<u>BEFORE THE ADJUDICATING OFFICER</u>

<u>SECURITIES AND EXCHANGE BOARD OF INDIA</u>

[ADJUDICATION ORDER NO. EAD5/MC/CB/2019-20/3726]

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 –

Laxmi Business and Cement Company Pvt. Ltd. (PAN: AAACL7094C) having address at – 71, B R B Basu Road, B-404, Kolkata – 700 001

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 at the BSE 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. M/s Laxmi Business and Cement Company Pvt. Ltd. (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, the alleged violation of aforesaid provisions of PFUTP Regulations by the Noticee. 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/29135/1/2018 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 it 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 15 such reversal trades in 7 unique contracts, which *allegedly* led to generation of artificial volume of 20,44,750 units between March 18, 2015 and March 31, 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 7 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 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.	ANBK15APR60.00CEW2	12.40	588000	20.92	588000	100%	40%
2.	GRSM15APR3550.00PE	60.00	60000	85.00	60000	100%	30%
3.	GRSM15MAR3650.00PE	5.00	57125	40.00	57125	100%	35%
4.	HULL15APR860.00PEW4	16.00	71500	30.00	71500	100%	42%
5.	IIBK15APR920.00CE	2.30	127000	13.30	127000	100%	100%
6.	KOTB15MAR1350.00PE	7.00	58750	24.00	58750	100%	23%
7.	MARU15MAR3650.00PE	5.00	60000	54.50	60000	100%	28%

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 its reply, if any, within 14 days from the receipt of the SCN. However, it was observed that no reply was filed by the Noticee towards the SCN.

7. The Noticee, *vide* letter dated November 02, 2018 was advised to file its reply towards the SCN by November 12, 2018. It was also informed that an opportunity of hearing was provided to it under the instant adjudication proceedings on November 13, 2018. However, the Noticee failed to file any reply as well as to avail the opportunity of hearing provided to it.

8. Therefore, final opportunity to file its reply towards the SCN was provided to the Noticee by June 15, 2019. The Noticee, *vide* Notice of Hearing dated June 06, 2019 was also provided an opportunity of hearing, in the interest of natural justice, on June 18, 2019. In respect of Notice of Hearing dated June 06, 2019, the Noticee claimed that it had not received any SCN or Notice of Hearing under the instant adjudication proceedings. Thereafter, copies of SCN as well as Notices of Hearing issued under the instant adjudication proceedings were provided to the Noticee *vide* e-mail dated June 18, 2019. The Noticee was also advised to file its reply, if any, towards the SCN within 14 days of receipt of SCN. It was also informed that an opportunity of hearing was provided to it in the instant matter on July 05, 2019.

9. Thereafter, the Noticee, *vide* letter dated June 28, 2019 submitted its reply towards the SCN stating that:

a) It undertook trades in the share market with a view to make some profits and the trades were undertaken for itself without any ill design or ill motive.

b) The scrips in which it carried out trades were neither banned nor barred from trading during the Investigation Period. BSE allowed trading in the alleged scrips and in absence of no warnings, estoppels from BSE, it could not gather awareness of these scrips being illiquid. No alert was received from its broker or BSE which could prompt it to take any caution.

c) Trades were executed in the normal course of business, and it is not related to the counterparty to the trades. SCN has failed to establish any connection between the Noticee and counterparty to its trades.

d) No investor complaints have been received for trading in these illiquid scrips.

e) All trades executed by it were well recognized, legal and permitted by BSE and carried out on the floor of exchange. There were no wrongful gains made by it out of the alleged trades. Therefore, no motive is established qua it for the presumption of non-genuine trades by us.

f) It was impossible for the Noticee to know the counter-party to its trades and that the trading system of BSE prevented members placing orders to identify a counter-party.

g) It would not indulge into any trade wherein losses are incurred to it. Prices of any stock vary due to various components including sentiments, market conditions, economic and political development etc. Therefore, its trades cannot be classified as non-genuine only for reasons of huge price variations.

h) There is a huge time difference between buy and sell trades.

i) The Noticee should be exonerated and the SCN should be withdrawn.

10. The hearing scheduled on July 05, 2019 was attended by Mr. Rajesh Khandelwal, who was appointed as authorized representative by the Noticee (hereinafter be referred to as, the "***Authorized Representative***"). During the hearing, the Authorized Representative reiterated the submissions made in the written reply of the Noticee dated June 28, 2019 and sought additional time till July 11, 2019 to make additional written submissions. The request of the Authorized Representative of the Noticee was acceded to.

11. Thereafter, *vide* e-mail dated July 17, 2019, the Noticee submitted additional written submissions towards the SCN in the instant matter, stating that:

a) It executed impugned trades on the floor of broker through a registered share broker where identity of client buying or selling shares cannot be known.
b) Trading system of exchange prevented a member placing any order from identifying counterparty to a trade.
c) There was no meeting of mind with the alleged counter party to its trades, nor did it have any connection with the counterparty.
d) A lenient view may be taken and the instant adjudication proceedings be dropped in this matter.

12. Since the inquiry in the instant matter is concluded, I proceed to decide the case on merit taking 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

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

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

14. The allegation that the trades carried out by the Noticee were reversal trades is directly supported with evidence from the trade log containing records of all trades and reversal trades carried out in the Stock Options segment of the BSE by it 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 15 such reversal trades in 7 unique contracts between March 18, 2015 and March 31, 2015.

15. To illustrate, on March 27, 2015 at 15:15:18 hrs, the Noticee executed one buy trade for 1,27,000 units of a contract named IIBK15APR920.00CE with counterparty, *Garuda Vyapar Pvt. Ltd.* at a rate of Rs. 2.3/- per unit. Thereafter, at 15:15:22 hrs on the same day, i.e. after 3 seconds of buying, the Noticee executed one sell trade for 1,27,000 units of the same contract with the same counterparty at a rate of Rs. 13.3/- per unit, at a huge variation of Rs.11 from the price of the first leg of the reversal trade. It is also noted that there was no time difference between buy order and sell order of counterparties in these transactions.

16. Similarly, on March 30, 2015 at 14:16:32 hrs, the Noticee executed one sell trade for 71500 units of a contract named HULL15APR860.00PEW4 with counterparty *Delta International Pvt. Ltd.* at a rate of Rs. 30/- per unit. Thereafter, at 14:16:35 hrs on the same day, i.e. after 3 seconds of the sell trade, the Noticee executed 1 buy trade for 71500 units of the same contract with the same counterparty at a rate of Rs. 16/- per unit, at a huge variation of Rs.14 from the price of the first leg of the reversal trade. It is also noted that there was no time difference between buy order and sell order of counterparties in these transactions.

17. A similar *modus operandi* is seen to be adopted by the Noticee in its trades on March 18-19, 24, 27, 30-31, 2015. There was large price difference in the buy and sell legs of the reversal trades, without any basis for the price difference, often within a few minutes of the first leg of the trade. While 1 trade was as a result of synchronized orders within 1 second of each other, remaining 14 trades resulted from simultaneous synchronized buy and sell orders.

18. 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 impugned trades were executed in the normal course of business and that it is not related to any of the counterparties. It also stated that the SCN had failed to establish any connection between the Noticee and counterparties to its trades. The Noticee also submitted that because the trading system of BSE prevented members from placing orders to identify a counterparty, it was impossible to know the counterparty to its trades. I also note that the Noticee submitted that it had no prior meeting of minds with broking entities or their clients (counterparties). In this regard I note that all the reversal trades carried out by the Noticee in 7 unique contracts were synchronized between the counterparties at matching prices and volume. While synchronised trades may occur by accident in a liquid stock, execution of synchronised trades in an illiquid market with anonymous trading indicates a prior meeting of minds between the counterparties with a view to execute the reversal trades at a pre-determined price, and cannot take place without pre-arrangement.

19. In this regard, I also 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….*".

20. In view of the aforesaid, the submission of the Noticee that transactions of the Noticee 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 and that they had no prior meeting of minds, cannot be accepted.

21. I note that the Noticee also stated that BSE had allowed trading in in the impugned scrips and that prices of any stock vary due to various components including sentiments, market conditions etc. It, therefore, submitted that its trades cannot be classified as non-genuine only for reasons of huge price variations. I note that 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 are traded, within minutes and some, even seconds, except for an element of pre-determination in the prices by both counterparties when reversing the trades.

22. 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, which indicates non-genuine nature of the trades. It is also noted that the trades by the Noticee generated volumes without any change of beneficial ownership. The law in this respect is well-settled through the decision of the Hon'ble Supreme Court in ***Securities and Exchange Board of India*** v. ***Rakhi Trading Private Limited*** (Civil Appeal Nos. 1969, 3174-3177 and 3180 of 2011 decided on February 08, 2018), which was a similar case involving execution of reversal trades in index options. The Supreme Court observed - "*The non-genuineness of these transactions is evident from the fact that there was no commercial basis to suddenly, within a matter of minutes, reverse a transaction when the value of the underlying had not undergone any significant change*."

23. Moreover, on reading the ratio of the Hon'ble Supreme Court in the matter of ***Rakhi Trading*** (*supra*) in conjunction with ratio of the Hon'ble Supreme Court in the matter of ***SEBI*** v. ***Kanaiyalal Baldevbhai Patel*** [(2017) SCC Online SC 1148], it is noted that an unfair trade practice in securities means a practice which does not conform to the fair and transparent principles of trades in the stock market. Where reversal trades involve pre-fixed price completely unrelated to the price of the underlying asset, and rights in the contract are not being effected in its true sense, such reversal trades constitute an unfair trade practice. Therefore, the submission of the Noticee that trades done by it were not committed with a wilful intent or with an intention to defraud cannot be accepted.

24. I note that the Noticee submitted that no investor complains have been received for trading in the impugned scrips. However, I note that the Supreme Court, in ***Rakhi Trading*** (*supra*) has held that, "*Orchestrated trades are a misuse of the market mechanism. It is playing the market and it affects the market integrity*". Thus, the submission of the Noticee that there were no investor complaints relating to its transactions cannot be accepted.

25. I am also of view that the submission of the Noticee that BSE or its member broker did not raise any warning / estoppel / alarm / alert regarding trades of Noticee does not absolve it from responsibility for indulging in such trades.

26. As has been brought out in the SCN, the Noticee generated a total trading volume of 20,44,750 units in 7 unique contracts (details of which have been reproduced in paragraph 5 hereinabove) through reversal of trades on March 18-19, 24, 27, 30-31, 2015. On perusal of the table produced at paragraph 5 hereinabove, I note that the Noticee, on an average contributed 43% of the volume in the contracts traded. The average volume contribution of the Noticee in 3 of these 7 contracts was 61%, which indicates that there was lesser public participation in these contracts. The Noticee traded to a lesser extent in the remaining 4 contracts, with average volume contribution of 29%. Upon verification of facts from the material available on record, I note that the total number of clients trading in the aforesaid 4 contracts (where the Noticee's average trading contribution was around 29%) ranged from 5 to 14 clients, indicating that there was very low public participation.

27. I find it relevant to reiterate here that in ***Rakhi Trading*** (*supra*), the Supreme Court while deciding upon a similar 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*."

28. 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?**

29. 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.*"

30. 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.

31. 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 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.

32. As noted earlier, the Noticee had contributed to artificial volumes in 7 contracts through 15 reversal trades on 6 days and thereby, had contributed around 0.01% of the artificial volume in the market during the Investigation Period.

33. Therefore, taking into account the facts and circumstances of this matter, the volume contribution by the Noticee and the proportion of trading carried out by the Noticee 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 committed by the Noticee.

ORDER

34. 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. *M/s Laxmi Business & Cement Company Private Limited* under Section 15HA of the SEBI Act for violation of Regulation 3(a), 4(1) and 4(2)(a) of the PFUTP Regulations.

35. 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 online payment facility available on the website of SEBI, i.e. www.sebi.gov.in on the following path, by clicking on the payment link:

ENFORCEMENT → Orders → Orders of AO → PAY NOW.

36. 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

37. 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 : July 25, 2019	**(Maninder Cheema)**
Place : Mumbai	**Adjudicating Officer**