BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. MC/CB/2018-19/47]

UNDER SECTION 15-I (2) OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 AND RULE 5 OF SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES BY ADJUDICATING OFFICER) RULES, 1995.

In respect of –

Lalit Gulati (PAN: AANPG3663Q) having address at – Maa Rani, 1, Gulmohar Avenue, Westend Greens, Rajokri, New Delhi – 110 038

In the matter of *Dealing in Illiquid Stock Options at the BSE*

BACKGROUND

1. Securities and Exchange Board of India (hereinafter be referred to as, the "***SEBI***") conducted investigation into the trading activity in illiquid stock options which are listed on the Bombay Stock Exchange Limited (hereinafter be referred to as, the "***BSE***") for the period April 01, 2014 to September 30, 2015 (hereinafter be referred to as, the "***Investigation Period***") after observing large scale reversal of trades in the Stock Options segment of the BSE.

2. Investigation revealed that during the Investigation Period, a total of 2,91,643 trades comprising 81.38% of all the trades executed in the BSE Stock Options Segment were trades which involved reversal of buy and sell positions by the clients and counterparties in a contract. Mr. Lalit Gulati (hereinafter be referred to as, the "***Noticee***") was one such client whose reversal trades involved squaring off transactions with significant difference in sell value and buy value of the transactions. The aforesaid reversal trades allegedly resulted into generation of artificial volumes by the aforesaid clients and counterparties, leading to allegations that the Noticee had violated Regulation 3(a), (b), (c), (d) and Regulation 4(1), 4(2) (a) of the SEBI (Prohibition of Fraudulent and Unfair Trading Practices related to Securities Markets) Regulations, 2003 (hereinafter be referred to as, the "***PFUTP Regulations***").

APPOINTMENT OF ADJUDICATING OFFICER

3. SEBI initiated adjudication proceedings and appointed the undersigned as Adjudicating Officer under Section 15-I of the Securities and Exchange Board of India Act, 1992 (hereinafter be referred to as, the "***SEBI Act***") read with Rule 3 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995 (hereinafter be referred to as, the "***Adjudication Rules***") *vide* order dated May 31, 2018 to inquire into and adjudge under Section 15HA of the SEBI Act against the Noticee for the alleged violation of aforesaid provisions of PFUTP Regulations. The appointment of the AO was communicated *vide* order dated June 04, 2018.

SHOW CAUSE NOTICE, REPLY AND HEARING

4. Show Cause Notice No. EAD5/MC/CB/29131/1/2018 dated October 17, 2018 (hereinafter be referred to as, the "***SCN***") was served upon the Noticee under Rule 4(1) of the Adjudication Rules to show cause as to why an inquiry should not be held and penalty be not imposed against him under Section 15HA of the SEBI Act for alleged violations of Regulations 3(a),(b),(c),(d) and 4(1), 4(2)(a) of the PFUTP Regulations.

5. The allegations levelled against the Noticee in the SCN are summarized as below:

a) The Noticee was one of the entities which indulged in reversal trades which allegedly created false and misleading appearance of trading, generating artificial volumes in Stock Options segment of the BSE during the Investigation Period.

b) The Noticee is alleged to have engaged in 59 such reversal trades in 12 unique contracts, which *allegedly* led to generation of artificial volume of 5898000 units, between October 20, 2014 and February 25, 2015.

c) The trades entered by the Noticee were reversed on the same day with same counterparties at a substantial price difference without any basis for significant change in the contract price which indicates that these trades are artificial and are non-genuine in nature.

d) A summary of dealings of the Noticee in 12 such Stock Options contracts in which the Noticee allegedly executed non-genuine reversal trades during the Investigation Period, as provided in the SCN is reproduced as under:

S. No.	Contract Name	Avg. Buy	Total Buy	Avg. Sell	Total Sell	% of Artificial	% of Artificial

		Rate (Rs.)	Volume (no. of units)	Rate (Rs.)	Volume (no. of units)	Volume generated by Noticee in the contract to Noticee's Total Volume in the Contract	Volume generated by Noticee in the contract to Total Volume in the Contract
1.	ALBK15FEB90.00CEW2	19.32	134000	11.50	134000	100%	54%
2.	ANBK15FEB70.00CEW2	17.13	152000	9.00	152000	100%	100%
3.	ANBK15JAN100.00CEW2	1.72	296000	0.10	296000	100%	62%
4.	APLT15FEB180.00PE	4.65	592000	0.22	592000	100%	100%
5.	BIOC15FEB390.00CEW2	23.19	120000	13.50	120000	100%	52%
6.	COAL15FEB350.00CEW2	30.00	136000	17.47	136000	100%	34%
7.	DABU15FEB255.00CEW2	17.40	125000	9.40	125000	100%	100%
8.	FEDB14OCT140.00CE	4.00	68000	0.25	68000	100%	100%
9.	JSWE14OCT70.00PE	2.00	128000	0.10	128000	100%	97%
10.	JSWE15MAR120.00CEW2	3.00	748000	0.10	748000	100%	29%
11.	OBNK15MAR230.00PEW2	6.95	500000	0.32	500000	60%	43%
12.	VOLT15FEB240.00CEW2	17.21	150000	8.40	150000	100%	38%

e) By indulging in execution of aforesaid non-genuine reversal trades, the Noticee was alleged to have violated Regulations 3(a),(b),(c),(d) and 4(1), 4(2)(a) of the PFUTP Regulations, text of which is reproduced as under:

"SEBI (Prohibition of Fraudulent and Unfair Trading Practices Related to Securities Markets) Regulations, 2003

3. Prohibition of certain dealings in securities

No person shall directly or indirectly -

(a) buy, sell or otherwise deal in securities in a fraudulent manner;

(b) use or employ, in connection with issue, purchase or sale of any security listed or proposed to be listed in a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of the Act or the rules or the regulations made thereunder;

(c) employ any device, scheme or artifice to defraud in connection with dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange;

(d) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with any dealing in or issue of securities which are listed or proposed to be listed on a recognized stock exchange in contravention of the provisions of the Act or the rules and the regulations made there under.

4. Prohibition of manipulative, fraudulent and unfair trade practices

(1) Without prejudice to the provisions of regulation 3, no person shall indulge in a fraudulent or an unfair trade practice in securities.

(2) Dealing in securities shall be deemed to be a fraudulent or an unfair trade practice if it involves fraud or may include all or any of the following, namely:-

(a) indulging in an act which creates false or misleading appearance of trading in the securities market;

…..”

6. It was stated in the SCN that the aforesaid alleged violations, if established, would make the Noticee liable for monetary penalty under Section 15HA of the SEBI Act. The SCN was served upon the Noticee by way of Speed Post with Acknowledgment Due (hereinafter be referred to as, the “**SPAD**”) and also by way of e-mail at the address(es) of the Noticee, an acknowledgment of which is available on record. The Noticee was also advised to file his reply, if any, within 14 days from the receipt of the SCN. However, no reply towards the SCN was received from the Noticee.

7. After considering the facts and circumstances of the case, the undersigned granted an opportunity of personal hearing to the Noticee on November 13, 2018 *vide* Notice of Hearing dated November 02, 2018. Thereafter, *vide* letter dated November 05, 2018, the Noticee communicated his inability to appear in the hearing and requested an adjournment in the same, which was granted.

8. Thereafter, the Noticee submitted his reply towards the SCN *vide* e-mail dated November 27, 2018. Submissions of the Noticee are summarized as under:

a) The Noticee submitted that the SCN had failed to appreciate that profits / losses are incidental to transactions on stock exchange and merely because the transactions on BSE in Stock Options Segment resulted in a loss, they cannot be said to be non-genuine.

b) The Noticee also stated that the SCN failed to appreciate that the anonymous systems of the Exchange do not allow a transacting party to know the details of the counter party and therefore, the allegation of executing reversal trades cannot hold good.

c) The Noticee stated that losses may occur in contracts with lower liquidity and wider spreads.

d) The Noticee also stated that while SEBI and Exchanges have put in place a mechanism of price band in Capital Markets Segment to control extreme volatility, no such price band mechanism was in place for options segment. This would mean that all prices at which Noticee's trades were executed were not unrealistic.

e) The Noticee stated that the SCN did not provide any evidence in regard to the Noticee's relation with the counterparties.

f) The Noticee contended that the SCN was not in line with the established principles recorded in various judgments of the Securities Appellate Tribunal in the matters of ***Jagruti Securities*** v. ***SEBI*** (2008 SCC Online SAT 184), "*.. we are of the view that in an artificial trade there has to be collusion between the buyer and the seller and in absence of any collusion, the trade cannot be termed as, artificial*". Similarly, the Noticee has cited another order of the Securities Appellate Tribunal in the matter of ***S.P.J. Stock Brokers Pvt. Ltd.*** v. ***Securities and Exchange Board of India*** [(2013) SAT 17] citing, "*unless some connection between appellant and counterparties with whom appellant traded is established, it is difficult to hold that trades in question were carried out with a view to manipulate market by creating false volumes resulting in upsetting market equilibrium.*"

g) Thus, the Noticee denied the charges levelled against him in the SCN and requested for an opportunity of hearing to be granted.

9. On considering the cause, written submissions of the Noticee and in the interests of natural justice, an opportunity of hearing was granted to the Noticee on December 20, 2018 which was communicated *vide* Notice of Hearing dated December 07, 2018. The hearing scheduled on December 20, 2018 was attended by Mr. Mukesh Agarwal who was appointed as authorized representative by the Noticee (hereinafter be referred to as, the "***Authorized Representatieve***"). During the hearing, the Authorized Representative reiterated the submissions made in the written reply of the Noticee dated November 27, 2018.

10. Since the inquiry in the instant matter is concluded, I proceed to decide the case on merit keeping into account the allegations mentioned in the SCN, submissions of the Noticee towards the SCN and material available on record.

CONSIDERATION OF ISSUES AND FINDINGS

11. The issues that arise for consideration in the instant matter are:

Issue No. I Whether reversal trades in illiquid Stock Options carried out by the Noticee during the Investigation Period were in violation of Regulations 3(a), (b), (c), (d) and 4(1) & 4(2)(a) of the PFUTP Regulations?

Issue No. II If yes, whether the violation, on the part of the Noticee would attract monetary penalty under Section 15HA of the SEBI Act?

Issue No. III If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in Section 15J of the SEBI Act read with Rule 5 (2) of the Adjudication Rules?

Issue No. I **Whether reversal trades in illiquid Stock Options carried out by the Noticee during the Investigation Period were in violation of Regulations 3(a), (b), (c), (d) and 4(1) & 4(2)(a) of the PFUTP Regulations?**

12. The allegation that the Noticee carried out reversal trades is directly supported with evidence from the trade log containing records of all trades and reversal trades carried out by the Noticee in the Stock Options segment of the BSE during the Investigation Period and which were provided to the Noticee by way of ***Annexure B*** and ***Annexure C*** to the SCN. On perusal of the details of trades carried out by the Noticee, it is observed that the Noticee indulged in 59 reversal trades in 12 unique contracts during the period October 20, 2014 to February 25, 2015.

13. To illustrate, on October 20, 2014 at 12:23:57 hrs, the Noticee executed three sell trades for 116000, 4000 and 8000 (cumulatively, 128000) units of a contract named JSWE14OCT70.00PE with counterparty, *Umang Nemani* at a rate of Re. 0.1/-, 0.1/- and 0.15/- per unit respectively. Thereafter, at 13:08:07 hrs. on the same day, the Noticee purchased the same 128000 units of the contract named JSWE14OCT70.00PE from to the counterparty, *Umang Nemani* at a rate of Rs. 2/-, i.e. at a price difference of Rs. 1.9/- per unit. The orders for buy trade in this contract were entered within 1 second of each other.

14. Similarly, on December 30, 2014 at 10:31:35 hrs., the Noticee executed three sell trades for 8000, 12000 and 276000 (cumulatively 296000) units of a contract named ANBK15JAN100.00CEW2 with the same counterparty as mentioned in paragraph 13 above, i.e. *Umang Nemani* at a rate of Rs, 1.7/-, 1/- and 1.75 respectively. Thereafter, at 11:21:44 hrs on the same day, the Noticee purchased the same 296000 units of the same contract ANBK15JAN100.00CEW2 from the counterparty, *Umang Nemani* at a rate of Rs. 0.1/- per unit, i.e. at a price difference of Rs. 1.6/- per unit. The orders for buy trade in this contract were entered within 1 second of each other.

15. A similar *modus operandi* is seen to be adopted by the Noticee in its trades on October 21, 2014, December 30, 2014, February 10, 2015, February 11, 2015, February 12, 2015, February 18, 2015, February 24, 2015 and February 25, 2015. It is also noted that out of the 59 reversal trades carried out by the Noticee on 9 days, 38 reversal trades had a time difference of less than 1 second between their sell order and buy order. and in 52 reversal trades, the time difference between sell order and buy order was less than 1 minute.

16. From the reply of the Noticee, I note that the Noticee has not disputed execution and subsequent reversal of trades as alleged in the SCN. However, the Noticee, in its reply, has contended that the transactions were carried out by him at an anonymous platform provided by the BSE where he had no knowledge of the counterparty. I also note that the Noticee has cited a judicial pronouncement of the Securities Appellate Tribunal in the matter of ***Jagruti Securities*** (*supra*) and ***S. P. J. Stockbrokers*** (*supra*) stating that some relation between the Noticee and counterparties needs to be established in order to prove a charge of generating artificial volume. I have considered the aforementioned contention of the Noticee. At this juncture, I find it relevant to refer to the decision of the Hon'ble Supreme Court in the matter of ***Securities and Exchange Board of India*** v. ***Kishore R. Ajmera*** [(2016) 6 SCC 368 : AIR 2016 SC 1079] wherein, the Supreme Court has held, "*…According to us, knowledge of who the 2nd party / client or the broker is, is not relevant at all. While the screen based trading system keeps the identity of the parties anonymous it will be too naïve to rest the final conclusions on the said basis which overlooks a meeting of minds elsewhere. Direct proof of such meeting of minds elsewhere would rarely be forthcoming.* The *test, in our considered view, is one of preponderance of probabilities so far as adjudication of civil liability arising out of violation of the Act or the provisions of the Regulations framed thereunder is concerned….*"

17. I also note that the Hon'ble Supreme Court, in ***Kishore R. Ajmera*** (*supra*) has held that, "*The conclusion has to gathered from various circumstances like that volume of trade effected; the period of persistence in trading in a particular scrip; the particulars of buy and sell orders, namely the volume thereof; the proximity of time between the two and such relevant factors…*". Placing reliance of the observation of the Hon'ble Supreme Court in the aforementioned matter, I find it difficult to accept the submission of the Noticee that transactions were genuine on account of them being carried out on an anonymous platform of the exchange wherein, the Noticee had no knowledge of the counterparty.

18. At this juncture, I also find it relevant to refer to the decision of the Supreme Court in the matter of ***Securities and Exchange Board of India*** v. ***Rakhi Trading Private Limited*** (Civil Appeal Nos. 1969, 3174-3177 and 3180 of 2011 dated February 08, 2018) wherein, the Hon'ble Supreme Court while cumulatively analysing the reversal transactions held that, "…*quantity, time and significant variation of prices, without major variation in the underlying price of the securities clearly indicate that Respondent's trades are not genuine and hand only misleading appearance of trading in the securities market…..*".

19. Applying the ratio of the Supreme Court in the matter of ***Kishore R. Ajmera*** (*supra*) and ***Rakhi Trading*** (*supra*), I am of the view that while synchronized trades may occur by accident in a liquid stock, execution of synchronized trades in an illiquid market with anonymous trading indicates a prior meeting of mind with a view to execute the reversal trades at a pre-determined price. I am also of the view that there is no justification for the wide variation in prices of the same contract, within minutes and some, even seconds, except for an element of pre-determination in the prices by both counterparties when reversing the trades. Thus, the nature of trading as brought out above clearly indicates an element of prior meeting of minds and therefore, a collusion to carry out trades at pre-determined prices. Therefore, the submission of the Noticee that the trades carried out by the Noticee during the Investigation Period (which have been discussed in the preceding paragraphs) and details thereof, i.e. rate, quantity and time difference were were genuine cannot be accepted.

20. On the contention of the Noticee that there was no price band mechanism for the Options Segment, I note that although there is no price band mechanism for the Options Segment, the price of a stock option is based on several parameters such as price of underlying stock, intrinsic value of option, expected volatility, interest rates, dividends etc. The change in price has to be justifiable based on change in the various underlying parameters. There is no justifiable basis for the wide variation in prices at which the contracts were traded by the Noticee within a short span of time.

21. I also note that as brought out in the SCN, the Noticee generated a total trading volume of 5898000 units in 12 unique contracts through reversal of trades between October 20, 2014 and February 25, 2015, details of which is reproduced as under:

S. No.	Contract Name	Avg. Buy Rate (Rs.)	Total Buy Volume (no. of units)	Avg. Sell Rate (Rs.)	Total Sell Volume (no. of units)	% of Artificial Volume generated by Noticee in the contract to Noticee's Total Volume in the Contract	% of Artificial Volume generated by Noticee in the contract to Total Volume in the Contract
1.	ALBK15FEB90.00CEW2	19.32	134000	11.50	134000	100%	54%
2.	ANBK15FEB70.00CEW2	17.13	152000	9.00	152000	100%	100%
3.	ANBK15JAN100.00CEW2	1.72	296000	0.10	296000	100%	62%
4.	APLT15FEB180.00PE	4.65	592000	0.22	592000	100%	100%
5.	BIOC15FEB390.00CEW2	23.19	120000	13.50	120000	100%	52%
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7.	DABU15FEB255.00CEW2	17.40	125000	9.40	125000	100%	100%

8.	FEDB14OCT140.00CE	4.00	68000	0.25	68000	100%	100%
9.	JSWE14OCT70.00PE	2.00	128000	0.10	128000	100%	97%
10.	JSWE15MAR120.00CEW2	3.00	748000	0.10	748000	100%	29%
11.	OBNK15MAR230.00PEW2	6.95	500000	0.32	500000	60%	43%
12.	VOLT15FEB240.00CEW2	17.21	150000	8.40	150000	100%	38%

22. From the table reproduced above, I note that the Noticee, on an average contributed 66.9% of the volume in the contracts traded, and in 6 of the 12 such contracts, the volume contribution by the Noticee was 92% which indicates a general lack of public participation in trading of such contracts.

23. Considering the synchronized manner of placing buy and sell orders within seconds of each other, reversing of the trades within a short time with widely varying prices of the two legs of trade in the same contract without any basis for such wide variation, I find that the reversal trades executed by the Noticee were *non-genuine* in nature and created an impression of ratification trading volumes in respective contracts. I am of the view that by engaging in such trades, the Noticee has violated provisions of Regulation 4(2)(a) of the PFUTP Regulations, which states that dealing in securities will be deemed to be a fraudulent or unfair trade practice if it involves "*indulging in an act which creates false or misleading appearance of trading in the securities market*".

24. I once again find it relevant to place reliance on the decision of the Supreme Court in ***Rakhi Trading*** (*supra*) wherein, the Supreme Court while decision upon a case involving execution of reversal trades in index options, observed, "*the traders thus having engaged in a fraudulent and unfair trade practice while dealing in securities are hence liable to be proceeded against for violation of Regulations 3(a), 4(1) and 4(2)(a) of the PFUTP Regulations*."

25. In view of the aforesaid, I find that the Noticee, by engaging in such non-genuine transactions, created a misleading impression of trading in respective contracts while dealing in Stock Options contracts in a fraudulent manner. I am of the considered view that the aforesaid act of the Noticee is in clear violation of Regulations 3(a), 4(1) and 4(2) (a) of the PFUTP Regulations.

Issue No. II **If yes, whether the violation, on the part of the Noticee would attract monetary penalty under Section 15HA of the SEBI Act?**

&

Issue No. III **If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in Section 15J of the SEBI Act read with Rule 5 (2) of the Adjudication Rules?**

26. Since violation of Regulations 3(a), 4(1) and 4(2) of the PFUTP Regulations by the Noticee is established, I am of the view that the same warrants imposition of monetary penalty upon the Noticee under Section 15HA of the SEBI Act, text of which is produced as under :

> ***SEBI Act***
>
> "***Penalty for fraudulent and unfair trade practices.***
> *15HA. If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.*"

27. While determining the quantum of penalty under Section 15HA of the SEBI Act, the following factors stipulated in Section 15J of the SEBI Act, have to be given due regard:

a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

28. As established in the preceding paragraphs, the trades carried out by the Noticee were non-genuine in nature and created a misleading appearance of trading. As brought out earlier, such trades were carried out by the Noticee in illiquid stock options contracts where there was negligible participation by the public. Investigation has shown amount of profit / loss of the counterparties to the trades as a result of such non-genuine trades. However, considering that the violation by the Noticee is creation of artificial trading volumes by trading between two counterparties and wider market is not involved in the trades, the trades are such that one of the counterparty books a profit while the other counterparty books a loss. Hence, it would be appropriate to consider the impact of these transactions between the two counterparties in totality. When the impact of artificial volumes created by the two counterparties is seen as a whole, it is not possible from the material available on record to quantify the amount of disproportionate gain or unfair advantage resulting from the artificial trades between the counterparties or the consequent loss caused to investors as a result of the default.

29. It is reiterated that during the Investigation Period, the Noticee has contributed to artificial volumes in 12 contracts through 59 reversal trades on 9 days and thereby, has contributed around 0.02% of the artificial reversal trades in the securities market during the Investigation Period.

30. Therefore, taking into account the facts and circumstances of this matter, mitigating factors and the proportions of trading carried out by the Notieee as compared to the total volume of reversal trades in the market during the Investigation Period, I am of the view that a penalty of ₹5,00,000 will be commensurate with the violations of Regulations 3(a), 4(1) and 4(2)(a) of the PFUTP Regulations committed by the Noticee.

ORDER

31. After taking into consideration all the facts and circumstances of the case, in exercise of powers conferred upon me under Section 15I (2) of the SEBI Act read with Rule 5 of the Adjudication Rules, I hereby impose a penalty of ₹5,00,000/- (Rupees Five Lakh only) upon the Noticee, i.e. Mr. Lalit Gulati under Section 15AHA of the SEBI Act for violation of Regulation 3(a), 4(1) and 4(2)(a) of the PFUTP Regulations.

32. The Noticee shall remit / pay the said amount of penalty within 45 days of receipt of this order either by way of Demand Draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, OR through e-payment facility into Bank Account the details of which are given below:

Account No. for remittance of penalties levied by Adjudication Officer	
Bank Name	State Bank of India
Branch	Bandra-Kurla Complex
RTGS Code	SBIN0004380
Beneficiary Name	SEBI – Penalties Remittable To Government of India
Beneficiary A/c No.	31465271959

33. The Noticee shall forward said Demand Draft or the details / confirmation of penalty so paid to the Enforcement Department – Division of Regulatory Action – I of SEBI. The Noticee shall provide the following details while forwarding DD/ payment information:

a) Name and PAN of the entity (Noticee)
b) Name of the case / matter
c) Purpose of Payment – Payment of penalty under AO proceedings
d) Bank Name and Account Number
e) Transaction Number

34. Copies of this Adjudication Order are being sent to the Noticee and also to SEBI in terms of Rule 6 of the Adjudication Rules.

Date : December 28, 2018 **(Maninder Cheema)**
Place : Mumbai **Adjudicating Officer**