BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

ADJUDICATION ORDER NO. Order/AA/2022-23/17878-17879

UNDER SECTION 15-I OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF THE SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995

In respect of:

S. no.	Name of Noticee	PAN
1	Macquarie Finance (India) Pvt Ltd	AAFCM9404N
2	Carron Investments Private Limited (Transferee Company) (Modern Trading Business Pvt Limited (erstwhile known as HOT n ICE Entertainment Company Private Limited) amalgamated with Carron Investments Private Limited)	AAACC1995K

In the matter of Box trade activities in long dated Nifty options expiring on June 26, 2014

A. BACKGROUND OF THE CASE

1. Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") conducted investigation from the first instance of alleged box-trade i.e. November 27, 2013 till contract expiry day i.e. June 26, 2014 (hereinafter referred to as '**Investigation Period/IP'**). Pursuant to the investigation, SEBI found that *interalia* Macquarie Finance (India) Pvt Ltd (hereinafter referred as "MFIPL") (**Noticee no. 1**) and Carron Investments Private Limited (Transferee Company) (Modern Trading Business Pvt Limited (erstwhile known as Hot N Ice Entertainment Company Private Limited) amalgamated with Carron Investments Private Limited) (hereinafter referred as "HNI") (**Noticee no. 2**) were *prima facie* in violation of certain provisions of Regulations 3(d), 4 (1), 4 (2) (a) and 4 (2) (e) of SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations, 2003 (hereinafter referred to as 'PFUTP Regulations, 2003').

B. APPOINTMENT OF ADJUDICATING OFFICER

2. SEBI initiated adjudication proceedings and appointed the undersigned as the Adjudicating Officer under Section 15-I of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the "**SEBI Act**") read with Rule 3 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as the "**Adjudication Rules**"), vide communication dated December 17, 2021 to inquire into and adjudge under Section 15HA of SEBI Act, 1992 for the violations alleged against the Noticees.

C. SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING

3. A common Show Cause Notice dated December 23, 2021 (hereinafter referred to as "**SCN**") was issued against the Noticees. The SCN was issued under Rule 4(1) of the Adjudication Rules to show cause as to why inquiry should not be initiated against the Noticees, and penalty should not be imposed under the provisions of Section 15HA of the SEBI Act, 1992.

4. The common SCN dated December 23, 2021 was served on Noticee no. 1 via Speed Post with Acknowledgment Due on December 29, 2021. Thereafter, Noticee no. 1 requested for inspection of documents vide email dated January 12, 2022 and the same was provided on February 01, 2022. Noticee no. 1, during the inspection and vide email dated February 07, 2022, sought certain documents including the investigation report, which were provided vide email dated February 14, 2022. Subsequently, Noticee no. 1 submitted its reply on March 7, 2022. Vide notice dated March 12, 2022, Noticee no. 1 was granted an opportunity of personal hearing on April 07, 2022. Pursuant to the hearing held on April 07, 2022, Noticee no. 1 provided its written submission on May 5, 2022.

5. The common SCN dated December 23, 2021 was served on Noticee no. 2 via email on February 06, 2022. Thereafter, SCN and Hearing notice for hearing scheduled on June 24, 2022 was served through public notice dated May 28, 2022. In response, Noticee no. 2 vide letter dated June 16, 2022 provided its submission. Subsequently, personal hearing was held on June 24, 2022.

D. FACTUAL MATRIX

6. A Box trade is an option arbitrage strategy wherein the spreads (i.e., net difference in option premium between bull call spread and bear put spread) are different from the expiration value of these options. The expiration value of spreads i.e., difference between bull call spread and bear put spread is always the difference between the two strikes.

7. A box trade strategy would result into fixed payoff regardless of settlement value of NIFTY on expiry day. Further, option buyer pays the premium to option seller and if the positions are run till expiry of contracts, option buyer would receive settlement amount from option seller. Keeping this fixed pay off as loan repayment with interest, it is alleged that initial option premium is so selected by the two parties (i.e., if the long-dated options are illiquid) on the basis of mutual understanding, so that it forms the initial loan amount from option buyer to option seller (through exchange settlement mechanism).

8. During IP, Noticees entered into following transactions on November 27, 2013.

Table 1

Trade Date	Symbol	Expiry Date	Buy Client Name	Sell Client Name	CE Strike Price	Qty	Value	PE Strike Price	Sum of trd_qty-PE	Sum of trd_val-PE	Sum of trd_qty	Sum of trd_val	Cash Inflow for Seller on trade date	Cash Outflow for Seller on Expiry day	Gains Involved
			MACQUARIE	HNI	4,000	10,000	21,445,000	8,000	10,000	16,525,000	20,000	37,970,000			
27-Nov-13	NIFTY	26-Jun-14	HNI	MACQUARIE	8,000	10,000	465,000	4,000	10,000	205,000	20,000	670,000	37,300,000	40,000,000	2,700,000

PE – Put European option, CE- Call European option

9. As observed from the above table, MFIPL and HNI allegedly entered into one box trade transaction – one using 4000 and 8000 strike price (10,000 quantity). The last 3 columns in the above table indicate that initial flow of premium from option buyer to option seller (i.e., Macquarie to HNI) is Rs. 3.73 cr. And if positions are run till expiry by both entities (i.e., till June 26, 2014), the return amount from HNI to Macquarie would be Rs. 4.00 cr. (second last column) which results into interest component of approximately Rs. 0.27 cr to the alleged loan. The individual trades constituting alleged Box Trades are given below.

Table 2

Option	Strike	Trade time	Sell Client	Buy Client	Price	Qty	Value	Market Volume	Nifty Value	Theoritical Price
PE	8000	27/11/2013 15:01	HNI	MACQUARIE	1670	3000	5010000	10000	6067.35	1664.31
CE	4000	27/11/2013 15:02	HNI	MACQUARIE	2125	3000	6375000	10100	6066.75	2226.57
PE	8000	27/11/2013 15:15	HNI	MACQUARIE	1645	3000	4935000	10000	6056	1674.49
CE	4000	27/11/2013 15:15	HNI	MACQUARIE	2150	3000	6450000	10100	6055.25	2215.12
PE	8000	27/11/2013 15:22	HNI	MACQUARIE	1645	4000	6580000	10000	6053.15	1677.05
CE	4000	27/11/2013 15:23	HNI	MACQUARIE	2155	4000	8620000	10100	6052.9	2212.77
PE	4000	27/11/2013 15:02	MACQUARIE	HNI	15	3000	45000	10050	6066.15	1.19
CE	8000	27/11/2013 15:03	MACQUARIE	HNI	50	3000	150000	10000	6064.4	48.62
PE	4000	27/11/2013 15:16	MACQUARIE	HNI	20	3000	60000	10050	6052.35	1.24
CE	8000	27/11/2013 15:16	MACQUARIE	HNI	45	3000	135000	10000	6051.85	47.34
PE	4000	27/11/2013 15:23	MACQUARIE	HNI	25	4000	100000	10050	6052.75	1.24
CE	8000	27/11/2013 15:24	MACQUARIE	HNI	45	4000	180000	10000	6052.7	47.42

10. From the table placed above, following have been observed:

i. Trade volume between Macquarie and HNI in individual contracts account for significant proportion of overall volume in the contract on November 27, 2013.

ii. A total of 12 trades had been executed between two clients in last half an hour of market closing with underlying index showing very little movement during this period.

iii. Trade price in most of the cases is away from the theoretical price of the contract as provided by NSE.

11. The trade time and corresponding value of NIFTY at that time for trades of the Noticees dated November 27, 2013 for individual 'deep in the money' options are given below.

Table 3

S No	Trade Date	Option	Trade Time	NIFTY Value at the time of trade	Intrinsic Value (IV) (Rounded off)	Traded Price	Discount/premium from IV (Rounded off)
1	November 27, 2013	8000 PE	15:01:53	6067.35	1932.65	1670	-14%
		4000 CE	15:02:12	6066.75	2066.75	2125	3%
		8000 PE	15:15:30	6056	1944	1645	-15%
		4000 CE	15:15:46	6055.25	2055.25	2150	5%
		8000 PE	15:22:34	6053.15	1946.85	1645	-16%
		4000 CE	15:23:13	6052.9	2052.9	2155	5%

12. It is observed from the above table that, 'deep in the money' calls were traded approximately within 5% of Intrinsic Value whereas 'deep in the money' puts were traded at a discount ranging from 14% to 16% of Intrinsic Value.

13. The following was observed with regard to time difference between buy order and sell order:

Table 4

Sr. no.	Trade No	Trade Date	Trade Date Time	Sell Order DT Time	Buy Order DT Time	Time difference between buy and sell (hh:mm:ss)
1	2013112701036757	27/11/2013	15:22:34	15:22:34	15:22:33	00:00:00
2	2013112700929969	27/11/2013	15:01:53	15:01:53	15:01:53	00:00:00
3	2013112700991103	27/11/2013	15:15:30	15:15:30	15:15:30	00:00:00
4	2013112700931280	27/11/2013	15:02:12	15:02:12	15:02:11	00:00:01
5	2013112700992105	27/11/2013	15:15:46	15:15:46	15:15:45	00:00:01
6	2013112701039560	27/11/2013	15:23:13	15:23:12	15:23:13	(00:00:01)
7	2013112700995564	27/11/2013	15:16:23	15:16:23	15:16:23	00:00:00
8	2013112701040889	27/11/2013	15:23:35	15:23:35	15:23:35	00:00:00
9	2013112700934402	27/11/2013	15:02:52	15:02:51	15:02:52	(00:00:01)
10	2013112701043053	27/11/2013	15:24:00	15:24:00	15:24:00	00:00:00
11	2013112700936732	27/11/2013	15:03:13	15:03:13	15:03:13	00:00:00
12	2013112700997847	27/11/2013	15:16:42	15:16:42	15:16:42	00:00:00

14. The traded volume by the Noticees in individual contracts and overall market volume in those contracts on/around trade dates is given below.

Table 5

S No	Date	Strike	C/P	HNI/ MFIPL Volume	Vol on the day of trade for trade expiring on June 26, 2014 (no. of contracts* Lot size)	Avg vol from Nov 20, 2013-Nov 26, 2013
1	November 27, 2013	8000	Put	10000	200*50=10000	0
			Call	10000	200*50=10000	0
		4000	Call	10000	202*50= 10100	0
2			Put	10000	201*50= 10050	0

15. From the above table, it was observed that the contracts traded by HNI/MFIPL were illiquid since a week before the trades were actually executed by HNI/MFIPL. Even on the days when HNI/MFIPL traded, there was no significant volume in the respective strikes by other market participants.

16. From the observations made in paras above, the following inferences can be made:

i. The contracts traded were illiquid in nature and HNI and MFIPL were well aware about its illiquidity.

ii. Even after knowing that these contracts were illiquid in nature, HNI and MFIPL, both entered into synchronized trades (without any compulsion to do so) at arbitrarily negotiated prices which were below the Intrinsic Value, with the intention of running them till expiry and getting a fixed pay out at maturity.

17. HNI vide emails dated March 7, 2021, March 18, 2021 and June 21, 2021 and MFIPL vide email dated March 05, 2021, October 20, 2020 and June 21, 2021 provided its response and the following have been observed from the same.

i. The trades were done to postpone the brokers payment liability.

ii. The trades were not done for any other person but done for the company only i.e., HNI.

iii. Eventual payoff in aforesaid option on June 26, 2014 was approx. Rs. 3.72 cr.

iv. Out of the aforesaid options trading HNI generated good amount of profit.

v. The trades entered into between HNI and MFIPL were below the Intrinsic Value.

vi. The trades are box trades (as already acknowledged by MFIPL) with a fixed amount to be received at the expiry which will be the difference between the pay in and pay out, being the interest on loan amount.

vii. With regard to the PE trades being traded below the Intrinsic Value on November 27 2013, MFIPL stated that the synthetic loan rate of 12% was commercially reasonable for the business and given the synthetic loan feature, this type of trade would be entered into below the intrinsic value. Further, w.r.t. the PE trades being traded below the Intrinsic Value on November 27 2013, HNI stated that to the extent it remembers the mentioned trades were done to postpone the brokers payment liability.

viii. The positions taken by HNI were not outstanding till the expiry of contracts but squared off little earlier.

18. Therefore, it was alleged that box trades were entered into by HNI and MFIPL, by indulging in synchronized trades using the exchange platform, with the intention to provide finance/loans to each other. Such trades create misleading appearance of trading. It is important to note that in a screen based electronic trading system, each trade on exchange platform is a perception of buyer and seller on likely future price of an instrument and volume of the trade indicates conviction as expressed by buyer/seller for price to be in certain direction in future. Accordingly, such high volume trades between HNI and MFIPL are likely to influence the trading/investment decision of other traders/investors.

19. It was further alleged that such acts of entering into box trades and bipartite execution of trades on exchange platform in multiple options below the intrinsic value at a discount of 14%, 15% and 16% of Intrinsic Value on November 27, 2013 whereas option premium is summation of intrinsic value of option plus time value of option (i.e. time left to expiry of options viz. more than 6 months in this case), which gives unreal and artificial picture of market activity to other market participants who are unaware of such understanding between two entities.

20. Further, it was alleged that HNI and MFIPL entered into box trades and have negotiated prices of various long dated deep in the money illiquid index options expiring on June

26, 2014 through trading member and thereafter executing them in such a manner with mutual understanding so that one leg of options was traded at discounts of 14%, 15% and 16% of its prevalent Intrinsic Value on November 27, 2013, resulting into false and misleading picture of market activity in options forming part of trades and especially 8000 PE. In view of the above findings, it was alleged that the Noticees are in violation of Regulation 3 (d), 4(1), 4 (2) (a) and Regulation 4 (2) (e) of SEBI (PFUTP) Regulations, 2003.

E. SUMMARY OF REPLY OF THE NOTICEES

21. The contentions submitted by the Noticees as regards alleged violations have been summarized below:

<u>Noticee no. 1:</u>

The reply of Noticee no.1 dated March 07, 2022 and May 05, 2022 are given below.

21.1. The Noticee had obtained registration as a non-deposit taking financial company registered with Reserve Bank of India and issued various financial products including secured, redeemable, non-convertible equity linked debentures (“**ELD”**) under its debenture programme.

21.2. In order to hedge the Noticee's ELD exposures issued under its debenture programme, the Noticee's trader at the relevant time gave an instruction to a broker (i.e., Edelweiss Securities Limited) ("Broker") to execute NIFTY options. The strategy used by the Noticee is a well-recognised and completely legitimate options strategy which combines buying a call spread with a put spread, with the ultimate payoff being in the form of difference between the strike prices.

21.3. The Noticee trader instructed the Broker by providing an indicative total size and an indicative total price and did not provide any direction to the Broker on how individual legs in the trading strategy must be executed. In another words, the Noticee did not decide the execution price of any of the relevant transactions and rather these were managed by the Broker.

21.4. The decision to execute the relevant transactions were taken by the Noticee on the basis of publicly available information with respect to its independent analysis of the risk metrics and theoretical prices. The instruction to execute were conveyed through 'Bloomberg Chat' at 7.59 am UTC (i.e. 1.29 pm. 1ST) with only a total price and size. Confirmation regarding the execution of the strategy was received at 9.55 am UTC (i.e. 3.25 pm IST) where Broker notified the Noticee trader of the total executed size and price (i.e. the Noticee was not aware of the traded price of each relevant Transaction even at that moment after the relevant transactions had been executed on NSE). It was only at 10.03am UTC (i.e. 3.33pm IST) that the Broker provided information about the execution details to the Noticee's trader.

21.5. The method used by the Noticee to calculate the theoretical value of the trades is based on the widely recognised Black-Scholes model, taking into account interest rate, dividend, residual time until maturity, the volatility skew etc. The theoretical value of an option is merely an estimate of what the option contract could be worth, based on both observable and unobservable inputs and assumptions. The trade prices of the relevant Trades do not deviate significantly from the theoretical value of the trades as calculated by the Noticee.

21.6. Moreover, as the individual trades were not independent of each other but rather part of the broader trading strategy, in comparing the traded and theoretical prices the entire trade would be considered as a whole, in which case the deviation between the traded price and the theoretical price is only around 2.2%.

Trade Date	Symbol	Expiry	Type	Strike	Trade of the Noticee	Average Traded Price	Traded Qty	Average Theoretical Price
27/11/2013	NIFTY	26/06/2014	PE	4000/8000	Buy	3730	1000 0	3813.97

21.7. The reliance on the concept of 'intrinsic value', as per the Notice, is erroneous as the relevant Transaction of the Noticee, as aforesaid, was based in the theoretical value. It is submitted that, by using this metric, the Notice fails to take into the account the correct and bona fide rationale of the Noticee to enter into the relevant transactions.

21.8. The Noticee paid a total premium of INR 3,73,00,000/- while executing this trade and received a pay-off of INR 4,00,00,000/- on the Expiry Date. This type of neutral strategy that generates an implied pay-off is a well-recognised international option strategy which as noted above, has been publicly recognised by NSE in its own publication (as aforesaid). Though this type of neutral strategy generates an implied pay-off, it is not prudent to compare the same with a synthetic loan by simply calculating the difference between the premium received and premium paid. The individual legs of a box trade strategy are exchange-traded-options hence subject to initial and exposure margin requirements to be paid by the option seller to the clearing corporation, and such margin elements must be considered in addition to the difference between premiums paid and received for a complete pay-off profile. In essence, the margin payments resulted in overall negative cash flows pay-out for both parties till the options expired or were unwound (whichever was earlier). Hence the box trade should not be likened to a synthetic loan in any manner, as it is unlikely that on a standalone basis any of the parties would have a positive cash flow till expiry date or unwinding of the position.

21.9. The transcript of the communication between the Noticee and the Broker shows that the Noticee had no knowledge of the counterparty to the relevant transactions, let alone any prior mutual understanding or business relationship with them nor did the Noticee provide any instructions to its Broker to enter into the relevant transactions with any other trader. As such, it is submitted that the relevant transactions were entirely bona fide, executed through the regular broking channels and without any reference to or arrangement with the counterparty, which now appears to be HNI as per the Notice.

<u>Delay in initiating proceedings</u>

21.10. The allegations framed in the Notice relate to the relevant transactions which were undertaken more than 8 years ago. In fact, from the documents available to the Noticee, it becomes clear that they were queried about the relevant transactions for the first time only on October 21, 2020 whereas the relevant transactions took place on November 27, 2013.

21.11. There is nothing on record to indicate the reason for the unexplained and unnatural delay in initiating these proceedings, which severely prejudices the Noticee's ability to adequately respond to the Notice in light of the dated nature of facts surrounding the relevant transactions and the fact that the Noticee no longer has any business operations nor employees in India.

21.12. Due to the above, the Noticee does not have access to other corroborative evidence to further support its position. Therefore, the issuance of the Notice after such unreasonable delay, places the Noticee in a gravely disadvantageous position for being called upon to respond to the allegations and facts relating to the relevant transactions and is as a result being prejudiced.

21.13. In this regard, it is an established judicial principle that wherever a power is vested in a statutory authority without prescribing any time-limit, such power should be exercised within a reasonable time. The Hon'ble Securities Appellate Tribunal ("SAT") has taken note of this principle on several occasions; for instance, in the matter of *HB Stockholdings Ltd. v. SEBI*, the Hon'ble SAT set aside, an order holding the appellants guilty of violating the PFUTP Regulations *inter alia* on the grounds of "*unconscionable and unexplained delay of more than 12 years in initiating and completing the proceedings against the three Appellants in question*."

21.14. The Hon'ble SAT had made similar observations in the matter of *Shri Ashok K. Chaudhary v. SEBI*, where it delved into the inordinate delay of six years in issuing the show cause notice, and observed that ".... *Long delays in issuing show cause notices to the delinquents will not subserve the purpose for which the Board has been set up. It would rather act against the interest of the securities market. Delays do not help anyone and besides depriving sometimes the delinquents of their right to defend themselves against the action sought to be taken against them, defeat the very purpose for which such notices are issued."*

21.15. Consequently, the delay in issuance of the Notice, after more than 8 years have lapsed since the relevant transactions, is a grave violation of the principles of natural justice since it severely impedes the Noticee's ability to defend itself. On this ground alone, the Notice stands vitiated and is liable to be set aside.

21.16. It is submitted that the Notice fails to clearly and specifically identify the particulars on which the charges against the Noticee were based. It is a fundamental principle of natural justice that charges levelled in a show cause notice must be precise and unambiguous, in order to enable the noticee to satisfactorily respond to the charges raised. Vagueness in the contents of a show cause notice must be treated as fatal to the case itself. In the present case it is submitted that the Notice is bereft of any clarity regarding the case being made out against the Noticee.

21.17. The judgment of Hon'ble Supreme Court in the case of *Canara Bank Vs. Debasis Das* held that allegations should be clear, specific and unambiguous and should be on reasonable basis:

> " *the first and foremost principle is what is commonly known as audi alteram partem rule. It says that no one should be condemned unheard. Notice is the first limb of this principle. It must be precise and unambiguous. It should apprise the party determinatively of the case he has to meet. ". To comply with the principles of natural justice and to serve the show cause notice containing precise and unambiguous charge is the obligation of the quasi-judicial body and any order stands vitiated if it is passed on the basis of a vague show cause notice*."

21.18. In fact, the Hon'ble SAT has disposed proceedings in the past due to vague and ambiguous nature of a show cause notice. Reliance may also be placed on the SAT's order dated April 20, 1999 in the case of *Dhanalakshmi Bank vs. SEBI,* wherein it was held that

> "*The show cause notice issued to the Appellant in the case is vague. The notice merely stated violation of certain provisions of the rule/regulations in a general manner without mentioning the particulars on which the charge against the appellant was based. Further, there is nothing in the adjudicating order to show that even at a later stage the Appellant was informed of the specific instances of default. Principles of natural justice demand that before adjudication starts, the authority concerned should give the affected party the basis of the charge against him so that he gets an opportunity to defend himself. A show cause notice should serve the purpose for which it is required. An abstract notice like the one in the instant case will not serve the purpose*."

21.19. The Hon'ble SAT went on and set aside the SEBI order by stating that "*a vague and abstract charge cannot sustain. An offence not proved should not end up in penalty. For these reasons the order falls*".

21.20. Further, in a recent judgment, the Supreme Court, while adjudicating on validity of a show cause notice proposing to blacklist the appellant, stated the following:

"13. *At the outset, it must be noted that it is the first principle of civilised jurisprudence that a person against whom any action is sought to be taken or whose right or interests are being affected should be given a reasonable opportunity to defend himself. The basic principle of natural justice is that before adjudication starts, the authority concerned should give to the affected party a notice of the case against him so that he can defend himself. Such notice should be adequate and the grounds necessitating action and the penalty/action proposed should be mentioned specifically and unambiguously. An order travelling beyond the bounds of notice is impermissible and without _jurisdiction to that extent. This Court in Nasir Ahmad v. Assistant Custodian General, Evacuee Property, Lucknow and Anr. MANU/SC/0377/1980 : (1980) 3 SCC 1, has held that it is essential for the notice to specify the particular grounds on the basis of which an action is proposed to be taken so as to enable the noticee to answer the case against him. If these conditions are not satisfied, the person cannot be said to have been granted any reasonable opportunity of being heard*."

21.21. In the present case, whilst allegations have been made against the Noticee for violation of PFUTP Regulations and SEBI's observations have been set out and has merely been followed by the table with extracts of regulations/circulars alleged to be violated, without a specific co-relation being drawn with the factual observations and the legal provisions invoked. For instance, although it has been alleged that Noticee has indulged in fraud and deceit, and has created a false or misleading appearance of trading, the Notice fails to explain how the relevant transactions deceived any person or how the market was impacted via the relevant transactions, and it fails to pinpoint any particular activity of the Noticee that is fraudulent, deceitful or unfair in nature.

21.22. With respect to the allegation that the relevant transactions were entered into by the Noticee and HNI with the intention to provide finance/loans to each other, the Notice is entirely silent on how or why such finance/loan is alleged to have been provided by the Noticee to HNI when HNI was entirely unknown to the Noticee and there is no material on record to indicate the contrary. The fact that the option strategy, which is a legitimate and NSE-recognized strategy, provides an implied payout doesn't mean it has a loan element in any manner whatsoever. In the relevant transactions, the option seller would have paid margin in excess of the total premium received, and none of parties received upfront cash analogous to a loan. Also, even in a stretched hypothetical scenario that the strategy gave the effect of a loan, it does not follow that the Noticee negotiated with HNI or indulged in any synchronized trades. The Notice has provided no evidence that there had been any negotiation between the Noticee and HNI, and not even evidence that the Noticee nor HNI nor their respective traders knew each other. There is also no evidence that the Noticee has ever instructed its broker to conduct negotiation with HNI. In contrast, the annexures to the Notice indicated that both the Noticee and HNI have confirmed independently that they do not know each other, and no material has been brought on record to dislodge these confirmations. The allegation of synchronized trades is simply unfounded.

21.23. With respect to the allegation that the relevant transactions created a false or misleading appearance of trading, the Notice makes it clear that these contracts were entirely illiquid and therefore fails to demonstrate who could have been misled by the same. The relevant transactions were entirely bona fide trades with positions held until expiry. These are genuine and legitimate investment. This becomes magnified by the fact that the relevant transactions were entered into without any knowledge of (much less in conjunction with) the identity of the counterparty or the counterparty's intentions behind entering into the relevant transactions. Since there was no "understanding between two entities", the allegation, that persons who were unaware of the same could be misled, falls flat. In addition, the fact that the option strategy makes an implied payout does not mean that it created misleading appearance of trading. Options can be traded for different purposes depending on the strategies.

21.24. The relevant transactions are genuine transactions traded on NSE for legitimate risk management purpose, and no misleading appearance of trading has ever been created as they are real and legitimate transactions. These options were available for trading on NSE and the fact that they are illiquid does not mean that trading in them is illegal or fraudulent.

21.25. Due to the same reason, the allegation that the prices with respect to the relevant transactions were 'negotiated' also becomes baseless.

21.26. Except the presumption that there was a meeting of minds between the Noticee and HNI, which is belied by the record, there is nothing in the Notice which suggests that the relevant transactions would fall foul of the provisions of Regulations 3(d), 4(1), 4(2)(a) and 4(2)(e) of the PFUTP Regulations.

21.27. It is submitted that such a fundamental anomaly in the Notice strikes at the heart of the Notice and does not meet the core principles of equity and natural justice that all administrative proceedings must comply with. On this ground alone, it is submitted that the present proceedings must stand wholly vitiated.

21.28. It is submitted that a plain reading of the Notice makes it abundantly clear that the entire charge against the Noticee hinges on the assumption that there was coordination between the Noticee and HNI, which is sought to be demonstrated by the time-difference between the relevant transactions. Accordingly, it is submitted that, once it is shown that the said time-difference was completely outside the remit of the Noticee, the charges against it ought to accordingly fail. Further, it is submitted that, as detailed herein, the Noticee had no control over the timing of the relevant transactions, having instructed the Broker to do the needful as early as 1.29 pm, i.e. about 2 hours prior to the same being actually executed.

21.29. From a plain reading of the Notice, it is clear that allegations on the Noticee are primarily based on the assumption that the relevant transactions were undertaken by the Noticee, in a 'synchronized' manner and in mutual prior understanding with HNI with the intent to manipulate the market. In fact, it is clear from a perusal of the Notice that the trades by the Noticee per se is not violative of legal or regulatory norms.

21.30. It is submitted that there was no mutual or prior understanding between the Noticee and HNI and the relevant transactions were undertaken in line with the commercial and business policies of the Noticee.

21.31. It is undisputed that the trading system on the stock exchanges is an anonymous trading platform which does not allow interaction amongst the buyers and sellers. Apart from the timings of the relevant transactions on the Execution Date, there is no material available on the record to demonstrate that the Noticee and HNI were at all known to each other, much less that there was any negotiation.

21.32. The Hon'ble SAT has observed that in absence of direct evidence to determine if trades were synchronized, the intentions of the parties may be gathered from surrounding circumstances including trading pattern, the frequency of trades, their volumes and such other circumstances as may be relevant for such determination.

21.33. In terms of SCN, the Hon'ble AO has made certain observations including that (i) trade volume between the Noticee and HNI in individual contracts accounted for significant overall volume of contract on the Execution Date, (ii) 12 trades were executed between the Noticee and HNI in the last half hour of market closing with underlying in index showing little movement and (iii) trade price in most cases was away from theoretical price of contract provided by NSE. The Notice further states that contracts entered on the Execution Date were illiquid in nature and alleges that Noticee was aware of such illiquidity and that the Noticee and HNI entered into synchronised trades with the intention of running them till expiry and getting a fixed pay out at maturity.

21.34. However, neither the contents of the Notice nor the annexures relied upon substantiate the above allegations levied on by the Hon'ble AO on the Noticee. On the other hand, as stated above, the Noticee entered into the relevant transactions for a reasonable commercial purpose employing a strategy to ensure there is no equity risk. Further, the communication between the Noticee and the Broker makes it completely clear that the Noticee only provided instructions to trade in options at NIFTY (around 1.29 pm on the Execution Date) and the relevant transactions took place two hours later. The decision to enter into such contracts in the last half hour of market was not taken by the Noticee, and no written or verbal instructions were provided which indicates that the relevant transactions were to be executed at that particular time.

21.35. It may further be noted that both the Noticee and HNI employed different brokers for buying/selling options on NSE and the Notice fails to demonstrate any connection/communication amongst the parties, to allow the alleged synchronised trading.

21.36. In absence of any evidence demonstrating a prior meeting of minds or mutual understanding between parties, the charge of violation of PFUTP Regulations should lapse instantly as the whole case of SEBI hinges on the same.

21.37. Further, even applying the test of 'preponderance of probabilities’, no adverse conclusion can be made against the Noticee since it is shown that the instructions were provided much in advance in relation to when they were executed and there is nothing on record to show that the timing of the trade was determined by the Noticee. Further, the communication between the Broker and the Noticee makes it abundantly clear that there were no instructions or directions with respect to the choice of counterparties or the timing of the trade. Charge of fraud and market manipulation is a grave one and cannot be levied based on such unfounded conjecture.

21.38. The provisions which have been invoked in the instant Notice are Regulations 3(d), 4(1), 4(2)(a) and 4(2)(e) of the PFUTP Regulations, whereby, the following are proscribed by the said Regulations:

a. Engaging in any act, practice, course of business which operates or would operate as fraud or deceit upon any person dealing in securities;

b. Indulging in fraudulent or unfair trading practices;

c. Indulging in an act which creates a false or misleading appearance of trading in the securities market; and

d. Indulging in acts which amount to manipulation of the price of securities.

21.39. In this context, it is submitted that, as aforesaid, since the relevant transactions were bona fide (with a clear commercial purpose to hedge exposures arising from the Noticee's issuance of ELDs) and undertaken independently by the Noticee (without any reference to or coordination with the counterparty), there could be no instance of any fraudulent or deceitful behavior on part of the Noticee and the Notice has failed to provide any evidence that suggests such behavior.

21.40. Further since these were routine hedging transactions and there was no subterfuge involved, there could also not be any allegation of creating any misleading appearance of trading.

21.41. Moreover, as aforesaid, the allegation with respect to providing finance/loans is also belied since HNI was entirely unknown to the Noticee and there is no material on record to indicate anything to the contrary. As noted above, the fact that the payoff was an implied sum cannot be equated to providing a loan to HNI especially when there had been no discussion of any loan transactions between the Noticee and HNI. Both Noticee and HNI traded independently on NSE via their own brokers without even knowing the identity of each other.

21.42. It is further submitted that the relevant transactions did not have any perceptible impact on the stock market during the relevant Period. In this regard, distinction is also ought to be made between the equities segment and the derivatives segment of the securities markets. It is neither a fact nor the case of SEBI that there was any market participant who could be influenced by the relevant transactions since trading in the contracts in question was highly illiquid, nor is this a case where prices of the contracts could have been affected by the relevant transactions. Also, given the Noticee did not decide the trading price, the allegation that Noticee traded at a discount to intrinsic value which gives an unreal and artificial/false or misleading picture of market activity cannot be substantiated. By the same reason, the Noticee cannot possibly have been manipulating the price when it was not the one who instructed or decided on the price of each leg. None of the key elements in Regulations 3(d), 4(1), 4(2)(a) and 4(2)(e) of the PFUTP Regulations has been established.

21.43. Without prejudice to the aforesaid, in the case of *SEBI v. Rakhi Trading Private Limited*, the Hon'ble Supreme Court observed that mere act of synchronized trading is not illegal per se and the same will be in violation of PFUTP Regulations only when the same have been done with intent of manipulating the market. This position is also supported by the judgment of the Hon'ble Supreme Court in the matter of *SEBI v. Kishore R. Ajmera* as well as the judgment of the Hon'ble SAT in the matter of *Subhkam Securities Private Limited v. SEBI* where it has been held that:

"*It is only when synchronized trades are executed with a view to manipulate the price of the scrip that the provisions of the PFUTP Regulations will get attracted*."

21.44. In addition to the above, the Hon'ble SAT has held that, when establishing a charge of market manipulation under PFUTP Regulations, a few aspects which are to be considered are whether (i) the traded volume was large enough to have an impact on market and (2) whether large transactions that could affect the market were executed with the motive of manipulating the market. The test of evidence to establish a charge of market manipulation is a realistic one and cannot be based on mere suspicion and adverse inference.

21.45. At the outset it is submitted that since no violation of the SEBI Act or the PFUTP Regulations, as alleged, can be demonstrated in light of the submissions made hereinabove, the facts of the case do not warrant any imposition of monetary penalty.

21.46. It is submitted that the imposition of any penalty whatsoever is totally unjustified in the given facts and that the case of the Noticee requires serious consideration. The Noticee submits that any imposition of penalty would be completely contrary to canons of securities laws and jurisprudence. Further any imposition of penalty bases an incorrect appreciation of the facts or untenable application of the law would irreparably prejudice the Noticee's reputation.

21.47. From the aforesaid facts, as also from the Notice itself, with reference to Section 15J of the SEBI Act, it becomes abundantly clear that the Noticee has not defrauded any investor or market participant, nor has it made any unlawful or disproportionate gains or attained any unfair advantage or avoided loss illegally. Further, without prejudice to the aforesaid, the Notice itself also does not indicate that there was any repetitive default. Additionally, there is also no case of any loss having been caused to anyone on account of the relevant transactions, whether intentionally or otherwise.

21.48. In the above background, it is relevant to note the observations of the Hon'ble SAT in *Piramal Enterprises Limited v. SEBI* which has observed as under:

"*24. Considering the aforesaid, we are of the opinion that the object of the Act is not only to protect the investors but also the securities market. The appellant is part of the securities market and its existence is required for the healthy growth of the securities market. SEBI is the watchdog and not a bulldog. If there is an infraction of a rule, remedial measures should be taken in the _ first instance and not punitive measures*..."

21.49. In *Adjudicating Officer, SEBI v. Bhavesh Pabari*, the Hon'ble Supreme Court held that the factors laid down in section 15J of the SEBI Act, 1992 are illustrative in nature. Factors other than those can also be considered in mitigating the quantum of penalty sought to be imposed in a given matter. In this context, it is humbly submitted that the minimal role of the Noticee in the execution of the relevant transactions may be duly appreciated and accordingly, the Noticee be discharged from the charges in the Notice.

21.50. In the Investigation Report, the options price has been compared with the intrinsic value instead of theoretical value. Looking at intrinsic value for any option with time till expiry is misleading and incorrect. All options are priced off their forward price which takes into account interest rates and dividends. Deep-in-the-money European put options (i.e., which cannot be exercised early) are expected to have a theoretical value less than intrinsic where interest rates are high (as was the case in the instant matter). Therefore, to say that an European option that trades at say a 20% discount to its intrinsic value, does not provide any cogent view into the valuation of the option or the methodology to arrive at the same.

21.51. Investigation Report alleges that the intention behind the relevant transactions was to provide finance/loans by the Noticees to HNI. The Investigation Report appears to rely heavily on the phraseology used in the responses to SEBI which used the term 'synthetic loan/deposit'. It is clarified that such reliance is misplaced in the circumstances of the matter, given the fact that the term was used to explain the aspect of fixed payout from the difference in strike prices with no equity risk. It is clearly not a loan to HNI since, as aforesaid, the Noticee neither knew nor had any dealing with HNI. As such, it is submitted that there were no lending transactions between the Noticee and HNI, whether "synthetic" or otherwise.

21.52. Further, the allegation that MFIPL had provided a loan to HNI cannot be substantiated if the margin implications are considered. NSE Clearing Limited, i.e. the clearing corporation, has robust risk management systems that includes stringent margin requirements. Initial margin for F&O is calculated using a software called - SPAN® (Standard Portfolio Analysis of Risk).

21.53. As per SPAN and based on Risk parameter files provided by NSE on November 27, 2013, an initial margin of around Rs. 4.10 crs and exposure margin of around Rs. 0.36 crs, aggregating to a total margin of around Rs. 4.46 crs would be applicable to the seller of the option for two of the concerned trades (being the 4000 strike price call option and 8000 strike price put option). Considering the option premium of Rs. 3.73cr received by the option seller for the said option trades, the same would have resulted in a negative cash flow of around Rs. 72.98 Lakhs for the option seller. In view of this, it does not appear reasonable or logical to suggest that there were financial arrangements in the guise of trading using the exchange platform to take undue advantage of TGF/ SGF Settlement Guaranteed fund because the margin provided would be more than the premium which would be received by the option seller.

21.54. The same paragraph of the Investigation Report alleged that the trades created misleading appearance of trading. The relevant transactions were part of a legitimate trading strategy and as aforesaid, were entirely bona fide on the part of the Noticee. As aforesaid, the strategy is well-recognised even by NSE in its published material. Thus, the allegation of misleading appearance of trading is entirely conjectural and not based on any material or evidence.

21.55. The relevant transactions cannot be seen in isolation and ought to be seen as a whole, as was always done by the Noticee. Further, the same cannot be characterised as a loan on account of the fact of the margin payments which resulted in neither of the parties receiving any upfront cash. Further, the option premium was also not selected by the Noticee and the execution was managed entirely by the broker. As such, the characterisation of the premium as the loan and the settlement as the loan repayment is not correct.

21.56. Further, even the Investigation Report does not contain any material to suggest that the Noticee and the counterparty were known to each other. Rather, on the contrary, the material suggests that both parties have denied any connection inter se. It is submitted that even the Investigation Report makes it clear that the Noticee only communicated with its broker (as detailed above) and had no connection with any other party. Any allegation that the Noticee and HNI has some form of understanding is unfounded and not supported by any evidence.

21.57. As stated in the Investigation Report, the Noticee's erstwhile employee Mr. Vivek Mishra only communicated with the broker Edelweiss and did not seek/receive price quotes from or negotiate the terms with any trading counterparty. It is not uncommon for orders to be managed by a broker, in this case Edelweiss, because it is part of a broker's mandate to arrange for execution of a transaction. Edelweiss agreed to execute the relevant transactions as per the general price and size parameters provided and hence, there was no reasons for the noticee to seek more quotes from other brokers.

<u>Noticee no. 2</u>

The reply dated June 16, 2022 of the Noticee no 2 is given below.

21.58. The box trades were done to post pone the payment liability to the brokers. There were several other trades that have been entered beside as their regular business activity and the trades pointed out in the captioned matter.

21.59. The Noticee does not deny that they entered into these contracts, however were not aware as to whether these contracts were liquid or illiquid. As they were available for trading on the Floor of the Exchange, the transactions were executed. However, they submitted that there is no law which prohibits them from entering into a contract in so called "illiquid contracts" as long as they are available for trading on the exchange. They denied the allegation that they were aware of the illiquid nature of the contract and accordingly dealt in only that contract.

21.60. The allegation about the Noticee having had entered into synchronised trades also was denied. As the trades were done on an electronic trading system where the trades are matched by the system, the Noticee had no idea who the counterparty for their trades were and their trades were matched with that of Macquarie Finance by the online trading system. They came to know the counterparty only after receiving letters from SEBI.

21.61. The Noticee denied the allegation that their trades were providing a misleading / artificial picture of unreal activity. There is no whisper of any loss caused to any investor due to the trades entered into by the Noticee anywhere in the show cause notice.

21.62. The allegation has again been made without any basis and on the basis of assumptions that there was an understanding between the Noticee and the counterparty Macquarie. They denied any understanding and reiterated that the allegation is without any basis. Hence, they denied having violated the provisions of Regulation 3(d),4(1),4(2)(a) and 4(2)(e) of the SEBI (PFUTP) Regulations, 2003.

21.63. The Noticee reiterated that they had entered into these contracts only to postpone the payment of liabilities to their brokers for some time. They settled the transaction before its expiry. They were genuine contracts and are not synchronised trades as alleged by SEBI. There was no meeting of minds or understanding between the Noticee and Macquarie.

F. ISSUES

22. Considering the findings of investigation, the allegations made out in the SCN and the submissions made by the Noticees, I find that following issues require consideration in the present case: -

I. Whether the noticees violated provisions of Regulations 3(d), 4 (1), 4 (2) (a) and 4 (2) (e) of SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations, 2003?

II. Does the violation, if any, attract penalty under Section 15HA of the SEBI Act, 1992?

III. If so, what would be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of SEBI Act, 1992?

G. CONSIDERATION OF ISSUES

<u>Issue 1: Whether the noticees violated provisions of Regulations 3(d), 4 (1), 4 (2) (a) and 4 (2) (e) of SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations, 2003?</u>

23. It is observed in the SCN that Noticees entered into box trades by executing 12 synchronised trades in illiquid options contracts, which resulted in initial flow of premium from options buyer i.e. Macquarie to option seller i.e. HNI amounting to Rs 3.73 Cr. Further, the return amount from HNI to Macquarie would have been Rs 4.00 Cr if the positions were run till expiry. It is alleged that on the basis of the aforesaid transactions, the trades were executed with an intention to provide loan of Rs 3.73 Cr from Macquarie to HNI, which was to be repaid with an interest amount of Rs 0.27 Cr. The said transactions were traded at discounts of 14%, 15% and 16% of its prevalent Intrinsic Value allegedly creating false and misleading picture of market activity in violation of provisions of Regulations 3 (d), 4 (1), 4 (2) (a) and 4 (2) (e) of SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations, 2003.

24. For the purpose of this order, synchronised trades are understood to be those trades where-

(i) the time difference, between buy order and sell order, is less than 60 seconds.

(ii) there is no difference between the price and quantity of the buy order and the sell order.

25. It is well-accepted that synchronised trading on the anonymous trading platform of stock exchanges is not per se illegal. The circumstances surrounding synchronised transactions and the inferences drawn thereof provide guidance in arriving at a conclusion as to the legality of the transactions. This legal position was laid down by the Hon'ble SAT in the case of *Ketan Parekh v. SEBI* (Appeal no. 2/2004) in its order dated July 14, 2006, extracts of which are reproduced as follows:

> "*.......... 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. ... Whether a transaction has been executed with the intention to manipulate the market or defeat its mechanism will depend upon the intention of the parties which could be inferred from the attending circumstances because direct evidence in such cases may not be available. The nature of the transaction executed, the frequency with which such transactions are undertaken, the value of the transactions, whether they involve circular trading and whether there is real change of beneficial ownership, the conditions then prevailing in the market are some of the factors which go to show the intention of the parties. This list of factors, in the very nature of things, cannot be exhaustive. Any one factor may or may not be decisive and it is from the cumulative effect of these that an inference will have to be drawn*."

26. I note that the box trades were entered into by the noticees by executing 12 trades and the trade volume between the noticees accounted for significant portion of the overall volume in the contract. In order to establish that there was illegal synchronisation of trades, it is necessary to prove that the trades were executed with an intention to provide loan using the exchange platform in the form of genuine trades. I also note that the SCN primarily relies on time difference between the buy and sell orders to bring out that the trades were synchronized.

27. Noticee no. 1 has contended that the alleged transactions were part of its hedging strategy for its exposure to Equity Linked Debentures (ELDs) as per their hedging policy. In this

regard, I note that Equity Linked Debentures (ELDs) are floating rate debt instruments whose interest relies on the returns of the underlying equity asset such as S&P Sensex, individual stocks, Nifty 50 or any customized basket of individual stocks. If the underlying (i.e., Nifty in the instant case) performs well, the return on ELDs is higher while the return drops where the underlying faces a slump.

28. A hedge is an investment that is made with the intention of reducing the risk of adverse price movements in an asset. A hedge consists of taking an offsetting or opposite position in a related security. In the event of an adverse price movement in the vulnerable asset, the inversely correlated security should move in the opposite direction, acting as a hedge against any losses. When used in a strategic fashion, derivatives can limit investors' losses to a fixed amount. A put option on a stock or index is a classic hedging instrument. If an investor has a substantial long position on a certain stock, they may buy put options as a form of downside protection. If the stock price falls, the put option allows the investor to sell the stock at a higher price than the spot market, thereby allowing them to recoup their losses.

29. Box spread strategy is an arbitrage opportunity that involves combining multiple Options to execute a risk-free trade. The objective of the box spread is to earn a risk-free profit. The quantum of profit in box spread may be limited. If there is an upside movement of any one of the spreads, it is balanced by the downside movement of the other spread. Being a market-neutral strategy, the price movement of the underlying does not have any impact on the box spread.

30. Box spreads effectively establish synthetic loans. Like a zero-coupon bond, they are initially bought at a discount and the price steadily rises over time until expiration where it equals the distance between strikes.

31. Longer dated derivatives products are useful for those investors who want to have a long-term hedge or long-term exposure in derivative market.

32. In the instant case, Noticee no. 1 would have faced an obligation to pay a higher return for the ELDs in case Nifty had performed well and the hedging position for the same should have been taking an inverse position i.e., buying call options on Nifty for lower strike price. Instead of taking inverse position to hedge its exposure to ELDs, Noticee no. 1 entered into box trade with Noticee no. 2 which is a market-neutral strategy. Hence, the submission that box trades were executed to hedge ELD exposure is not acceptable.

33. It was also submitted that the Noticees were unknown to each other and that Noticee no. 1 did not decide the execution price of the relevant transactions and were managed by the Broker. The Noticee no. 1 has also submitted that it was their dealer who had instructed the broker to execute the trades and provided extracts of Bloomberg chat for the same. In this regard, I note that there is nothing available on record to directly show that the Noticees were known to each other or that noticees had provided any specific instructions to the broker. The charge of illegal synchronization should typically commence with the assumption that there is a meeting of minds between persons who are connected with each other. However, persons may be deemed to be connected if the magnitude of synchronization is so large that the relationship between parties to the transaction is unassailable. This in essence was the legal position laid down in the case of *SEBI v. Kishore Ajmera & Ors* wherein the Hon'ble Supreme Court by order dated February 23, 2016 (hereinafter referred to as "SC Order") held that knowledge of who the counter party is, whether client or broker, is not relevant for the purpose of proving that illegal synchronised trades had taken place. The following extracts of the said order of the Hon'ble Supreme Court are instructive in this regard:

"*...knowledge of who the 2nd party/client or the broker is, is not relevant at all.*"
(para 26 of the SC Order)

"While it is correct that trading in such illiquid scrips is per se not impermissible, yet, voluminous trading over a period of time in such scrips is a fact that should attract the attention of a vigilant trader engaged/engaging in such trades."
(para 23 of the SC Order)

"When over a period of time such transactions had been made between the same set of brokers or a group of brokers a conclusion can be reasonably reached that there is a concerted effort on the part of the concerned brokers to indulge in synchronized trades the consequence of which is large volumes of fictitious trading resulting in the unnatural rise in hiking the price/value of the scrip(s)."
(Para 25 of the SC Order)

"*The conclusion has to be gathered from various circumstances like that volume of the trade effected; the period of persistence in trading in the particular scrip; the particulars of the buy and sell orders, namely, the volume thereof; the proximity of time between the two and such other relevant factors*."
(Para 26 of the SC Order)

34. Therefore, as a principle, absence of direct proof of connection will not by itself imply absence of illegal synchronisation.

35. The pattern of order placement clearly points out that the transactions were carried out with the intention that various orders of the Noticees should match among themselves and there was a prior arrangement with respect to these transactions. The time difference between buy and sell order was at best one second.

36. Large scale of transactions and the repetitive nature of the same coupled with impact on volume on securities which are otherwise illiquid, cumulatively lead one to infer that illegal synchronisation had in fact taken place.

37. As regards the contention that the margin payments resulted in overall negative cash flows for both the parties, I note that in respect of the buyer of the option (Noticee no. 1), the cash outflow will be the premium paid for it. I also note that Noticee no. 1 has submitted that the margin requirement for the seller of the option i.e., Noticee no. 2 would have caused negative cash flow of around for around Rs. 72.98 Lakhs. However, the submission of Noticee no. 2 is that the transactions were done to postpone the payment liability to the broker, which is not in line with the submission of Noticee no. 1. Further,

margin payments could have been done in the form of securities also. This indicates that Noticee no. 2 received positive cash flow on account of executing the box trades which was used to meet the liability to the broker. Therefore, the contention that margin payment incurred by Noticee no. 2 (option seller) would have been more than the premium received and hence, the box trades cannot be construed as loan transaction is not acceptable.

38. Noticee no. 1 has also submitted that the theoretical value of the trades is based on the widely recognised Black-Scholes model and the trade prices of the relevant trades do not deviate significantly from the theoretical value of the trades as calculated by the Noticee. The deviation between the traded price and the theoretical price is only around 2.2%.

39. Theoretically, the price of an option is a combination of its intrinsic value and time value. The former is a function of difference between option strike price and the underlying price and the latter being a function of time remaining till expiry of the option contract. In normal conditions, the minimum price which the option seller would demand to take the risk of writing the option would be equivalent to the intrinsic value of the option. In-the-money calls and puts can sometimes trade for less than their intrinsic value with the occurrence more common for deep-in-the-money options as the expiration day approaches.

40. The allegation in the SCN is that the noticees traded at discounts of 14%, 15% and 16% of its prevalent intrinsic value. The theoretical value of an option using pricing models provides a fair value of an option and in the instant case, I note that the trades were entered into at a discount of around 2 to 5 % of their theoretical value for individual trades. Hence, the allegation of entering into trades at discount of 14%, 15% and 16% of their intrinsic value resulted in false and misleading picture of market activity is not established.

41. Noticee no. 2 submitted that no investor was put to loss. In this regard, I note that the charge against the Noticees is that they created misleading appearance of trading by way of executing synchronized trades.

42. Reference is drawn to Hon'ble Supreme Court judgement in the matter of *SEBI* v. *Rakhi Trading Private Ltd*. decided on February 8, 2018, wherein, the Apex court held that:

"***Pronounced by His Lordship Justice Kurian Joseph***

35. Having regard to the fact that the dealings in the stock exchange are governed by the principles of fair play and transparency, one does not have to labour much on the meaning of unfair trade practices in securities. Contextually and in simple words, it means a practice which does not conform to the fair and transparent principles of trades in the stock market. In the instant case, one party booked gains and the other party booked a loss. Nobody intentionally trades for loss. An intentional trading for loss per se, is not a genuine dealing in securities. The platform of the stock exchange has been used for a non-genuine trade. Trading is always with the aim to make profits. But if one party consistently makes loss and that too in preplanned and rapid reverse trades, it is not genuine; it is an unfair trade practice. Securities market, as the 1956 Act provides in the preamble, does not permit "undesirable transactions in securities". The Act intends to prevent undesirable transactions in securities by regulating the business of dealing therein. Undesirable transactions would certainly include unfair practices in trade. The SEBI Act, 1992 was enacted to protect the interest of the investors in securities. Protection of interest of investors should necessarily include prevention of misuse of the market. Orchestrated trades are a misuse of the market mechanism. It is playing the market and it affects the market integrity.

41. …. The stock market is not a platform for any fraudulent or unfair trade practice. The field is open to all the investors. By synchronization and rapid reverse trade, as has been carried out by the traders in the instant case, the price discovery system itself is affected. Except the parties who have pre-fixed the price nobody is in the position to participate in the trade. It also has an adverse impact on the fairness, integrity and transparency of the stock market.

Pronounced by Her Ladyship Justice R. Banumathi

26. There was no possibility of such perfect matching of quantity, timing, prices etc. between the same parties unless there was prior meeting of minds or a specific understanding/arrangement between the parties….

35. Regulation 3 deals with "Prohibition of certain dealings insecurities". Regulation 4 deals with "Prohibition of manipulative, fraudulent and unfair trade practices". Regulation 4 starts as "Without prejudice to the provisions of Regulation 3....". Regulation 4(2) is an inclusive provision. Regulation 4(2) stipulates that "Dealing insecurities shall be deemed to be a fraudulent or an unfair trade practice if it involves fraud and may include all or any of the...." instances pointed out thereon. Regulation 4(2)(a) deals with "....an act which creates false or misleading appearance of trading in the securities market"., ….An act to fall within Regulation 4(2)(a), it is not necessary that the transactions entered into by the party was with intention to manipulate the market and that the market was in fact manipulated. Market manipulation is a deliberate attempt to interfere with the free and fair operation of the market and create artificial, false or misleading appearances with respect to the price, market, product, security and currency.

36. If the factum of manipulation is established, it will necessarily follow that the investors in the market have been induced to buy or sell and that no further proof in this regard is required. The market, as already observed, is so widespread that it may not be humanly possible for the Board to track the persons who were actually induced to buy or sell securities as a result of manipulation and the Board cannot be imposed with a burden which is impossible to be discharged.

38. The smooth operation of the securities market and its healthy growth and development depends upon large extent on the quality and integrity of the market. Unfair trade practices affect the integrity and efficiency of the securities market and the confidence of the investors. Prevention of market abuse and preservation of market integrity are the hallmark of securities law."

43. Instead of taking an inverse position to hedge its exposure to ELDs, Noticee no. 1 entered into box trades with Noticee no. 2. By entering into such a trade, Noticee no. 1, being the buyer of the box will always generate a profit while the seller of the box will always generate a loss, if run till expiry. Hence, by entering into a synchronized box trade with

the same Noticee, the initial debit i.e., payment of premium by Noticee no. 1 represents credit for the seller of the box. i.e., Noticee no. 2.

44. I also note that the option contracts in Nifty at the strike prices noticees entered into were illiquid and there was no significant volume in the respective strikes by other market participants on the day of the box trades.

45. In view of the facts and circumstances described above, I find that the Noticees entered into synchronized trades with an intention to facilitate loan transaction and the same has resulted in creating a false and misleading appearance in the market in violation of provisions of Regulations 3(d), 4 (1), 4 (2) (a) and 4 (2) (e) of SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations, 2003.

Other issues to be considered:

Delay in initiation of proceedings:

46. The Noticees have contended that there is delay in the proceedings and SCN does not provide any explanation/justification of the delay in the matter. Noticee relied upon the judgements in the matter of *HB Stockholdings Ltd v. SEBI* (SAT Order dated August 27, 2013), *Mohamad Kavi Mohamad Amin v. Fatmabai Ibrahim* (SC Judgement) and *Sanjay Soni v. SEBI* (SAT Order dated November 14, 2019) *Libord Finance Ltd v. Whole Time Member, SEBI* (SAT Order dated March 03, 2008 confimed by SC on Jan 07, 2016) and *Rajeev Bhanot and Ors v. SEBI* (Appeal no. 396 of 2016).

47. In this regard, it is pertinent to refer to observations of the Hon'ble SAT in the matter of Bipin R Vora vs SEBI dated March 22, 2006, "*As regards the plea of delay and latches and submission that the show cause notice is barred by limitation, I do not find any merit in these contentions as the time and efforts involved in an investigation though may vary from case to case, generally investigations per-se is a time consuming process which invariably involve collection, scrutiny and careful examination of voluminous records/ order-trade details of all the concerned including the exchanges/recording*

of statements etc. and therefore no time limit can be fixed in this regard to enable a regulator to take appropriate disciplinary action for the safeguard and improvement of the system/market".

48. In this context I find it relevant to refer to the order passed by Hon'ble SAT in the case of *Metex Marketing Pvt. Ltd. vs. SEBI* (order dated June 4, 2019) wherein Hon'ble SAT held that: "*This Tribunal has consistently held that in the absence of any specific provision in the SEBI Act or in the Takeover Regulations, the fact that there was a delay on the part of SEBI in initiating proceedings for violation of any provision of the Act cannot be a ground to quash the penalty imposed for such violation*."

49. In this regard, it is relevant to refer here the observations of Hon'ble SAT in the matter of Ranjan Varghese Vs. SEBI (Appeal no.177 of 2009 and Order dated April 08, 2010), as under: - "*The fact that the appellants acting in concert with each other had made the acquisitions which triggered the Takeover Code, it was incumbent upon them to make a public announcement which, admittedly, they have failed to do so. This failure has seriously prejudiced the public investors/shareholders of the company who have been deprived of their valuable right to exit by offering their shares to the acquirer. We cannot lose sight of the fact that one of the primary objects of the Takeover Code is to allow the public shareholders an exit route when the target company is either taken over by an acquirer or an acquirer makes a substantial acquisition therein."*

50. Further, I would like to rely upon the judgement of Hon'ble SAT in the case of Ravi Mohan & Ors. vs. SEBI (SAT Appeal no. 97 of 2014, DoD 16/12/2015) wherein it was held that: -

"...................Based on decision of this Tribunal in case of HB Stockholdings Ltd. vs. SEBI (Appeal no.114 of 2012 decided on 27.08.2013) it is contended on behalf of the appellants that in view of the delay of more than 8 years in issuing the show cause notice, the impugned order is liable to be quashed and set aside. There is no merit in this contention, because, this Tribunal while setting aside the decision of SEBI on merits has clearly held in para 20 of the order, that delay itself may not be fatal in each and every case. Moreover, the Apex Court in case of Collector of Central Excise, New Delhi vs. Bhagsons Paint Industry (India) reported in 2003 (158) ELT 129 (S.C) has held that if

there no statutory bar for adjudicating the matter beyond a particular date, the Tribunal cannot set aside the adjudication order merely on the ground that the adjudication order is passed after a lapse of several years from the date of issuing notice.................”

51. In this context I find it relevant to refer to the order passed by Hon'ble SAT in the case of *Metex Marketing Pvt. Ltd. vs. SEBI* (order dated June 4, 2019) wherein Hon'ble SAT held that: "*This Tribunal has consistently held that in the absence of any specific provision in the SEBI Act or in the Takeover Regulations, the fact that there was a delay on the part of SEBI in initiating proceedings for violation of any provision of the Act cannot be a ground to quash the penalty imposed for such violation*.".

52. In this context, I would also like to refer the observations of Hon'ble Supreme Court of India in the matter of *State vs. R. Vasanthi Stanley* reported in AIR 2015 SC 3691 wherein the Apex Court has held that "*…serious economic offence or for that matter the offence that has the potentiality to create a dent in the financial health of the institutions, is not to be quashed on the ground that there is delay in trial*…".

53. I find that there is no unreasonable delay in the present adjudication proceedings. The Investigation Period of the matter is of 2013-14. The alleged violations pertain to transactions during the period November 2013. Investigation was carried out in the instant case wherein correspondences were exchanged during 2018-19 and summons were issued during 2020-2021 to various entities. The investigation was completed in July 2021. Thereafter, upon examination SEBI, recommended adjudication proceedings in the matter. The undersigned was appointed AO in the matter on December 17, 2021 and SCN was issued on December 23, 2021.

54. Therefore, I find it difficult to accept the arguments of the Noticees that there was delay on the part of SEBI, and I find no merit in the arguments of the Noticees in this regard.

Issue 3: Does the violation, if any, attract penalty under Section 15HA of the SEBI Act, 1992?

55. I note that the Hon'ble Supreme Court of India in the matter of *SEBI v/s Shri Ram Mutual Fund [2006]* 68 SCL 216(SC) held that "*In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant….*"

56. I am of the view that monetary penalty needs to be imposed upon the noticees. The text of provision of 15HA is reproduced hereunder: -

> ***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."*

Issue 4: If so, what would be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of SEBI Act, 1992?

57. While determining the quantum of penalty under Section 15HA of the SEBI Act, 1992, it is important to consider the factors stipulated in Section 15J of the SEBI Act, 1992 read with Rule 5(2) of the Adjudication Rules, 1995 which read as under:

SEBI Act, 1992

> *15J While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely*
>
> *(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.

58. I observe, that the material available on record does not quantify losses, if any, suffered by the investors due to such violations on the part of the said Noticees. Further, material available on record does not show that the said failure is repetitive. However, in the present matter I note that in the noticees have violated provisions of Regulations 3(d), 4 (1), 4 (2) (a) and 4 (2) (e) of SEBI (Prohibition of Fraud and Unfair Trade Practices) Regulations, 2003.

H. ORDER

59. Considering all the facts and circumstances of the case and exercising the powers conferred upon me under section 15I of SEBI Act read with rule 5 of the Adjudication Rules, I hereby hold the Noticees liable for penalty as given below:

S. no.	**Noticees**	**Penalties**
1	Macquarie Finance (India) Pvt Ltd (PAN: AAFCM9404N)	Rs. 5,00,000 (Rs. Five lakhs only)
2	Carron Investments Private Limited (Transferee Company) (Modern Trading Business Pvt. Limited (erstwhile known as HOT n ICE Entertainment Company Private Limited) amalgamated with Carron Investments Private Limited) (PAN: AAACC1995K)	Rs. 5,00,000 (Rs. Five lakhs only)

I note that the penalties imposed on the Noticees is commensurate with the violations committed by them.

60. The Noticees shall remit / pay the said amount of penalty within 45 days of receipt of this order either by way of Demand Draft in favor 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

61. The Noticee shall forward said Demand Draft or the details / confirmation of penalty so paid to "The Division Chief (Enforcement Department-1 DRA-1), Securities and Exchange Board of India, SEBI Bhavan, Plot no. C – 4 A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051.". The Noticee shall also provide the following details while forwarding DD / payment information:
    - Name and PAN of the Noticee
    - Name of the case / matter
    - Purpose of Payment – Payment of penalty under AO proceedings
    - Bank Name and Account Number
    - Transaction Number

62. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, SEBI may initiate consequential actions including but not limited to recovery proceedings under section 28A of the SEBI Act, 1992 for realization of the said amount of penalty along with interest thereon, *inter alia*, by attachment and sale of movable and immovable properties.

63. In terms of the provisions of Rule 6 of the Adjudication Rules, a copy of this order is being sent to the Noticees and also to the SEBI.

Date: July 07, 2022 **ANITHA ANOOP**

Place: Mumbai **ADJUDICATING OFFICER**