BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 13 of 2007

Date of decision : 5.2.2008

Kishor R. Ajmera …… Appellant

Versus

Securities and Exchange Board of India …… Respondent

Mr. Pesi Modi Advocate with Mr. N. Lashkari Advocate and Ms. Chaitra Rao Advocate for Appellant.
Mr. Chirag Balsara Advocate with Ms. Daya Gupta Advocate and Ms. Chloris John Advocate for Respondent.

Coram : Justice N.K. Sodhi, Presiding Officer
Arun Bhargava, Member
Utpal Bhattacharya, Member

Per : Justice N.K. Sodhi, Presiding Officer (Oral)

Whether the appellant who is a registered stock broker had failed to exercise due diligence, care and skill thereby violating his code of conduct is the short question that arises for our consideration in this appeal filed under section 15T of the Securities and Exchange Board of India Act, 1992 (for short the Act). Facts giving rise to this appeal are these.

On receipt of some reports from the Bombay Stock Exchange (BSE) the Securities and Exchange Board of India (for short the Board) ordered investigations into the alleged irregularities in the trading in the scrip of Malvica Engineering Ltd. (hereinafter called the company). The investigations were carried out for two periods from December 20, 1999 to March 31, 2000 and again from August 7, 2000 to August 31, 2000. During the course of the investigations it transpired that the company had forfeited more than 37 lac shares held by the public on account of non-payment of call money and that more than 35 lacs of these shares were allotted in December 1999 to a large number of allottees including M/s. Mayekar Investments Pvt. Ltd. and M/s. K.P. Investment Consultancy (hereinafter referred to as Mayekar and KP respectively). It

also transpired that Mayekar and KP alongwith other allottees had dealt in the shares of the company during the period from 1.12.1999 to 31.8.2000 and that they indulged in creating artificial volumes in the scrip by carrying out matched trades among themselves.

The appellant before us is a member of the BSE and a registered stock broker with the Board. He claims to have 11 sub-brokers and more than 100 clients and it is stated that his total turnover was more than Rs.573 crores per annum. It is common case of the parties that M/s. Prakash Shantilal & Company-a partnership firm was one of the sub-brokers of the appellant and it will hereinafter be referred to as the firm. It is also not in dispute that when Mayekar executed trades with KP in the scrip of the company, it (Mayekar) traded through the firm as the sub-broker of the appellant and KP-a proprietorship concern of Ms. Kirtida P. Desai acted through some other broker. On the basis of the investigations carried out by the Board, the appellant was served with a show cause notice dated October 16/20, 2003 under Regulation 6 of the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 alleging that he had controverted the provisions of the Act, the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 (for short the broker regulations) and Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003. The details of the contravention alleged were contained in Annexure A to the show cause notice. We have carefully gone through this Annexure and find that the gravamen of the charge levelled against the appellant is contained in para 9 thereof which reads as under :

> "Both M/s. Mayekar Investments Pvt. Ltd. and M/s. K.P. Investments are entities related to Mr. Pankaj A. Desai and these two entities matched trades and created artificial volumes in the market "

It was alleged that the gross purchases made by the appellant through the firm-his sub-broker were 63200 in the low volume scrip of the company and that the appellant had

traded through the firm on behalf of Mayekar. Since the appellant's sub-broker allegedly executed matched trades and created artificial volumes it was alleged that the appellant had failed to exercise due skill, care and diligence in the conduct of his business as a broker and thereby violated the code of conduct prescribed in the broker regulations. The appellant filed his reply controverting the allegations made against him.

On a consideration of the material collected during the course of the investigations and the enquiry and relying on the joint statement of the appellant and Prakash Shantilal Doshi a partner of the firm recorded by the investigating officer, the Board concluded that the charge levelled against the appellant stood established. Accordingly, by order dated 27.12.2006 the whole time member of the Board suspended the certificate of registration of the appellant for a period of four months. It is against this order that the present appeal has been filed.

We have heard the learned counsel for the parties. Having gone through the record of the case carefully we are of the opinion that the appeal deserves to succeed. The charge levelled against the appellant, as already observed, is that he failed to exercise due diligence, care and skill while carrying on his business as a stock broker. Admittedly, the transactions in question which are alleged to be matching trades executed between Mayekar and KP were executed through the firm as a sub-broker of the appellant. It is by now well settled that a sub-broker is an agent of the broker. In other words, the firm was the agent of the appellant and since it had executed the trades in question on behalf of the appellant, the latter could be held responsible for the acts of the firm provided that it was alleged and established that the firm as a sub-broker had done something wrong. We have gone through the show cause notice as well as the impugned order and find that it is no where alleged that the firm as the sub-broker had done anything wrong for which the appellant as the principal could be held responsible. It is clear from para 9 of Annexure A to the show cause notice which has been referred to hereinabove, the gravamen of the charge is that Mayekar

and KP which are related to one Mr. Pankaj A. Desai had executed matched trades and created artificial volumes in the scrip of the company. Assuming this allegation to be correct, we fail to understand how the firm which executed the trades on behalf of Mayekar was responsible because it only acted as a sub-broker on behalf of the appellant. Merely because two clients have executed matched trades, it does not follow that their brokers were necessarily a party to the game plan. On a screen based trading through the price order matching mechanism of the exchange, it is not possible for either of the brokers (or sub-brokers) to know who the counter party or his broker (or sub-broker) is and when the trade is executed, their names or codes do not appear on the screen. A unique feature of the stock exchange is that, unlike other moveable properties, securities are bought and sold among the unknowns who never get to meet and they are traded at prices determined by the forces of demand and supply. If the Board is to hold the broker (or sub-broker) responsible for a matching trade, it has to allege and establish that the broker (or the sub-broker) was aware of the counter party or his broker at the time when the trade was executed. There is no such allegation in this case. In the impugned order there is no finding recorded that the firm as a sub-broker did anything wrong for which the appellant could be held responsible. We asked the learned counsel for the respondent as to whether any such finding had been recorded and he could only refer to paragraph 4.4 of the impugned order. We have gone through this paragraph and find that no such finding has been recorded. What is stated therein is that a broker cannot avoid action and preclude the Board from taking any action against him by stating that the trades were done by his sub-broker "as long as it is established that all the dubious trades in question were executed through the broker." This is a general statement and does not point to any wrong doing on behalf of the firm as a sub-broker nor does it establish that the appellant as a broker had failed in his duty to carry out due diligence, care and skill. In the absence of any allegation and also in the absence of any finding that the firm as a sub-broker had done anything wrong, we cannot hold the appellant as the principal responsible for any

wrong doing of the sub-broker as an agent. This apart, we also find that the Board in the impugned order has failed to point out any lack of due diligence on the part of the appellant. What was the appellant required to do as a broker which he failed to carry out and what did he do which he ought not to have done has not been pointed out. No such act or omission on the part of the appellant has been referred to either in the show cause notice or even in the impugned order. It is pertinent to mention that the Board has taken no action against the firm for any wrongdoing which acted as a sub-broker of the appellant. How could it then proceed against the appellant for the allegedly dubious trades executed by his sub-broker. In this view of the matter, we are unable to uphold the impugned order.

In the result, the appeal is allowed and the impugned order set aside with no order as to costs.

The Vakalatnama of Earnest Legal Associates is taken on record.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Arun Bhargava
Member

Sd/-
Utpal Bhattacharya
Member

5.2.2008bk