

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: DR. K.M. ABRAHAM, WHOLE TIME MEMBER**

ORDER

**UNDER REGULATION 28(2) OF THE SECURITIES AND EXCHANGE BOARD
OF INDIA (INTERMEDIARIES) REGULATIONS, 2008 AGAINST CFL
SECURITIES LIMITED IN THE MATTER OF VXL INSTRUMENTS LIMITED**

1. The Securities and Exchange Board of India (hereinafter referred to as SEBI) had initiated an enquiry, vide Order dated November 14, 2003, under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (since rescinded) against CFL Securities Limited (hereinafter referred to as the stock broker), a trading member of the National Stock Exchange of India Limited (hereinafter referred to as NSE) and a stock broker registered with SEBI. The said enquiry was directed on the basis of the findings of an investigation conducted by SEBI into the dealings *inter alia* of the stock broker in the shares of VXL Instruments Limited (hereinafter referred to as VXL). The Enquiry Officer, on completion of the enquiry, found that the stock broker had contravened Regulation 4(a) and (b) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 (hereinafter referred to as the PFUTP Regulations) and Clauses A(3), (4) and (5) of the Code of Conduct for Stock Brokers specified in Schedule II of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 (hereinafter referred to as the Stock Brokers Regulations) and vide Report dated February 16, 2005 recommended that the certificate of registration of the stock broker be suspended for a period of six months. Thereafter, SEBI vide notice dated March 1, 2005 enclosing therewith a copy of the Enquiry Report, called upon the stock broker to show cause as to why action should not be taken against it as recommended by the Enquiry Officer. The stock

broker submitted its response, vide replies dated March 18, 2005 and June 20, 2005. While the instant proceeding was in progress, the stock broker had filed an application for passing of a Consent Order in terms of SEBI Circular dated April 20, 2007 and pursuant to the rejection of the said application, the present proceeding was resumed and the stock broker was granted an opportunity of hearing on July 2, 2009. On the said date of hearing, Mr. Bhupen C. Dalal, Advocate appeared on behalf of the stock broker and made submissions. Mr. Milan B. Dalal, director of the stock broker and Mr. Deepak Sheth were also present in the hearing. The learned advocate while making submissions, requested SEBI to dispose off all proceedings pending against the group entities. The learned advocate also undertook to file written submissions at the earliest. Thereafter, the written submissions of the stock broker was forwarded to SEBI by Mr. Bhupen C. Dalal, Advocate, vide letters dated September 22, 2010 and February 4, 2011. The submissions made by the stock broker are considered and discussed below in this Order.

2. I have considered the Enquiry Report, the replies/written submissions of the stock broker, the oral submissions made during the hearing and other material available on record. The Enquiry Officer has found that the stock broker had contravened Regulation 4(a) and (b) of the PFUTP Regulations and Clause A (3), (4) and (5) of the Code of Conduct for stock brokers prescribed under the Stock Brokers Regulations. The findings of the Enquiry Officer, in brief, are given below:

- i. Majority of the trades in the scrip were done for the clients, namely, Harbinger Trading Company Private Limited, M/s. Aditi A. Dalal and Shriya Capital Services Private Limited, which indicated a concentrated activity in the shares of VXL and the concerted effort on the part of the stock broker with its other entities.
- ii. a. Entities (the clients) related to the stock broker, Harbinger Trading Company Private Limited (trading through the stock broker) and M/s. Aditi

- A. Dalal (trading through Nikko Capital Services Limited, another stock broker), indulged in transactions and were buying and selling at the same time and for the same price and that shares which were sold by them were purchased by them by a scheme of finance.
- b. The stock broker (trading for Harbinger Trading Company Private Limited, a related entity) had entered into matched transactions with DGP Securities Limited, another stock broker. Before the Enquiry Officer (as mentioned in paragraph 6.3 of the Enquiry Report), the stock broker had stated that volumes were created due to repeated transactions done for the purpose of funding. Therefore, the stock broker was found to have entered into fictitious transactions.
- iii. The stock broker was found to have indulged in cross deals and had submitted before the Enquiry Officer (mentioned in paragraph 6.4 of the Enquiry Report) that the purpose behind doing those transactions were primarily for tiding over financial commitments to the stock exchange so as not to commit default in payments. The stock broker had admitted that the transactions were not meant for transferring beneficial ownership of shares. In view of the same, it was held that the stock broker had created artificial volumes by its transactions.
3. The Enquiry Officer had further observed the following :

“6.4.....

“I, therefore, hold that these are fictitious trades not reflecting the natural price determination mechanism of the stock exchange. As admitted by the broker these trades were undertaken not for the purpose of trading in securities but only for the purpose of financing. These transactions defy the traditional anonymous trading mechanism envisages in the stock exchange trading mechanism. I therefore hold the broker guilty of entering into matched and structured transactions which are fictitious in nature.

Therefore, I hold that the broker is guilty of creating artificial volumes by indulging in cross deals and acting with a client who is an associate entity who is also a broker.”

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6.5.....

The modus operandi for the purported financing transactions is that it appears that as a means to arrange finance, the broker and his related and associated entities sold shares as “spot/off market deals” to various entities and would receive funds immediately. The entities, who bought these shares on “spot/off-market” would, in turn, sell these shares on the exchange and would therefore safeguard their interests as they would get covered by the settlement guarantee fund of the exchange. In most of these trades, the purchasing counter party has been found to be one of the related entities of the broker’s group, who had initially sold the shares on a spot/off market basis. The above cycle of sale on spot/off market basis, subsequent sale by the purchasing entities on the market by entering into matched/structured deals with the entities who had initially offered the shares on spot/off market basis, continued settlement after settlement during the time period of investigation. It appears, therefore, that the trading which took place on the exchanges, during the time period of investigation, was mirroring the financing arrangements which had crystallized outside the exchange as spot/off market deal. Most of the transactions, which took place during this time period, were crossed and matched/structured between broking entities, who were directly/indirectly a party to the financing transactions. Therefore, these matched/structured transactions were entered into with a purpose. At NSE, the major concentration of such trades took place between the broker in conjunction with its related client M/s. Harbinger Trading Company Pvt. Ltd and Shriya Capital Services Pvt. Ltd on one hand and M/s. DGP acting on behalf of its client and proprietary account was buying shares on spot basis from Aditi Dalal. Ms. Aditi Dalal is related to the broker. The shares were sold by DGP on behalf of their client, the counter party trading member was yourself which is clearly evident from the instances of matched transactions between the broker and DGP. Therefore DGP and its clients were acting in concert in (i) mis-utilising the exchange system and (ii) putting the exchange system to risk. Their trading assisted the counter parties to create false market for the scrip of VXL detrimental to the investors’ interest and which led to interference with the fair and smooth functioning of the market, thereby violating Clause A(3) and A(4) of Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

The broker did not contradict the above sequence of events. It is also an admitted position that broker entered into financing transactions. The broker’s argument that these transactions did not result in any loss to any investor or any broker has been noted in this context. However, it is to be kept in mind that it is very difficult to pin point the exact loss caused to a single individual when a scrip has been deliberately manipulated either to create volumes or raise the prices. The broker contention during the hearing that he had an alternative way of getting finance from the market i.e. by selling the shares he was holding. However, since he was of the view that at that particular point of time these scrips was very high and that once he came out of temporary financial requirements he would have been in a better position to exit at a higher price. This position of the broker suggest that to make a profit, or to avoid a loss the broker has indulged in this kind of fictitious and artificial trades not reflected in market trend. I therefore hold the broker guilty of creating a misleading appearance of liquidity in the scrip and thereby enabled his clients and associates to off load in an illiquid scrip. Thus, the broker has misused the exchange mechanism, settlement after settlement to serve his vested interest, thereby putting the investors at large, to undue risk”.

4. The stock broker has not disputed the transactions in his replies/submissions or in the hearing. The stock broker's submissions in its replies/written submissions dated September 22, 2010 and February 4, 2011 have been that *"there has not been the case of SEBI and neither have we resorted to any other violations except excessive volumes in ill liquid scrips....."* and that *"...we have for almost the same period transactions in few other scrips and the nature of transaction is similar i.e. financing only..."* I also note the submission of the stock broker that *"...our transactions were merely spot funding and that there was no motive or intention to gain out of these transactions and neither has that been the finding of SEBI, though inadvertently it has resulted in excessive volume on those particular days."* Even in its earlier replies dated March 18, 2005 and June 20, 2005, the stock broker has admitted that along with its group associates and clients, it had entered into a series of transactions in the shares of VXL during the investigation period for the purpose of creating temporary funding arrangements for its pay-in to the stock exchanges. It has also stated *"If violation, if any to SEBI rules has occurred was un-intentional and therefore we request you to kindly condone the same"*. Thus, I note that the stock broker has not disputed the transactions and has admitted indulging in them for the purposes of financing arrangements. Though, the stock broker has stated that it had not intentionally entered into fictitious trades, its transactions since executed not for the genuine purpose of purchase or sell, have indeed created false or artificial volumes in the shares of VXL. Further, there was no real transfer of beneficial ownership of shares so traded. It is observed that the stock broker has traded mainly for its related entities, namely Harbinger Trading Company Private Limited and Shriya Capital Services Private Limited as follows:

- a. purchased 5,39,100 shares and sold 3,36,700 shares for Harbinger Trading Company Private Limited, with a net position of 2,02,400;
- b. purchased 2,05,500 shares and sold 46,000 shares for Shriya Capital Services Private Limited, with a net position of 1,59,500 shares.

5. I find that the transactions executed by the stock broker in the shares of VXL during the investigation period were not for genuine purposes, instead were executed for the purposes of temporary funding to satisfy the pay-in obligations of the stock exchanges. Thus, the said transactions were fictitious. The same also created artificial volumes in the shares of VXL during the relevant period. Further, I note that there were price fluctuations in the shares of VXL during the relevant period. The clients, Harbinger Trading Company Private Limited and Shriya Capital Services Private Limited were already found to have contravened the relevant provision of the PFUTP Regulations and have been restrained from assessing the securities market and prohibited from dealing in securities by SEBI, vide an earlier Order dated January 17, 2011. In view of the foregoing, I find that the conduct of the stock broker is in contravention of Regulation 4(a) and (b) of the PFUTP Regulations. The stock broker by indulging in non-genuine transactions in the shares of VXL during the relevant period had contravened Clause A (3) and (4) of the Code of Conduct for stock brokers specified in the Stock Brokers Regulations. Further, by not abiding with the statutory provisions in this regard, the stock broker has also contravened Clause A (5) of the said Code of Conduct. I also note that the stock broker had committed similar violations in the scrip of DCM Shriram Consolidated Limited more or less during the same period and for the said violations, its certificate of registration was suspended by SEBI for a period of three weeks, vide an Order dated January 17, 2011. SEBI had also suspended the certificate of registration of the stock broker for a period of two weeks, vide a separate Order dated February 21, 2011, in respect of its dealings in the shares of Ceat Limited for similar violations.

6. I note that the present enquiry proceeding has been initiated under the provisions of the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002. The said Regulations was subsequently repealed with effect from the notification of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 and

therefore, this Order is being passed under the corresponding provisions of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

7. In view of the foregoing, I, in exercise of powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulations 28(2) and 38(2) of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008, hereby suspend the certificate of registration of the stock broker, CFL Securities Limited (Registration No. INB230629433), trading member, National Stock Exchange of India Limited, for a period of two weeks.

8. As the Securities and Exchange Board of India had already suspended the certificate of registration of the aforesaid stock broker for a period of three weeks, vide an Order dated January 17, 2011 and for a period of two weeks, vide an Order dated February 21, 2011, the penalty imposed in paragraph 7 above would run concurrently and shall come into force with immediate effect.

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

**PLACE: MUMBAI
DATE: FEBRUARY 21, 2011**