

**BEFORE THE SECURITIES APPELLATE TRIBUNAL  
MUMBAI**

**Appeal No. 64 of 2007**

**Date of decision: 19.11.2010**

M/s. Active Finstock Pvt. Ltd.  
1801, Stock Exchange Tower,  
Dalal Street, Mumbai – 400 001.

.....Appellant

Versus

Securities and Exchange Board of India  
Mittal Court, B Wing, 1<sup>st</sup> Floor,  
22, Nariman Point,  
Mumbai – 400 021.

..... Respondent

Mr. P. N. Modi, Advocate for the Appellant.

Dr. Poornima Advani, Advocate with Ms. Pranita Mhatre, Advocate for the Respondent.

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

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

This appeal is directed against the order dated May 24, 2007 passed by the whole time member of the Securities and Exchange Board of India (for short the Board) holding the appellant guilty of violating Regulation 4(a), (b) and (c) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 and also Clause A(2) of Schedule II read with Regulation 7 of the Securities and Exchange Board of India (Stockbrokers and Sub-brokers) Regulations, 1992 and imposing a minor penalty of suspension of its certificate of registration for a period of one month. The appellant is a stockbroker registered with the Board and it executed trades on behalf of its clients in the scrip of Mazda Fabrics and Processors Limited (hereinafter referred to as the company). It is not in dispute that the appellant executed trades in the scrip of the company on behalf of M/s. Chirag Investments, a proprietorship concern and also on behalf of Khandwala Finstock Pvt. Ltd., Ayush & Co., and Kejriwal Investments.

Most of the trades that have been impugned in the proceedings culminating in the passing of the impugned order had been executed on behalf of Chirag Investments. Before we deal with the charges levelled against the appellant, it is necessary to refer to the background in which those charges had been levelled.

2. The Board carried out investigations into the market manipulation in the scrip of the company and examined the trading details of various entities who traded in the scrip including the appellant before us. Investigations revealed that the company had come out with a public issue in the year 1996 which was under subscribed. Bharatkumar Babulal Jain and Prakash Jain were the promoters of the company and they approached Anil Jain, Suresh Bafna and Ashok Bharadia who were the directors of Wallfort Financial Services Limited (for short Wallfort) to bail out the issue. Clio Finance Limited which was also promoted by the promoters of Wallfort were appointed the merchant bankers to the public issue and it was also the co-lead manager to the issue. It is the case of the Board that the promoters of Wallfort had brought in some financiers who pumped in money and the issue went through. It is not necessary for us to go into the details of this aspect any further as that is not relevant for deciding the present appeal. Apart from bailing out the public issue, the brief given to the promoters of Wallfort was to rig the price of the scrip of the company upwards and with this object in view, they brought in several clients some of which are said to be fictitious entities and they opened several trading and bank accounts. Several brokers including the appellant were also brought in through whom the entities are said to have traded in the market. It is also the case of the Board that these entities then traded in the scrip of the company among themselves and executed circular trades thereby increasing artificially the volumes and also raised the price of the scrip. The appellant was found to be one of the top six brokers which contributed to the total volumes on the exchange and which had actively traded in the scrip on behalf of Chirag Investments and some others. Investigations further revealed that the trades of the appellant in the scrip of the company on behalf of Chirag and Khandwala constituted 2.9 per cent and 2.33 per cent of the total

volumes on the exchange. In view of these findings in the investigations, the appellant was served with a show cause notice dated June 2, 2004 alleging violation of Regulation 4(a), 4(b), 4(c) and 4(d) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 and the code of conduct prescribed for the stockbrokers. The appellant was called upon to show cause why suitable action be not taken against it for the aforesaid violations. The show cause notice had 8 annexures annexed thereto which obviously form part of the said notice. Since we are of the view that the allegations made in the show cause notice read with the annexures thereto even if taken to be correct do not make out a case against the appellant, we are reproducing the operative part of the show cause notice hereunder for ease of reference:-

“Investigations have been conducted by SEBI into the case of Mazda Fabrics and Processors Ltd. (MFPL). The findings of the investigation are enunciated below:

1. It is observed that your major client, trading in the shares of the company Mazda Fabrics and Processors Ltd. (MFPL), for settlement nos. 6-8 of the year 1996, was M/s. Chirag Investments. You were advised to produce this client before the investigation team. However, you failed to produce him.
2. You have stated to SEBI that Chirag Investments was introduced to you by one Shri Ashok Bharadia. From an examination of your general ledger of Chirag Investments for the year 1997-98, it is noticed that an amount of Rs.1006.60 (which was lying as credit with Chirag Investments) was transferred to Wallfort Investments account maintained with the you and Rs. 8693.40 was transferred to the account of V&U Account. As per the narration in the ledger, all these transfers were made on the instructions of Chirag investments. However, you could not produce any proof in support of this. You appear to have been aware of the link between Chirag Investments Ltd. and Wallfort (Shri Anil Jain was the Promoter Director of Wallfort Investments & Trading Ltd.). Investigation revealed that Shri Anil Jain used to operate the account of Chirag Investments.
3. You were not able to explain as to how you verified the bonafides and financial worthiness of your client. From the finding of investigation as indicated above, it is seen that you failed to take steps to verify the bonafides and financial worthiness of your client – M/s. Chirag Investments. You appear to have assisted promoter associated entities to transact heavily in the shares of the company in the name of Chirag Investments. You appear to have failed to exercise due care, skill and diligence in the conduct of your professional responsibility.
4. In addition to the above, it was also noticed that whenever you are transacting on behalf your major client – Chirag Investments, the

counter party brokers are taking the opposite position (buy/sell) shares for clients who are related to your client/associated entities of the company/its promoters. Similarly when you were selling shares for your client, these same set of brokers were the counter party brokers. This is shown in Annexure 1.

5. M/s. Sneha Investments, Subhash Trading, Rajesh Financial Services, Sikha Investments and Chirag Investments were the main buyers and sellers in the scrip of Mazda Fabrics. They had created huge volumes among themselves and these clients had a net buy position at the end of most of the settlements. By trading among themselves and generating huge volumes, they had created a false illusion of genuine liquidity in this scrip.

6. Thus, once the scrip was listed in BSE 29<sup>th</sup> May 1996, Rajesh Financial Services, Sneha Investments, Sikha Finance, Chirag Investments and Subhash Trading Co. started purchasing and selling heavily in this scrip, among themselves and were working in tandem, through brokers Saurashtra Capital Services, Bhagwandas Bhogilal & Co., SVS Securities, Active Finstock and Libord Securities respectively. These purchases/sales of these entities led to an artificial rise in the price from a level of Rs.8.50 on 6<sup>th</sup> June 1996 to a level of Rs.112.50 on 30<sup>th</sup> August 1996. This act of these entities also led to creation of artificial volume in this scrip which induced genuine unsuspecting investors also to trade in these scrips. Moreover, since the floating stocks was very less as the promoters had control of about 80% of the post issue capital, the short sellers got trapped as they were not able to deliver the shares. As a result, their sale position got auctioned and these above mentioned entities have offered the shares, on which they had control, in the auction at manipulated prices. You were a broker to the above mentioned client who indulged in such practices.

7. From the said findings of investigations and above, it is alleged that you are guilty of violation of item 2 of Clause A of Schedule II read with regulation 7 of SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 and regulation 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 read with regulation 4(a), 4(b), 4(c) and 4(d) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995.”

Of course, the appellant has denied all the allegations made in the show cause notice but without looking to the reply filed by the appellant, let us examine what is said/alleged in the show cause notice itself. Para 1 of the show cause notice does not level a charge against the appellant. We have already noticed that the appellant is a stockbroker and it had traded in the scrip on behalf of Chirag who was its main client in the scrip of the company. It is common ground between the parties that the appellant executed trades on behalf of Chirag only in the month of June 1996 as the scrip of the company was listed on May 29, 1996. It is also not in dispute that the

appellant did not trade in the scrip on behalf of any client after August 1996. The appellant had a ledger account of Chirag in its books of account and what is stated in para 2 of the show cause notice is that the Board noticed that a sum of ` 1006.60 which was lying as credit in the name of Chirag was transferred by the appellant to Wallfort and another sum of ` 8693.40 was transferred to the account of V&U, a sub-broker of the appellant. It is further stated that these transfers were made on the instructions of Chirag. Para 2 of the notice also talks about some links between Chirag and Wallfort without furnishing any further details and then it is alleged that the account of Chirag was being operated by Anil Jain who is admittedly one of the promoters of Wallfort. We do not think that any charge is made out against the appellant in para 2 of the show cause notice. There is nothing wrong in the amounts being transferred by the appellant to the account of others on the instructions of Chirag. Again, if Anil Jain, a promoter of Wallfort was operating the account (we do not know whether it was the bank account or the trading account) of Chirag we cannot understand how the appellant who is a broker is concerned in this regard nor do the allegations made in para 2 establish the violation of the provisions referred to in the show cause notice. Now we come to para 3 of the show cause notice. It appears to us to be contradicting what is said in para 2. It is alleged that the appellant could not explain as to how he verified the bonafides and financial worthiness of Chirag whereas in para 2 of the show cause notice it is clearly stated that Chirag had been introduced to the appellant by Ashok Bharadia who was the managing director/promoter of Wallfort. Having observed that the appellant had failed to verify the bonafides and financial worthiness of Chirag, the Board immediately jumps to the conclusion that the appellant assisted promoter associated entities of the company to transact heavily in the shares of the company. We fail to understand how this follows even if the appellant had failed to verify the bonafides of Chirag. It may be mentioned that the Board by its circular of November 18, 1993 had issued some instructions to the brokers some of which were mandatory while others were guidelines to be followed as and when circumstances warranted. One of

the mandatory requirements for every stockbroker was to “Ensure that the client is personally known to the member-broker or has been introduced to him by a person known to him.” This was the only requirement which the stockbrokers were required to comply with at the relevant time. However, in the year 1998 “know your client” guidelines were issued where more stringent conditions were laid down for the brokers to verify the antecedents of their clients. We are not concerned with those. It is, thus, clear that in the year 1996 when the impugned trades were executed, it was enough if a client had been introduced to a broker by a person known to him. The show cause notice itself states in para 2 that Chirag had been introduced to the appellant by Ashok Bharadia, the managing director of Wallfort. Where was then the need for the appellant as a broker to verify further antecedents of the client. The allegations made in para 4 of the show cause notice are equally incomprehensible. It is alleged that when Chirag traded through the appellant, the counter parties were either related to Chirag or were associated entities of the company or its promoters. So what, if the clients of both the sides were related to each other. Let us not forget that the appellant was only a broker and the trades executed do not become invalid or artificial merely because the clients of the two brokers may be related or associated unless some further mischief or wrongdoing is alleged which is not the case here. It is also well known that the trading system is anonymous which does not enable one broker to know who the counter party is or even the counter party broker at the time of executing the trade. What is alleged in para 4 of the show cause notice is sought to be substantiated by the chart contained in annexure 1 thereto. Obviously, annexure 1 to the show cause notice has to be read as a part thereof. When we look at the chart in Annexure 1, the heading thereof suggests that the appellant alongwith other brokers is said to have executed some circular trades, the details of which were furnished to the appellant in this chart. Whatever else this chart may show, it does not indicate that the appellant had executed any circular trade. A circular trade is a trade where two or more persons join hands together and start trading in a scrip among themselves. To illustrate, A

sells to B and B sells to C and C sells it back to A. The circle gets completed when the shares come back to A. The circle may consist of two or more persons. The chart in annexure 1 does not show any such circular trading. It only reveals that one Rajesh Financial Services sold 62,500 shares in settlement no. 6 out of which the appellant purchased 15,000 shares on behalf of Chirag. There is no further trading by the appellant during this settlement. The chart further shows that in settlement no. 8, Rajesh Financial Services sold 20,700 shares of the company out of which the appellant purchased 7,200 on behalf of Chirag. The remaining quantities were purchased by others. There are no other trades shown to have been executed by the appellant in this chart. It is pertinent to mention at this stage that in the year 1996 the settlement cycle was of two weeks and it is always open to traders and brokers to buy and sell shares within a settlement cycle which trades are settled at the end of the settlement period. Since the appellant executed one trade each in settlements no. 6 to 8 and there is no further trade shown to have been executed, we wonder how the Board could allege that these trades were a part of circular trading. Annexure 1 on the face of it does not establish the charge of circular trading and this was the only material that was relied upon in the show cause notice and furnished to the appellant. To be fair to the learned counsel for the Board, even she concedes that the chart in Annexure 1 to the show cause notice does not reflect any circular trading by the appellant. In paragraphs 5 and 6 of the show cause notice, the gravamen of the charge levelled is that the appellant alongwith some others had created artificial volumes among themselves and had a net buy position at the end of the settlements. It is also alleged that in this manner they artificially increased the price of the scrip from ` 8.50 on June 6, 1996 to ` 112.50 on August 30, 1996. We do not think that the charge on the face of it can stand. Artificial volumes are created when brokers/traders execute artificial trades. Genuine trades, no matter how many they are and irrespective of the number of shares traded, can never generate artificial volumes. An artificial trade may take a variety of forms, one of which is circular trading. Again, a trade will be fictitious/artificial if the buyer and the seller are the

same. It is nowhere stated in paragraphs 5 and 6 of the show cause notice as to how the trades were fictitious or artificial giving rise to artificial volumes. In the preceding paragraph it has been alleged that the appellant executed circular trades which fact is not established even on the basis of Annexure 1 referred to above. The other charge against the appellant is that while trading alongwith others, it had raised the price of the scrip as aforesaid. The details of the trades executed by the appellant are on the record and it is common ground between the parties that the appellant traded on behalf of Chirag in settlements no. 6 to 8. In these three settlements when trades were executed on behalf of Chirag, the rate at which the shares were traded is mentioned. The appellant traded between ` 14.97 and ` 35.92 per share. This being so, how can it be said that the trades of the appellant raised the price from ` 8.50 to ` 112.50 as alleged in the show cause notice. It is interesting to note that having alleged that the price of the scrip had been raised by the appellant, neither the show cause notice nor the annexure attached thereto refers to the price of the scrip or even to the last traded price before the trades were executed by the appellant. It is only with reference to the last traded price that a charge could be levelled that there was an attempt to raise the price upwards. In the absence of any material on the record showing the price or the last traded price, the charge in this regard must fall flat. The learned counsel for the respondent Board drew our attention to the trades executed by the appellant on behalf of Khandwala and pointed out that the trades were executed between ` 39.70 and ` 84.07 per share and argued that this is clearly indicative of the fact that the appellant was conniving with others to raise the price. We cannot accept this argument. Firstly, the trades executed by the appellant on behalf of Khandwala do not form the subject matter of the show cause notice and they have not been called in question. The appellant had no opportunity to offer its explanation. This apart, the Board has not found anything wrong with these trades either and secondly, the price of ` 84.07 that has been pointed out by the learned counsel for the Board in settlement no. 11 was in an auction carried out by the stock

exchange itself in which it purchased shares in the open market as per its own procedures. The appellant cannot be held responsible for establishing this rate.

3. There is one more allegation made against the appellant in para 6 of the show cause notice. It has been stated as a fact that the floating stock of the company was very less as the promoters were controlling about 80 per cent of the shares. Having said this, it is alleged that the short sellers got trapped in the process as they were not able to deliver the shares and meet their settlement obligations as a result whereof the stock exchange had to conduct an auction to purchase the shares from the open market to meet the delivery obligations. It is in such auctions that the appellant also offered some of the shares in settlement no. 7. It is alleged that in the auction conducted by the stock exchange, the appellant offered shares at manipulated prices. We are amazed that such a charge has been levelled against the broker. Admittedly, the auction was conducted by the stock exchange which invited open bids from the market and one of the bids of the appellant was accepted by the stock exchange. How can it be said that the appellant had offered shares at manipulated prices. Had it been so, the stock exchange would not have accepted the same because it was the exchange that was buying the shares. The charge as made against the appellant in this regard must also fail.

4. Having heard the learned counsel for the parties and after going through the show cause notice we are satisfied that no case whatsoever is made out against the appellant and, therefore, the impugned order holding the appellant guilty cannot be sustained. In view of these findings of ours, it is not necessary to examine the other contentions of the learned counsel for the appellant challenging the findings recorded in the impugned order.

5. Before concluding, we may notice another argument advanced by the learned counsel for the respondent. She has placed before us a compilation of documents including extracts of the order logs to contend that the appellant as a broker had executed circular trades with other brokers. The learned counsel for the appellant seriously disputes the correctness of the documents now placed before us for the first

time and objects to the same being taken on record. We have perused these documents and find that they contain information culled out from the trade and order logs. Apart from the fact that the appellant is seriously disputing the veracity of these documents, it is admitted before us that these documents were never examined at any stage of the proceedings to hold that the appellant and others had executed circular trades. They were not examined by the investigating officer and nor do they find mention in the enquiry report. The show cause notice reproduced hereinabove does not refer to any of these trade and order logs. These have also not been referred to by the whole time member in the impugned order. They are seeing the light of the day for the first time before us. Since the appellant has had no opportunity to controvert the documents which are not in their original form, we cannot accept the same at this stage of the proceedings. The request of the respondent for taking these documents on record is accordingly declined.

For the reasons stated above, 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

Sd/-  
P. K. Malhotra  
Member

19.11.2010  
ptm

Prepared & Compared by  
PTM