

Sebi Vs. N. Khemani

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Court : SEBI Securities and Exchange Board of India or Securities Appellate Tribunal SAT

Decided On : Jan-21-2003

Judge : G Bajpai

Appellant : Sebi

Respondent : N. Khemani

Judgement :

1.1 N Khemani was a member of the Calcutta Stock Exchange and was registered with SEBI as a stock broker with Registration No.INB031085815.

1.2 The Securities and Exchange Board of India (hereinafter referred to as SEBI) initiated investigation against Shri Ketan Parekh and some entities associated with him (hereinafter referred to as KP Group) and also some brokers of the Calcutta Stock Exchange (hereinafter referred to as the CSE) including N. Khemani (hereinafter referred to as the broker) for alleged market manipulation. During the course of investigation, SEBI prima facie found that several lapses and violations have been found committed by the broker, which resulted in market manipulation.

2.1 A show cause notice dated November 7, 2002 was issued to the broker, stating the alleged lapses and violations, to show cause as to why appropriate directions should not be issued under sections 11 and 11B of the SEBI Act, 1992 restraining him from trading or dealing in securities market pending completion of investigations.

2.2 The main allegations in the Show cause notice are interalia as under: 2.2.1 That the broker transacting in huge volumes of off the floor transactions, and thereby organizing a parallel stock exchange for the purpose of assisting in, entering into or performing contracts in Securities and concealing these off the floor transactions, appears to have acted in violation of Section 19(1) of the Securities Contract Regulations Act, 1956.

2.2.2 That by giving wrong declarations to CSE and thereby by concealing the dealings of the clients including the KP Group, the broker avoided compliance with the prudential exposure limits and margin requirements of CSE prevailing during the relevant period and thereby, interfered with the fair and smooth functioning of the market in violation of Regulation 4(b) of SEBI (Prohibition of Fraudulent & Unfair Trade Practices) relating to Securities market Regulations, 1995.

2.2.3 Violation of Regulation 7 of SEBI (Stock brokers & sub brokers)Regulation, 1992 read with Clause A (1,4 &5) of Code of Conduct stipulated in Schedule II of the said Regulations.

2.3 The broker vide letter dated November 18, 2002 replied to the aforesaid show cause notice. An opportunity of hearing was given to the broker on 30.11.2002. As the broker failed to appear, vide letter dated 5.12.02, one more opportunity of hearing was given to the broker on 18.12.2002. The broker failed to avail the second opportunity of hearing also. The broker made his further submissions vide letter dated December 17, 2002 in reply to letter dated 5.12.02. The broker or his representatives failed to attend the hearing on the said day also.

Therefore, I am satisfied that the ends of justice would meet if I proceed further on the basis of material available on record.

3.1 He stated that out of all the alleged off market transactions only two transactions remained to be reported to CSE therefore, there is no element of suppressing the same and thus provision of Section 19(1) are not at all applicable. In view of above there is no intentional default and the violations of the referred acts does not exist for all the transactions but for two and therefore the charges leveled may kindly be dropped at this stage only.

3.2 He stated that he had requested that he be provided with the basis of the figures of buying and selling including trading with NSE members and how the off market transactions have been worked out. The working of the same which has inclined SEBI to believe that the turnover of Rs.65.07 crores represented the off the floor transaction. He further demanded that the data given by SEBI must be inclusive of compulsory carry forward positions of shares with their values and market Badla done in CSE of shares with their values which are not accountable in the off market deals and also the Bad deliveries returned received from the clients and Brokers and returned to them after rectification. He stated that in the absence of the requisite information/details it is impossible to submit any reply in rebuttal. The broker stated that on perusal of the same would show that the sum total for the period works out to Rs.64,23,79,854. Therefore, out of total turnover of Rs.65,07,00,000, Rs.64,23,79,854 is to be deducted to arrive at the correct off-the floor transactions which works out at Rs.83,20,146. He submitted that the proceedings initiated on the basis of such wrong presumption and also false and incorrect figures are void ab-initio which suffers from grave infirmity. The broker enclosed details in the form of 1)Delivery and Receipt Instruction received from CSE for the settlement referred above 2) Carry forward Badla Sheet (Badla Break up Report for settlements) for verification of facts.

3.3 With respect to the allegation that by transacting such huge volumes of off-the floor transactions the broker along with other Brokers had organized a parallel stock exchange for the purpose of assisting in, entering into or performing contracts in securities, he submitted that the names of such other Brokers and the volume of such transactions have not been mentioned or provided with.

3.4 As regard to the alleged violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 particularly referring to Regulation 4(B) he submitted that if the transactions are off the floor transaction then it cannot be said to be in the nature of false or misleading appearance of trading on the securities market (emphasis supplied) because if they are on the securities market they are not off the market deals, he stated that the transactions were duly reported to the stock exchange and all the transactions were duly accounted for in the regular books of accounts and the audited copies of

which have been submitted to the concerned authorities as and when required.

3.5 He stated that no evidence had been furnished to the effect that the broker had created a false market either singly or in concert with others or indulge in any act detrimental to the investors interest or which leads to interference with the fair and smooth functioning of the market.

3.6 He submitted that all the alleged "off-the-floor" transactions were duly reported to the Stock Exchange and having regard to other material facts/defects pointed out in the proceeding paragraphs, there is no interference with the fair and smooth functioning of the market.

3.7 He submitted that the brokers involvement has been pointed in the impugned show cause notice for the year 2000-2001. There is no question of taking any preventive measure for the past deals alleged to have been done during the relevant period. He further stated that as on today he is not conducting the business, he is prepared to give an undertaking that he shall not carry out any business activities as a member of Kolkata Stock Exchange either directly or indirectly, if the present proceedings are dropped.

3.8 He submitted that the proposed actions are against a member of Stock and not against some other entity. Any action against the member Broker of any Exchange can only be taken after procedure enquiries are conducted which are mandatory. No action under Section 11 or 11B of the Act can be taken to bypass the procedure of normal set enquiry. Any preventive order passed under these regulations would tantamount to penalty therefore would not have any legal backing.

3.8.1 He further submitted that the whole proceedings are in violation of principles of natural justice and equity.

4. I have carefully considered the allegations in the Show cause notice and the replies of the broker. Before considering the issues, it has to be borne in mind that the present proceedings are interim measures taken as preventive step. The following issues are therefore considered to find out a prima facie case.

4.1 Whether the broker indulged in organizing a parallel stock exchange in violation of Section 19(1) of SC (R) Act.

4.1.1 The broker has not given the exact figure of off-the floor transaction he had reported to the Exchange. As per CSE, the broker had not reported any of his off-the floor transactions whereas as per the findings of the investigations, at present stage, the value of off market transactions of the broker during the year 2000-2001 is around Rs.65.07 crores. The broker has not denied that he had dealt with brokers outside the Stock Exchange trading system. The broker has not produced any evidence that he had reported his off-the floor transactions. Further, he admitted that he had not reported two off-the floor transactions. The broker has also not given any explanation for wrong declarations of client's trades as proprietary trades.

As per Section 19 (1) of SC (R) Act " no person shall, except with the permission of the Central Government, organize or assist in organizing or be a member of any stock exchange (other than a recognized stock exchange) for the purpose of assisting in, entering into or performing contracts in securities." This prohibition is applicable inter alia within the municipal limits of Calcutta.

4.1.2 Therefore, it prima facie appears that, by transacting such huge volumes of off-thefloor transactions, the broker has organized a parallel stock exchange for the purpose of assisting in, entering into or performing contracts in securities.

4.2 Whether the broker has interfered in the fair and smooth functioning of the market in violation of Regulation 4(b) of SEBI (Prohibition of Fraudulent & Unfair Trade Practices relating to Securities Market) Regulation 1995 and Regulation 7 of SEBI (Stock brokers and Sub-brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations.

4.2.1 It is mentioned in the show cause notice that by giving wrong declarations to the CSE and by concealing the dealings of the clients including KP group, the broker avoided compliance with the prudential exposure limits and margin requirements of CSE prevailing during the relevant period and the broker had thereby, interfered with the fair and smooth functioning of the market. The broker

has not denied that he had dealt with brokers outside the Stock Exchange trading system. The broker himself admitted that he done off the floor transaction to the extent of Rs.83,20,146. However, the broker has not produced any evidence that he had reported his off-the floor transactions. Further, he admitted that he had not reported two off-the floor transactions.

The broker has also not given any explanation for wrong declarations of clients' trades as proprietary trades.

4.2.2 The broker has been provided all the data collected from him in soft format based on which the off the floor transaction amount of Rs.65.07 crores is arrived. The broker has not given the exact figure of off-the floor transactions he had reported to the Exchange and as per CSE the broker had not reported any of his off-the floor transactions. The alleged compulsory carry forward transactions which are stated by broker in his Exhibit -1 of the above said reply letter, have now found to be included in the above calculations of off-the floor transactions (which are valued only around Rs.64.24 crores). The broker has not given this explanation earlier and as stated in the investigation report and he could not be contacted over telephone and was also not available in his office when the investigation team visited Khemani group's office located at No. 16, India Exchange Place, Kolkata 700001 on January 30, 2002. Therefore, necessary explanations and informations could not be obtained from the broker on the findings of the investigations. As explained to the investigation team by broker's office staff, when the investigation team visited to broker's office, these transactions are treated as off-the floor transactions since these trades do not have trade ID and trade time. The broker has not produced any evidence that he had reported any of his off-the floor transactions.

4.2.3 Therefore, it prima facie appears that the broker violated Section 19(1) of SC(R) Act and Regulation 4(b) of SEBI (FUTP) Regulations and Regulation 7 of SEBI (Stock brokers and Sub-brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations considering the fact that the broker has not given any explanation for his wrong declaration of client trades (including KP group) as proprietary trades.

4.3 Whether the present proceedings are in violation of principles of natural justice and equity.

4.3.1 The broker has vehemently contended that the proceedings are in violation of principles of natural justice for the following reasons.

4.3.2 He contended that the working which made SEBI to believe that the turnover of Rs.65.07 crores is representing the alleged off the floor transaction was not furnished. He stated that it was not informed to him how the figures of buying value and sale value of the alleged off the floor transaction have been worked.

4.3.3 He stated that the copies of details requisitioned from CSE and the information supplied by CSE in response to SEBI was not furnished.

Non supply of this material information would amount to vitiated proceedings.

4.3.4 He stated that an inspection of the case record as maintained by SEBI was not given.

4.3.5 He submitted that without supplying him with the basis as requested and without allowing the inspection he has been asked to remain present for personal hearing on December 18, 2002. On one hand it is been stated that from the data furnished by him it has been observed that the broker is indulged in the alleged huge volume of off the floor transactions for the period April 1999 to March 2001 and the particulars of the same has been worked out by SEBI from it and even though the said details are not supplied to him.

4.3.6 He contended that the data furnished by him was in response to SEBI's investigation/queries but no clarifications has been sought from him on such data. Therefore, the figures worked out by SEBI are not correct and hence wrong.

4.3.7 The broker requested to supply him with the details/information sought, to comply with the issues raised and to allow an inspection of the record. He further requested that reasonable and sufficient time may also be allowed to submit his reply in rebuttal and a personal hearing may also be granted.

4.3.8 He stated that if SEBI is not agreeable to his views, the same should be distinctively brought to his notice in writing with elaborate reasons and also by adducing sufficient evidences. That in such an eventuality, he may be afforded another opportunity to submit further to substantiate his case.

4.3.9 I have gone through the contentions of the broker. As already stated, the aforesaid data are the broker's own data, he should be aware of the names of the brokers with whom he entered in off-the floor transactions. As per CSE, the broker had not reported any of his off market transactions. The broker has not denied that he had dealt with brokers of CSE and NSE outside the Stock Exchange trading system. The broker has also not given any explanation for wrong declarations of clients trades as proprietary trades. The broker himself admitted that he had done off-the floor transaction to the extent of Rs.83,20,146.

Further, it would be in detriment to the on going proceedings if the names of other brokers are given to him.

4.3.10 Though the broker had submitted a written statement on 14.5.01, he did not provide all the informations required for investigation and he could not be contacted over telephone by the investigation team and was also not available in his office when the investigation team visited Khemani group's office located at No16, India Exchange Place, Kolkata 700001 on January 30, 2002. The broker has been provided all the data collected from him in soft form based on which the investigation findings have been arrived. As the said data are broker's own data, no inspection is felt necessary at the interim stage.

4.3.11 The broker failed twice to appear for the personal hearings granted to him on this matter to present his case with the evidence that he seeks to adduce in his defence. Further, the proposed actions are not penal actions and is only preventive action pending Enquiry. I, therefore hold that the principles of natural justice are scrupulously followed since the facts available on record are sufficient to take a prima facie view.

4.4 The contention of the broker that no action under Section 11 or 11B of the Act can be taken to by pass the procedure of normal set enquiry and any preventive

order passed under these regulation tantamount to penalty without any legal backing, is also not tenable. This is only a preventive action pending Investigation and Enquiry based on the prima facie findings. Section 11 & 11B of SEBI Act, 1992 empower SEBI to take preventive action pending Enquiry. The proceedings against the broker are therefore in consonance with the provisions of SEBI Act and the Rules and Regulations framed thereunder. This is also perfectly in consonance with the ratio of law as laid down by Hon'ble Bombay High Court in Anand Rathi's case.

5. In light of the above submissions made by the broker and the findings on the same, I am of the view that the brokers actions and conduct are against the interest of genuine investors and detrimental to the orderly development of securities market and is prima facie in violation of Section 19 (1) of Securities Contracts (Regulation) Act, 1956, Regulation 4 (b) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 and Regulation 7 of SEBI (Stock brokers and Sub-brokers) Regulations, 1992 read with Clause A (1, 4 & 5) of Code of Conduct stipulated in Schedule II of the said Regulations.

6.1 In view of the above some preventive action is urgently required to be taken by SEBI against him in order to ensure that the investors in the securities market do not in any way suffer any losses and are not put to any harm and that the safety and integrity of the market remain unimpaired. It is felt that preventive action is necessary in order to prevent N Khemani from dealing in the securities market pending completion of the investigation.

6.2 It should also be not lost sight of that these proceedings are for the limited purpose of preventing the said broker from carrying out a similar manipulation pending completion of the investigation, under sections 11 and 11B of the SEBI Act. They are not for the conclusive determination of all facts, which may be possible only after completion of the investigation. The Bombay High Court has upheld SEBI's power under sections 11 and 11B to pass preventive orders pending completion of investigation in Anand Rathi v. SEBI, [2001] 32 SCL 227.

Therefore any further proceeding in the matter by SEBI would be conducted uninfluenced by any observation or finding made in this interim order.

6.3 In view of the said emergent situation, it is felt necessary to ensure that no further harm or detriment is caused to the market and that investors confidence is restored. Hence after taking into consideration the above mentioned facts and circumstances of the case, in exercise of the powers conferred upon me under section 4(3) of the SEBI Act, 1992, read with Sections 11 and 11B of the SEBI Act, 1992, I hereby debar M/s N Khemani from associating with securities market activities and dealing in securities market till the completion of investigation. During the said period, N Khemani is directed not to buy, sell or deal in the securities market directly or indirectly.

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