BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 213 of 2011

Date of Decision: 18.05.2012

Saroj & Co. proprietor Sanjay Agrawal
681, Padam Tower 1, 14/113 Civil
Lines, Kanpur – 208001 (U.P.) …Appellant

Versus

The Adjudicating Officer
Securities and Exchange Board of India
SEBI Bhavan, Plot No.C4A, G Block,
Bandra Kurla Complex,
Bandra (East), Mumbai – 400 051. …Respondent

Mr. Joby Mathew, Advocate for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Mobin Shaikh, Advocate for the Respondent.

CORAM : P. K. Malhotra, Member & Officiating Presiding Officer (*Offg*.)
S.S.N. Moorthy, Member

Per : S.S.N. Moorthy

The appellant is a Member of U P Stock Exchange Limited and a sub-broker of UPSE Securities Limited. He is said to be in regular business of purchase and sale of shares on behalf of his clients. One of his clients, Mr. Ashesh Agarwal, was dealing in several scrips including that of Rich Capital & Financial Services Limited (referred to hereinafter as the company). In this appeal, the appellant objects to imposition of a penalty of ` 5 lac under section 15HA and 15HB of the Securities and Exchange Board of India Act, 1992. The adjudicating Officer found the appellant guilty of violating regulations 3 and 4 of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003 and Regulation 15(1)(b) relating to code of conduct for sub-brokers specified in Schedule II of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulation, 1992 (hereinafter referred to as FUTP Regulations and Brokers Regulation respectively). The adjudicating officer levied a penalty of ` 3,50,000 for the violation of FUTP Regulations and a sum of ` 1,50,000 for the violation of the code of conduct for sub-brokers.

2. The cause of action for the impugned order arose during investigations in the scrip of the company for the period March 27, 2009 to August 12, 2009. The investigation was triggered on account of sharp price rise and trading in heavy volumes in the scrip of the company. During the investigation period, the shares were traded for 138 days and the price of the scrip rose from ` 8.90 to a high of ` 80.15. The adjudicating officer verified certain circular/reversal trades between connected parties which resulted in artificial volumes in the market. He also analysed the factors relating to price rise and inferred that placing orders consistently at a price higher than the last traded price contributed to new high price and in this manner the value of the scrip was jacked up over a period of time. The dealings related to the client Ashesh Agarwal in the scrip of the company. A show cause notice was issued to the appellant on June 23, 2010. The allegations in the show cause notice were mainly threefold - (1) While trading in the scrip of the company the appellant contributed to new high price. (2) He entered into trades at a price higher than the last traded price. (3) He executed reversal/circular trades creating artificial volumes in the scrip and thereby manipulated the price of the scrip. The adjudicating officer held the appellant guilty of violating regulations 3 and 4 of the FUTP Regulations dealing with fraudulent practices. It was also alleged that he was guilty of violating the code of conduct of sub-brokers contained in the Brokers Regulations. The appellant filed his reply on July 7, 2011 denying the allegations leveled against him. After due consideration of the reply filed by the appellant, the adjudicating officer absolved the appellant of any connivance in the execution of trades observing that there was no material to show any connection of the appellant with the counter party broker and the client with whose sell orders the appellant's buy orders matched. Further, the appellant was also absolved of any role in the contribution to the price rise through new high price and placing orders above the last traded price. In short, two of the charges were dropped and the appellant was found guilty of executing reversal/circular trades leading to manipulation of the scrip and not showing due diligence and integrity in overseeing the conduct of the clients.

3. The appellant's learned counsel strenuously opposed the finding of the adjudicating officer with regard to reversal/circular trades. According to him, the conclusion drawn by the adjudicating officer is self contradictory in as much as the appellant has been found to be not involved in any connection with the client and counter parties and having no role in

contribution to the new high price. It is argued that manipulation of scrip by way of reversal/circular trades primarily calls for connection among the trading parties and in the absence of the same the charge regarding manipulation cannot survive. With reference to the trades executed by the appellant, it is contended that there was no systematic matching of trades which normally leads to manipulation. In the present case there were only matching of trades in parts on a few days which cannot be attributed to any act of deliberate and wilful manipulation. During the course of the hearing of the appeal, the appellant's learned counsel submitted a chart showing the data by which alleged reversal/circular trades were carried out and observed that out of a total of 35 trading days, reversal trades happened only on 8 days which is insignificant as compared to the total volume of trades and counter parties traded with. So the allegation regarding matching of trades in large volumes on many occasions is said to be totally unfounded. In the grounds of appeal also the appellant has set out an analysis of the trades which took place in the relevant period of 35 days. The result, as shown in the chart submitted during the hearing of the case, has been highlighted to justify the appellant's case. So, according to the appellant, the data regarding trading days and matching of trades relied on by the adjudicating officer is basically incorrect and so the charge regarding reversal based on such data cannot be sustained. As a broker, the appellant could not have raised his eyebrows with respect to the marginal and insignificant quantum of squared of trades as compared to the broad spectrum of lacs of transactions carried out in respect of the clients of the appellant. According to the appellant, the impugned transactions of the client in the scrip of the company cannot be regarded as manipulative since there was no connivance and no contribution to periodic price rise. It is also submitted that there is no evidence regarding any illegal gain by the appellant and no case of repetitive wrong doing has been established. With regard to the compliance with the code of conduct of a sub-broker it is argued that the appellant had placed reasonable surveillance system in place and there was no alert from Bombay Stock Exchange (BSE) which had full-fledged and highly equipped surveillance system in place. The client, Ashesh Agrawal, was one among the various clients for whom the appellant had traded and the impugned transactions were very few in numbers to give rise to any suspicion of any wrong doing. The alleged wrong doing can be identified only when trade and order logs are available and the present allegation could be raised only in hindsight. There were very few squared up deals as mentioned above and the volume was too insignificant for raising any

alarm and so there cannot be any complaint about non compliance with the code of conduct. A reference is made by the appellant's learned counsel to the decision of the adjudicating officer in the case of M/s. Prabhat Financial Services Ltd. concerning the same group in the same investigation period. Our attention is also invited to the decision of this Tribunal in SMC Global Securities Ltd. vs. Adjudicating Officer, Securities and Exchange Board of India (Appeal no.176 of 2011 dated 25.11.2011).

4. Learned senior counsel for the Board defended the order of the adjudicating officer observing that a look at the entire picture of the transactions would establish that there were reversal trades on many occasions and the appellant was party to those transactions. According to him, the exoneration was only in respect of creating new high price and connection between the parties. It is his case that the appellant was actually involved in the reversal trades alongwith the clients and there was a clear meeting of minds in this regard. The manipulation spanned over a period of 35 days, even though intermittently, and this cannot be disregarded especially when the scrip was illiquid. The adjudicating officer has established in the order that the intermittent sell and buy orders over a period of time at the rate of about 50,000 shares per day resulted in reversal/circular trades and the appellant cannot brush this aside on the plea that the squared up trades were minor and insignificant. There was manipulation of volume through reversal trades and a look at the entire chain of transactions as done by the adjudicating officer clearly establishes the wrong doing of the appellant. With regard to the code of conduct it is argued that the broker was expected to look at all the transactions especially when there was periodical price rise. The broker was aware of the nature of transactions since the scrip was illiquid and the volume of trades was of a high order. It was not necessary to look for an alert from the BSE which is concerned with the macro picture as against the appellant who could have focused on the specifics of a few transactions.

5. We have heard the rival submissions. The counsel for the parties took us through the details of the transactions. In the show cause notice appellant has been charged with violation of FUTP Regulations and non-compliance with code of conduct set out for brokers. As regards the wrong doing in respect of FUTP Regulations the adjudicating officer's charge had three parts out of which two have been dropped. It is necessary to highlight the findings of the adjudicating officer in this regard. In paragraph 17 of the

impugned order, the adjudicating officer has come to the following conclusion after analyzing the transactions which are alleged to have contributed to the new high price.

> "I note that except in one instance which is on 22/06/2009 Noticee placed buy orders for 2175 shares which got executed at the pending sale order rate. It is thus observed that the trades got executed at the market rate. The above orders placed by the Noticee do not appear to have impacted the price of the scrip in RCFL. Further based on the materials available I do not find substantive corroborative evidence to establish the allegation that the Noticee had any significant role in manipulating the price of the scrip by establishing new high price in the scrip of RCFL. Hence the charge against the Noticee does not stand established."

Para 19 of the impugned order contains the findings of the adjudicating officer with regard to the connection/connivance of the appellant and the parties to the transactions.

> "I find that the Noticee placed orders at a price higher than the LTP in few cases however the order got executed at the pending sell order rate which was lower than the order placed. In other cases the Noticee was placing the buy order which as observed from above were the market orders, at the pending sell order rate. It is observed that the trades were executed at the market rate. Investigation observed that there were 584 trades during the investigation period which were higher than the LTP and of which in 43 instances the Noticee's trades allegedly influenced the price and contributed to price rise of ` 15.2 There is no material before me to show any connection of the Noticee with the counter party broker and client with whose sell orders the Noticee's buy orders matched. Further there is no material on record to show any connivance of the Noticee with the counter parties to influence the price of the scrip. In absence of any corroborative evidence on record I am inclined to give benefit of doubt to the Noticee and hence the charges against the Noticee of influencing the price of the scrip by placing orders higher than LTP does not stand established".

In para 29 of the impugned order there is a further reiteration of the findings which reads as under:

> "With regard to provisions of Regulation 4(2)(e) which provides 'any act or omission amounting to manipulation of the price of the security' it is observed in para 17 and 19 that the Noticee had no role in the contribution to the price rise through new high price and through LTP. Hence the allegation of violation of Regulation 4(2)(e) does not stand established".

6. As regards violation of FUTP Regulations the only charge that survives for consideration is that of execution of reversal/circular trades resulting in artificial volumes in the scrip of the company. The adjudicating officer has given details of all the transactions, which, according to her, establish reversal/circular trades. The transactions in question spread over a period of 35 dyas. According to the adjudicating officer the trades which took place for 35 days consisted of 25.72 per cent of the total volume of shares traded and in many cases

the buy and sell orders matched and the time difference was only a few seconds. During the hearing of the appeal the appellant's learned counsel submitted a chart showing the transactions which took place on all the 35 days. The chart is only a summary of the details already contained in the grounds of appeal. On a perusal of the chart, it is seen that out of the total 35 trading days there was matching of trades only on 8 days. According to the appellant, the adjudicating officer has considered the transactions on all the 35 days without verifying whether they involved both purchase and sales. It has been brought on record that on a few days there were only purchases and on a few days there were only sales. On certain days there was no trade at all. The matching as alleged by the adjudicating officer has taken place only on 8 days as per the contention of the appellant's learned counsel. The adjudicating officer has taken the stand that "the pattern of trade continued for a number of days and the fact that it was not confined to one or two occasions is proof enough to establish reversal/circular trades". She is also of the view that the transactions took place repeatedly over a period of time and the fraudulent trades were meant only to increase volumes on the screen so as to generate investor's interest. The learned senior counsel for the Board drew our attention to the transactions between MTL Shares and Securities Limited, the appellant and the client Ashesh Agarwal and observed that the bigger picture of the trades among the three should be noticed to understand the real transaction and this is in the nature of reversal/circular trades. He was of the view that the reversal took place almost throughout the impugned period and there was a clear meeting of minds.

7. We are unable to appreciate the stand taken by the adjudicating officer. The transactions of the appellant during the investigation period have to be viewed holistically. The appellant is a sub-broker. So his role is to place orders as per the directions and demand of the client. He cannot be regarded as a co-conspirator unless it is established that he had connection with the parties in crystallising the trades in a fraudulent manner or had knowledge of the fraudulent activities of his clients. In a case where a trader indulges in fraudulent trade the objective is primarily to create artificial increase in price and volumes. This is generally adopted to create investor interest and thereby get undue enrichment from sale of shares. So the connection/connivance of the broker in the fraudulent transaction has to be established. Generally, efforts are made in a systematic manner over a period of time to jack up the price and volume of the shares. In the present case, the adjudicating officer has already ruled out the connivance/connection of the appellant with his client in respect of a

segment of the transactions during the period under investigation. So it is a debatable issue whether meeting of minds can be established for a part of the period only. Even assuming so, the period during which alleged reversal has taken place is considerably insignificant in the facts of the case. The role of the broker and the client in the manipulation has to be viewed in the proper perspective. It is reported that action has been taken against the client in the present case. But in the case of the broker, close co-ordination with the client in reversing the trades has to be established. As already observed above, the adjudicating officer has proceeded from the assumption that the reversal took place over a number of days repeatedly over a period of time. The adjudicating officer has not established that reversal took place repeatedly over a period of time. The details of trades contained in the grounds of appeal and the details of buy and sell orders would show that there was no pattern of trades spread over a period of time in a repeated fashion. We do agree that reversal trades are manipulations and they are fraudulent. But in the circumstances of the present case the adjudicating officer has not established a pattern of reversal trades which would show the fraudulent involvement of the appellant in the impugned transactions.

8. The decision of the adjudicating officer in the case of M/s. Prabhat Financial Services Ltd. mentioned above may not be of much help to the appellant since the facts are not identical. The decision of this Tribunal in the case of Ashok K. Chaudhary vs. Securities and Exchange Board of India (Appeal no.69 of 2008) decided on November 5, 2008 lays down the ratio that reversal/circular trades are fraudulent in the facts of that case. We are of the view that the facts of the present case can stand in their own right. As observed above, nexus between the parties for establishing reversal trades has not been brought on record in the present case. The reference to mere matching of a few trades may not necessarily point to fraudulent intention of the appellant. Screen based trading functions on the basis of anonymity and sometimes orders may get matched when trades are executed keeping in mind price, time and volume. But it is important to establish the nexus between the parties, especially so in the case of a broker since he acts according to the directions of the client. Even though a detailed analysis of the trades is part of the adjudication order, the adjudicating officer has not been able to establish a pattern of wrong doing aimed at fraudulent practices in the market. The appellant has been able to analyse each trade which took place during the impugned period of 35 days and show that orders were placed in the normal course of business. The adjudicating officer has not established with sufficient supporting material that

the appellant was a party to a handful of matching trades which have taken place in the course of the trading as directed by the appellant. So, considering the detailed explanations offered by the appellant and the nature of the transactions we are not able to uphold the charge of reversal/circular trades in the present case.

9. With respect to the allegation regarding non compliance with the code of conduct of brokers we find that the appellant had taken all reasonable precautions to avoid possible malpractices in the market. We have already observed above that the appellant was not a party to the reversal/circular trades. There is considerable merit in the argument of the appellant that the allegation of reversal could be levelled by the Board only after perusing the trade and order logs i.e. in hindsight. The adjudicating officer has held the appellant non compliant with the standards of integrity and fairness considering the fact that alleged fraudulent transactions took place repeatedly over a period of time. But this has been considered by us above and found to be not established in the facts of the case. So the appellant cannot be hauled up in this case alleging that he has failed to exercise due diligence. The decision of this Tribunal in the case of SMC Global Securities Ltd. vs. The Adjudicating Officer, Securities and Exchange Board of India (Appeal no.176 of 2011 dated 25.11.2011) also supports the stand of the appellant.

In the result, the order of the adjudicating officer is set aside. Appeal is allowed. No costs.

Sd/-
P.K. Malhotra
Member &
Presiding Officer (*Offg*.)

Sd/-
S.S.N. Moorthy
Member

18.5.2012
Prepared and compared by
RHN