BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. MC/CB/2018-19/2345]

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 –

M J Shares & Securities Pvt. Ltd. (PAN: AADCM0139Q) having address at – 43, 4th Floor, Venus Apartment, Cuffe Parade, Colaba, Mumbai – 400 005 (Maharashtra)

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 M J Shares & Securities 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/31658/2018 dated November 15, 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 2 unique contracts, which *allegedly* led to generation of artificial volume of 2030000 units on March 26, 2015 and March 27, 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 2 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.	DABU15APR240.00CEW1	24.86	455000	13.90	455000	100%	57%
2.	LICH15MAR400.00CE	41.80	560000	23.90	560000	100%	46%

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.

7. In respect of the SCN, the Noticee, *vide* letter dated December 12, 2018 sought an inspection of material relied upon during the investigation and sought furnishing of a copy of the same. The Noticee also sought an extension of three weeks to submit its reply. *Vide* letter dated December 21, 2018, the Noticee was informed that all information considered relevant for the purpose of allegations levelled against it, including relevant extracts of investigation report, trade and order log / data and other information collected during the investigation which was relevant to the Noticee had already been provided to the Noticee by way of the SCN and Annexures thereto. The Noticee’s request of extension of three weeks to file its reply was acceded to and it was advised to file its reply by January 16, 2019. An opportunity of personal hearing was also provided to the Noticee on January 24, 2019 *vide* Notice of Hearing dated December 21, 2018.

8. The Noticee submitted its reply towards the SCN *vide* letter dated January 16, 2019. Noticee in its reply made submissions stating that:

a) The Noticee had executed the Impugned Trades as part of its day trading strategy, and the reversal trades were purely coincidental which occurred on account of the illiquidity of the Stock Options.

b) The impugned trades were screen-based and the Noticee was not aware of the counter-parties in the impugned trades. Further, the Noticee had no pre-existing relationship with the counter-parties and the trades were not executed with a view to manipulate the market. It placed reliance on the case of ***SPJ Stock Brokers Private Limited*** v. ***SEBI*** (SAT Appeal No. 52 of 2013 dated September 04, 2013) to substantiate that some connection between party and counterparty needs to be established.

c) The SCN has not alleged synchronization of the Impugned trades and there has been no meeting of minds of various counterparties to warrant a presumption of synchronization. The Noticee placed reliance on a decision of the Securities Appellate Tribunal in the matter of ***Ketan Parekh*** v. ***Securities and Exchange Board of India*** (SAT Appeal No. 2 of 2014 dated July 14, 2006), ***HB Stockholdings Limited*** v. ***Securities and Exchange Board of India*** (SAT Appeal No. 114 of 2012 dated August 27, 2013) and ***Subhkam Securities Private Limited*** v. ***SEBI*** (SAT Appeal No. 73 of 2012 dated July 25, 2012) to substantiate the same.

d) The SCN only makes a bald presumption that the reversal trades to be manipulative and does not provide any valid reasons for alleging that the impugned trades are non-genuine and manipulative.

e) Mere reversal trades are not conclusive proofs of manipulation and SEBI ought to look at the circumstances surrounding each trade to arrive at a conclusion.

f) SEBI in its risk disclosure document had envisaged the risk of higher volatility, lower liquidity and wider spreads in options contracts, especially in trades involving illiquid stock options. The reason for reversal trades was on account of the manifestation of these risks.

g) The Supreme Court's order in Rakhi Trading cannot be arbitrarily applied to the current matter as the factual situation of Rakhi Trading is different from factual situation of the current matter.

h) There has been no evidence that the Noticee engaged in fraudulent and unfair practices, and the impugned trades are genuine, non-manipulative and did not create any artificial volume. In light of this, there has been no violation of PFUTP Regulations as alleged in the SCN.

i) The SCN is without any basis and deserves to be withdrawn.

9. The hearing scheduled on January 24, 2019 was attended by Mr. Anil Choudhary and Mr. M. Raghuvamsi who were appointed as authorized representatives by the Noticee (hereinafter be referred to as, the "***Authorized Representatives***"). During the hearing, the Authorized Representatives reiterated the submissions made in the written reply of the Noticee dated January 16, 2019.

10. Since the proceedings for inquiry in the instant matter are 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

11. 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?**

12. 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 2 unique contracts on March 26, 2015 and March 27, 2015.

13. To illustrate, on March 26, 2015 at 15:21:45 hrs., the Noticee executed one buy trade for 5,60,000 units of a contract named LICH15MAR400.00CE with counterparty *N J Impex Private Limited* at a rate of Rs. 41.8/- per unit. Thereafter, the Noticee executed seven sell trades aggregating to 5,60,000 units of the same contract with the same counterparty, *N J Impex Private Limited*, details of which are produced as under:

Trade Time	Trade Rate (rupees)	Price Difference (rupees)	Traded Quantity	Time difference from the sell trade
15:21:53	37.2	4.6	1000	8 seconds
15:21:58	35.4	6.4	1000	13 seconds
15:22:05	29.2	12.6	1000	20 seconds
15:22:11	25.8	16	1000	26 seconds
15:22:24	24	17.8	168000	39 seconds
15:22:47	23	18.8	172000	1 minute 2 seconds
15:23:10	24.4	17.4	216000	1 minute 25 seconds

14. Similarly, on March 27, 2015 at 11:05:58 hrs, the Noticee executed one sell trade for 4,55,000 units of a contract named DABU15APR240.00CEW1 with counterparty, *Jayesh Ramniklal Dedhia* at a rate of Rs. 13.9/- per unit. Thereafter, the Noticee executed six buy trades aggregating to 4,55,000 units of the same contract with the same counterparty, *Jayesh Ramniklal Dedhia*, details of which are produced as under:

Trade Time	Trade Rate (rupees)	Price Difference (rupees)	Traded Quantity	Time difference from the sell trade
11:06:04.07	16.9	3	1000	6 seconds
11:06:08.12	19.8	5.9	1000	10 seconds
11:06:17.27	23.8	9.9	1000	19 seconds
11:06:46.67	24.85	10.95	172000	49 seconds
11:07:02.17	24.9	11	192000	1 minute 4 seconds
11:07:14.08	24.95	11.05	88000	1 minutes 16 seconds

15. It is also noted that 9 of these 15 reversal trades carried out by the Noticee on the date mentioned hereinabove did not have any time difference, whereas 6 trades of these 15 reversal trades had a time difference of 1 second between their sell order and buy order. Thus, all the reversal trades carried out by the Noticee 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 with a view to execute the reversal trades at a pre-determined price, and cannot take place without pre-arrangement.

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 it was not aware of the counter parties in the impugned trades. It also stated that it did not have any pre-existing relationship with the counter parties and that these trades were not executed with a view to manipulate the market. I also take note of the reliance placed on the judicial pronouncements, i.e. ***SPJ Stock Brokers Private Ltd.*** (*supra*) some connection between the Noticee and the counterparty needs to be established to bring about a charge of manipulation.

17. I also note that the Noticee has submitted that the impugned trades in the instant case are not synchronized trades. This contention is factually incorrect as all the 15 trades emanate from orders which have been entered in synchronised manner with a time difference of 0 seconds or 1 second between the buy and sell order. Noticee has further contended that even if these trades are considered to be synchronized trades, they would be considered illegal only if a meeting of minds among the parties involved and execution of trades with a view to manipulate the market are established

18. 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….*". As noted above, the Noticee entered into synchronised trades in a manner which indicates a meeting of minds and pre-arrangement. Hence the contention of the Noticee that transactions did not involve a meeting of the minds, that the trades were coincidental or that the Noticee had no knowledge of the counterparty is unacceptable.

19. I note that the Supreme Court, in the matter of ***Kishore R. Ajmera*** (*supra*) had observed that standard of proof in a quasi-judicial proceeding before SEBI is preponderance of probability, wherein proof has to be inferred by a logical process of reasoning from the totality of attending facts and circumstances surrounding the allegations / charges made and levelled.

20. It is relevant to mention here that the trades by the Noticee generated volumes without any change of beneficial ownership. Additionally, there was no justification for the significant price difference in the same contract in a span of a few minutes. Thus the trading volumes generated by the aforesaid trades was non-genuine, artificial and manipulative. 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*." Hence, the submission of the Noticee that the impugned trades carried out by the Noticee were genuine & purely coincidental trades and were not entered with a view to manipulate the market cannot be accepted.

21. On the contention of the Noticee that the risk disclosure document by SEBI envisaged wider spread on account of greater volatility in illiquid derivative contracts, 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, dividents etc. While the price of an option can vary depending on various parameters, the change in price has to be justifiable based on change in various underlying parameters. I also note that the Noticee has not made any attempt to provide any justifiable basis for wide variation in price in such derivative contracts.

22. The Noticee has submitted that the ratio of ***Rakhi Trading*** (*supra*) is not applicable on the facts of this case as the SCN did not allege that Noticee has entered into synchronized trades. This contention is erroneous as the Noticee had been provided trade and order details giving evidence of synchronized trades as part of the SCN.

23. As has been brought out in the SCN, the Noticee generated a total trading volume of 2030000 units in 2 unique contracts (details of which have been reproduced in paragraph 5 hereinabove) through reversal of trades on March 26, 2015 and March 27, 2015. On perusal of the table produced at paragraph 5 hereinabove, I note that the Noticee, on an average contributed 51% of the volume in the contracts traded which indicates a low level of public participation in trading of such contracts.

24. I note that the Noticee has placed reliance on ***KSL & Industries*** v. ***Chairman SEBI*** (SAT Appeal No. 9 of 2003 dated September 30, 2013) in contending that fraud is a grave charge and a fraudulent act cannot be imputed based on surmises, probabilities, conjectures and refutable evidence. However, 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 trades executed by the Noticee were reversal trades, and thus, were *non-genuine* in nature and created an impression of artificial 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*".

25. 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*."

26. 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?**

27. 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.*"

28. 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.

29. 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.

30. As noted earlier, the Noticee has contributed to artificial volumes in 2 contracts through 15 reversal trades on 2 days and thereby, has contributed around 0.01% of the artificial volume in the market during the Investigation Period.

31. 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 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 committed by the Noticee.

ORDER

32. 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 M J Shares & Securities Private Limited* under Section 15AHA of the SEBI Act for violation of Regulation 3(a), 4(1) and 4(2)(a) of the PFUTP Regulations.

33. 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

34. 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

35. 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 : February 28, 2019 **(Maninder Cheema)**
Place : Mumbai **Adjudicating Officer**