

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: V. K. CHOPRA, WHOLE TIME MEMBER

ORDER

[Against M/s The First Custodian Fund (I) Ltd., Broker, National Stock Exchange Under Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 in the matter of Ranbaxy Laboratories Limited]

1.0 BACKGROUND

- 1.1 Ranbaxy Laboratories Ltd. (hereinafter referred to as “Ranbaxy”) was incorporated in June 1961 as a private limited company. The company is engaged mainly in the business of manufacturing and marketing of pharma products. The price of the scrip of Ranbaxy moved up significantly from Rs.270/- in January 1999 to about Rs.1200/- in October 1999 accompanied by significant increase in volumes. Considering the above major spurt in price and volumes traded in the Exchanges particularly on the Stock Exchange, Mumbai (BSE), National Stock Exchange (NSE), Calcutta Stock Exchange (CSE) and Delhi Stock Exchange (DSE), Securities and Exchange Board of India (hereinafter referred to as “the Board”) had conducted an investigation into the dealings of several entities and brokers including M/s The First Custodian Fund (I) Ltd., a member (hereinafter referred to as “the Broker”) of NSE bearing SEBI Registration no. INB230638130 in the shares of Ranbaxy.
- 1.2 The Board after considering the Investigation Report, appointed an Enquiry Officer vide Order dated November 29, 2002 to enquire into the violations of the provisions of Regulation 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995 (hereinafter referred to as “PFUTP Regulations”) Regulation 7 read with clause A(3) and (4) of the

Code of Conduct for Stock Brokers as specified in Schedule II of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to in short as “Stock Brokers Regulations”), SEBI Circular dated September 14, 1999 and Rules, Regulations and Bye-laws of Stock Exchanges.

- 1.3 The Enquiry Officer, after conducting an enquiry in accordance with the provisions of Regulation 6 of the Securities and Exchange Board of India (Procedure for holding Enquiry by Enquiry Officer and imposing penalty) Regulations, 2002 (hereinafter referred to as “Enquiry Regulations”) submitted a report dated September 10, 2003 wherein he observed that the Broker violated the provisions of Regulation 7 read with clause A(3) and (4) of Code of Conduct as specified in Schedule II of Stock Broker Regulations, Regulation 4(b) & (c) of SEBI PFUTP Regulations, SEBI circular No.SMDRP/POLICY/CIR-32/1999 dated September 14, 1999 and Regulation 4.6.2 of NSE Capital Market Regulation. He recommended suspension of registration of the Broker for a period of four months.

2.0 SHOW CAUSE NOTICE

- 2.1 Pursuant to the receipt of the said enquiry report, a show cause notice dated September 23, 2003 was issued to the Broker, along with a copy of the said Enquiry Report, advising it to show cause as to why the action, as recommended by the Enquiry Officer should not be imposed on it. The Broker submitted its reply to the said show cause notice, vide letter dated October 07, 2003.

3.0 REPLY OF THE BROKER

- 3.1 The Broker submitted that the subject Show Cause Notice is bad in law and ultra vires the SEBI Act and Regulations. The said Show Cause Notice contravenes the provisions of Regulation 13(2) of Enquiry Regulations. The said regulation specifically provides that, on receipt of the report from Enquiry Officer, only the

Chairman or the member as the case may be, shall issue Show Cause Notice. The said duty cast on the Chairman / member cannot be delegated. Since the subject Show Cause Notice has been issued by the Division Chief (Integrated Surveillance Dept), same is bad in law.

- 3.2 The Broker submitted that they had not violated the provisions of Regulation 4(b) and (c) of PFUTP Regulations and Regulation 4.6.2 of NSE Capital Market Regulations as well as Regulation 7 read with Clause A(3) and (4) of Code of Conduct as specified in Schedule II of Stock Broker Regulations.
- 3.3 The Broker further submitted that the Enquiry Report dated September 10, 2003 made by the Enquiry Officer is bad in law, as it is against natural justice in as much as reasonable opportunity of personal hearing in the matter was not given to them and also did not give any opportunity to submit their detailed written statement alongwith documentary evidence.
- 3.4 The Broker submitted that its concerned Director had to be in Delhi for some family function and he was unable to be present for the personal hearing on August 19, 2003 and the same was not intimated due to oversight. In all fairness and having regard to natural justice, equity and fair play, another date should have been given before proceeding ex-parte.

4.0 HEARING

- 4.1 The Broker was accordingly advised to attend the personal hearing before me at Head Office, SEBI at Mumbai on September 26, 2006 and October 13, 2006 which it did not avail. Therefore, I am proceeding in the matter on the basis of the submissions of the Broker and the material before me.

5.0 CONSIDERATION OF ISSUES & FINDINGS

- 5.1 I have carefully examined the enquiry report, show cause notice and reply of the Broker.
- 5.2 At the very outset, I find that the Broker has taken a stand in its reply that post enquiry show clause notice issued to them is bad in law as it contravenes the provisions of Regulation 13(2) of Enquiry Regulations. It stated that the Chairman or the member as the case may be, shall issue Show Cause Notice and not the Division Chief. It is pertinent to note that the Board has power under Section 19 of SEBI Act, 1992 to delegate its functions. Accordingly Division chief is empowered to issue show cause notices. As a result, the issuance of show cause notice and action taken pursuant to the show cause notice are legally valid.
- 5.3 The scrip of Ranbaxy traded around the price range of Rs.270/- at the beginning of January 1999. The price of the scrip moved up to Rs.320/- by the end of January 1999. Subsequently, price continued to move upward during February – March 1999 and reached Rs.650/- by end of March 1999. Further, the price of the scrip moved to Rs.700/- during May 1999 and came down to Rs.600/- during June 1999. The price subsequently moved upwards and touched Rs.800/- during July 1999 and Rs.1000/- during August 1999. The scrip was being traded in the range of Rs.900/- to Rs.1100/- during August – September 1999 and increased to Rs.1200/- during October 1999. Effectively, the price of the scrip moved up from Rs.267 on 01.01.99 to a high of Rs.1215/- on 13.10.99. Later on the price started falling gradually and closed at Rs.869 on 29.10.99 at BSE. The price of the scrip of Ranbaxy had moved significantly during the period from Rs.270/- in January 1999 to about Rs.1200/- in October 1999. The price rise in the scrip was accompanied by significant increase in volumes.

5.4 The Enquiry Officer has arrived at a conclusion in his Enquiry Report that the Broker carried out 16 instances of synchronization of trades with a view to create misleading appearance of trading which tampers with price discovery mechanism of stock exchange. Hence, the charges levelled against the Broker are on the basis of the aforesaid 16 synchronized trades. The synchronized trade is a kind of transaction where the seller and buyer execute the trade for almost same quantity and price at substantially the same time. Synchronized deal per se is not illegal. On the other hand, the synchronized deal with fraudulent or deceptive intention to create misleading appearance of trading and to manipulate the price and volume of the scrip price to tamper the price discovery mechanism of stock exchange with a view to get undue gain out of it, is no doubt a serious matter.

5.5 Hence the issue to be decided in this case is whether the Broker has carried out any such synchronized trades and to take a decision as to whether the penalty recommended by the Enquiry Officer against the Broker is proper or not. In order to decide the said issue, I felt it necessary to analyze the details of synchronized trades executed by the Broker (As given on next page)

Trade Dt	Trd Time	Trd Pr	Trd Qty	Buy Order Entry Time	Buy Mem ber Code	Buy Member Name	Buy User Id	Buy Clie nt Code	Buy Orig inal Volume	Buy Limit Price	Sell Order Entry time	Sell Memb er Code	Sell Member Name
13-Apr-99	11:16:06	563.50	3707	11:16:06	6381	The First Custodian	1032	6381	3757	563.50	11:16:05	6381	The First Custodian
4-May-99	13:23:13	615.75	3000	13:23:12	6381	The First Custodian	1037	6381	3000	615.75	13:23:13	6381	The First Custodian
4-May-99	13:23:37	615.75	4805	13:23:37	6381	The First Custodian	1037	6381	5000	615.75	13:23:37	6381	The First Custodian
7-May-99	13:23:25	688.20	2000	13:23:25	6381	The First Custodian	1033	CLI	2000	688.20	13:23:24	6381	The First Custodian
7-May-99	13:23:44	687.75	2000	13:23:43	6381	The First Custodian	1033	6381	2000	687.75	13:23:44	6381	The First Custodian
7-May-99	13:24:01	688.25	3000	13:24:00	6381	The First Custodian	1033	6381	3000	688.25	13:24:00	6381	The First Custodian
7-May-99	13:24:16	688.25	4000	13:24:16	6381	The First Custodian	1033	6381	4000	688.25	13:24:16	6381	The First Custodian
15-Jun-99	11:18:26	556.50	4950	11:18:19	6381	The First Custodian	1034	6381	5000	556.50	11:18:26	6381	The First Custodian
3-Aug-99	10:20:18	883.50	2150	10:20:18	6381	The First Custodian	1034	6381	3000	883.50	10:20:10	6381	The First Custodian
23-Aug-99	11:37:35	1059.00	1100	11:37:15	6381	The First Custodian	1034	CLI	2000	1059.00	11:37:35	6381	The First Custodian
23-Aug-99	11:41:30	1057.00	1724	11:41:30	6381	The First Custodian	1034	CLI	2000	1057.00	11:41:18	6381	The First Custodian
24-Sep-99	15:00:13	1066.90	1480	15:00:13	6381	The First Custodian	1034	CLI	2000	1066.90	14:59:57	6381	The First Custodian
28-Sep-99	11:57:43	1057.00	1350	11:57:43	6381	The First Custodian	1034	5103	2000	1057.00	11:57:36	6381	The First Custodian
30-Sep-99	13:56:54	1082.50	1780	13:56:54	6381	The First Custodian	1034	CLI	1980	1082.50	13:56:44	6381	The First Custodian
30-Sep-99	14:54:18	1081.70	1488	14:54:18	6381	The First Custodian	1034	CLI	3000	1081.70	14:54:03	6381	The First Custodian
27-Oct-99	13:59:23	991.50	1979	13:59:23	6381	The First Custodian	1034	CLI	2000	991.50	13:59:16	6381	The First Custodian

5.6 I find from the above table that the Broker had executed 16 synchronized / matching trades in the shares of Ranbaxy. It is clear from the above table that the Broker had placed both buy and sell order in all the 16 trades which are synchronized cross deals. The Enquiry Officer also found that there are three instances of matched trades on May 04, 1999, August 23, 1999 and September 30, 1999. He also observed that on May 07, 1999, the Broker had placed both buy and sell orders in the scrip of Ranbaxy as follows:

- ? *The buy order of 2000 shares of Ranbaxy was placed at 13.23.25 and the corresponding sale order of 2000 shares was placed at 13.23.24. The number of shares which matched for trading was 2000 shares (13.23.25).*
- ? *In the second instance the buy order of 2000 shares was placed at 13.23.43 and corresponding sale order of 2000 shares was placed at 13.23.44. The number of shares which matched for trading was 2000 shares (13.23.44).*
- ? *On the third instance the buy order of 3000 shares was placed at 13.24.00 and the corresponding sale order was placed at 13.24.00 for 3000 shares. The number of shares which matched for trading was 3000 shares (13.24.00)*
- ? *In the fourth instance the buy order of 4000 shares was placed at 13.24.16 and the corresponding sale order of 4000 shares was placed at 13.24.16. The number of shares which matched for trading was 4000 shares (13.24.16).*

5.7 I find that the buying and selling clients in most of the trades executed by the Broker are the same. Further, the Broker has never disputed the said 16 trades. What they submitted in their reply is that they did not get any fair opportunity to present their case before the Enquiry Officer which is against the principles of natural justice. I observe that sufficient opportunity was given to the Broker prior

to and pursuant to the enquiry proceedings. The Broker had not availed the given opportunities and even did not attend for a personal hearing before me.

5.8 It may be noted that synchronized deals with exact matching of price and quantity for 16 instances of trade are only possible if the trades are put in the system with prior understanding. In the instant matter, Broker itself had placed both buy and sell orders which is cross deal and the same is more serious. The intention of the Broker to execute such synchronized cross deal could be inferred from the above attending circumstances.

5.9 It is also seen from the above table that the Broker executed five instances of synchronised cross deals from its own proprietary account (Code 6381) where both buy and sell orders were placed by the Broker itself. In all these cases, the price, quantity and time were structured and synchronised. For eg: On April 13, 1999, the Broker had punched both buy and sell orders for a quantity of 3757 shares at the price of Rs 563.50. Such exact matching of price and quantity shows that the trades were fictitious and were intended to create artificial volumes. Similar transactions were observed on May 4, 1999 (2 trades), June 15, 1999 and August 3, 1999. While this is the case with the proprietary account, the Broker was involved in similar transactions for his clients. On May 7, 1999, the Broker had executed synchronised trades for its client 'CLI'. Similar pattern is observed on August 23, 1999 for this client 'CLI' indicating that the transactions were not mere coincidence. Further, considering that the quantity ordered as well as the price in all these cases were exactly matching, any claim of unintentional trades by different terminals will not hold good. It is also seen that the Broker executed similar synchronised trades from its proprietary account with this client 'CLI' on May 7, 1999 (3 trades) and this establishes the nexus between the client and the Broker. I have also noted that the Broker has not given any explanation for the execution of above trades.

5.10 I also observe that on September 28, 1999, the clients of the Broker 5103 and CLI (client codes) executed synchronised trades through the Broker for quantity of 1350 shares (synchronised order quantity 2000 shares). On September 30, 1999 a reversal trade (synchronised) was done between these entities for the order quantity of 3000 shares. The executed quantity was 1488 shares. While the trade on September 28, 1999 was made at Rs 1057/- the reversal price on September 30, 1999 was Rs 1081.70. These trades are of circular / reversal in nature and apparently not genuine trades.

5.11 In this context, I observe that the Hon'ble SAT while upholding the findings of Adjudicating Officer in deciding the similar issue in Appeal No 100 of 2006 (Ask Holdings Private Limited Vs SEBI), observed as follows.

The buyer and the seller were the appellants themselves and these trades were executed primarily with a view to artificially increase the trading volumes in the scrip of the Company. Artificial increase in the volumes of a scrip has the adverse effect on the innocent investors of the market who get induced to buy the shares because they seldom have knowledge about the scrip and follow the herd mentality while trading. The adjudicating officer was, therefore, right in holding that the appellants had violated the provisions of Regulation 4 of the Securities & Exchange Board of India (Prevention of Fraudulent & Unfair Trade Practices relating to Securities Market) Regulations, 1995. The allegations are rather serious and the appellants by indulging in artificial trades had polluted the stock market.

5.12 In the instant matter also the buyer and the seller were the appellants themselves and these trades were executed primarily with a view to artificially increase the trading volumes in the scrip of Ranbaxy as explained in paragraphs above. Artificial increase in the volumes of the shares of a company has the adverse effect on the innocent investors of the market who get induced to buy the shares because they seldom have knowledge about these transactions and its nature. Further, I am of the view that several synchronization of trades in the nature of cross deals cannot be treated as mere coincidence. In such cases, prices and

quantities had been negotiated outside the system and orders had been executed simultaneously. I find that all the aforementioned transactions give an impression that these were all synchronized and traded to create artificial market, otherwise there was no possibility of such perfect matching of quantity price, etc. The said issue was already discussed by the Hon'ble Securities Appellate Tribunal (SAT) in Appeal Nos 54 to 57 of 2002 in the case of Nirmal Bang Securities (P) Ltd. vs. SEBI. While examining the issue of synchronized trades, the Hon'ble SAT observed as under:

“BEB has been charged for synchronized deals with First Global. I have examined the data provided by the parties on this issue. I find many transactions between BEB and FGSB. There are many instances of such transactions. I find the scrip, quantity and price for these orders had been synchronized by the counter party brokers. Such transactions undoubtedly create an artificial market to mislead the genuine investors. Synchronized trading is violative of all prudential and transparent norms of trading in securities. Synchronized trading on a large scale can create false volumes. The argument that the parties had no means of knowing whether any entity controlled by the client is simultaneously entering any contra order elsewhere for the reason that in the online trading system, confidentiality of counter parties is ensured, is untenable. It was submitted by the Appellants that it was not possible for the broker to know who the counter party broker is and that trades were not synchronized but it was only a coincidence in some cases. Theoretically this is OK. But when parties decide to synchronize the transaction the story is different. There are many transactions giving an impression that these were all synchronized, otherwise there was no possibility of such perfect matching of quantity price etc. As the Respondent rightly stated it is too much of a coincidence over too long a period in too many transactions when both parties to the transaction had entered buy and sell orders for the same quantity of shares almost simultaneously. The data furnished in the show cause notice certainly goes to prove the synchronized nature of the transaction which is in violation of regulation 4 of the FUTP Regulations. The facts on record categorically establish that BEB had indulged in synchronized trading in violation of regulation 47 of the FUTP Regulations. In a synchronized trading intention is implicit.” (emphasis not supplied)

- 5.13 Keeping in mind the dicta of the SAT as reproduced above; I see no reason to take a different view. Further, I observe that the standard of proof required in a proceeding of this nature is at variance with the standard of proof required in

criminal cases. It is sufficient if the preponderance of probabilities suggests towards the indulgence of the delinquent in the misconduct. The strict rules of Evidence Act and proof beyond reasonable doubt are not applicable to a proceeding of this nature. The Supreme Court's decision in Gulabchand vs Kudilal AIR, 1966, SC 1734 and the decision of the Special Court for trial of offences relating to transactions in securities in the matter of National Housing Bank versus ANZ Grindlays Bank, 1998 (2) LJ 153 is relied upon in this regard.

5.14 In view of this, I find that that Broker has put these trades with a view to create misleading appearance of trading which tampers with price discovery mechanism of stock exchange and is against the concept of transparency. The synchronized cross deals entered into by the Broker abetted in creating artificial volumes and false market in the scrip of Ranbaxy Laboratories Ltd. This may also induce the innocent investors of the market. Thus, the Broker through these dealings in the scrip of Ranbaxy has violated the provisions of Regulation 4 (b) and (c) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995, which provides that,

4 No person shall -

- (b) indulge in any act, which is calculated to create a false or misleading appearance of trading on the securities market;
- (c) indulge in any act which results in reflection of prices of securities based on transactions that are not genuine trade transactions;

5.15 Further, the Broker has violated Regulation 7 read with the clause A (3) and (4) of Code of Conduct as specified in Schedule II of Stock Brokers Regulations, which provides that

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

(4) Malpractices : A stock-broker shall not create false market either singly or in concert with others or indulge in any act detrimental to the investors interest or which leads to interference with the fair and smooth functioning of the market. A stock-broker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness”.

5.16 I have also noted that the certificate of registration granted to the Noticee was suspended for a period of 12 months from July 14, 2003 vide Order dated March 5, 2004 passed by the then Chairman of SEBI for the irregular transactions of the Noticee in the scrip of Nedungadi Bank Ltd. Having considered all aspects and circumstances of the case, I am satisfied that it is necessary to impose a penalty on the Broker. However, considering the volume of synchronised trades executed by the Broker in Ranbaxy when comparing with market volume of Ranbaxy, I feel that the suspension of certificate of registration of the Broker for a period of 15 days will act as a deterrent to avoid any recurrence of such trades.

6.0 ORDER

6.1 Therefore, in exercise of the powers conferred upon me in terms of Section 19 of the SEBI Act, 1992 read with Regulation 13(4) of Enquiry Regulations, I hereby impose a minor penalty of suspension of certificate of registration of the Broker, M/s The First Custodian Fund (I) Ltd. (SEBI Registration No. INB230638130) for a period of 15 days.

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

Place: Mumbai

Date: March 29, 2007

V. K. CHOPRA

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA