entities/entities to claim capital gain benefit. It was observed that during the period 1997-1999, the shares of the company were illiquid. However, certain stock brokers including the Broker showed trading of thousands of shares of the company for certain entities. It was observed that the said clients had shown to have purchased the shares at Rs. 2/- to 3/- and then sold at Rs. 30/- to Rs. 35/- to enable them to claim capital gain. It was noted that one Naresh Kumar having his address at R/o 183-A, Aggar Nagar, Ludhiana was one of the persons who got the capital gain of approximately Rs. 15,00,000/- on the shares of the company, through fictitious transactions and the said amount was

utilized by him for the construction of a house in the same locality and for the purpose of claiming exemption under Section 54F of the Income Tax Act, 1961. It was observed by the Enquiry Officer that the said details were mentioned in the show cause notice and were not denied by the Broker. The Enquiry Officer had also observed that Mr. Naresh Kumar had admitted before the Income tax Department that he had purchased 42,000 shares on January 20, 1998 and 38,000 shares on April 21, 1998 @ Rs. 2/- to Rs. 2.50/- per share and received the purchase bills from the stock brokers M/s S. K. Sharma & Co. and M/s Ashok Makkar & Co., in which the shares of the company were shown to have purchased in his name. Mr. Naresh Kumar further stated that, he never got the physical deliveries of the said shares as it was mere adjustment entries. According to him, out of the above mentioned shares, 42,000 shares were sold on March 15, 1999 and 22,300 shares were sold on April 26, 1999 and May 18, 1999 for Rs. 25/- to Rs. 28/- per share. He stated that for the abovementioned sale, he had *inter alia* received sale bill from the Broker in respect of 42,000 shares. It was also observed in the Enquiry Report that one of the clients of the Broker (Mr. Praveen Kumar Jagota) who was allotted 4,44,000 shares in the public issue of the company had sold those shares and received Rs. 12,67,110/- from the Broker. It was found that the copies of the contract note and bill issued by the Broker in respect of sale of 2,60,000 shares by the said person (to one Ashok Kumar Gupta) were found from the business premises of the stock broker viz. M/s Neeraj Aggarwal & Co, during the course of search by the Income Tax Department on June 25, 1999. It was also observed that the representative of the Broker had admitted before the Income Tax Department that the contract notes and bills found during the above mentioned search, were issued by the Broker. The Broker further stated before the Income Tax Department that it had received the payment in cash in respect of the aforementioned sale transaction, but could not produce any details. I also note that during the course of investigation, SEBI had confronted the Broker with the

contract notes issued by it to Mrs. Jagdish Kaur and Mrs. Parveen Lata Aengrish, wherein they were shown to have earned profits out of certain transactions. Mrs. Jagdish Kaur earned a profit of Rs 2,03,896 on an investment of Rs 25,256 over 37 days (She bought 7,700 shares of the company at Rs.3.28/- on February 2, 1998 and sold them at Rs.29.76/- on March 10, 1998). Similarly, Mrs. Parveen Lata Aengrish earned a profit of Rs 71,760 on an investment of Rs 5,750 over 68 days (She purchased 2,300 shares of the company at Rs.2.50/- on January 20, 1998 and sold them at Rs.33.70/- on March 27, 1998). Being one of the key intermediaries of the securities market, a stock broker should not have involved itself in such serious irregularities. The Broker had issued contract notes without executing the trades to enable certain persons to claim capital gain benefit. The proprietor of the Broker has not denied the allegations leveled against it and submitted that the Broker had issued such contract notes. Such act of the Broker cannot be justified and deserves severe condemnation. As a stock broker, it should have maintained high standards of integrity and fairness in its dealings. The Broker had failed and failed miserably to adhere to such basic principles and thereby violated Clause A(1) of the Code of Conduct for stock brokers specified under Schedule II of the Stock Brokers Regulations. Such transgressions do not merit any leniency and such market participants should be penalized in accordance with law.

4. The Enquiry Officer had given detailed findings in respect of the allegations leveled against the Broker. The copy of the Enquiry Report was forwarded to the Broker who was advised to furnish its submission in respect of the same. The representative of the Broker admitted before me that the Broker had issued the contract notes just for obtaining certain commission. For the reasons stated above in this order and also the fact that the Broker has not taken any steps to controvert the findings of the Enquiry Officer, I do not have

any reason to disagree with the findings and recommendation of the Enquiry Officer. I note that the present case has been initiated under the provisions of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002. Since, the said Regulations were repealed with effect from the notification of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008, this order is being passed under the corresponding provisions of the Securities and Exchange Board of India (Intermediaries Regulations), 2008. The present proceeding is thus disposed of as ordered herein below.

5. In view of the foregoing, I, in exercise of the powers conferred on me in terms of Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulation 28(2) of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, hereby, suspend the certificate of registration of the stock broker namely, M/s P. K. Khanna & Co. (Registration no. INB 120592219), Member, Ludhian Stock Exchange Limited, for a period of one month.

6. This order shall come into force immediately on the expiry of twenty one days from the date of this order.

DR. K. M. ABRAHAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place: MUMBAI

Date: NOVEMBER 30, 2009