

**BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI**

Appeal No. 143 of 2008

Date of decision: 29.06.2009

M/s. Dimensional Securities Pvt. Ltd. Appellant

Versus

Securities and Exchange Board of India Respondent

Mr. Somasekhar Sundaresan, Advocate with Mr. Ravichandra S. Hegde for the Appellant.

Mr. Kumar Desai, Advocate with Ms. Daya Gupta, Advocate for the Respondent.

CORAM : Justice N.K. Sodhi, Presiding Officer
Samar Ray, Member

Per : Justice N.K. Sodhi, Presiding Officer (Oral)

This order will dispose off two appeals no. 143 and 148 of 2008 both of which arise out of similar set of facts though the adjudicating officer passed separate orders imposing penalty on each of the appellant. A penalty of Rs. 50,000/- has been imposed on Ms. Sharda Mehta the appellant in appeal no. 148 of 2008 and her broker who is the appellant in the other appeal has been levied a penalty of Rs. 2 lacs under two different heads. Since arguments were addressed in appeal no. 143 of 2008, the facts are being taken from this case.

SOFTBPO Global Services Limited (for short the company) is a public limited company whose shares are alleged to have been manipulated by Ms. Sharda Mehta who traded in the scrip through M/s Dimensional Securities Pvt. Ltd. (hereinafter referred to as the broker). The shares of the company are listed on the Bombay Stock Exchange Ltd. (BSE). The total paid up capital of the company is Rs. 15 lacs and total number of shares are 1,50,000 of Rs. 10/- each. The promoters of the company hold 88.9% of the

shares and the remaining are with the public including individuals and private corporate bodies. It is common ground between the parties that the scrip of the company is thinly traded on BSE. During the period from February 14, 2005 to March, 21, 2005, BSE observed abnormal increase in the price of the scrip. It submitted its report to the Securities and Exchange Board of India (for short the Board) which conducted its own investigations relating to the buying, selling or dealing in the shares of the company during the period from May 14, 2004 to March 29, 2005. The investigations revealed that the price of the scrip increased from Rs. 15.20 to Rs. 230.40 in 34 trading days. The Board prima-facie found that the broker who traded on behalf of Ms. Sharda Mehta in the scrip created artificial volumes which resulted in substantial rise in the price of the scrip. It also found that the broker failed to exercise due care and diligence and thereby violated the Code of Conduct prescribed for the stock brokers. Accordingly, notice dated October 3, 2007 was issued to the broker calling upon it to show cause why adjudication proceedings be not initiated against it. The broker filed its detailed reply dated October 30, 2007 denying all the allegations. It was pointed out that Ms. Sharda Mehta was a bonafide client and that it had exercised due diligence and had also complied with all the guidelines relating to 'Know Your Client'. It would be pertinent to extract the relevant portion of the reply submitted by the broker and it reads as under:

"1. We had earlier placed the full facts before SEBI during our various submissions. We would like to place the following facts again for your consideration :

- a. Mrs. Sharda Mehta (hereinafter referred to as "SM"), is our bonafide client and we had exercised adequate due diligence and had also complied with all the then applicable guidelines relating to "Know Your Customer" before accepting SM as our client.
- b. SM is a small investor. SM acquires low priced shares in small quantity particularly of companies where there has been some announcement in the past. Datamatics group had come out with open offer to acquire equity shares of SOFTBPO Global Services Ltd. (hereinafter referred to as "SGGL") in November 2002. During the period in which SM placed order for shares of SGGL, SGGL was known as Datamatics Global Services Ltd. and was part of very well known group with reputed management. Armed with this information, SM, in

her own wisdom, decided to acquire about 2,000 shares in SGGL.

- c. SGGL had a low equity base and very low floating stock. Due to this reason, the shares of SGGL were very infrequently and thinly traded. In view of this, SM stood the chance of acquiring the SGGL's shares only if her order was the first order in the trading system.
- d. SM placed her 1st order on 14th May 2004, which was at a price lower than the last traded price. Since, SM could not get any share, SM decided to place order at the upper band fixed by the Bombay Stock Exchange (hereinafter referred to as "BSE") so that she stands to get a chance to acquire shares of SGGL. SM kept on placing the orders, intermittently at the same price for the next 2½ months (between 17th May 2004 and 5th August 2004) and did not get a single share. For the next 15 days (between 6th August 2004 and 20th August 2004), SM again placed the order intermittently at the upper price band and did not get any share. For the next 20 days (between 26th August 2004 and 16th September 2004), SM again placed the order intermittently at the upper price band and did not get any share. For the next 15 days (between 22nd September 2004 and 7th October 2004), SM again placed the order intermittently at the upper price band and finally could get 50 shares having market value of less than Rs. 1,600. Even those shares were not delivered by the seller and as such the trade was closed out by the BSE. For the next 1 month (between 9th October 2004 and 4th November 2004), SM again placed the order intermittently at the upper price band and did not get any share. This was continued for the next 2 months and in between SM could get a total of 200 shares on three occasions, which were not delivered by the seller, as in the past, and accordingly had to be closed out. With the increase in the price, the SM reduced the quantity of shares to be purchased.
- e. As you are aware, the trading system of BSE does not have facility of placing orders which are "Good Till Cancelled". Orders, which could not be executed on a particular day, get cancelled and if the client would like to acquire shares, he has to place order again on the next trading day. SM had never placed order of more than 2000 shares and the average value of order placed by SM was less than Rs. 50,000 during the period under investigation.
- f. SM is not, directly or indirectly, connected with the promoters or management of the SGGL. Each order was keyed in by us on receipt of specific order by us.
- g. As stated in your letter referred to above, BSE in its finding had observed that no common / connected client dealing through more than one member was observed. Also, no connection of the major clients with company or its promoters could be established.

2. As mentioned above, to be first in the queue, orders were placed first thing in the morning, which resulted into almost 95% of the orders being rejected by the BSE system. As you are aware, the rejected orders are not displayed on the trading terminal of the members, it can not have any impact whatsoever either on the price, volume or order quantity as order is

rejected by the system before a valid order no. is generated. Thus, 113 valid orders (with each order not exceeding 2,000) only were visible to other trading members over a period of about 10 months.”

On a consideration of the reply and the material collected by the adjudicating officer during the course of the enquiry, he came to the conclusion that both the charges levelled against the broker stood established and by his order dated September 18, 2008 imposed a penalty of Rs. 1 lac under section 15HA and another sum of Rs. 1 lac under section 15HB of the Securities and Exchange Board of India Act, 1992. Hence this appeal.

We have heard the learned counsel for the parties and are of the view that the impugned order cannot be sustained. As regards the charge pertaining to the violation of the Code of Conduct, the adjudicating officer has recorded his findings against the broker in para 20 of the impugned order and this is what he has said -

“20. Further, as regards the allegation that the noticee was placing the buy orders before starting of day trading sessions, the noticee has submitted that its client was not able to get the shares at lower rate and hence there was no alternate but to bid the same at higher rate and in order to get the preference over other buyers, the client wanted to place her order as earlier as possible. It is to be noted that this pattern of trading and creating heavy buy pressure before the opening of the market lead to establishing higher opening price. In this regard it is pertinent to note that such pattern of placing the orders continued for a period of 34 days. Further on the said 34 days the orders were placed at upper circuit rates. Out of 2,122 buy orders placed / updated by it 2,009 buy order have been rejected by the exchange mechanism. This is not the normal pattern of behaviour observed by the brokers. Such pattern of placing the orders continuously influenced the price of the scrip to a great extent. Further by placing continuous buy orders inspite of being aware that its orders were getting cancelled the noticee failed to exercise due care and diligence as a broker.”

It is not in dispute that the broker on behalf of its client was placing large number of buy orders before the commencement of the trading session over a long period of time which orders were not being accepted by the system. Referring to this pattern of trading by the broker, the adjudicating officer has observed that this created heavy buying pressure before the opening of the market which led to establishing the higher opening price. We are unable to agree with this observation. It is the case of the adjudicating

officer himself that out of 2,122 buy orders placed by the broker, 2,009 buy orders had been rejected by the exchange mechanism. It is a matter of common knowledge that orders that are rejected by the system of the exchange do not appear on the system and that neither the market nor the investors are aware of those orders. Such orders cannot possibly affect the market mechanism nor can they influence the opening price. When the orders that were rejected did not influence the market or the price of the scrip, we fail to understand how the broker failed to exercise due care and diligence in the conduct of his business. The reason why the broker was putting in buy orders before the start of the trading session is not far to seek. It is not in dispute that the buy and sell orders match on the screen of the system subject to price time priority. The orders punched in the system earlier in point of time sometimes have priority in the execution of the trade and this is the reason why the brokers punch in the orders even before the start of the trading session. We had an occasion to examine this aspect of the matter in M/s. Jagruti Securities Ltd. versus Securities and Exchange Board of India appeal no. 102 of 2006 decided on 27.10.2008 and this is what we observed.

“The adjudicating officer has rightly observed that on a screen based trading system, buyers and sellers put in their orders through their respective brokers and the trade gets executed only when the buy and sell orders match subject to price time priority. We may like to add that the price time priority signifies two things; first is the matching of price and second is the priority in point of time. When a buy order is placed on the system, it will be matched with the best sell order (lowest price) available on the system subject to the condition that no buyer will be made to buy at a price more than what he has offered. If more than one pending sell orders match the buy order, the sell order placed earlier in point of time will be picked up to complete the trade. Similarly, a sell order will be matched with the best buy order (highest price) subject to the condition that no seller will be made to sell at a price lower than what he has fed into the system. If more than one pending buy orders match the sell order, the buy order placed earlier in point of time will be matched first. This is how the price discovery mechanism of the system works as it is based on the free inter play of the forces of demand and supply.”

The brokers sometime place orders before the start of the trading session in an effort to ensure that their order is first in point of time. This is quite a common feature and nothing much should be read into it. This usually happens when the scrip is thinly

traded. We do not think that in the instant case the broker violated the Code of Conduct prescribed under the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations 1992. The findings of the adjudicating officer in regard to this charge are set aside.

Now coming to the charge of manipulation levelled against the broker. This charge as contained in the show cause notice dated October 3, 2007 reads as under –

“3. Further, it is also alleged that on most of the days the buy orders were placed before starting of day trading sessions and because of this, out of 2,122 buy orders placed continuously, 2,009 buy orders were rejected by the exchange mechanism, and in view of the same it is alleged that you were interested in increasing the price of the scrip by placing continuous buy orders at higher price and thereby created artificial price rise in the market and indulged in the act of manipulating the market in the scrip of SGCL. The relevant extracts of the investigation report, which details the violations alleged to have been committed by you, is annexed herewith as Annexure A. The violations attract penalty under section 15HA of the SEBI Act.”

It is a fact that the appellant as a stock broker was placing buy orders on behalf of Ms. Sharda Mehta. It is also not in dispute that it placed large number of buy orders continuously before the start of the trading session and that out of 2,122 buy orders placed, 2,009 orders had been rejected by the exchange mechanism. On this basis it was alleged that the broker was interested in increasing the price of the scrip by placing continuous buy orders at a higher price and thereby increase the price of the scrip artificially and indulged in the act of manipulating the scrip. The scrip of the company was trading under ‘Z’ group as the company had not signed with the depositories which means that the scrip of the company was not compulsorily deliverable in demat form. The adjudicating officer found that the company had made a meagre profit and the earning per share was running into negative figures. He also found that there had not been any corporate announcement regarding dividend or bonus or any such announcement which could create investors interest in the scrip. Having said this, the adjudicating officer jumps to the conclusion that the broker had manipulated the scrip. How that manipulation took place is not disclosed nor has he referred to the trades or

the manner in which those were executed by the broker on behalf of its client which could throw some light regarding manipulation. Merely because the price of the scrip increased from Rs. 15.20 to Rs. 230.40 is by itself is not enough to conclude that the broker had manipulated the price of the scrip. Again, the broker had placed buy orders ranging from Rs. 15/- to Rs. 119.05 on behalf of Ms. Sharda Mehta and this by itself is not enough to conclude that the price was being manipulated. The adjudicating officer has himself noticed in para 12 of the impugned order that the total percentage of the buy orders placed by the broker was 5.21. This clearly indicates that there were large number of other investors who were buying the scrip in the market and the broker was not the only one. Who was responsible for the increase in the price is not borne out from the record. We cannot, therefore, uphold the findings of the adjudicating officer that the broker manipulated the price of the scrip upwards and raised it from Rs. 15/- to Rs. 230.40. It is on record that the broker had placed the buy orders only between Rs. 15/- and Rs. 119.05. Moreover, we cannot loose sight of the fact that the broker having traded on behalf of Ms. Sharda Mehta for about 11 months could purchase only 250 shares for her. This fact is not only admitted but is borne out from the trade log which is on the record. We do not think that this miniscule purchase by the broker could by itself result in manipulating the price of the scrip or could even affect the market in any manner whatsoever. Again, we cannot agree with the adjudicating officer that the broker created artificial demand of shares and created artificial price rise in the market. We have already observed that the rejected orders do not affect the market at all and Ms. Sharda Mehta had a demand for only 2,000 shares which appears to be within her means. Be that as it may, artificial increase in the price could be created only if there was collusion between the buyer and the seller and had that been so, the broker would not have taken 11 months to purchase only 250 shares. The findings in this regard cannot, therefore, be upheld.

Before concluding, we may mention that the broker in its reply had furnished an explanation as to why the orders were repeatedly placed before the start of the trading

sessions continuously for months together. The pleas taken by the broker in its reply though noticed in the impugned order have not been dealt with by the adjudicating officer. It is also pertinent to mention that the adjudicating officer has referred to 2,122 buy orders placed by the broker on behalf of its clients giving an impression that it was trading very heavily in the scrip which was admittedly illiquid. The impression sought to be created is not correct. The trading system at BSE did not have the facility of placing orders such as “Good Till Cancelled” and the orders which could not be executed on a particular day got automatically cancelled and fresh orders were placed on the following day. The adjudicating officer seems to have added all the orders to arrive at the figure of 2,122 which gives the impression of very heavy trading. As a matter of fact, Ms. Sharda Mehta was trying to purchase only 2,000 shares during the period of about 11 months when she traded through the broker and could manage to purchase only 250 shares. As already observed, we are not inclined to accept the plea of the respondent that this could have manipulated the price of the scrip.

In the result, the appeal is allowed and the impugned order set aside with no order as to costs.

Sd/-

Justice N.K.Sodhi
Presiding Officer

Sd/-

Samar Ray
Member

29.06.2009

Prepared and compared by :
msb