

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Date of Decision: 12.01.2016

Appeal No. 433 of 2014

Religare Securities Limited
Plot No. A-3,4,5, GYS Global,
Sector- 125,
Noida U. P. 201 301

...Appellant

Versus

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

...Respondent

Mr. Somasekhar Sundaresan, Advocate with Mr. Paras Parekh and
Ms. Neeraja Balakrishnan, Advocates i/b J. Sagar Associates for the
Appellant.

Mr. Kumar Desai, Advocate with Mr. Tomu Francis, Advocate for the
Respondent.

CORAM: Justice J.P. Devadhar, Presiding Officer
Jog Singh, Member

Per: Justice J.P. Devadhar (Oral)

1. Whether the Adjudicating Officer (“AO” for short) of Securities and Exchange Board of India (“SEBI” for short) by his order dated August 27, 2014 is justified in imposing penalty of ₹ 8 lac and ₹ 2 lac on the appellant under Section 15HA and Section 15HB of the Securities and Exchange Board of India Act, 1992 (“SEBI Act” for short) respectively is the question raised in this appeal.

2. It is relevant to note that the impugned order is a common order passed against the appellant and its client Shri. Jai Kishan Lakhmani (“said client” for short). In the impugned order, while penalty of ₹ 8 lac and ₹ 2 lac is imposed against the appellant under Section 15HA and

15HB of the SEBI Act respectively, penalty of ₹ 10 lac is imposed on the said client under Section 15HA of the SEBI Act. Appellant has filed the present appeal to challenge the penalty imposed against the appellant, whereas, the said client has not filed any appeal against the said decision.

3. Appellant is a stock-broker registered with SEBI and is a member of the National Stock Exchange Limited (“NSE” for short), the Bombay Stock Exchange (“BSE” for short) and MCX Stock Exchange Limited (“MCX-SX” for short). Apart from providing offline and online platform for its clients to trade in securities, appellant offers broking services in equity, currency and commodity market through its subsidiary. Depository participant services are also rendered by the appellant.

4. During the course of its business, appellant had provided internet based trading facility to various clients including the said client. The said client had dealt in 119 scrips during the years 2009-2010 with an approximate total turnover of ₹ 1.20 crore, out of which, the turnover in the scrip of Veritas (India) Limited (“VIL” for short) was 1.51% of the total turnover.

5. SEBI conducted investigation relating to the dealings in the scrip of VIL for the period from May 26, 2008 to October 30, 2009 and November 03, 2009 to February 06, 2010. During the said investigation it was noticed that the price of the scrip of VIL had increased from ₹ 100 as on April 06, 2009 to ₹ 825.63/- as on May 10, 2010. The investigation revealed that the said client through the internet facility provided by the appellant had sold 72 shares of VIL in 44 trades during October 23, 2009 to March 10, 2010 and purchased 107 shares of VIL in 25 trades during

March 23, 2009 to March 02, 2010 and contributed to the increase over the Last Traded Price (“LTP” for short) by ₹ 506.45. It was also noticed that the said client had placed self trades in 9 instances and traded 9 shares of VIL during January 19, 2010 to March 02, 2010 through the appellant. It was also noticed that out of the nine trades, trades executed on three days were first trades which were higher than the LTP.

6. According to SEBI, the trades in VIL executed by the said client of the appellant were fraudulent and manipulative trades and therefore show cause notices were issued to the said client as also the appellant calling upon them to show cause as to why action should not be taken against them for violating the provisions contained in the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 (“PFUTP Regulations” for short) and the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (“Brokers Regulations” for short).

7. In its reply to the show cause notice, the appellant denied the allegations made against the appellant in the show cause notice. During the course of personal hearing the appellant reiterated the submissions made in the affidavit in reply. However, the said client neither replied to the show cause notice nor participated in the personal hearing offered by SEBI.

8. By the impugned order dated August 27, 2014 it is held by the AO of SEBI that the trades in the shares of VIL executed by the said client during the period in question were fictitious transactions carried out in violation of PFUTP Regulations. Accordingly, penalty of ₹ 10 lac is

imposed against the said client under Section 15HA of the SEBI Act for violating the provisions contained in PFUTP Regulations. By the said impugned order it is held that the appellant by assisting the said client in executing fictitious trades has violated regulation 3(a),(b),(c),(d) and regulation 4(1), 4(2)(a) of the PFUTP Regulations and Clauses A(1),A(3),A(4) and A(5) of the code of conduct as specified in Schedule II under Regulation 7 of Brokers Regulations. Accordingly, penalty of ₹ 8 lac and ₹ 2 lac is imposed against the appellant under Section 15HA and Section 15HB of the SEBI Act respectively for violating the PFUTP Regulations and Brokers Regulations. In this appeal, we are only concerned with the penalty imposed against the appellant.

9. Mr. Somasekhar Sundaresan learned counsel appearing on behalf of the appellant submitted as follows:

- a) The appellant has neither directly nor indirectly entered into any transactions relating to purchase or sale of VIL shares and therefore, the appellant cannot be held guilty of violating the provisions contained in the PFUTP Regulations.
- b) Assuming that the said client of the appellant had indulged in manipulative trades, there is not an iota of evidence to establish that the appellant had connived with the said client in executing the manipulative trades. Apart from providing internet based trading platform to the said client in accordance with law, the appellant had neither aided nor abetted the said client in executing the manipulative trades. In the absence of

any evidence, the AO is not justified in holding that the appellant had aided and abetted the said client in executing fraudulent transactions in violation of PFUTP Regulations. In the present case, the appellant had permitted the said client to trade on the internet based trading platform of the appellant, in the ordinary course of business without there being any other connection or relationship between the appellant and the said client.

- c) The trades in question were entered into by the said client through his online trading account with absolutely no involvement of the appellant. In the online trading mechanism the order is placed by the client on the website of the broker and the website of the broker routes the trade to the exchange platform for execution. Thus, in the internet based trading system, the question of the involvement of the broker does not arise. The entire process is automated and software driven with no human involvement at all. Hence AO is not justified in holding that the appellant was aiding and abetting the said client in executing fictitious trades. Consequently, penalty imposed under Section 15HA of SEBI Act for allegedly violating the PFUTP Regulations is unjustified.

- d) The value and volume of the trades in question were so low that they did not raise any suspicion. Appellant had put in place automated software for surveillance and control over the activities of its clients. The appellant's surveillance system provided for alerts to be generated, where the percentage of trades was more than 20% of the market value or where the value of such transactions was more than ₹ 10,000/-. As the quantity of the trades executed by the client in the scrip of VIL was so low that no alerts could be generated.
- e) It is not the case of SEBI that the systems put in place by the appellant were not in accordance with the requirements prescribed in that regard. Since the appellant had installed appropriate mechanism to detect any suspicious or irregular trading activity by its clients, it could not be said that the appellant had violated the Brokers Regulations.
- f) The said client had traded in approximately 119 scrips during the year 2009-2010 resulting in an aggregate turnover of around ₹ 1.20 crore. Since, the turnover of the impugned trades in the scrip of VIL constituted only 1.51% of the total turnover of the said client during the investigation period stretched over a period of 3.3 years, it cannot be said that on bare perusal of the said trades, the appellant-broker ought to have

visualized that the said client was executing fraudulent trades and accordingly taken remedial measures.

- g) Appellant in discharge of its duties as a stock broker had always taken due precaution by implementing systems of checks and balances as safeguards employed in order to prevent any untoward occurrences in relation to the trades being executed by it on behalf of its clients. Only because, the trades executed by the said client in the instant case resulted in self trades, it cannot be assumed that there was manipulative intent underlying such trades by the client and that the appellant was hand in glove with the said client.
- h) On coming to know about the fraudulent transactions carried out by the client, the appellant immediately suspended the trading facility provided to the said client and also withheld the positive closeout difference of ₹ 82,987/- from the client's account of the said client which is still lying with the appellant.
- i) In the case of Arcadia Share and Stock Brokers Pvt. Ltd. which is similar to the case of the appellant, the AO of SEBI has passed an order on November 21, 2013 wherein it is held that in the absence of any evidence on record to suggest that the broker was in any manner involved with its clients in executing the

self trades, it is difficult to hold that the broker has violated the Brokers Regulations. Similarly, in the case of J.V. Stock Broking Pvt. Ltd the same AO of SEBI has passed an order on April 30, 2014 holding that where the percentage of self trades executed by the client are negligible when compared to the day's total market volume, the charges leveled against the broker that the Brokers Regulations have been violated do not stand established. In the present case, the percentage of self trades executed by the said client being negligible, the AO is not justified in holding that the appellant by failing to stop execution of such trades has failed to perform duties as contemplated under the Brokers Regulations.

- j) Any occurrence of self trade is not per se illegal. Since the trades get executed at the level of exchange, it is not possible for a broker to prevent self trades being executed by its clients. In fact the BSE and NSE by their respective circulars dated February 11, 2015 have introduced a functionality in its trading systems which prevent self trades at the level of the exchange. This factor establishes that at the relevant time it was not possible for brokers such as the appellant to prevent self trades being executed by its client. In these circumstances, the AO is not justified in holding that the appellant has violated the Brokers Regulations

and consequently not justified in imposing penalty against the appellant.

10. Mr. Kumar Desai, learned counsel appearing on behalf of SEBI, on the other hand submitted as follows:-

- a) Admittedly, nine self trades executed by the said client of the appellant were one share trades. It is not in dispute that each of the nine self trades resulted in the price rise of the scrip by about 2%. Thus the total price rise by the nine self trades was to the tune of about 18%. Bare look at these abnormal transactions would have alerted any broker who is vigilant. Admittedly, the appellant-broker failed to notice these abnormal trades executed on the internet based trading platform of the appellant. Therefore, the AO was justified in holding that the appellant-broker being not vigilant, is guilty of violating Brokers Regulations.
- b) Admittedly, shares of VIL was an illiquid scrip. Three out of nine single share trades were first trades and the buy orders placed by the said client in those three trades were higher by about 2% from the last traded price (LTP) on the previous day. If the appellant had glanced through the trades executed on those days, the appellant could have easily detected the abnormal transactions and thereupon taken remedial steps. Having failed to exercise reasonable care and caution,

appellant cannot plead that there is no violation of Brokers Regulations.

- c) Apart from the above, the finding recorded in the impugned order is that the fictitious trades executed by the client of the appellant were responsible for increase in the price of VIL from LTP by ₹ 506.45. It is further recorded in the impugned order that in 22 other trades, the said client of the appellant had traded above the last traded price. It is also recorded in the impugned order that 14 trades of the said client were found to establish new high price. Moreover, out of the 9 trades, 3 trades were first trades wherein the said client of the appellant had placed buy orders above the last traded price i.e. the last trade executed on the previous day. Since the appellant failed to notice these glaring facts, it is apparent that the appellant by being guilty of gross negligence or otherwise has permitted fictitious trades to be executed by the said client through the internet based trading platform provided by the appellant. Thus, the appellant by its conduct aided and abetted the said client in executing the fictitious transactions and hence the appellant is guilty of violating the provisions contained in the PFUTP Regulations as well as Brokers Regulations.
- d) A broker is required to put in place adequate systems or mechanism to detect all illegal and manipulative

trades including self trades and especially one share self trades. Internet trading does not absolve the broker of its responsibility to detect artificial, illegal and manipulative trades. Since the said client was permitted to enter the buy or sell orders on the internet platform provided by the broker i.e. the appellant, the appellant-broker was required to be far more vigilant and monitor the trades regularly either by manual verification or by installing stringent system in place that would detect execution of self trades. The fact that the appellant had not put in place any system or mechanism to detect self trades especially one share self trades clearly shows that the appellant had not exercised due care and skill in discharge of its duties as contemplated under the Brokers Regulations.

- e) Relying on the decisions of this Tribunal in case of Angel Broking Pvt. Ltd. vs SEBI (Appeal No. 46 of 2014 decided on 01.10.2014), M/s Jayantilal Khandwala & Sons Pvt. Ltd. vs SEBI (Appeal No. 24 of 2011 decided on 08.06.2011), Systematix Shares & Stocks (India) Limited vs SEBI (Appeal No. 21 of 2012 decided on 23.04.2012), M/s Marwadi Shares and Finance Limited vs SEBI (Appeal No. 85 of 2011 decided on 26.07.2012), Anita Dalal vs SEBI (Appeal No. 211 of 2012 decided on 03.12.2012), H.J. Securities Pvt. Ltd. vs SEBI (Appeal No. 76 of 2012

decided on 11.05.2012), Smt. Krupa Sanjay Soni vs SEBI (Appeal No. 32 of 2013 decided on 24.01.2014) and Balwinder Singh, Prop. of Gogia Investments vs SEBI (Appeal No. 103 of 2013 decided on 11.02.2014), it is submitted that since the appellant permitted fictitious trades to be executed on the internet based trading platform of the appellant, in the facts of present case it is apparent that by being guilty of not being vigilant, the appellant has aided and abetted the said client in violating the PFUTP Regulations and Brokers Regulations. Although the penalty imposable against the appellant runs into crores of rupees, after taking into consideration all mitigating factors, the AO has imposed nominal penalty of ₹ 8 lac and ₹ 2 lac under Section 15HA and 15HB of SEBI Act which cannot be said to be unreasonable or excessively harsh. Accordingly, it is submitted that the appeal being devoid of any merit is liable to be dismissed with costs.

11. We have carefully considered the rival submissions.

12. First question that is to be considered in this appeal is, whether the AO is justified in holding that the appellant has violated the Brokers Regulations and consequently justified in imposing penalty of ₹ 2 lac under Section 15HB of SEBI Act.

13. In the impugned order, the AO has recorded the submission of the appellant that the surveillance system put in place by the appellant did not generate alerts and therefore, the fictitious trades executed by the said client were not noticed by the appellant. The AO has further recorded that the appellant as a registered stock broker was under an obligation to perform its duties with due care and by failing to exercise due care the appellant has violated the Brokers Regulations.

14. Providing internet based trading platform is not akin providing STD Booth facility to a customer. In the STD Booth facility, the service provider is not expected to know the purpose for which the STD facility is being used by the customer. However, in case of internet based trading platform, inspite of the fact that the trades are executed by the client directly, the stock broker is required to monitor the trades and ensure that the trades executed by the client through the internet based trading platform are in conformity with the rules and regulations framed by SEBI.

15. Fact that the stock broker has installed requisite parameters in the surveillance system cannot be a ground for the stock broker to be complacent. It is the duty of the stock broker under the Brokers Regulations to constantly monitor the trades executed by the client through the internet based trading platform so as to ensure that the trades are executed in accordance with law and do not disturb the market equilibrium.

16. In the present case, even if the appellant had glanced through the trades executed by the said client it would have revealed that the said

client had time and again indulged in unusual trades by trading in single share trades and each of such trades contributed price rise by about 2% from the LTP. It is relevant to note that, such unusual trades were executed on nine different dates in the scrip of VIL which was illiquid. If the appellant was vigilant, in monitoring these trades then, certainly the appellant could have noticed the anomaly. Fact that in the past the said client had traded through the internet based trading platform provided by the appellant for crores of rupees in accordance with law cannot be a ground for the appellant to take it easy and wait for the alerts to be generated by the surveillance system put in place by the appellant. Similarly, fact that the appellant took prompt remedial steps after the fictitious trades executed by the said client were brought to the notice of the appellant by the stock exchange cannot be a mitigating factor in favour of the appellant for falling to monitor the trades executed by the said client.

17. Decisions of SEBI in case of Arcadia Shares and Stock Brokers Pvt. Ltd. (supra) and J.V. Stock Broking Pvt. Ltd. (supra) relied upon by the counsel for SEBI do not support the case of the appellant. No doubt that in those cases also self trades were executed. However, in the present case, it is relevant to note that nine self trades were single share trades which could be easily detected on perusal of day's trade. This factor distinguishes the present case, from the aforesaid two decisions.

18. For all the aforesaid reasons, it is difficult to hold that the appellant was vigilant in monitoring the trades executed by the said client through the internet based trading facility provided by the appellant. Therefore,

the decision of AO that by not being vigilant, the appellant has violated the Brokers Regulations cannot be faulted. Consequently, as against the penalty of Rupees one crore imposable under Section 15HB of SEBI Act for violating Brokers Regulations, imposition of ₹ 2 lac penalty against the appellant cannot be said to be unreasonable or excessively harsh.

19. Second question to be considered in this appeal is, whether the AO is justified in holding that the appellant is guilty of violating the PFUTP Regulations and consequently imposing penalty of ₹ 8 lac under Section 15HA of SEBI Act.

20. On perusal of the impugned order it is seen that the AO has arrived at the conclusion that the appellant is guilty of violating the PFUTP Regulations, because, the fictitious trades were executed by the said client through the internet based trading facility provided by the appellant.

21. There is nothing in the impugned order to suggest that apart from providing the trading platform to trade in the ordinary course of business, the appellant was party to the manipulative, fraudulent and unfair trade practices executed by the said client of the appellant. There is no finding recorded in the impugned order to the effect that the appellant was in complicity or connected with the said client in executing the fictitious trades in question. Fact that the appellant was not vigilant in monitoring the trades executed by the said client through the trading platform provided by the appellant cannot be a ipso-facto ground to hold, that the appellant was aiding and abetting the said client in executing fictitious trades in violation of PFUTP Regulations.

22. Various decisions relied upon by the counsel for SEBI are distinguishable on facts, in as much as in all those cases, self trades were executed by stock broker on behalf of the client, whereas, in the present case the trades are executed by the said client directly through the internet based trading facility provided by the appellant. Fact that the stock brokers in those cases who had executed fictitious trades on behalf of their clients have been held guilty of violating PFUTP Regulations cannot be a ground to hold that in the present case, the appellant has violated PFUTP Regulations especially when the fictitious trades are executed by the said client directly through the internet based trading facility provided by the appellant. In the present case, fact that the appellant is found to be not vigilant in monitoring the trades of the said client cannot be a ground presume that the appellant was not vigilant with a view to aid and abet the said client in executing the fictitious trades in violation of PFUTP Regulations.

23. For all the aforesaid reasons, decision of AO in holding that the appellant has violated the PFUTP Regulations cannot be sustained. Consequently penalty of ₹ 8 lac imposed under Section 15HA of the SEBI Act cannot be sustained.

24. In the result, the appeal is partly allowed by deleting the penalty of ₹ 8 lac imposed under Section 15HA of SEBI Act and by sustaining the penalty of ₹ 2 lac imposed under Section 15HB of the SEBI Act.

25. Appeal is disposed of in the above terms with no order as to costs.

Sd/-
Justice J.P. Devadhar
Presiding Officer

Sd/-
Jog Singh
Member