BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER: EAD-5/MC/VS/2018-19/50]

In respect of -

Kay Power and Paper Limited. [PAN: AABCK1295P]

having address at - Gat No. 454/457, Village Borgaon, Tal./Dist. Satara - 415 519, Maharashtra

In the matter of *Dealing in Illiquid options on the BSE*

BACKGROUND

1. The Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") conducted an investigation into the trading activity in illiquid Stock options at BSE for the period between April 1, 2014 to September 30, 2015 (hereinafter referred to as the "**Investigation Period**") after observing large scale reversal of trades in the Stock Options segment of the Bombay Stock Exchange Ltd. (hereinafter referred to as "**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 BSE Stock Options Segment were trades which involved reversal of buy and sell positions by the clients and counterparties in a contract. **Kay Power and Paper Ltd.** ("**the Noticee**") was one such client whose reversal trades involved squaring off transactions with significant difference in the sell value and buy value of the transactions. The aforesaid reversal trades allegedly resulted into generation of artificial volumes by the abovesaid client and counterparties, leading to the allegation that the Noticee had violated Regulation 3(a),(b),(c),(d), 4(1) and 4(2)(a) SEBI (Prohibition of Fraudulent and Unfair Trading Practices related to Securities Markets) Regulations, (hereinafter, referred to as "**PFUTP Regulations**").

APPOINTMENT OF ADJUDICATING OFFICER

3. SEBI initiated adjudication proceedings and appointed the undersigned as Adjudicating Officer (hereinafter referred to as "**AO**") under section 15-I of 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 15 HA of the SEBI Act, the alleged violations of the aforesaid provisions of the PFUTP Regulations, by the Noticee. The appointment of the AO was communicated vide order dated June 4, 2018.

SHOW CAUSE NOTICE, REPLY AND HEARING

4. Show Cause Notice No. EAD5/MC/VS/24591/1/2018 dated August 31, 2018 (hereinafter referred to as "**SCN**"), was issued to the Noticee in terms of Rule 4 (1) of the Adjudication Rules, to show cause as to why an inquiry should not be held and penalty not be imposed against the Noticee in terms of section 15 HA of the SEBI Act, for alleged violation of Regulation 3(a),(b),(c),(d), 4(1) and 4(2)(a) of the PFUTP Regulations.

5. The allegations levelled against the Noticee in the SCN are summarized as follows:-
    (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 the Stock Options Segment of BSE during the Investigation Period.
    (b) The Noticee is alleged to have engaged in 130 such reversal trades in 64 unique contracts, which led to generation of artificial volume of 5070000 units, on May 15^{th} and 20^{th}, 2015, June 5^{th} and 9^{th}, 2015, July 3^{rd}, 6^{th}, 10^{th}, 16^{th}, 22^{nd}, 23^{rd} and 30^{th}, 2015 and August 3^{rd}, 4^{th} and 10^{th}, 2015. These 130 trades of the Noticee on 13 days during the investigation period involved reversal with the same counterparty on the same day, but at different prices.

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

(d) A summary of dealings of Noticee in 64 Stock Options contracts in which Noticee allegedly executed non-genuine reversal trades during the Investigation Period, as provided in the SCN, is reproduced below:-

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	ASPL15AUG900.00CE	17.25	32000	30.00	32000	100%	33%
2	ASPL15OCT900.00CE	34.65	29000	54.00	29000	100%	100%
3	ASPL15SEP860.00PE	20.25	33000	33.00	33000	100%	57%
4	AUPL15AUG700.00PE	2.65	39000	10.00	39000	100%	29%
5	AUPL15SEP705.00PE	3.05	38000	12.00	38000	100%	100%
6	AUPL15SEP810.00CE	10.45	32000	19.00	32000	100%	100%
7	AXIS15AUG520.00PE	0.50	35000	5.00	35000	100%	10%
8	AXIS15AUG540.00PE	1.00	44000	5.00	44000	100%	28%
9	AXIS15AUG540.00PEW2	0.25	44000	5.00	44000	100%	64%
10	AXIS15SEP480.00PE	1.76	96000	7.13	96000	100%	41%
11	AXIS15SEP520.00PE	1.00	44000	6.00	44000	100%	9%
12	AXIS15SEP640.00CE	7.25	49000	16.00	49000	100%	20%
13	BPCL15AUG900.00PEW3	4.00	45000	14.00	45000	100%	100%
14	BPCL15JUL940.00PE	6.00	45000	15.00	45000	100%	100%
15	BPCL15SEP880.00PE	6.00	45000	20.00	45000	100%	64%
16	CENT15JUL700.00CE	27.00	20000	39.00	20000	100%	36%
17	CENT15SEP600.00PE	9.00	30000	16.00	30000	100%	23%
18	CIPL15AUG540.00PE	1.70	50000	6.80	50000	100%	24%
19	CIPL15AUG620.00PE	0.75	39000	5.75	39000	100%	18%

20	CIPL15SEP560.00PE	1.40	50000	7.80	50000	100%	34%
21	CIPL15SEP620.00PE	3.05	41000	11.00	41000	100%	20%
22	CIPL15SEP760.00CE	2.35	40000	9.00	40000	100%	17%
23	COLG15AUG1980.00PEW3	9.00	22000	28.00	22000	100%	100%
24	COLG15JUL2010.00PE	5.70	22000	15.60	22000	100%	100%
25	GRSM15AUG3000.00PE	20.00	10000	59.00	10000	100%	100%
26	GRSM15JUL3050.00PEW1	12.00	10000	29.00	10000	100%	100%
27	GRSM15JUL3150.00PE	29.00	10000	79.00	10000	100%	59%
28	GRSM15JUN3250.00PE	22.00	10000	72.00	10000	100%	28%
29	HDBK15SEP1020.00PE	9.65	39000	19.00	39000	100%	44%
30	HDBK15SEP1080.00PE	21.25	36000	36.00	36000	100%	35%
31	HDFC15JUL1260.00PE	2.25	42000	7.00	42000	100%	51%
32	HDFC15SEP1230.00PE	12.25	36000	27.00	36000	100%	20%
33	HDFC15SEP1290.00PE	22.35	38000	33.00	38000	100%	58%
34	HDFC15SEP1380.00CE	31.25	30000	49.00	30000	100%	59%
35	HDFC15SEP1410.00CE	27.25	41000	45.00	41000	100%	32%
36	INFY15AUG1890.00PE	24.00	10000	58.00	10000	100%	100%
37	INGL15SEP410.00PE	2.25	54000	5.50	54000	100%	100%
38	ITCL15AUG280.00PE	5.00	36000	9.00	36000	100%	100%
39	KOTB15AUG1230.00PE	20.00	10000	33.00	10000	100%	100%
40	KOTB15SEP690.00PE	16.75	34000	25.00	34000	100%	100%
41	KOTB15SEP750.00CE	7.25	32000	16.00	32000	100%	100%
42	LNTF15JUL65.00PE	0.10	300000	0.70	300000	100%	18%
43	LNTF15JUL75.00CE	0.15	124000	0.90	124000	100%	49%
44	LNTL15AUG1770.00CE	51.00	20000	70.00	20000	100%	100%
45	LNTL15JUL1470.00PE	12.00	20000	25.00	20000	100%	22%
46	LNTL15JUL1530.00PEW1	7.00	10000	12.00	10000	100%	100%
47	LNTL15JUL1800.00PE	2.25	12000	14.75	12000	100%	22%
48	LNTL15OCT1740.00PE	21.25	16000	34.00	16000	100%	50%
49	LUPL15JUL2010.00CE	6.25	12000	18.00	12000	100%	26%
50	PIDI15SEP580.00CE	6.65	37000	18.00	37000	100%	45%
51	RELI15JUL940.00PE	1.05	45000	6.00	45000	100%	66%
52	RELI15SEP940.00PE	8.00	30000	16.00	30000	100%	100%
53	SBIL15AUG190.00PE	1.00	50000	2.00	50000	100%	100%
54	SBIL15AUG210.00PE	0.25	75000	2.60	75000	100%	26%

55	SBIL15AUG230.00PE	0.35	72000	2.70	72000	100%	43%
56	SRFL15AUG1230.00PE	12.05	25000	18.00	25000	100%	26%
57	SRFL15AUG1260.00PE	18.00	25000	32.00	25000	100%	35%
58	SRFL15SEP1170.00PE	12.05	35000	19.00	35000	100%	37%
59	STAC15JUN870.00PE	4.00	25000	12.00	25000	100%	100%
60	SUNT15AUG270.00PEW3	1.00	30000	3.00	30000	100%	100%
61	TCSL15JUL2700.00CE	4.00	20000	15.00	20000	100%	100%
62	TECM15JUL500.00CE	3.25	46000	7.70	46000	100%	48%
63	UBRL15JUL1050.00CE	6.25	20000	20.00	20000	100%	23%
64	UBRL15SEP940.00PE	22.35	44000	36.00	44000	100%	48%

Note: *"Unit" refers to lot size in contract multiplied by number of contracts traded.*

6. By indulging in execution of the aforementioned reversal trades, the Noticee allegedly violated regulations 3(a),(b),(c),(d), 4(1) and 4(2)(a) of the PFUTP Regulations, which are reproduced below:-

"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 there under;

(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 and 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."

7. A time period of 14 days was granted to the Noticee to present its reply to the SCN. However, the said SCN was returned undelivered as "unclaimed". Accordingly, service of SCN with Annexures was made vide e-mail dated October 9, 2018 requiring the Noticee to file its reply to the SCN within 21 days of receipt of the e-mail. Subsequently, vide letter dated October 11, 2018, the Noticee denied the allegations contained in the SCN and requested that all documents and information gathered during investigation by SEBI be provided to the Noticee in order to enable an effective defence.

8. Vide letter dated November 2, 2018 the Noticee once again sought all the documents and information gathered during investigation. Vide letter dated November 16, 2018 the Noticee was given an *in seriatim* response to its request for specific documents. Further, the Noticee was once again advised to submit its reply to the SCN by November 26, 2018 and to appear for personal hearing on November 29, 2018 at 3:30 p.m. Vide e-mail dated November 23, 2018, the Noticee sought reschedulement of hearing on November 29, 2018 between 10:00 am to 12:00 pm, and the said request was acceded to.

9. Vide reply dated November 26, 2018 submitted during the personal hearing on November 29, 2018, the Noticee made its submissions with respect to the allegations levelled against it in the SCN. The Noticee's submissions are summarized as follows –

   (a) The Noticee is a public limited company incorporated in Borgaon, Satara, in 1991. It is engaged in manufacturing of paper and its equity shares are listed on the Bombay Stock Exchange

   (b) A power generation plant set up by the Noticee in 1999-2000 went out of operation in 2007, leading to heavy losses and rendering the Noticee a sick company in 2003. The Noticee closed its operations in 2006-7 to 2008-9 and restarted its paper division operations from 2009-10. The paper plant is currently operating at almost 100% of capacity and management is planning an expansion in future.

(c) The Noticee's trades on the BSE are genuine, *bonafide* and executed in compliance with all the requirements of SEBI and the stock exchanges

(d) The complete materials/documents in support of the allegations against the Noticee have not been made available to the Noticee, so the Noticee is unable to effectively answer the charges levelled against it in the SCN. This is against the settled principles of natural justice.

(e) The SCN does not contain evidence in support of the contents of the SCN. No data or documents have been provided to the Noticee regarding large scale reversal of shares in the stock options segment of BSE leading to creation of artificial volumes. Therefore, the Noticee presumes that no such data or documents exist with the AO.

(f) The Noticee disputes that any investigation was conducted by SEBI into the trading activities of certain entities in illiquid stock options at BSE from April 1, 2014 to September 30, 2015 as no documents or details about the investigation have been provided.

(g) The words "artificial' and "non-genuine" are not defined in the PFUTP Regulations or the SEBI Act/Regulations. The Noticee's trades are genuine and not artificial going by the dictionary meanings of the terms. The trades were executed on the anonymous platform of the exchange at price ranges permitted by the exchange and SEBI.

(h) In order to allege creation of artificial volume particularly with reference to reversal/synchronized trades in the market it is imperative to show that the two parties who are carrying out the trades alleged to be artificial trades were connected to each other or shared a common objective. Since the Noticee was completely unaware of the identity of the counterparties while trading on the screen-based transactions, there could not have been any meeting of minds of Noticee with counterparties, and there is no evidence in the SCN to this effect either. Further, synchronized trades are not *per se* illegal.

(i) A charge of fraud and manipulation cannot be levelled merely on the basis of possibility of reversal. Some collusion/connection/relation/nexus has to be shown to substantiate the charges. The Noticee has cited the order dated October 27, 2008 of the SAT in *Jagruti Securities Ltd. v. SEBI* to state that in an artificial trade there has to be collusion between buyer and seller.

(j) The specific role of the Noticee in the reversal trades, where other entities have also traded, has not been brought out. Further, the SCN does not mention the trades of other entities/counterparties which executed the alleged reversal trades. Therefore, SEBI has taken action only against selected entities and not against all who were allegedly involved in the alleged reversal trades.

(k) The Noticee denies that it violated regulations 3 and 4 of the PFUTP Regulations as it did not carry out any of the omissions/commissions stipulated in regulations 3 and 4 of the PFUTP Regulations. The SCN does not contain any evidence to show that the Noticee's actions were fraudulent as per the definition of "fraud" or "fraudulent trade practice" in the PFUTP Regulations, as in 22 out of the 64 contracts traded in by the Noticee, the Noticee contributed the entire volume in the said contract, so the Noticee cannot be said to have induced any other entities to trade in these contracts. Since trade and order logs of other entities were not provided to the Noticee, it is not possible to say whether the trading of the Noticee induced any entity to deal in the contract.

(l) On the basis of the trade and logs and order of the Noticee it is seen that the Noticee traded only in 64 distinct options contracts from May 15, 2015 to August 10, 2015. Thus, the meagre trades of the Noticee did not warrant a charge of artificial volumes. Since options are derivatives deriving their value from the underlying scrip, therefore allegation of fraud with respect to generating artificial volume has to be proved and shown in the underlying scrip. As all the contracts belong to scrips which are liquid/highly traded scrips on stock exchanges, so the meagre trades of the Noticee could not have affected volumes. As per the SCN, the Noticee carried out only 130 reversal trades out of a total number of

291643 reversal/non-genuine trades, which could not have had an impact on the underlying scrip of the options segment.

(m)The SCN does not bring out the effect of the alleged reversal trades of the Noticee on volume or price in the options segment. The volume and price of the cash segment was unfazed by the alleged non-genuine trades in the options segment. The alleged fraudulent trading of the Noticee has not caused any loss to other market participants, especially since the Noticee's trades were executed in illiquid options segment. Since there was no public involvement in these options, no harm could have been caused to any other market participants.

(n) The SCN does not take into account the number of trades and volumes generated in the complete options segment in BSE in a particular scrip on a particular day. What has been considered in the SCN is only a particular option and not the total trading in the options segment.

(o) The counterparties to all the alleged reversal trades executed by the Noticee are different. Further, the Noticee has traded in various contracts during the investigation period, so it is not possible to say that the trades executed by the Noticee were manipulative or created artificial volumes in the market.

(p) Even if the Noticee were involved with the other entities in the alleged scheme of option trading, there is nothing fraudulent or illegal about the same.

(q) The SCN alleges that the non-genuine trades executed by the Noticee had significant differences in buy and sell rates. In this regard it is submitted that the pricing of an option depends on various factors which are taken into consideration by the option writer – such as price of underlying scrip, movement of market, number of trades in other options, volatility index prevailing etc. Since none of these details have been provided to the Noticee despite them being sought for by the Noticee, it is impossible for the Noticee to now explain why the Noticee dealt in a particular option at a particular price at a particular time. Therefore, the AO should ignore the allegations based on pricing.

(r) As per normal market behaviour, the Noticee bought shares at a low price and sold at a high price. The Noticee made profits through trades executed in the normal course, unlike in the case of *SEBI v. Rakhi Trading Pvt. Ltd.* where the Appellant had consistently incurred losses.

(s) No penalty should be imposed on the Noticee as there is no ground for levy of penalty based on the factors mentioned in section 15J of the SEBI Act. Further, the Noticee is a sick company since 2003, and has gradually settled and paid its dues to financial institutions and banks except IREDA. As per SAT order in *Jay Bharat Fabric Mills Limited v. SEBI* dated June 11, 2014, various aspects including the sickness of the company and its poor financial health should be taken into account while levying penalty in terms of section 15 C and 15HB of the SEBI Act. Since SEBI has failed to make out a prima facie case against the Noticee, the SCN needs to be quashed and set aside in its entirety.

10. During the personal hearing conducted at 10:30 a.m. on November 29, 2018, the Noticee was represented by Mr. Pulkit Sharma, Mr. Jitendra Sharda and Ms. Nirali Mehta ("Authorized Representatives" or "ARs" of the Noticee). The ARs of the Noticee reiterated the submissions made vide reply dated November 26, 2018.

11. The Noticee reiterated during hearing that the investigation report and the trade and order logs for the entire market during the investigation period were required in order to respond effectively to the charges levelled against it in the SCN. It was also submitted that certain mitigating factors should be considered by the AO during levy of penalty, if any, against the Noticee. These factors included the following:-

(a) If the contribution of the Noticee to market volume as mentioned in Annexure D is 100% and the Noticee is the only one trading at that time, this be considered a mitigating factor during levy of penalty by the AO

(b) Genuine business transactions following prudent business decisions are being carried out by the Noticee to repay its debts as a sick company (under the SICA/BIFR). Levy of penalty might affect its ability to repay its debts.

12. In view of the above, I hereby proceed to decide the case on merits on the basis of the SCN, the reply dated November 26, 2018, and the submissions made during the personal hearing conducted on November 29, 2018.

CONSIDERATION OF ISSUES AND FINDINGS

13. The issues arising for consideration in the instant proceedings before me are:-
    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), 4(1) and 4(2)(a) of the PFUTP Regulations?
    II. If yes, whether the Noticee is liable for imposition of monetary penalty under Section 15 HA of the SEBI Act?
    III. If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in section 15 J of the SEBI Act read with rule 5 (2) of the Adjudication Rules?

14. Before considering the abovementioned issues, it is necessary to consider a preliminary issue raised by the Noticee. The Noticee has submitted that in contravention of principles of natural justice, it has not been provided with the documents and material, including a copy of the Investigation Report as well as trade and order logs for all entities during the investigation period, based on which the SCN has been issued, which has prevented the Noticee from effectively answering the charges levelled against it in the SCN.

15. In this regard, I observe that the SCN issued to the Noticee (alongwith the Annexures thereto) contains the trade and order details relevant to the alleged non-genuine reversal trades executed by the Noticee. The facts culled from the findings of investigation undertaken by SEBI which have led to crystallisation of charges under the PFUTP Regulations against the Noticee form a part of the SCN and its Annexures. As noted by the Securities Appellate Tribunal in its order dated 12.05.2017 in Shri B. Ramalinga Raju v. SEBI - "*There can be no dispute that while determining the rights and obligations of the parties the quasi-judicial authority must adhere to the principles of natural justice which inter alia, includes the obligation to furnish requisite documents on the basis of which charges are framed….*".

16. On perusal of the material available on record, I note that the charge under the PFUTP Regulations - based on reversal of trades with significant difference in buy and sell prices, leading to generation of artificial volumes - does not derive from any facts extraneous to those contained in the SCN and its Annexures. A reasonable opportunity of being heard has been provided to the Noticee to respond to the allegations in the SCN based on facts relevant to the Noticee and any additional information the Noticee may have had pertaining to its own trading behaviour as brought out in the SCN. Therefore, I find no merit in the Noticee's contention that it has not been provided with relevant material/documents based on which the SCN has been issued, or that the AO provided a hearing opportunity without considering the reply of the Noticee. Thus, the Noticee's submissions in this regard are untenable.

ISSUE 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), 4(1) and 4(2)(a) of the PFUTP Regulations?

17. The allegation that the Noticee carried out reversal trades is directly supported by evidence from the trade log records in Annexures B and C of the SCN. On May 15th and 20th, 2015, June 5th and 9th, 2015, July 3rd, 6th, 10th, 16th, 22nd, 23rd and 30th, 2015 and August 3rd, 4th and 10th, 2015. The Noticee is seen to have carried out 130 reversal trades in 64 contracts through 8 brokers, on 13 days during the investigation period. To illustrate, on May 15, 2015 at 14:05:44.73 hrs the Noticee placed a sell order for 10000 units of the contract named "GRSM15JUL3150.00PE", which were all bought by one Welcome Enterprises at a price of Rs. 79 per unit. Within the next 5 seconds, the Noticee bought back the said 10000 units of the abovementioned contract from the same counterparty client at a price of Rs. 29 per unit. Thus, the Noticee reversed its sale of 10000 units of the abovementioned contract with the same counterparty within five seconds, with a substantial price difference of around Rs.50 between the two legs of the trade in the same contract. Almost all the buy and sell orders in this case were placed within 1 second of each other.

18. On the same day, May 15th, 2015, at 14:07:11.78 hrs the Noticee sold 10000 units of a contract called "GRSM15JUN3250.00PE" at a price of Rs. 72 per unit to Welcome Enterprises. The buy and sell orders were placed within a second of each other. In less than 4 seconds, the Noticee reversed its sale of 10000 units by buying back the said number of units from the same counterparty client at Rs. 22 per unit.

19. Similar sets of reversal trades were observed in 62 other contracts with 10 other counterparties on 12 other days during the investigation period. Overall, the reversal trades of the Noticee accounted for 58% of the total trading volume in the said contracts.

20. I note that in all the 130 reversal trades, the counterparty client to the two legs of the trades was the same. I also note that trades were reversed by executing opposite trades within less than a minute of the first leg of the reversal trades with the same counterparty, and at a substantial price difference from the first leg without any basis for significant change in the contract price within such a short period. Further, I note that the buy and sell orders in the case of almost all the 130 reversal trades were synchronised to within 1 second.

21. On synchronisation, the Noticee has submitted that the Noticee did not know the counterparty to its trades on the anonymous screen-based order matching system of the exchange. In this context I note that 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.

22. The Noticee has also submitted since the Noticee was not aware of or connected to the parties to the impugned reversal trades which allegedly generated artificial volumes, therefore the Noticee's trades were genuine. The law in this regard 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.*" The Supreme Court also cited SAT order in the matter of *Ketan Parekh v. SEBI* (decided on 14.07.2006) which stated – "*A synchronised transaction will, however, be illegal or violative of the Regulations if it is executed with a view to manipulate the market or if it results in circular trading or is dubious in nature and is executed with a view to avoid regulatory detection or does not involve change of beneficial ownership or is executed to create false volumes resulting in upsetting the market equilibrium. Any transaction executed with the intention to defeat the market mechanism whether negotiated or not would be illegal.*" I find that the reversal trades executed by the Noticee were reversed through trades synchronised with the counterparty client, and were not intended to transfer beneficial ownership, thus indicating that the trades were non-genuine and in violation of the PFUTP Regulations.

23. Similarly, in terms of the aforesaid decision of the Supreme Court in *Rakhi Trading*, which held that the stipulation in regulation 4 (1) of the PFUTP Regulations viz. "no person shall indulge in a fraudulent or unfair trade practice", read with the ruling of the Supreme Court in *SEBI v. Kanaiyalal Baldevbhai Patel and Ors*. (2017 SCC Online SC 1148), means that a "*trade practice is unfair if the conduct undermines the ethical standards and good faith dealings between parties engaged in business transactions...the concept of unfairness is broader than and includes the concept of 'deception' or 'fraud'.* Thus, 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.

24. The specific role of the Noticee in engaging in reversal trades is evident from the trade and order data provided to the Noticee along with the SCN, including details

of other entities/counterparties which executed the alleged reversal trades. With regard to contention of Noticee on o impact of the impugned transactions on the options and cash segments of the exchange, or on other market participants, I note that the issue has been dealt with in the Supreme Court ruling in *Rakhi Trading* where it was held that non-genuine transactions affect free and fair trading and price discovery, and prevent innocent investors from getting a true picture of the market. Impact on price of underlying scrip and on profits of parties unconnected with the reversal trades need not be the only measure of impact on market integrity. Therefore, the Noticee's submissions in this regard are unacceptable.

25. With reference to the Noticee's contention that the words "reversal trades", "artificial" and "non-genuine" are not defined, it is noted that though not defined in the PFUTP Regulations, these terms have been recognised in various judicial pronouncements including the case of *SEBI v. Rakhi Trading Pvt. Ltd,* by the Hon'ble Supreme Court. While reversal trades in the context of the allegations levelled in the SCN mean trades which have been reversed by executing opposite trades involving the same number of shares by the same parties, the words 'artificial" and "non-genuine" indicate that the trades were not a result of free play of market forces in an anonymous trading system, but were orchestrated to achieve the objectives of the parties to the particular arrangement for buying/selling shares. As per the Supreme Court order in *Rakhi Trading*, non-genuine trades are a misuse of the market mechanism and have no true commercial basis or intention to transfer beneficial ownership. Such artificial or non-genuine trades deprive other market players from full participation, restrict free and fair operation of the market forces and affect price discovery. This in turn fulfils the elements of "fraud" as stipulated in regulations 3 and 4 of the PFUTP Regulations.

26. With respect to the Noticee's contentions that not all the orders which were placed by it were executed in the system which would have been the case had the Noticee been involved in reversal trades, I find that while all relevant trade details with respect to the charges levelled against the Noticee are available in the Annexures to the SCN, the Noticee has been unable to provide any details regarding trades

which were not executed or which were placed in the system but not reversed in the manner of the impugned reversal trades. Further, in order to support a charge of non-genuine reversal trades by an entity, it is not essential to prove that all of the entity's trades were non-genuine. Therefore, I find this contention of the Noticee to be unacceptable.

27. With respect to the Noticee's contention that its impugned trades had resulted in profits and that unlike the <u>*Rakhi Trading*</u> case, the Noticee did not incur losses and that therefore the trades were based on normal market behaviour, I note that in reversal trades of this nature, while one of the parties incurs loss, the counterparty consequently incurs profit, and this booking of profit and loss by the two counterparties is a consequence of the non-genuine trade. Hence, the artificial nature of trades is not dependent on whether there has been loss or profit.

28. With respect to unrealistic price for options contracts, the Noticee has submitted that the pricing of an option depends on various factors which are taken into consideration by the option writer – such as price of underlying scrip, movement of market, number of trades in other options, volatility index prevailing etc., which data has not been provided to the Noticee. Further, the Noticee has submitted that the trades were executed at price ranges permitted by the exchange and SEBI. I note that while there is no price band mechanism for the Options segment, price of a stock option is based on parameters such as price of underlying stock, intrinsic value of option, expected volatility, interest rates, dividends etc., and all such information is available in the public domain. The Noticee has made no attempt to provide justification for the widely varying prices at which the reversal trades were carried out in a short span of time.

29. Finally, the Noticee has cited certain mitigating factors - such as the sickness of the company and effect of a monetary penalty on the Noticee's financial health - for consideration during levy of penalty. The said submissions are noted.

30. As stated in the SCN, the Noticee generated a total trading volume of 5070000 units by executing 130 reversal trades in 64 unique contracts on 13 days between

May 15, 2015 and August 10, 2015 during the investigation period, with 11 counterparty clients - as per the table reproduced as follows:-

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	ASPL15AUG900.00CE	17.25	32000	30.00	32000	100%	33%
2	ASPL15OCT900.00CE	34.65	29000	54.00	29000	100%	100%
3	ASPL15SEP860.00PE	20.25	33000	33.00	33000	100%	57%
4	AUPL15AUG700.00PE	2.65	39000	10.00	39000	100%	29%
5	AUPL15SEP705.00PE	3.05	38000	12.00	38000	100%	100%
6	AUPL15SEP810.00CE	10.45	32000	19.00	32000	100%	100%
7	AXIS15AUG520.00PE	0.50	35000	5.00	35000	100%	10%
8	AXIS15AUG540.00PE	1.00	44000	5.00	44000	100%	28%
9	AXIS15AUG540.00PEW2	0.25	44000	5.00	44000	100%	64%
10	AXIS15SEP480.00PE	1.76	96000	7.13	96000	100%	41%
11	AXIS15SEP520.00PE	1.00	44000	6.00	44000	100%	9%
12	AXIS15SEP640.00CE	7.25	49000	16.00	49000	100%	20%
13	BPCL15AUG900.00PEW3	4.00	45000	14.00	45000	100%	100%
14	BPCL15JUL940.00PE	6.00	45000	15.00	45000	100%	100%
15	BPCL15SEP880.00PE	6.00	45000	20.00	45000	100%	64%
16	CENT15JUL700.00CE	27.00	20000	39.00	20000	100%	36%
17	CENT15SEP600.00PE	9.00	30000	16.00	30000	100%	23%
18	CIPL15AUG540.00PE	1.70	50000	6.80	50000	100%	24%
19	CIPL15AUG620.00PE	0.75	39000	5.75	39000	100%	18%
20	CIPL15SEP560.00PE	1.40	50000	7.80	50000	100%	34%
21	CIPL15SEP620.00PE	3.05	41000	11.00	41000	100%	20%
22	CIPL15SEP760.00CE	2.35	40000	9.00	40000	100%	17%
23	COLG15AUG1980.00PEW3	9.00	22000	28.00	22000	100%	100%

24	COLG15JUL2010.00PE	5.70	22000	15.60	22000	100%	100%
25	GRSM15AUG3000.00PE	20.00	10000	59.00	10000	100%	100%
26	GRSM15JUL3050.00PEW1	12.00	10000	29.00	10000	100%	100%
27	GRSM15JUL3150.00PE	29.00	10000	79.00	10000	100%	59%
28	GRSM15JUN3250.00PE	22.00	10000	72.00	10000	100%	28%
29	HDBK15SEP1020.00PE	9.65	39000	19.00	39000	100%	44%
30	HDBK15SEP1080.00PE	21.25	36000	36.00	36000	100%	35%
31	HDFC15JUL1260.00PE	2.25	42000	7.00	42000	100%	51%
32	HDFC15SEP1230.00PE	12.25	36000	27.00	36000	100%	20%
33	HDFC15SEP1290.00PE	22.35	38000	33.00	38000	100%	58%
34	HDFC15SEP1380.00CE	31.25	30000	49.00	30000	100%	59%
35	HDFC15SEP1410.00CE	27.25	41000	45.00	41000	100%	32%
36	INFY15AUG1890.00PE	24.00	10000	58.00	10000	100%	100%
37	INGL15SEP410.00PE	2.25	54000	5.50	54000	100%	100%
38	ITCL15AUG280.00PE	5.00	36000	9.00	36000	100%	100%
39	KOTB15AUG1230.00PE	20.00	10000	33.00	10000	100%	100%
40	KOTB15SEP690.00PE	16.75	34000	25.00	34000	100%	100%
41	KOTB15SEP750.00CE	7.25	32000	16.00	32000	100%	100%
42	LNTF15JUL65.00PE	0.10	300000	0.70	300000	100%	18%
43	LNTF15JUL75.00CE	0.15	124000	0.90	124000	100%	49%
44	LNTL15AUG1770.00CE	51.00	20000	70.00	20000	100%	100%
45	LNTL15JUL1470.00PE	12.00	20000	25.00	20000	100%	22%
46	LNTL15JUL1530.00PEW1	7.00	10000	12.00	10000	100%	100%
47	LNTL15JUL1800.00PE	2.25	12000	14.75	12000	100%	22%
48	LNTL15OCT1740.00PE	21.25	16000	34.00	16000	100%	50%
49	LUPL15JUL2010.00CE	6.25	12000	18.00	12000	100%	26%
50	PIDI15SEP580.00CE	6.65	37000	18.00	37000	100%	45%
51	RELI15JUL940.00PE	1.05	45000	6.00	45000	100%	66%
52	RELI15SEP940.00PE	8.00	30000	16.00	30000	100%	100%
53	SBIL15AUG190.00PE	1.00	50000	2.00	50000	100%	100%
54	SBIL15AUG210.00PE	0.25	75000	2.60	75000	100%	26%
55	SBIL15AUG230.00PE	0.35	72000	2.70	72000	100%	43%
56	SRFL15AUG1230.00PE	12.05	25000	18.00	25000	100%	26%
57	SRFL15AUG1260.00PE	18.00	25000	32.00	25000	100%	35%
58	SRFL15SEP1170.00PE	12.05	35000	19.00	35000	100%	37%

59	STAC15JUN870.00PE	4.00	25000	12.00	25000	100%	100%
60	SUNT15AUG270.00PEW3	1.00	30000	3.00	30000	100%	100%
61	TCSL15JUL2700.00CE	4.00	20000	15.00	20000	100%	100%
62	TECM15JUL500.00CE	3.25	46000	7.70	46000	100%	48%
63	UBRL15JUL1050.00CE	6.25	20000	20.00	20000	100%	23%
64	UBRL15SEP940.00PE	22.35	44000	36.00	44000	100%	48%

31. From the table above, I note that the Noticee on average contributed 58% of the volume in the contracts traded. In 54 of the 64 contracts, the average volume contribution by Noticee was 65%, and of these in 22 contracts volume contribution by the Noticee was 100% which indicates a lack of public participation in the contracts.

32. Considering the synchronised manner of placing buy and sell orders within a few seconds of each other, reversing of the trades within a short time with widely varying prices of the two legs of the trade in the same contract without any basis for such wide variation, I find that the reversal trades executed by the Noticee were not genuine trades and being non-genuine, created an impression of artificial trading volumes in the respective contracts. By engaging in such trades, the Noticee violated provisions of Regulation 4(2)(a) of PFUTP Regulations, which states that dealing in securities will be deemed to be a fraudulent and unfair trade practice if it involves "*indulging in an act which creates false or misleading appearance of trading in the securities market*".

33. In view of the above, I find that the Noticee, by engaging in such non-genuine transactions which created a misleading impression of trading in respective contracts, dealt in the stock options contracts in a fraudulent manner in violation of Regulation 3(a) and 4(1) of the PFUTP Regulations.

34. I also find it relevant to reiterate here that in the matter of <u>Securities and Exchange Board of India v. Rakhi Trading Private Limited</u> (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 Hon'ble Supreme Court

observed that "*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 PFUTP Regulations.*"

Issue II **If yes, whether Noticee is liable for imposition of monetary penalty under Section 15HA of SEBI Act?**

and

Issue 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?**

35. As it has been established that the Noticee violated provisions of Regulations 3(a), 4(1) and 4(2) (a) of the PFUTP Regulations, hence the Noticee is liable for imposition of monetary penalty under Section 15 HA of the SEBI Act.

36. 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.

37. As established above, the trades by the Noticee were non-genuine in nature and created a misleading appearance of trading. I note that the trading was in illiquid stock option 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 the non-genuine trades However, I note that the Noticee indulged in creation of artificial trading volumes by trading with three counterparties in illiquid options contracts, where wider market was not involved in the trades, and 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 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. I further note that the Noticee contributed around 0.044 % of the artificial reversal trades in the market during the Investigation Period.

38. As noted earlier, the Noticee has contributed to artificial volumes in 64 contracts through 130 trades on 13 days during the Investigation Period. Therefore, taking into account the facts and circumstances of this case, the proportion of trading by the Noticee as compared to the total volume of reversal trades in the market during the Investigation Period, the mitigating factors mentioned by the Noticee, I am of the view that a penalty of Rs.10,00,000/- will be commensurate with the violations committed by the Noticee.

ORDER

39. After taking into consideration all the facts and circumstances of the case, in exercise of powers conferred upon me under Section 15-I of the SEBI Act read with Rule 5 of the Adjudication Rules, I hereby impose a penalty of Rs.10,00,000/- (Rupees Ten Lakh only) upon the Noticee i.e. Kay Power and Paper Ltd.under Section 15 HA of the SEBI Act, for violation of regulations 3(a), 4(1) and 4(2)(a) of the PFUTP Regulations.

40. 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

41. 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 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

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

Date: January 17, 2019

Place: Mumbai

Maninder Cheema

(Adjudicating Officer)