BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.75 of 2012

Date of decision: 25.7.2012

M/s. Master Capital Services Ltd.
(Pursuant to merger of M/s. MTL
Shares & Stock Brokers Ltd.)
1012, Arunachal Building,
10th Floor 19, Barakhamba Road,
New Delhi – 110 001. …Appellant

Versus

The Adjudicating Officer
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East), …Respondent
Mumbai - 400 051.

Mr. Prakash Shah, Advocate for the Appellant.

Dr. Poornima Advani, Advocate with Mr. Ajay Khaire and Ms. Rachita Romani, Advocates for the Respondent.

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

Per : S.S.N. Moorthy

The appellant M/s. MTL Share and Stock Brokers Ltd is a public limited company registered under the Companies Act, 1956 which got merged with its group company Master Capital Services Ltd. from January 5, 2012. It is a registered stock broker. Securities and Exchange Board of India (for short the Board) conducted investigation in the trading in the scrip of Rich Capital & Financial Services Ltd. (hereinafter referred to as the company) for the period March 27, 2009 to August 12, 2009. The investigation was triggered on account of sharp price rise in the scrip and heavy volumes in the trading in the market. The price of the scrip rose from ` 8.90 on March 27, 2009 to ` 80.15 on August 12, 2009. The investigation period related to 138 trading days. The appellant was found to be one of the top brokers in the scrip and it traded for its clients Big Brokers Houses Stocks Ltd. and Mr. Sanjeev Agarwal. The investigation revealed reversal/circular trades contributing to artificially inflated price rise and volumes. The appellant, being the

broker of the clients mentioned above, was charged with violation of regulations 3 and 4 of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 and regulation 7 read with clause A of the code of conduct for stock brokers specified under Schedule II of Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulation, 1992 (hereinafter referred to the FUTP Regulations and Brokers Regulations respectively). A show cause notice was issued to the appellant on June 23, 2011 calling upon the appellant to show cause why penalty should not be imposed under sections 15HA and 15HB of the Securities and Exchange Board of India Act, 1992 (the Act) for the aforesaid violation. After due consideration of the replies filed by the appellant the adjudicating officer absolved the appellant of the charge of violation of FUTP Regulations. However, he held it liable to penalty under regulations governing code of conduct of brokers. Accordingly a penalty of ` 2 lacs was imposed under section 15HB of the Act. In the present appeal the appellant objects to the imposition of the above penalty.

2. Shri Prakash Shah, learned counsel appearing for the appellant, argued at length contending that the adjudicating officer has not established any case of negligence or lack of due diligence in the case of the appellant after exonerating it from the charge of violation of FUTP Regulations. It is submitted that after having satisfied with the credentials of the clients the appellant provided them with the facility of Internet Based Trading (IBT) and the clients, in turn, placed orders on the trading terminals. The appellant and the clients had no direct relationship other than through the trading activity and they were acting through one of the sub brokers HMV Investments (HMV). It is submitted that the appellant had taken all reasonable care by putting in place proper surveillance mechanism as directed by the Board from time to time and it had no reason to suspect the trades as and when they were put on the terminal. The trades were executed by the clients by themselves using IBT facility and the appellant had no knowledge about the manipulative transactions, if any, entered into by the clients. The appellant had no opportunity to know the counter party in respect of buy transactions in the trading system of the exchange because of its essential feature of anonymity. It is argued that the percentage of alleged manipulation was meager as compared to the total volume of transactions handled by the appellant as a broker and

there were no negative signal from any quarter warranting the appellant's alertness or remedial action. Having satisfied with the bonafides of the customers through KYC norms, the appellant had allowed them to trade in its terminal through the sub broker. It had no knowledge, let alone participation, in the alleged manipulative trades and so the imposition of penalty on the charge of negligence and lack of due diligence is not warranted in the present case. It is also emphasized that the appellant, having been found to be not guilty in the manipulative trades there is no basis for charging it with negligence in the absence of specific material showing its involvement, participation or other acts in this regard which would point to deliberate negligence of the code of conduct.

3. Dr. Poornima Advani, learned counsel for the respondent Board, supported the order of the adjudicating officer holding the view that the appellant should have been alert when cross trades took place between two clients on its terminal. According to her, the appellant cannot avoid its responsibility of due care since the manipulation took place in its trading terminal. It is submitted that the scrip in question was illiquid at the relevant point of time and that itself should have alerted the appellant for taking extra care with regard to the transactions taking place in its terminal. Since the contract notes are issued by the appellant it should have checked the cross trades which took place in the present case and so the appellant had failed in its duty of exercise of due diligence. With reference to the charge contained in the show cause notice the learned counsel for the Board would observe that the appellant has contributed to the manipulative trades due to its negligence even though it had no active role in the manipulation.

4. We have considered the rival submissions. It is necessary to refer to the charge leveled against the appellant in the show cause notice for a proper appreciation of the stand taken by the adjudicating officer. For ease of reference, the allegation as contained in the show cause notice is extracted below:

> "In view of the above mentioned facts, it is alleged that while dealing on behalf of the clients you have contributed to new high price, entered into trades at a higher price than the last traded price in the scrip and also executed reversal/circular trades thereby created artificial volumes in the scrip of RCFL and manipulated the price of the scrip which led to manipulative, fraudulent and unfair trade in the scrip during the investigation period.
> It is therefore alleged that you have violated Regulation 3, 4(1), 4(2)(a), (b), (e) and (g) of the SEBI (Prohibition of fraudulent and Unfair Trade Practices relating to Securities Market) Regulation, 2003 and Regulation 7 r/w clauses

> A(2), (3), (4) and (5) of the code of conduct for stock brokers specified under Schedule II of SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992."

A reading of the charge makes it clear that it is basically one of violation of FUTP Regulations. While dealing with the statutory provisions relating thereto the adjudicating officer has split the charge into two – one relating to the violation of FUTP Regulations and the other relating to code of conduct of brokers. However, the charge as contained in the show cause notice would show that basically the wrong doing is one relating to FUTP Regulations and the connected charge of violation of code of conduct of brokers has been added to it since in normal practice violation of FUTP Regulations and that of code of conduct for brokers go hand in hand. In the present case, admittedly, the appellant had been absolved of the primary charge of violation of FUTP Regulations. Finding of the adjudicating officer with respect to violation of FUTP Regulations reads as under in the impugned order:

> "I find merit in the submissions of the Noticee and observe that there is no clear indication to impute knowledge on part of the Noticee or to prove that it played any active role in market manipulation. Therefore the violation of Regulation 3, 4(1), 4(2) (a), (b), (e), and (g) of SEBI (Prohibition of fraudulent and Unfair Trade Practices relating to the Securities Market) Regulation, 2003 does not stand established against the Noticee."

5. The short issue to be decided in the present case is whether the appellant can be held guilty of violating the code of conduct for brokers after having been found that there is no clear indication to impute knowledge on the part of the appellant or to prove that it played an active role in the market manipulation. Having regard to the stand taken by the adjudicating officer with regard to the primary charge of violation of FUTP Regulations and the facts brought on record with regard to lack of due diligence in the impugned order we are of the view that the appellant cannot be held guilty of violating the code of conduct for brokers. The main plank of the finding of the adjudicating officer is that though the clients traded through the sub broker the ultimate responsibility to monitor the transactions is on the appellant and it should have taken due care especially when the impugned scrip was illiquid. When we consider this finding in the backdrop of the case, we have to hold that the adjudicating officer has not established any case of negligence or lack of due diligence with reference to the conduct of the appellant. The appellant's clients were Big Brokers Houses Stocks Ltd. and Mr. Sanjeev Agarwal in the transactions relating to the

company. It is on record that the appellant provided the IBT platform to the clients to put in their trades. It is also on record that the clients registered their trades by themselves and they acted through a sub broker HMV. In this background, the appellant's responsibility is one of overall supervision of the trades registered in its terminal. The appellant was satisfied about the credentials of the clients as established through KYC norms and other guidelines circulated by the Board from time to time. So, prima facie, the appellant had no reason to suspect the conduct of the clients or the trades put in by them through the sub broker. There was no contemporaneous signal to alert the appellant to the alleged manipulative trades. It is true that the clients engaged themselves in certain manipulative trades on the terminal of the appellant. But there was no alert from the stock exchange or other sources when the alleged manipulations took place. In hindsight, the transactions may be termed as manipulative and fraudulent but there was no occasion for the appellant to suspect the transactions in the trading platform when the clients engaged themselves directly in the transaction through the sub broker. Due care and diligence as contemplated in the regulations governing code of conduct of brokers relates to due care and diligence as expected of a prudent broker operating in the normal circumstances of the market. In short, the appellant has exercised due care and put in place necessary surveillance systems as envisaged by the regulator. In the present case, the alleged manipulative trades constitute only a very minor percentage as compared to the total trading volume of the appellant. The observation of the adjudicating officer that the appellant should have exercised a "higher level of diligence" since the shares were illiquid cannot also be laid down as a basic norm for trading by the brokers. This aspect has to be seen along with other relevant considerations. Above all, in the system of trading which is anonymous, the buy orders put in by the clients cannot be verified instantaneously by the broker. In fact, the screen based trade mechanism is formulated in such a way that the counter party cannot be identified immediately and so the trades are allowed to take place in an objective manner. It is also on record that the appellant had no connection with the clients and the sub broker apart from the normal trading relationship.

6. A reference has been made by the appellant's learned counsel to the decision of this Tribunal in Indiabulls Securities Limited vs. Securities and Exchange Board of India

Appeal no.51 of 2009 decided on October 26, 2010. It has been held in the above decision that:

> "……..even if we assume that the appellant's clients had executed reverse trades with the same counter party for some mischief, we cannot impute knowledge of the same to the appellant when the anonymity of the trading system does not allow a broker to know who the counter party or counter party broker is. The screen based trading system provides complete anonymity and the trades are executed through the price order matching mechanism."

7. The observation of this Tribunal in Kishore R. Ajmera vs. Securities and Exchange Board of India Appeal no.13 of 2007 decided on February 5, 2008 are also noteworthy.

> "Merely because two clients have executed matched trades, it does not follow that their brokers were necessarily a party to the game plan. On a screen based trading through the price order matching mechanism of the exchange, it is not possible for either of the brokers (or sub-brokers) to know who the counter party or his broker (or sub broker) is and when the trade is executed, their names or codes do not appear on the screen. A unique feature of the stock exchange is that, unlike other moveable properties, securities are bought and sold among the unknowns who never get to meet and they are traded at prices determined by the forces of demand and supply. If the Board is to hold the broker (or the sub-broker) responsible for a matching trade, it has to allege and establish that the broker (or the sub-broker) was aware of the counter party or his broker at the time when the trade was executed. There is no such allegation in this case."

8. The decision of this Tribunal in Saroj & Co. proprietor Sanjay Agrawal vs. The Adjudicating Officer, Securities and Exchange Board of India Appeal no.213 of 2011 decided on May 18, 2012 is also to the effect that the allegation of reversal could be leveled by the Board only after perusing the trade and order logs, that is, in hindsight and the appellant had no chance to evaluate the trades as and when the trades took place.

9. With regard to the quantum of transactions it is observed from the records that the clients of the appellant executed 23 trades contributing to price rise of ` 20.20 and 10 trades contributing to ` 9.40 during the period of investigation. It is admitted that the appellant has a large client base and the daily turnover is around 36 crores and as against the above, the volume of manipulation noticed is very small.

10. It was submitted by the learned counsel for the Board that each case law is unique in its facts and the present case has to be appreciated in the background of the manipulative trades and overall responsibility of the broker. On a consideration of the facts on record and the case laws referred to by us hereinabove, we are of the view that no specific material

evidence has been brought on record to establish lack of diligence by the appellant in the present case. So the penalty imposed in the present case for violation of code of conduct of brokers cannot be upheld in the facts of the case. The order of the adjudicating officer is set aside and appeal allowed. No costs.

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

Sd/-
S.S.N. Moorthy
Member

25.7.2012
Prepared and compared by
RHN