BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

In the matter of:

Appeal No.50/2002

Shriram Mutual Fund	**Appellant**
Vs.	
1. The Chairman, SEBI	
2. Adjudicating and Enquiry Officer, SEBI	**Respondents**

Appeal No.51/2002

Shriram Asset Management Co. Ltd.	**Appellant**
Vs.	
1. The Chairman, SEBI	
2. Adjudicating and Enquiry Officer, SEBI	**Respondents**

Appearance :

Shri N.R. Sridharan **Trustee** **Shriram Mutual Fund**	**for Appellant in Appeal No.50/2002**
Shri K. Prakash **Company Secretary,** **Shriram Asset Management Co. Ltd.**	**for Appellant in Appeal No.51/2002**
Shri D. Sura Reddy **Asst. Legal Adviser, SEBI**	**for Respondents**

ORDER

The Respondent No.1 (SEBI) appointed Respondent No.2 (the Adjudicating Officer) to inquire into and adjudge alleged contravention of section 15 D(b) and section 15E of the Securities and Exchange Board of India Act, 1992 (the SEBI Act) by Shriram Mutual Fund and Shriram Asset Management Co. Ltd., the Appellants herein. The charge against the Appellants was that they had conducted business through brokers associated with them, in excess of the limits prescribed under regulation 25(7)(a) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (the Regulations) in 12 cases, during the period from June 1998

24.6.2002 imposed a sum of five lakh rupees as penalty on Shriram Asset Management Company under section 15E of the SEBI Act for failure to comply with regulation 25(7)(a) and two lakh rupees on Shriram Mutual Fund under section 15 D(b) of the SEBI Act for failure to comply with the terms and conditions attached to the certificate of registration. As per the SEBI Act no person is entitled to carry on the business of mutual fund without obtaining a certificate of registration from SEBI. The certificate of registration is issued subject to certain conditions. One of such conditions is that the Mutual Fund will comply with the provisions of the Regulations. The Appellants claiming to be aggrieved by the said order preferred the present appeals.

The findings on the charges levelled against the Appellants and reasons for imposing penalty, have been stated in the impugned order. The relevant portion from the order is extracted below:

"**Appreciation of Evidence and Findings**

The main allegations against the Fund are that it had transacted business through associate brokers in excess of the permissible limits prescribed under Regulations 25(7)(a) of SEBI (Mutual Funds) Regulations. 12 such instances falling under 6 quarters between June 1998 and September 1999 were detailed in the notice dated 1st April, 2002.

Regulations 25(7)(a) of SEBI (Mutual Fund) Regulations, 1996 reads as under

Asset management Company and its obligations.

" An Asset Management Company shall not through any broker associated with the sponsor, purchase or sell securities, which is average of 5 per cent or more of the aggregate purchase and sale of securities made by mutual fund in

Provided further that the aforesaid limit of 5 per cent shall apply for a block of any three months".

It is not disputed that the Fund had exceeded the aforesaid prescribed limits when it had transacted business through brokers associated with the sponsor in the following instances:-

Sr. No.	Quarter ended	Name of the Associate Brokers	Percentage of Business
1	June 1998	Springfield Securities	10.65%
2	September 1998	--do--	6.6%
3	March 1999	--do--	16.57%
4	September 1999	--do--	9.57%
5	December 1999	--do--	91.68%
6	September 1998	SIS Shares and Stock Brokers	19.59%
7	March 1999	--do--	33.81%
8	September 1999	--do--	38.01%
9	September 1998	Shriram Indus Stock	9.86%
10	December 1998	--do--	6.39%
11	March 1999	--do--	28.95%
12	September 1999	--do--	52.42%

However, it was contended that the limits prescribed were exceeded principally on account of small size of the Fund, low volume of transactions, thinly traded securities, administrative and operational exigencies. It was, further submitted that between 1/4/98 and 30/9/2000, the total brokerage paid to the associate brokers is Rs. 4.66 lakhs.

It is not disputed that the aforesaid brokers are associated brokers within the meaning of the aforesaid Regulations.

The objective behind imposing certain limits on the business that can be conducted by a mutual fund through its associate brokers is to eliminate any undue advantage to these class of brokers by virtue of their close association

businessthrough brokers. Any undue concentration of the business of mutual fund with its affiliated brokers by paying huge commissions to such brokers is neither desirable nor in the interest of the unit holders.

In the 12 instances as set out in the aforesaid table, the percentage of business through some of the associate brokers is as high as 91.68% and 52.42% in certain quarters.

PENALTY

In terms of section 15E where an AMC fails to comply with any of the Regulations providing for restrictions on the activities of AMC, such AMC shall be liable to a penalty not exceeding Rs.5 lakhs for each such failure. In the instant case, there are 12 instances wherein the fund has routed transactions through its associate brokerage houses in excess of the permissible limits prescribed under Regulations 25(7)(a) of SEBI (Mutual Funds) Regulations, 1996. The importance of adhering to these prudential norms of investments through associate brokers has already been dealt with in the preceding pages and cannot be overemphasized.

The total brokerage paid to the associate brokers between 1/4/98 and 30/9/2000 is Rs.4.66 lakhs. Therefore, the amount of brokerage paid in excess of 5% to the associate brokers could be less than Rs.4.66 lakhs, if the permissible limit of 5% is deducted from this figure. However, the repetitive nature of default i.e. the number of times this default has occurred which is 12 times between June 1998 and September 1999 has also taken into account. It is also noted that all schemes have been wound up and payments were made to the unit holders.

In view of the above, a penalty of Rs.5 lakhs is considered sufficient,

A mutual fund which is registered with the Board has to comply with the terms and conditions of certificate of Registration. Needless to say, such terms and conditions include an obligation to comply with the provisions of the Act and Regulations made thereunder.

As the mutual fund has not exercised due diligence and care to ensure that its investment activities through its associate brokers conform to the prescribed limits under the Mutual Funds Regulations, the Mutual Fund has not complied with the terms and conditions for grant of certificate of registration and is liable to pay a penalty under Section 15D(b).

Taking into account, the 12 instances in which such due diligence has not been exercised by the fund, Shriram Mutual Fund shall pay a penalty of Rs.2 lakhs.

ORDER

In view of the above, I hereby impose a penalty of Rs.5,00,000/- (Rupees Five lakhs only) under Section 15E of SEBI Act, 1992 on M/s. Shriram Asset Management Company Ltd. for failure to comply with Regulation 25(7)(a) of SEBI (Mutual Fund) Regulations, 1996 with regard to routing of transactions through associate brokers. I also impose a penalty of Rs.2,00,000/- (Rupees two lakhs only) under section 15D(b) of SEBI Act, 1992 on M/s. Shriram Mutual Fund for its failure to comply with the terms and conditions for grant of certificate of registration of a Mutual Fund."

Learned Representative appearing for the Appellant in the appeal no.51/2002 submitted that Shriram Mutual Fund was registered in the year 1994, that its activities were very much limited in as much as it floated only five schemes with a total corpus of Rs.43.6 crores, that all the schemes have been by now wound up and payments have also been made to the unit holders, that there are no complaints from

transactions entered into with the associate brokers, for the year ended on 31.3.1999 was 94 in number, of which 46 transactions were through Springfield Securities Ltd., 23 transactions through SIS Share & Stock Brokers P. Ltd., and 25 transactions through Shriram Indus Stocks Ltd. It was further submitted that the total number of transactions entered into with the associate brokers for all the schemes of the Fund for the entire year ended on 31/3/2000 were 28 in number i.e. 9 transactions with Springfield Securities Ltd., 8 transactions with SIS Share & Stock Brokers P. Ltd., and 11 with Shriram Indus Stocks Ltd.

It was also submitted that for the entire period of two and half years, the total number of transactions entered into with the associate brokers for all the schemes of the Fund were 918, that out of the same the transactions with the associated brokers were only 122 or say 13.29% of the total transactions, that this also proves that the Fund had not tried to offer any undue advantage to the associate brokers. It was submitted that looking at the size of the corpus of the Fund, which was dwindling gradually and also the need to generate funds for meeting the repurchase obligations as well as the nature of the securities involved, it was practically difficult to ensure even spread of purchase/ sale order.

With reference to the total brokerage paid to the associate brokers under reference for the entire year ended on 31.3.99 it was submitted that the total amount paid was only Rs.1,53,409/-, i.e. Springfield Securities Ltd Rs.57,672/-, SIS Share & Stock Brokers P. Ltd. Rs.52,538/- and Shriram Indus Stocks Ltd. Rs.43,199/-, that for the entire year ended on 31.3.2000 the total payment of brokerage made to the three brokers was Rs.3,12,856, i.e. Rs.19,516 to Springfield Securities Ltd Rs.1,96,840/- to SIS Share & Stock Brokers P. Ltd. and Rs. 96,500/- to Shriram

to be given to associate brokers, that the alleged deviation from the prescribed limit was not with any malafide motive but was due to exigencies.

It was submitted that the total number of brokers dealt with by the Appellant for the year ended 31.3.99 was 32 and for the period of two and half years ending on 30.9.2000, the total number was 33, that this indicates that the Appellant had no intention to have undue concentration of business with its associates. With reference to the observation of the Adjudicating Officer that any undue concentration of business with the associate brokers by paying huge commission to such brokers is neither desirable nor in the interest of the unit holders, it was submitted that factual position as on record would show that there was neither any undue concentration of business nor payment of huge commission to associate brokers and as such it was not fair and appropriate on the part of the Respondents to invoke the Regulations and slap notices and impose penalties on the Appellants.

It was further submitted that when the number of transactions in a particular quarter is small, then the percentage exposure per broker tends to be on higher side for the reason that when the number of transactions is less in a quarter it becomes difficult to evenly spread the business with several brokers so as to comply with the Regulations and as a consequence thereof, the total business for that quarter gets distributed to smaller number of brokers When the volume of business to be transacted in a particular quarter falls low, it also becomes difficult to ensure even spread and consequently the exposure per broker tends to rise. It was submitted that the associate brokers had in fact assisted the Mutual Fund in selling several of its holdings of thinly traded securities or those which did not have large volumes or number of trades in the market.

normal Stock Exchange route or were relating to securities which did not have large volumes or trades in the market, that these securities which are either thinly traded or did not have volumes/ number of trades in market were being valued by the Mutual Fund in its respective scheme at Rs.61.86 lakhs in aggregate prior to their sale, that these securities were disposed off by the Fund by engaging the services of associate brokers during the quarters in question and the Fund realized a sum of Rs.172.42 lakhs, that this establishes that the associate brokers had in fact assisted the Fund which in turn had enabled the Fund to protect the interest of the investors and to provide a better return while attending to repurchase obligations.

According to the Appellant had it strictly adhered to the prudential norms mechanically, the Mutual Fund schemes would have found it extremely difficult to dispose off the holdings of thinly traded securities, which in turn would have affected the repurchase activities undertaken by the Mutual Fund schemes, and consequently would have affected the investors of these schemes. It was submitted that there were no malafide intentions, whatsoever, in dealing with the associate brokers and that the circumstances prevalent at the relevant time perforce required the Mutual Fund to transact with the associate brokers, which resulted in crossing the prescribed limits.

It was submitted that non compliance of Clause 25(7)(a) of the Regulation cannot be construed to be a continuing violation as Clause 25(7)(a) requires the percentage of business transacted to be ascertained in a block of 3 months. As the excess business carried out or otherwise is to be calculated for the quarter itself and cannot spill over to any day of the subsequent period, there cannot be any question of continuing violation / deviation in any quarter, that Clause 25(7)(a) of the

part of the quarter which leaves little scope to the Appellant to adhere to the Regulations in that quarter.

With reference to the Adjudicating Officer's observation that the percentage of business carried out with the associate brokers were as high as 91.68% and 52.42% in certain quarters, it was submitted that the reference relates to the quarter ended December 1999 and September 1999 respectively, that for the quarter ended December 1999 the total volume of business done was only Rs.4.55 lakhs and the total number of transactions were only 20 which undoubtedly is very small for a Mutual Fund, that even this business was put through 3 brokers to take care of the repurchase activities. Besides, out of the total of 20 transactions for the quarter, the number of transactions effected through the associate broker in question was only 8 for the entire quarter, that it was found practically very difficult and unviable to spread over such small volumes with several brokers so that the Regulations are strictly adhered to, as the brokers are normally not interested in transacting small volumes. For the quarter ended September 1999, the total transactions were only 21; that the securities transacted during this quarter with the associate brokers entirely relate to thinly traded securities, that the Adjudicating Officer had gone by the apparent higher percentage of volume and did not appreciate the fact that the number of transactions and the volume of business were small and hence would have been difficult to spread over with several brokers to ensure compliance.

The Respondent's finding that there was repetitive nature of default as the alleged default had occurred 12 times between June 1998 to September 1999 is not correct, that the deviation, was caused on account of low volumes, the small number transactions in the concerned quarters and the nature of scrips involved, and

Appellant had not dealt with any of the associate brokers from December 1999 onwards.

Shri Sridharan, learned Representative of the Appellant in appeal no.50/2002 adopted the submissions of the Appellant in appeal no.51/2002 and further submitted that the alleged excess transactions should not be taken in isolation but be viewed in the light of the attendant circumstances and the interest of unit holders of the Fund, that there was no other alternative in the then prevailing circumstances but to transact business through the limited number of brokers, as others were unwilling, and that in the interest of the Mutual Fund transactions could not be stopped. He submitted that from the meagre quantum of brokerage paid it is clear that the brokers were not given "excess brokerage" to benefit them, that infact they were under paid rather than over paid for their services.

He submitted that even though the Respondent has stated that the brokerage paid to the brokers for the transactions referred to in the order spread over a period of more than 2 years was just four lakh and sixty six thousand rupees it imposed a penalty of seven lakh rupees on the Appellants. Shri Sridharan submitted that the Respondent was required to take into consideration all the relevant aspects including the requirement of section 15J while considering the quantum of penalty. The fact that the Mutual Fund Schemes have been wound up and the unit holders have been paid the dues have been ignored by the Respondent. He submitted that section 15D(b) has no application to the facts of the case that the said section has nothing to do with conditions of grant of certificate of registration. He submitted that in the light of the facts and circumstances of the case, the order can not be sustained, and that in any case imposition of such a huge penalty on the Appellants can not be

Adjudicating Officer and submitted that the Appellants have not disputed the factual position of violation of the provisions of the Regulations, that they are only seeking leniency on the quantum of the penalty imposed. Learned Representative further submitted that the Appellants have been found guilty not for paying brokerage to the associate brokers, but for violation of regulation 25(7)(a) and that the violation of the said regulation has been conclusively established. Countering the Appellants' submissions that the deviations from the permissible limit of 5% in the quantum of transaction were due to circumstances beyond the control of the Appellants in the context of the urgent necessity to provide funds for meeting the redemption / repurchase request promptly in the prevailing market conditions, the learned Representative submitted that in as much as every Mutual Fund has to redeem the units as per the terms and conditions of the scheme and on the request of the unit holders and this cannot in any manner be considered as an extraordinary circumstance or some thing which was not known to the Appellants, that therefore it cannot be said that the regulations were contravened due to circumstances beyond the control of the Appellants. He submitted that the Adjudicating Officer while drawing the conclusion that the Appellants had violated the Regulations, had taken into consideration all the relevant aspects placed before him such as the small size of the fund, low volume of transactions, thinly traded securities, administrative and operational exigencies.

Learned Representative referred to regulation 10 and regulation 25(7)(a) and submitted that every Mutual Fund registered with SEBI has to conduct its business in compliance with the terms and conditions subject to which registration has been granted and the provisions of the said Regulations, that it is a requirement of the regulation that not more than 5% or more of the aggregate purchase and sale of

and provisions of the said regulation is liable to penalty as provided under section 15D(b) of the Act. Shri Sura Reddy submitted that quantum limit prescribed in the regulation is for certain reasons. In this context he referred to the following observation made by the Adjudicating Officer with reference to the purpose of limiting the transaction limit provided in regulation 25(7)(b).

> "The objective behind imposing certain limits on the business that can be conducted by a mutual fund through the associate brokers is to eliminate any undue advantage to these class of brokers by virtue of their close association with the AMC, sponsor, etc. and that there is no concentration of business only in such entities so that there is an indirect pecuniary advantage to the persons associated with the sponsor, AMC. These are prudential norms which have to be complied with by the fund / AMC while transacting business through brokers. Any undue concentration of the business of a mutual fund with its affiliated brokers by paying huge commissions to such brokers is neither desirable nor in the interest of the unit holders."

According to the learned Representative as per section 15D(b) of the SEBI Act, a penalty not exceeding Rs.10,000/- for each day during which such failure continues or 10 lakh rupees whichever is higher for the failure to comply with the terms and conditions of certificate of registration of a mutual fund, is prescribed, that in the instant case, the Adjudicating Officer, after taking into account all the facts and circumstances, has imposed only a token penalty of Rs.2 lakhs against the Appellant mutual fund for its failure on 12 occasions, to comply with the terms and conditions of certificate of registration in terms of regualtion10 of the said Regulations, although the charging section permits imposition of a maximum penalty of Rs.10 lakhs in case of each violation, that the impugned order imposing penalty of Rs.2 lakhs against the Appellant Mutual Fund is therefore fully justified.

the breach of regulation. The said regulation specifies the limit of 5% of aggregate purchase and the sale of securities and the low volume of business/less number of transactions etc. do not in any manner bring such transactions within the specified limit of 5%. It is clear that the Adjudicating Officer had taken into consideration all the relevant aspects while deciding the quantum of penalty. The following observation in the impugned order was referred to:

> "In terms of Section 15E where an AMC fails to comply with any of the Regulations providing for restriction of the activities of AMC, such AMC shall be liable to a penalty not exceeding Rs.5 lakhs for each such failure. In the instant case, there are 12 instances wherein the fund has routed transactions through its associate brokerage houses in excess of the permissible limits prescribed under Regulation 25(7)(a) of SEBI (Mutual Funds) Regulations, 1996…..
>
> In view of the above, a penalty of Rs.5 lakhs is considered sufficient although if each infraction is considered separately, the AMC would be liable to pay a higher penalty. Therefore, Shriram Asset Management Company Ltd. , shall pay a penalty of Rs.5 lakhs."

It was submitted that in the instant case, the Adjudicating Officer, after taking into account all the facts and circumstances of the case, has imposed only a token penalty of Rs.5 lacs against the Appellant company for its failure on 12 occasions though, the charging section permits imposition of a maximum penalty of Rs.5 lakhs for each such violation. Therefore, the impugned order imposing penalty of Rs.5 lacs against the Appellant is fully justified. Learned Representative submitted that the Appellants' contention that section 15E has no application to the facts of the case is not tenable, that as per the said section any asset management company failing to

I have considered the pleadings, the oral submissions and the material available on record. Shriram Mutual Fund, the Appellant in appeal no 50/2002 is a mutual fund registered under the SEBI Act. Mutual fund has been defined in the Regulations. According to the said Regulations "mutual fund means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market securities." A registered Mutual Fund is required to comply with the provisions of the Regulations. As per the Regulations mutual fund is required to ensure proper conduct of the assessment management company with reference to the investment activities etc. It is the trustees who hold the property of the mutual funds in trust for the benefit of the unit holders. Trustees are not the mangers of the business activities of mutual funds. For the purpose of asset management, each mutual fund is required to appoint Asset Management Companies fulfilling the prescribed qualifications. The Regulations have specifically provided for the duties and obligations of the Trustees and Asset management company. Shriram Asset Management Company Ltd., the Appellant in appeal no.51/2002 is the asset management company of the Appellant Mutual Fund. Respondent SEBI is the authority for enforcing the Regulations.

It is noted from the order that monetary penalty of five lakh rupees has been imposed on the Appellant Shriram Asset Management Company under section 15E of the SEBI Act by the adjudicating officer holding that the Appellant had failed to comply with the requirements of regulation 25(7)(a) of the Regulations. Penalty of two lakh rupees has been imposed on Shriram Mutual Fund under section 15 D(b) of the SEBI Act holding that the Appellant had failed to fulfil the conditions

Section 15 D(b) If any person, who is –

(a) ……..

(b) registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty not exceeding ten thousand rupees for each day during which such failure continues or ten lakh rupees whichever is higher.

Section 15E: Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company shall be liable to a penalty not exceeding five lakh rupees for each such failure.

Section 12 (1B):

"No person shall sponsor or cause to be sponsored or carry on or causing to be carried on any venture capital funds or collective investment schemes including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations."

Section 15 J. While adjudging quantum of penalty under Section 15I, 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.

In terms of regulation 9 SEBI is empowered to register the mutual fund and grant a

subject to the following conditions:

(a)the trustees, the sponsor, the asset management company, and the custodian shall comply with the provisions of these regulations

(b)**. . . . . .**

(c) **. . . . . .**

(d) **. . . . . .**

Regulation 24:

"The asset management company shall –

(1) not act as a trustee of any mutual fund;

(2) not undertake any other business activities except activities in the nature of port folio management services, management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis if any of such activities are not in conflict with the activities of the mutual fund.

Provided that the asset management company may itself or through its subsidiaries undertake such activities if it satisfies the Board that the key personnel of the asset management company, the systems, back office, bank and securities accounts are segregated activity-wise and there exist systems to prohibit access to inside information of various activities;

Provided further that asset management company shall meet capital adequacy requirements, if any, separately for each such activity and obtain separate approval, if necessary under the relevant regulations.

(3) The asset management company shall not invest in any of its schemes

Regulation 25 (7) (a)

An asset management company shall not through any broker associated with the sponsor, purchase or sell securities which is average of 5 per cent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes,

Provided that for the purpose of this sub regulation, the aggregate purchase and sale of securities shall exclude sale and distribution of units issued by the mutual fund;

Provided further that the aforesaid limit of 5 percent shall apply for a block of any three months.

It is not under dispute that during the period from June 1998 to September 1999 the Appellants had conducted business transactions through three associated brokers, over and above the limit prescribed in regulation 25(7)(a). Regulation 25(7)(a) mandates the asset management company, i.e. Shriram Asset Management Company in the present case, not to purchase or sell through any broker associated with the sponsor, five percent or more of the aggregate purchase and sale of securities made by the mutual fund in all its schemes in any block period comprising three months. Primarily it is the asset management company which is responsible for the investment activities of a mutual fund that is why the mandate under regulation 25(7)(a) is on the asset management company.

However, Regulation 18 "on the rights and obligation of the trustees of the mutual funds" inter alia provides that:

"The trustees shall ensure that an asset management company has been diligent in empanelling brokers, in monitoring securities transactions and avoiding undue concentration of business with any broker" (sub regulation 5)

"The trustees are to ensure that the transactions entered by the asset management company are in accordance with these regulations and the scheme" (sub regulation – 7)

(emphasis supplied)

Thus it thus clear that even though the mandate under regulation 25(7)(a) is on the asset management company, the trustees of a mutual fund can not escape from their obligation from ensuring the compliance of the said regulation by the asset management company. However in terms of sub regulation 26 of regulation 18 "not withstanding anything contained in sub regulation (1) to (25) the trustees shall not be held liable for acts done in good faith <u>if they have exercised adequate due diligence honestly.</u>

(emphasis supplied)

The Appellants' argument that section 15E is attracted only when an asset management fails to comply with any of the regulations providing for <u>restrictions on the activities of the asset management companies</u> and that the restrictions are those stated in regulation 24 and management of investment transactions within the stipulated 5% is not a restriction under the said regulation to warrant penalty, is not tenable. It is clear from the scheme of the Regulations that restrictions on the business activities of the asset management company are not confined to regulation 24. Some of the obligations specified under regulation 25 are also in the nature of restrictions. Sub regulation 7(a) of regulation 25 is one of such restrictions. In fact regulation 24 is <u>on restrictions on business activities of the asset management company.</u> But section 15E is not confined to business activities of the asset management company . It's scope is wider as it refers to failure on the part of the asset management company to comply with <u>any of the regulations providing for</u>

providing for restrictions, in section 15E also suggests that the scope of the section is not restricted to restrictions provided in one regulation, but wide enough to take care of the restrictions provided in any regulation in the Broker Regulations.

It is to be noted that the adjudicating officer having quoted the provisions of regulation 25(7)(a) has stated the objective of the said regulation. Shri Sura Reddy, the learned Representative appearing for both the Adjudicating Officer and the Securities and Exchange Board of India (SEBI) had reiterated the views of the Adjudicating Officer on the objective of the said regulation. It is to be noted that the Regulations are framed and notified by SEBI. It has been recorded in the impugned order that

> "The objective behind imposing certain limits on the business that can be conducted by a mutual fund through its associate brokers is to eliminate any undue advantage to these class of brokers by virtue of their close association with the AMC (i.e. Asset Management Company), sponsors etc. and that there is no concentration of business only in such entities so that there is no indirect pecuniary advantage to the persons associated with the sponsor, AMC. These are prudential norms which have to be complied with by the Fund/AMC while transacting business through brokers. Any undue concentration of the business of mutual fund with its affiliated brokers paying huge commissions to such brokers is neither desirable nor in the interest of the unit holders."

It is in the said context that we are required to see as to whether or not the transaction had resulted in undue concentration of business with the associated brokers and as a result those brokers were paid huge commissions to the detriment of the unit holders. The extent of transactions, brokerage paid etc. as stated by the

1999/2000. The commission paid to the associated brokers during the period was Rs.4.66 lakhs. The Respondent has cited just 12 instances in a period of 2-1/2years where the Appellants' transactions exceeded the prescribed limit. The reason for routing the business through the three associated brokers have also been stated. The Respondent has not disputed any of these facts.

In the light of the undisputed factual position available on record it is difficult to come to the conclusion that there was undue concentration of the business of mutual fund with its affiliated brokers and huge commissions were paid to them. In this context it is also noted that the mutual fund schemes of the Appellants have already been wound up and the amounts due to the unit holders have also been paid. In the facts of the case it is difficult to subscribe to the view that the Appellant company failed to adhere to the prudential norms of investments so as to warrant penalty of 5 lakh rupees. It is true, as I could see from the facts of the case, that the Appellant had acted in good faith, to protect the interest of the investors, rather than enriching the associated brokers. The intent of regulation 25(7)(a) is clear. It is intented to ensure that the brokers associated with the sponsors and AMC are not given undue benefit by way of commission/brokerage by concentrating transactions through them and also to avoid the risk element in dealing with such brokers. In the facts of the case it is difficult to conclude that the Appellants were favouring the associate brokers, at the cost of the mutual fund, that on the contrary the evidence suggests that the Appellant was making use of the associate brokers to the benefit of the mutual fund, when other brokers were not willing to take transactions involving small quantity of shares, thinly traded shares etc.

The charge against Shriram Mutual fund is that it had not exercised due

conduct' under regulation 18 "Mutual fund's schemes should not be organized, operated and managed or the portfolio of securities selected, in the interest of sponsors, directors of asset management companies members of Board of trustees or directors of trustee company, associated persons as in the interest of special class of unit holders, other than in the interest of all classes of unit holders of the scheme." Regulation 18 prescribes "Rights and obligations of the trustees" In the said regulation it has been inter alia prescribed in sub regulation (6) that "the trustees shall ensure that the asset management company has not given any undue or unfair advantage to any associates or dealt with any of the associates of the asset management company in any manner detrimental to the interest of the unit holders".

From the factual position discussed earlier, it has been established that the asset management company has not given any undue or unfair advantage to any associated broker or dealt with any of its associates in any manner detrimental to the interest of unit holders. Regulation 25(7)(a) should not be viewed in isolation. It has to be read in conjunction with the other provisions of the regulations.

Section 15I of the SEBI Act empowers SEBI to adjudicate. Said section 15I reads as under:

> "15I (1) For the purpose of adjudging under sections 15A,15B,15C,15D,15E, 15F,15G and 15H, the Board shall appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.
>
> (2) While holding an inquiry the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document

specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections".

Section 15J on factors to be taken into account by the Adjudicating Officer reads as under:

" 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".

On a perusal of section 15I it could be seen that imposition of penalty is linked to the subjective satisfaction of the Adjudicating Officer. The words in the section that "he may impose such penalty" is of considerable significance, especially in view of the guidelines provided by the legislature in section 15J. "The Adjudicating Officer shall have due regard to the factors" stated in the section is a direction and not an option. It is not incumbent on the part of the Adjudicating Officer, even if it is established that the person has failed to comply with the provisions of any of the sections specified in sub section (1) of section 15I, to impose penalty. It is left to the discretion of the Adjudicating Officer. But the decision should not be an arbitrary one. The authority has to be exercised judicially taking into consideration the facts and circumstances of each case.

In this context, it is relevant to have a look at the guidelines provided by the Hon'ble Supreme Court in Hindustan Steel Ltd. V State of Orissa (AIR 1970 SC 253). Para 7 from the judgement considered relevant in this context is extracted

An Order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceeding, and penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligation. Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on a consideration of all the relevant circumstances. Even if a minimum penalty is prescribed the authority competent to impose the penalty will be justified in refusing to impose penalty, when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bonafide belief that the offender is not liable to act in the manner prescribed by the statute".

The back ground of the said case leading to the above observation by the Hon'ble Court is as follows:

"In proceedings for assessment of tax under the Orissa Sales Tax Act, 1947, the Sales Tax Officer held that the Company was a dealer in building material, and had sold the material to contractors and was on that account liable to pay tax at the appropriate rates under the Orissa Sales Tax Act. The Sales Tax Officer directed the Company to pay tax due for ten quarters ending December 31, 1958, and penalty in addition to the tax for failure to register itself as a dealer. The Appellate Assistant Commissioner confirmed the order of the Sales Tax officer. In second appeal the Tribunal agreed with the tax authorities and held that the Company was liable to pay tax on its turnover from bricks and cement and steel supplied to the contractors. The Tribunal however substantially reduced the penalty imposed upon the

The observation of the Hon'ble Court cited above was in answer to the question "whether the Tribunal is right in holding that the penalties under section 12(5) of the Act (Orissa Sales Tax Act, 1947) had been rightly levied?"

In the light of the clear observation of the Hon'ble Court as to when penalty for failure to carry out a statutory obligation could be imposed, it is to be seen as to whether the facts of the present case warranted penalty. The facts to be considered are whether there is anything to show that the Appellants acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest or acted in conscious disregard of its obligation. It is also to be seen that whether the breach flows from a bonafide belief of the Appellant that it was not liable to act in the manner prescribed by the statute.

In this context it is also relevant to note the significance of the expression "shall be liable to a penalty" appearing in the section 15D and 15E. The Hon'ble Supreme Court in Superintendent & Remembrancer of Legal Affairs to Govt. of West Bengal V Abani Maity (1979) 4 SCC 83) had held that the expression "shall be liable to a penalty" occurring in many statutes has been held as not conveying the sense of an absolute obligation or penalty but merely importing a possibility of such obligation or penalty".

As already stated above, in terms of section 15I whether penalty should be imposed for failure to perform the statutory obligation is a matter of discretion left to the Adjudicating Officer and that discretion has to be exercised judicially and on a consideration of all the relevant facts and circumstances. Further in case it is felt that penalty is warranted the quantum has to be decided taking into

In the light of the facts specific to the case discussed above and in view of the principles laid down in Hindustan Steels case cited, I am of the view that the order imposing penalty on the Appellants can not be sustained and the same deserves to be set aside. I do so.

The appeals are allowed.

Sd/-

(C. ACHUTHAN)
PRESIDING OFFICER

Mumbai,
August 21 , 2003.