

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Appeal No. 176 of 2011

Date of decision: 25.11.2011

SMC Global Securities Limited
11/5B, Shanti Chambers,
Pusa Road,
New Delhi – 110005.

.....Appellant

Versus

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

..... Respondent

Mr. Prakash Shah, Advocate with Mr. Prabhakar Kengar, Advocate for the Appellant.

Dr. Poornima Advani, Advocate with Mr. Omprakash Jha, Ms. Amrita Joshi, Advocates for the Respondent.

CORAM : P. K. Malhotra, Member
S. S. N. Moorthy, Member

Per : P. K. Malhotra, Member

Challenge in this appeal is to the order dated July 29, 2011 passed by the adjudicating officer of the Securities and Exchange Board of India (for short Sebi) imposing a monetary penalty of ` 50,000/- under section 15HB of the Securities and Exchange Board of India Act, 1992 (for short the Act) on the appellant for violating Clause A(2) of the Code of Conduct for stock brokers prescribed in Schedule II under regulation 7 of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 (for short the Regulations).

2. The appellant is a company registered under the Companies Act, 1956 and is into the broking business since 1995. It claims to have Pan India presence rendering service to more than 2 lac investors and on an average handling over

3.5 lac trades per day. In the course of its share broking activity, it had opened share trading account of one Ms. Abhilash Sharma (Abhilash) on October 4, 2007 and of one Mr. Aditya Kumar Sharma (Aditya) on January 19, 2008. It is claimed by the appellant that it had taken all reasonable steps to assess the background, genuineness, financial soundness and trading cum investment objectives of the said clients. These clients were introduced to the appellant by Mr. Bhagwati Prasad Lohia, one of its sub-brokers, who is also registered with Sebi.

3. Sebi conducted investigations in respect of trading activities of Aditya and Abhilash during the period from January 1, 2008 to May 31, 2008. It was noted that both of them had traded through Mr. Bhagwati Prasad Lohia, sub-broker of the appellant. Investigations also revealed that Aditya and Abhilash were trading consistently with three investment companies namely Amar Investments Limited, Rishra Investments Limited and Shibir India Limited and a related entity, namely, Ms. Shakuntala D. Wadhwa Sharma. Aditya and Abhilash had dealt in the securities through their sub-broker on the Bombay Stock Exchange (BSE) as well as National Stock Exchange (NSE). It was alleged that Aditya and Abhilash had executed large value transactions in the securities market at BSE and NSE which were not commensurate with their income level as disclosed in the KYC details. According to Sebi, the broker and the sub-broker had allowed these clients to take large positions in the market which were not consistent with their financial position. Sebi observed that trades of these clients resulted in artificial volumes and price manipulation in the various scrips dealt with by them. The broker and sub-broker exhibited negligence and lack of due diligence as they allowed these clients to take large positions resulting into artificial volumes and price manipulation of the scrip. Sebi came to a prima facie conclusion that as a broker, the appellant had violated provisions of Clause A(1) to A(5) of the Code of Conduct specified in Schedule II of the Regulations. Accordingly, it issued a show cause notice dated May 10, 2011 calling upon the appellant to show cause as to why an enquiry should not be held against it under the Securities and

Exchange Board of India (Procedure for Holding Enquiry and Imposing a Penalty by the Adjudicating Officer) Rules, 1995. The appellant replied to the show cause notice denying the allegations levelled against it. After affording an opportunity of personal hearing, the adjudicating officer held that though there is no nexus established between the broker and the clients, the fact remains that the clients executed trades from the terminal of the broker and the responsibility of fair conduct in the market is on all the participants to the trade including the broker. The adjudicating officer further observed that although intention of the broker is not apparent vis-à-vis the trades of the clients, the broker cannot escape responsibility for the manipulative trades that have been executed through its terminal on behalf of both the clients. He has, therefore, come to the conclusion that the appellant has failed to exercise due care and diligence in discharging its duties and found it guilty of violating Clause A(2) of the Code of Conduct as specified in Schedule II of the Regulations and imposed a penalty of ₹ 50,000/-. Hence this appeal.

4. We have heard the learned counsel for the parties who have taken us through the record and the impugned order. On a query made by us, we were told by the learned counsel for the respondent that Sebi initiated separate proceedings against the two clients for manipulative trades executed by them as also against the sub-broker through whom the trades were executed. We are not concerned with those proceedings in this appeal. The charge levelled against the broker in the show cause notice is that it has exhibited negligence and lack of due diligence as it has allowed the clients to take large positions which are beyond their declared income. As per KYC details, the annual income of Aditya was reported to be in the range of ₹ 5-10 lacs and that of Abhilash was ₹ 1-5 lacs. However, the clients have taken large positions in the market running into lacs of rupees which were not consistent with their financial standing. The adjudicating officer has observed that both the clients had never defaulted in their pay in and delivery obligations and that there is no nexus between the broker and the clients and also the intention of the broker is not apparent vis-a-vis the trades executed by these

clients. Having said so, he goes on to hold that the broker cannot escape responsibility for the manipulative trades that have been executed through its terminal on behalf of its clients.

5. We are not inclined to agree with the conclusion arrived at by the adjudicating officer. Admittedly, the appellant had installed trading terminal at the sub-broker's office at Kolkata and the sub-broker used to place orders on the trading terminal as per the instructions of its clients. The orders/transactions of the two clients in question were also executed from the terminal of the sub-broker at Kolkata. Both the clients used to place orders themselves and have executed both intra day and delivery based transactions and also executed trades in F&O segment as general investors in the normal course of business and have met with their margin and pay in obligations. Admittedly, the appellant has no relationship either with the sub-broker or the clients except the professional relationship. Regulation 7 of the Regulations prescribes that stock broker holding a certificate shall at all times abide by the Code of Conduct as specified in Schedule II. Clause A(2) of the Code of Conduct mandates that a stock broker shall act with due skill, care and diligence in the conduct of all its business. Such due skill, care and diligence can only mean that broker shall act in such a way that a person of ordinary prudence would act in the normal circumstances in carrying out activities and functions relating to its business and will remain careful and diligent so that nothing untoward happens in the market or in the activities connected with it. The appellant is a broker and hence will welcome orders for trading in the scrips by his clients. It is not in dispute that there was no default on the part of the clients in meeting with the market obligations. The two clients were squaring off their positions in accordance with the laid down norms at the relevant time. There was nothing remiss in the conduct of these clients that might have aroused suspicion that they were indulging in some manipulation. There is nothing on record to suggest that the appellant was in any manner involved in the manipulation that might have been done by the clients. In fact, there is no allegation in the show cause notice attributing knowledge of manipulative trades

to the appellant. The transactions were carried out by the sub-broker who is also responsible and bound by the code of conduct prescribed in the Regulations. There was nothing untoward in the trades to generate alert on the risk monitoring system. In the absence of any alerts, the appellant who is having a large client base probably could not anticipate any foul play by the clients. We are, therefore, of the view that, in the facts and circumstances of the case, the adjudicating officer erred in holding the appellant guilty of violating clause A(2) of the Code of Conduct specified in Schedule II of the Regulations.

In the result, the appeal is allowed and the impugned order set aside. No costs.

Sd/-
P. K. Malhotra
Member

Sd/-
S. S. N. Moorthy
Member

25.11.2011
Prepared & Compared by
ptm