BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

APPEAL NO. 59/2001

In the matter of:

Atul Kanodia **Appellant**

Vs.

Securities and Exchange Board of India **Respondent**

APPEARANCE

Mr. B.B.Merchant
Advocate

Mr.Utpal Joshi
Advocate
I/b. Thakordas & Madgavkar **for**
Appellant

Ms Poonam A Bamba
Jt.Legal Adviser, SEBI

Mr. Joby Mathew
Legal Officer, SEBI **for**
Respondent

(Appeal arising out of the order dated 26.12.2001 made by Securities and Exchange Board of India)

ORDER

The Appellant is a member of the Uttar Pradesh Stock Exchange (UPSE) and registered with the Securities and Exchange Board of India (the Respondent), as a stockbroker, since 1992. Respondent is the statutory body established under the Securities and Exchange Board of India Act, 1992 (the Act) mandated to protect the

interests of investors in securities and to promote the development of, and to regulate the securities market for matters connected therewith or incidental thereto. Registering and regulating the working of stock brokers and sub brokers is one of the functions assigned to the Respondent. The Respondent has notified the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 (the Regulations) for registering and regulating the working of the stock brokers and sub-brokers. In terms of regulation 19 of the Regulations, the Respondent is empowered to appoint one or more persons as inspecting authority to undertake inspection of the books of accounts etc., of the stock brokers for any of the following purposes, viz. (a) to ensure that the books of accounts and other books are being maintained in the manner required; (b) the provisions of the Act, rules, regulations and the provisions of the Securities Contracts (Regulation) Act, 1956 (SCR Act) and the rules made thereunder are being complied with; (c) to investigate into the complaints received from investors, other stock brokers, sub brokers or any other person on any matter having a bearing on the activities of the stock brokers and (d) to investigate suo motu in the interest of securities business or investors' interest.

The Respondent's officer appointed for the purpose of undertaking inspection referred to in regulation 19, carried out inspection of the books of account etc. of the Appellant on 17.12.1998. The inspecting authority on completion of the inspection concluded that the Appellant had failed to comply with certain statutory requirements relating to conduct of its business activities and in particular with reference to maintenance of records. The findings of the inspecting authority were communicated to the Appellant on 1.3.1999 seeking his comments thereon and the Appellant submitted his reply vide letter dated 22.4.1999. As the Appellant's reply was not found satisfactory, the Respondent vide its order dated 31.8.1999 ordered to conduct an inquiry into the

following contraventions stated to have been made by the Appellant. According to the inspection report (i) the document register maintained by the Appellant did not contain the requisite details such as distinctive numbers of securities purchased and sold (ii) the contract notes issued by the Appellant did not contain pre-printed/computer generated serial numbers and were not stamped with time of execution of order (iii) the Appellant did not maintain strict segregation of the clients' account and own account (iv) the Appellant did not make payment of the required fees to the Respondent, (v) the Appellant did not report off the floor transactions (vi) the Appellant did not report short sales and long purchase positions, (vii) the Appellant had indulged in carry forward contracts and (viii) the Appellant had been dealing with brokers who are not registered with the Respondent. The Inquiry officer submitted his report on 10.5.2001 recommending that the certificate of registration of the Appellant be suspended for a period of 3 months for the failure to (i) properly maintain the document register (ii) failure to use the proper contract note format and (iii) failure to segregate clients' accounts and the firm's account. On 28.5.2001 the Respondent issued a show cause notice to the Appellant. The Appellant submitted his reply thereto on 19.6.2001. After considering the Appellant's written and oral submissions, the Respondent passed the impugned order on 26.12.2001. The relevant portion of the order, which is impugned, is as follows: -

> "As found by the Enquiry officer, I note that the document register maintained by the said broker did not contain particulars such as distinctive numbers etc. of shares and securities received and delivered. Clause (g) of sub-regulation (1) of regulation 17 of the said regulations, requires that the documents register maintained by every stock broker should include particulars of shares and securities received and delivered. Further clause (g) of sub-rule (1) of Rule 15 of SC (R) R also require that the document register

shall contain all particulars of securities received and delivered. Since, the said broker has failed to include details of distinctive numbers of shares and securities received and delivered, in the document register maintained by them, they have violated the aforesaid provisions. The violation of the said provision by the said broker also amounts to violation of item (5) of Part A of the Code of Conduct as contained in Schedule II read with regulation 7 of the said regulations. Item (5) of Part A reads as under:

> "Compliance with statutory requirements: A stock broker shall abide by all the provisions of the Act and rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him".

As found by the Enquiry Officer, it is also noted that the contract notes issued by the said broker did not contain pre-printed or computer generated serial numbers and time of execution of order was not stamped on the said contract notes. The same amounts to contravention of item (2) of Part B of the code of conduct as contained in Schedule II to the said regulations which provides that-

> "Issue of contract note: A stock broker shall issue without delay to his client a contract note for all transactions in the form specified by the stock exchange".

UPSE vide its circular UPSE/97-98/mem/34 dated July 22, 1998 had specified that contract notes should bear pre-printed serial numbers and should be stamped with time of execution of order. Thus, by not stamping of time of execution of order and issuance of contract notes without pre-printed serial numbers, the said broker has also contravened the said circular of UPSE and such non-compliance attracts penalty as specified under bye-law 347(a) of UPSE.

It has been found by the Enquiry officer that the said broker has not maintained segregation between clients account and own account. Bye-law 225A of UPSE requires every stock broker who is a member of the exchange to maintain two separate accounts – client account and own account and to maintain strict segregation between the two accounts. The said broker, in failing to maintain segregation between the two accounts has violated bye-law 225A of the UPSE.

The certificate of registration to a stockbroker is granted by SEBI subject to the certain conditions as laid down in Rule 4 of the said rules. Sub rule (b) of rule 4 of the said rules provide that –

> "4. The Board may grant a certificate to a stockbroker subject to the following conditions, namely: -
>
> a)……
>
> b) he shall abide by the rule, regulations and bye-laws of the stock exchange or stock exchanges of which he is a member"

The said broker having contravened the above provisions of SC(R) R, the said regulations, the bye-laws of UPSE and the directives issued by UPSE by way of the circulars has thus not complied with one of the conditions subject to which registration was granted to them.

Failure of a stock broker to comply with any of the conditions subject to which registration has been granted, attracts penalty as specified under clause (a) of sub-regulation (2) read with clause (d) of sub-regulation (1) of regulation 25 of the said regulations i.e. either suspension of registration for a specified period after enquiry or cancellation of registration. The said provisions read as under-

> "25 (1) A stock broker who –

(a)

(b)

(c)

(d) contravenes the rules, regulations or bye-laws of the stock exchange; shall be liable to any of the penalties specified in sub regulation (2).

(2) The penalties referred to in sub-regulation (1) may be either-

(a) suspension of registration, after enquiry for a specified period……."

Further, clause (i) (ii) & (ix) of sub-regulation (1) of regulation 26 of the said regulations states that-

"(1) A penalty of suspension of registration of a stock broker may be imposed if –

(i) the stock broker violates the provisions of the Act, rules and regulations.

(ii) The stock broker does not follow the code of conduct annexed at Schedule II…

(iii) the stock broker violates the conditions of registration.

The said broker has also not paid the turnover fees despite assuring to pay the outstanding fee due from them during the personal hearing. They also collected necessary details from SEBI in this regard and assured to pay the outstanding dues. However, later, vide their letter dated August 07,2001 the said broker disputed the amount payable by them. They have stated that

"……..

7) A statement of account towards Turnover Tax was made available through your Ms Anita Kehkare

On going through the statement, following discrepancies has been observed:

The statement provided does not bear any official seal or authentication by any authority of SEBI

The Turnover figures shown grossly differ with our Turnover.

Apart from other discrepancies, the credit figures as shown, also do not tally with our record…..

Further, at this juncture, we promise to pay the dues of SEBI, immediately on hearing from you…."

It may be mentioned that sub-clause (viii) of sub-regulation (1) of regulation 26 of the said regulations specifies penalty of suspension of registration if the stock brokers fails to pay the fees specified under the said regulations or cancellation of registration, in case of repeated default.

In view of the above violations by the said broker, I find that a penalty of suspension of registration for three months, as recommended by the enquiry officer would be commensurate in the facts of the case. The said broker shall also be careful in future and shall ensure strict compliance with the provisions of the Rules, the said Regulations and directives issued by SEBI, and Rules, Regulations and Bye Laws of the Stock Exchange and of the provisions of SEBI Act and SC(R) A, and SC(R) R. Contravention by the said

broker of any of the provisions of the same, in future shall attract stern action.

So far as the contention of the said broker pertaining to the action being time barred, is concerned, it may be mentioned that the proceedings were not concluded and another opportunity was granted to the said broker to enable him to explain his case, in view of the contentions later on raised by them regarding the fee payable to SEBI and other violations. Therefore, the said broker cannot now plead that the proceedings are time barred. Hence, it cannot be said that the time period stipulated for passing of the order under sub-regulation (3) of Regulation 29 has expired.

In view of the above, in exercise of the powers conferred on me by virtue of sub section (3) of section 4 of the Securities and Exchange Board of India Act, 1992 read with regulation 29(3) of the SEBI (Stock Brokers and sub Brokers)Regulations, 1992, I hereby suspend the registration of the said broker for a period of 3 months.

This order shall come into effect from 31.12.2001."

The Appellant stated to be aggrieved by the said order has filed the present appeal on 31.12.2001. Even though the Appellant had prayed for interim order staying the operation of the impugned order during the pendency of the appeal, the prayer was not pressed when the request was taken up for consideration on 4.1.2002, in view of the possibility of the main appeal itself being expeditiously disposed of in the light of the Respondent's undertaking to file its reply very early.

Shri B.B.Merchant, learned Counsel appearing for the Appellant submitted that the impugned order is time

barred and on this ground itself the order deserves to be set aside. He narrated the sequence of events from the date, on which the Inspecting team of the Respondent carried out the inspection, culminating in the issuance of the impugned order on 26.12.2001. Shri Merchant submitted that the failures, for which the Appellant has been put off from the business for 3 months, do not survive to warrant suspension of registration certificate that too with immediate effect. He stated that while other brokers of UPSE, for the alleged failures of the same nature were treated "softly" the Appellant was singled out and punished severally, effectively even denying the remedy, which it can seek by filing the appeal provided in the statute. He submitted that, the Respondent despite being fully aware of the fact that the law provided 45 days to file an appeal before the Tribunal, the impugned order was passed intentionally on 26.12.2001 and made it effective from 31.12.2001 knowing fully well that as a result of the intervening holidays and the distance involved, the Appellant located at Kanpur would not be able to file an appeal before the Tribunal located in Mumbai and seek interim relief before the order comes into operation. Learned Counsel submitted that the alleged failures relate to 1997/98 and that if the matter could wait for more than 3 years to pass an order, and the time factor being also not very urgent, being not an interim measure, the Respondent should have made the order operative prospectively by providing reasonable time to the Appellant to seek recourse to the appellate remedy provided in the statute. According to the learned Counsel the attitude of the Respondent is thus indicative of its prejudice and the order made by the Respondent is based on prejudice and bias and therefore not sustainable.

Shri Merchant submitted that the order is bad in law as it is made beyond the mandatory time limit of 30 days prescribed in the regulation. He submitted that in terms of regulation 29(3) in an inquiry proceeding the

Respondent is required to pass the order of suspension or cancellation within 30 days of the receipt of the reply to the show cause notice. In this context he submitted that the inquiry officer submitted the report on 10.5.2001. The Appellant was served with show cause notice on 28.5.2001. The Appellant submitted his explanation vide letter dated 19.6.2001. The Appellant was given a personal hearing on 18.7.2001. Since there was no response thereafter from the Respondent, the Appellant again wrote on 7.8.2001. Though the Appellant vide the said letter had only requested to drop the proceedings, the Respondent of its own, vide letter dated 27.9.2001 called the Appellant for a hearing on 24.10.2001, which the Appellant did not attend as the hearing was considered not necessary in view of the hearing already held on 18.7.2001, that it was only a device to beat the requirement of time limit prescribed in the regulation. The Respondent passed the impugned order on 26.12.2001. According to the learned Counsel the order passed on 26.12.2001, on every count is beyond the statutory limit prescribed in regulation 29(3) and therefore void. He submitted that the delay is (i) more than 5 months from 19.7.2001 (being statutory time limit for passing the order) (ii) more than 4 months from 7.8.2001 being the date of letter of the Appellant (iii) more than 4 months from 18.8.2001 in view of the hearing held on 18.7.2001, (iv) more than 1 month from 20.11.2001 which was the last date for issuing the order in view of the reply having been given vide letter dated 20.10.2001 (v) more than 30 days from 24.11.2001 from the last date of hearing scheduled on 24.10.2001.

Learned Counsel, submitted that the language of regulation 29(3) is clear in as much as it requires the order to be made by the Respondent as soon as possible but not later than 30 days from the receipt of the reply to the show cause notice. According to Shri Merchant no discretion is available to the Respondent to enlarge the specific time limit prescribed in regulation 29(3), that

wherever discretion is available the regulation has clearly provided so. He submitted that the obligation of accountability fastened on the public authorities through legislative provisions cannot be diluted by the public authorities, that the mandatory provisions of the Regulations are meant to protect the public interest by taking timely action. He submitted that 30 days time limit has been prescribed in the regulation intentionally.

In this context he referred to several regulations notified by the Respondent prescribing different time limits for passing the order of suspension or cancellation of certificate of registration. By way of illustration he cited SEBI (Custodian of Securities) Regulations 1996 and SEBI (Depositories and Participants) Regulations 1996 which requires the Respondent to pass orders in just 14 days. He also referred to SEBI (Merchant Bankers) Regulations, 1992, SEBI (Portfolio Managers) Regulations, 1993, SEBI (Registrar to an Issue and Share Transfer Agents) Regulations, 1993, SEBI (Under Writers) Regulations 1993, SEBI (Debenture Trustees) Regulations 1993 SEBI (Bankers to an Issue) Regulations, 1994 and SEBI (Foreign Institutional Investors) Regulations 1995 and stated that these regulations prescribe 30 days to pass the order as has been provided in the Brokers Regulations. Shri Merchant stated that there are certain other regulations such as SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations 1995 and SEBI (Venture Capital Funds) Regulation 1996, where under specific time limit has not been prescribed for passing orders. Learned Counsel submitted that the object of the regulation is thus clear, as to where it has to be lenient and where it has to be strict, the Regulations have provided for suitable measures, leaving little discretion to the Respondent to stretch out the time limit. Shri Merchant further submitted that the Respondent has not mentioned anywhere in its pleadings or oral submissions on the authority which it has for enlarging the statutory time limit, that the Respondent has only tried to explain

meekly that there is no delay on its part and the order is not in any way vitiated. He submitted that regulation 29 (3) is a prosecuting provision affecting the rights and obligations of the parties and as such strict adherence to the requirements of the regulation is required. In support to this contention he cited the decision of the Hon'ble Supreme Court in Ramachand & Ors v. Union of India (1994) 1 SCC 44 and this Tribunal's order in Doogar Associates Ltd v. SEBI (2001 CLC 1243). Learned Counsel further submitted that since the Respondent has not adhered to the strict time schedule provided in regulation 29(3), the order is bad and deserves to be set aside.

With reference to the charge of non-maintenance of document register by the Appellant, in terms of rule 15(1) (g) of the Securities Contracts (Regulation) Rules, 1957 (the 1957 Regulations) and regulation 17(g) of the SEBI Regulations, Shri Merchant submitted that the charge has not been established. He submitted that there is no specific format prescribed by the stock exchange or any other authorities as to what all materials are required to be included in the document register, that the Appellant has been maintaining the document / stock register in the manner required to be maintained in terms of the circulars issued by UPSE and there was no let up in the matter. He submitted that there was no requirement of indicating the distinctive number of the securities purchased and sold in the register as these particulars are even otherwise available in the sales / purchase bills properly secured and maintained by the Appellant, that at present the requirement of even providing the distinctive numbers to securities has been done away as the shares are now required to be transacted in De-mat form. He submitted that though all these facts were explained to the Respondent by the Appellant vide his letter dated 1.11.2001 (copy filed in the proceedings), there is not even an indication in the impugned order as to whether these explanations were considered and if so

why it was not acceptable, that it is therefore apparent that the Chairman of the Respondent has simply endorsed the view of the inquiry officer and has not independently assessed the submission and evidence and as a result the order is made without applying his mind.

Regarding the failure to provide preprinted or computer generated serial numbers to the contract notes issued and the failure to make provision therein for "time stamping" with reference to the transactions, the learned Counsel submitted that the contract notes were issued as per the proforma prescribed by UPSE and the printed copies of the form were supplied at the stationery counter of the exchange till 22.10.1999, i.e the date of issue of circular by UPSE, that the circular No. UPSE / 97-98 dated 1.2.1997 relied on by the inquiry officer, as per the record was not circulated among the members by the exchange, as is evident from the absence of the "outward number" on the circular, that the revised format of the contract notes was introduced for the first time by UPSE vide circular dated 22.10.1999. The said format contains the provision for information such as serial number, order time, order number, order trade number and trade time, which was introduced for the first time, that the inquiry officer had found the Appellant guilty of non compliance of the requirements of the said format, even before the issuance of the said circular, as the inspection was carried out on 17.12.1998 i.e. when the old contract note form was in force whereas the circular was issued on 22.10.1999. Learned Counsel submitted that after the new format was brought in, the contract notes are issued in accordance with the said circular and the new formats used were shown to the inquiry officer. Shri Merchant submitted that the charge of issuing the contract notes without full information is untenable as the Appellant had used the format as supplied by the stock exchange and as per the instructions in vogue at that point of time.

Regarding failure to segregate the firm's account from the clients' account referred to in the impugned order, the learned Counsel submitted that the Appellant has his account and the clients account both in Standard Chartered Bank and ANZ Grindlays Bank and the account numbers are closely identical as detailed below:

Name of the bank Appellant's A/c. No. Clients A/cs.No.

ANZ Grindlays Bank OIC-GP-03830-00 OIC-GP-03830-01

Standard Chartered Bank 014-20-75067-00 015-20-75067-01

He pointed out that as there is very slight difference in account number between the Appellant's and the clients' account and due to this fact there has been mistake in posting the account numbers at the Banks end in few entries, that there has been no deliberate intention and more over the Appellant has not used the clients' money in any manner whatsoever. Learned Counsel submitted that the Appellant has also taken up the matter with the Bankers. In this context he referred to the paying slips used for the purpose, annexed as exhibit to the appeal. Learned Counsel stated that since the factual position was putforth before the Respondent and if the Respondent was not satisfied it should have verified the position by summoning the records from the Bank or at least got the Bank's version in this regard before confirming the charge against the Appellant. It could have been verified either by the inquiry officer or at least by the Chairman before blindly endorsing the recommendations of the inquiry officer, as the Chairman is duty bound to satisfy the authenticity of the facts, which are contested.

With reference to the charge of failure to pay the fee to the Respondent, the learned Counsel submitted that the Appellant has paid the fee as required. He submitted that the Appellant had brought to the notice of the

Respondent the order passed by the Hon'ble Allahabad High Court on 4.7.1996 in Writ No. 20838 of 1996 (UP Stock Exchange Brokers Association v. Union of India & Ors) wherein the Court had directed the brokers "to pay only Rs. 5, 000 per year as registration fee and no further amount", that the Appellant has paid the fee according to the said order and on the question of registration fee for the year 1998-99 the same is not payable since turnover fee in sixth year has been paid for a block year of 5 years as provided by the Respondent. It was further submitted that turnover fee for the financial year 1998-99, as per the guidelines is not required to be paid by the Appellant. In this context he referred to the circular UPSE/98-99/58 dated 26.10.1999 issued by UPSE and read out the portion that "all those members (including those converted to corporate, and members who were party in Writ Petition in the Hon'ble Allahabad High Court) who have registered with SEBI (in) the year 1992-93 and paid the SEBI fee for sixth year (1997-98) are not required to pay fee upto 31.3.2002 i.e.

Year of initial registration 6th year fees valid for 5-year ending

1992-93 1997-98 31.03.2001

1993-94 1998-99 31.03.2003

However, those members who were first registered in 1993-94 and afterwards are required to submit SEBI fees latest by 31.10.1998 to avoid any further action by the Exchange against non payment of SEBI fee. Members of the Exchange are requested to take note of the above and act accordingly." Shri Merchant submitted that in terms of the said circular the Appellant is not required to pay the fee and therefore cannot be charged for not paying the fee. He further submitted that even otherwise the Appellant had promised SEBI vide its letter dated 7.8.2001 that it is ready to pay the dues of SEBI,

immediately on hearing from it, that in para 6.2 of the order this factual position has been acknowledged. Learned Counsel submitted that the Respondent itself is not clear about the quantum of fee due from the Appellant, and that is why it did not demand the arrears, despite the promise made by the Appellant and in such a situation the Appellant cannot be penalised as the fault is not his.

Ms Poonam Bamba, the learned Representative of the Respondent explained in detail the mandate given to the Respondent and the legislative provisions in the Act enabling the Respondent to achieve the purpose of the Act. Ms Bamba in this context referred to the preamble to the Act and the powers and functions of the Board stated in section 11 and also the provisions of section 12. She submitted that the stock brokers are required to abide the requirements of the Act, rules and regulations and this requirement flowing from rule 4 of the SEBI (Stock brokers and Sub Brokers) Rules, 1992 has been clearly spelt in the registration certificate itself as a condition. She also referred to schedule II to the Regulation which prescribes the code of conduct for the stock brokers, which also interalia prescribes that a stock broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchanges from time to time as may be applicable to him. She read out the requirements under rule 15(1)(g) of the SCR Rules and regulation 17(1)(g) of the Regulations requiring the brokers to maintain the documents or register showing full particulars of shares and securities received and delivered. She submitted that even if there is no precise prescribed format of the document register, the requirement of disclosure therein is clear from regulation itself as it requires that the "document register should include particulars of shares and securities received" that by no stretch of imagination it can be said that distinctive number which enabled identification of shares is not coming under "particulars"

and not sufficiently important to find a place in the register. The argument that the stock register / bill register contains the distinctive numbers and as such it is not necessary to record these particulars in the document register is untenable as the very purpose of maintaining the register, will be defeated if the register does not contain the full particulars, that if any sale / purchase bill is lost then the document register with the details will be helpful to identify the details of the shares. She further submitted that the argument that the requirement of distinctive numbers is no more relevant as the securities are now traded in the De-mat form is also irrelevant as the omission in this regard by the Appellant is with reference to the shares which are not in the De-mat form and had the distinctive number at that point of time.

Referring to the Appellant's version on the finding relating to the deficiencies in the contract notes, Ms Bamba submitted that the requirements had been brought to the notice of all the exchanges vide the Respondent's circular dated 29.10.1993, a copy of this circular and the subsequent circular dated 5.8.1996 annexed to the reply was cited by her. She submitted that the circular dated 5.8.1996 addresses issues referred to in the order. She read out the text of the order. The core portion of the circular is reproduced below:

> "SUB; INSPECTION OF BROKERS AND COMMON IRREGULARITIES OBSERVED
>
> This has reference to SEBI's circular No.SMD (B) / 104 / 22775 / 9 dated October 29, 1993 on the captioned subject. SEBI has conducted inspections of brokers of various Stock Exchanges during March 1996 and have observed certain common irregularities / deficiencies as under:
>
> Related to Contract Notes:
>
> Not having pre-printed serial numbers
>
> Not issuing contracts in Form B while acting as

principal
Not affixing stamps
Not having SEBI registration numbers
Signed by unauthorised persons or not signed
Not maintaining counterfoil of contract notes without adequate details
Despatching contract notes after 24 hours
Not obtaining client's consent while acting as principal
Dealing with unregistered sub-brokers.
a Not having separate bank account for client's funds
Having separate bank account for clients but not segregating clients' funds from his own funds
Non-maintenance or improper maintenance of Books of Accounts which are required to be maintained as per Rule 15 of SC® Rules, 1957 and Regulation 17 of SEBI(Brokers and sub-brokers) Regulations 1992:
Hard copy of client account not available
Books are available but the details of which are inadequate to correlate or trace the transactions.
Non-payment of Registration Fee or making part payment of fee
Not reporting off-the-floor transactions (e.g):
The transactions with members of other exchanges
Principal-principal transactions with clients
Transactions done after the trading hours
Belated payments and deliveries and delayed rectification of Bad Deliveries
Violation of trading restrictions imposed by the Stock Exchange

The above deficiencies should be brought to the notice of all the members through a circular with an advice that serious view will be taken if such deficiencies are observed during the course of future inspections of the brokers by SEBI or by Stock

Exchange. The Stock Exchanges are also advised to carry out inspections of at least 10% of the members every year and ensure that these common irregularities are not repeated".

Ms Bamba submitted that there is no reason to believe that UPSE had failed to bring the circular to the notice of the brokers as required in the last para of the circular.

Referring to another circular dated 11.2.1997 which required the exchange to initiate immediate action in certain matters, she stated that the requirement of stamping of orders was highlighted therein in the following words that "the broker member should maintain record of time when the client has placed the order and reflect the same in contract note along with the time of execution of the order". She refuted the Appellant's version that the circular dated 1.12.1997 was not circulated. In the said circular it was clearly stated that

"All the members of the Exchange are hereby informed that the following facilities are available in the VECTOR Software used in UPSE on-line Trading (UPOLT): -

Segregation of Broker / Client (own) transactions
Unique order ID for each order
Time stamping of order execution

All the members are advised to make use of the above facilities in particular segregation of Broker / Client transactions. If no Client name is given the transaction is presumed automatically for broker, as the relevant figures are required to be reported to SEBI from time to time.

The Contract form No.A & B as per Regulation No.14 (2) are being revised to incorporate the above changes"

She pointed out that the circular of UPSE itself is "captioned to members", that it is not a draft as stated by the Appellant as it is signed and circulated. She also referred to the exhaustive circular issued by UPSE on 22.7.1998, requiring the members to comply with the requirements with reference to maintenance of books of account, contract notes and a host of other matters, and stated that the Appellant still did not comply with the requirements, as was revealed in the inspection carried out in December, 1998 i.e. after 5 months of the circulation of the said circular.

With reference to the charge relating to non-maintenance of segregated accounts, she stated that it is not an isolated entry on any particular day. She referred to 8 instances involving a total sum of about Rs. 20 lakhs referred to in the inquiry report and stated that these are all only sample cases. She submitted these illustrative cases of mix up of funds were found on different dates in December 1997, February 1998 and March 1998. She further stated that the Appellant did not produce the original paying slip or any letter from the Bank, controverting the findings of the inspecting officer/inquiry officer, which was not a difficult task, if his contention was right, that the argument that the funds so credited were not misused by the Appellant is not a ground to absolve the Appellant from the failure on his part. Non segregation of clients accounts from own account is a serious matter as the said indiscipline would affect the investors' interest at times heavily and benefit the broker as its exposure limit would increase. She reiterated that the Appellant has not disproved the findings recorded in the order, but has only attempted to trivialise the failures.

Regarding the charge relating to failure to pay the fees, Ms Bamba submitted that the Appellant was asked to give the details of turnover etc., but he did not give, that

the amount due from him is about Rs. 7 lakhs. She submitted that the order of the Hon'ble Allahabad High Court cited by the Appellant no longer holds good in view of the decision of the Hon'ble Supreme Court in the BSE Brokers Forum case decided on 2.1.2001.

Ms Bamba stated that in the appeal memorandum the Appellant has admitted the omissions on his part but has taken it upon himself to decide that the omissions are "technical", "inconsequential" and not serious etc. She submitted that the violations committed by the Appellant based upon which the impugned order was passed are not trivial or merely technical, rather the same are of serious nature. Learned Representative submitted that the Appellant has violated one of the conditions subject to which the certificate of registration was granted to him, that in view of the admissions on the part of the Appellant having violated the provisions as indicated in the order, and the same having been established from facts on record, the registration of the Appellant was suspended for a period of 3 months and the impugned order is thus perfectly justified to be sustained.

Learned Representative submitted that the order is based on the facts born out of the records and not on the basis of any prejudice or bias as alleged. She submitted that the settlement cycle in UPSE of which the Appellant is a member, runs from Monday to Friday, that the impugned order was to come into effect from 31.12.2001 which was Monday, the first day of the next settlement, so that the Appellant may not take any fresh positions and the order was passed accordingly. Learned Representative refuted the Appellant's allegation that the Respondent had treated the Appellant discriminately vis-à-vis others. She stated that the nature of penalty in each case is decided on the facts specific to each case and not in a general way and that the Appellant's case was decided on the basis of the facts available before the authority.

Ms Bamba refuted the Appellant's version that the impugned order is time barred. She submitted that the Appellant in his letter dated 19.6.2001 in reply to the show cause notice had requested for a personal hearing to further clarify his submissions and accordingly the Respondent scheduled a personal hearing for him on 18.7.2001. She referred to the Appellant's submission that after 18.7.2001, there was no intimation from the Respondent, and submitted that as per the request of the Appellant, at the time of hearing, the Respondent had furnished, inter alia the details of fee payable by him and the Appellant had assured that he would make the payment of fees, that since the Appellant had disputed the amount of fee payable by him, another opportunity for personal hearing before the Chairman of the Respondent on 24.10.2001 was granted, that on that date the Appellant failed to appear and submissions from him were waited, the impugned order was passed beyond 30 days from last date of hearing, Ms Bamba submitted that even assuming that the order was passed beyond 30 days from the last date of hearing, the same does not vitiate the order.

Referring to the Ramchand's case (supra) cited by the learned Counsel for the Appellant, Ms Bamba submitted that the observation therein relied on that "the authorities are enjoined by the statute concerned to perform their duties within a reasonable time, and as such they are answerable to the Court, why such duties have not been performed by them, which has caused injury to the claimants', is not applicable to the case as the Respondent has explained in the order the reasons for issuance of the order beyond the prescribed time limit. Referring to Doogar's case (supra) relied on by the Appellant's Counsel, she stated that the Tribunal in the said order had stated that "on bar of limitation on the ground that the order was issued after 30 days from the date of the reply to the show cause notice, it is to be noted that the scope of the expression "reply" in sub regulation 3 of

regulation 40 cannot be restricted only to written reply to the show cause notice. Oral submissions are also to be treated as replies. Since the order was issued within 30 days of the completion of the oral submission, it cannot be said that the order was issued beyond the time limit prescribed in regulation 40(3) of the 1992 Regulations". She submitted that in the light of the above observation the 30 days time limit has to be reckoned not with reference to the reply to the show cause notice but with the last hearing in the matter.

I have very carefully considered the rival contentions of the parties and my views thereon are as follows. Since the learned Counsel for the Appellant has challenged the very validity of the order on the ground of bar of limitation, it is felt that this objection has to be examined and decided first before going to the challenge on merits.

It is on record that the impugned order whereunder the Appellants′ registration with the Respondent as stockbroker was suspended for 3months, was made by the Chairman of the Respondent on 26.12.2001 in terms of regulation 29(3) of the Regulations. As mentioned in the introductory para in this order detailing the background leading to the filing of the present appeal, the Respondent is empowered to appoint one or more persons as inspecting authority to undertake inspection of the records of the stock brokers for any purpose specified in sub regulation (2) of regulation 19. Regulation 22 requires that "the inspecting authority shall, as soon as may be possible, submit an inspection report to the Board". Regulation 23(1) stipulates that "Board shall after consideration of the inspection report communicate the findings to the stock broker to give him an opportunity of being heard before any action is taken by the Board on the findings of the inspecting authority". As per sub regulation (2) " on receipt of the explanation, if any, from the stock broker, the Board may call upon the stock broker to take such measures as the Board may deem fit

in the interest of the securities market and for due compliance with the provisions of the Act, rules and regulations. Regulation 25 enumerates the liabilities for action in case of default and regulation 26 refers to the violations, which would attract the penalty of suspension. Sub regulation (2) refers to the circumstances in which cancellation of the certificate of registration is permissible. Regulation 28 states that no order of penalty or suspension or cancellation shall be imposed except after holding an inquiry in accordance with the procedure specified in the regulation. In the proviso to the regulation the requirement of inquiry in certain cases to precede suspension or cancellation has been dispensed with. Regulation 28 prescribes the manner of holding inquiry, that in terms of sub regulation (7) the "enquiry officer shall, after taking into account all relevant factors and submissions made by the stock broker, submit a report to the Board and recommend the penalty to be awarded as also on the justification of the penalty proposed in the notice. Regulation 29 on "show cause notice and order" on which the Counsel has harpened considerably reads as under:

> "29(1) On receipt of the report from the enquiry officer, the Board shall consider the same and issue a show cause notice as to why the penalty as it consider appropriate should not be imposed
>
> (2) The stockbroker shall within twenty-one days of the receipt of the show cause notice send a reply to the Board
>
> (3) The Board after considering the reply to the show cause notice, if received, shall as soon as possible but not later than thirty days from the receipt of the reply, if any, pass such order as it deems fit
>
> (4) Every order passed under sub regulation (3) shall be self-contained and give reasons for the conclusions stated therein including justification of the penalty

imposed by that order.

(5) The Board shall send a copy of the order under sub regulation (3) to the stock brokers, the stock exchange of which the stock broker is the member

As per regulation 31 "the order of suspension or cancellation of certificate passed in sub-regulation (3) of regulation of 29 shall be published in at least two daily news papers by the Board".

It is on record that the Appellant had replied to the show cause notice on 19.6.2001 and also had requested for a personal hearing and the personal hearing was given on 18.7.2001. The Respondent has referred to a letter dated 7.8.2001 from the Appellant and stated that in the light of the said letter the decision was taken by the Respondent to give the Appellant another opportunity of hearing on 24.10.2001 and that it sent a communication to this effect on 27.9.2001. A copy of the Appellant's letter dated 7.8.2001 is found as Exhibit 6 to the appeal. I have perused the said letter and find no request from the Appellant therein seeking any further opportunity to present his case. On the contrary the Appellant, for the reasons stated in the said letter had requested the Respondent to drop the enquiry proceedings and promised to pay the dues to SEBI immediately on hearing from it. The Appellant had also stated therein that "in case any clarification is sought from our end we shall be pleased to furnish the same as and when called for". The letter dated 27.9.2001 from the Respondent to the Appellant in this context is also relevant. The text of the said letter is extracted below:

"Sub: Personal hearing with the Chairman, SEBI

This has reference to your letter dated August 07, 2001, Chairman, SEBI is pleased to grant you personal hearing at 11.30 a.m. on October 24, 2001. You are advised to remain present at SEBI, Mittal Court, B-Wing, 224,Nariman Point, Mumbai on the scheduled

date and time"

The Respondent's submission that the hearing on 24.10.2001 was fixed at the instance of the Appellant is not supported by facts available on record. It was a suo motu decision. The letter dated 27.9.2001 does not in any way help to strengthen the Respondent's case in this regard. In fact it is seen that the Appellant vide his letter dated 20.10.2001 (issued even before the scheduled date of hearing), which is available at Exhibit 8 to the appeal, had written to the Respondent in reply to its letter of 27.9.2001 as under:

"Ref: Your letter No. SMD/DBA-I/ENQ/AM/37589/2001 Dt. 27/9/2001

Dear Sir,

We are in receipt of your above cited letter and have noted the contents with great surprise, by now, i.e. after 3 months instead of dropping the matter, you have fixed personal hearing for the reasons best known to you. In this regard, we wish to submit as under:

Your kind attention is drawn to the personal hearing held on 18.7.2001 before the Chairman and our letter dt.7/8/2001, by way of which, we have clarified our stand. Against our reply, no further queries have been raised from your end, this implies that you are convinced with our statement.

You are requested to kindly refer sub regulation (3) of Regulation 29 of SEBI (Stock Brokers and Sub Brokers regulation 1992) which states that:

"the board after considering the reply to the show cause notice, if received , shall as soon as possible, but not later than 30 days from the receipt of reply, if any, pass such order as it deems fit".

as such since you have been silent during the prescribed period it is deemed that you are satisfied with our reply and accordingly the proceedings have been dropped.

It would worth mentioning that during the course of enquiry for almost three years we have always extended our fullest cooperation, we have attended personal hearing before the enquiry officer and Chairman, inspite of bad health and financial constraints. It is painful that instead of dropping the case, date has been fixed arbitrarily.

Under the circumstances stated above, you will appreciate that under the SEBI Regulations proceedings are barred by limitations and hence, you are requested to drop the proceedings for which we shall remain grateful.

We stand to cooperate with SEBI at all times."

From the letters referred to above it is clear that the Appellant never wanted any hearing after 18.7.2001 i.e. the date on which the Respondent heard the Appellant. The Respondent's averment in its reply to the appeal that "as the date of hearing was fixed on 24.10.2001, on which date the Appellant failed to appear and submissions from him were awaited, the impugned order was passed beyond 30 days from the last date of hearing. Even assuming that the order was passed beyond 30 days from the date of hearing, the same does not vitiate the order" is difficult to accept. There is "no waiting time" as such as per regulation 29(3) once the reply is received. The "reply" as held by this Tribunal in Doogar's case (supra), can be oral submissions as well.

The question that need be considered in this context is whether the impugned order was passed beyond the 30 days time stipulated in regulation 29(3) and in case the answer is in the affirmative, whether such an order is

illegal.

The relatable date to compute the 30 days stated in the regulation is 18.7.2001 or 24.10.2001 is not of much significance as by taking either of the said dates, it would be seen that the order being made on 26.12.2001 is clearly beyond the 30 days time prescribed in regulation 29(3). The extent of the delay i.e. whether it is four months or one month is of no significance, as the question is whether any delay is permissible beyond the stipulated 30 days. There is no provision in the Act to condone the delay. Having thus come to the conclusion that the order was passed beyond the prescribed time, the next question is as to whether the time limit provided in regulation 29 (3) is only directory or mandatory. If it is directory the delay is not fatal. But if it is mandatory, the delay is fatal. For this purpose one has to take into consideration the consequences flowing from the order and the nature of command behind the requirement.

According to regulation 29(3) the requirement as already mentioned is that the Board after considering the reply to the show cause notice, if received, is mandated, as soon as possible but not later than thirty days from the receipt of the reply to pass such order as it deems fit. The portion "shall as soon as possible but not later than thirty days from the receipt of the reply, if any" in the regulation is of considerable significance. In this context it has to be noted that the Regulation has prescribed time limit for action by the Respondent for different purposes. Regulation 8(4) requires the Respondent to communicate its decision "as soon as possible" in a representation received against refusal to grant registration. Similar provisions are in regulation 13(4) relating to refusal of registration as sub brokers. According to regulation 16A on receipt of an application for registration in the Derivative Segment etc., "derivatives exchange or segment or clearing house or corporation as the case may be shall forward the application (received from the

applicant seeking registration) to the Board as early as possible but not later than thirty days from the date of its receipt". Regulation 16E(4) provides that "the Board shall reconsider an application made under sub regulation (3) (reconsidering the decision not to grant the certificate) as soon as possible…….". In terms of regulation 22 the inspecting authority appointed by the SEBI is required to submit its report as soon as may be possible. Regulation 28(7) requires the enquiry officer to submit a report to the Board. But no time limit has been prescribed in the regulation for submitting the enquiry report. The regulations also provide time frame to file the reply to show cause notice within twenty-one days of the receipt of the show cause notice. The Regulations are made by the Respondent for the purpose of the Act. In this context it has been noted that in several other Regulations notified by the Respondent for regulating the activities of the market intermediaries, etc., time limit for suspension or cancellation of the certificate of registration has been prescribed uniformly that "the Board after considering the reply to the show cause notice , if received, shall as soon as possible but not later than 30 days from the receipt of the reply, if any, pass such orders as it deems fit". Such identical provisions are in the SEBI Regulations for (1) Merchant Bankers, (2) Bankers to an Issue), (3) Debenture Trustee, (4) Foreign Institutional Investors, (5) Under Writers, (6) Registrars to an Issue and Share Transfer Agents, (7) Portfolio Managers (8) Custodian of Securities etc. In the SEBI Regulations relating to Mutual Funds, Venture Capital Funds, Foreign Venture Capital Investors etc., the requirement to pass the suspension or cancellation order is that "the Board after considering the reply, if any, shall as soon as possible pass such order as it deems fit. So it is clear that wherever the Regulator felt that the time frame is to be strictly adhered to, it gave an option to the authority to decide the matter as soon as possible, but mandated not to go beyond 30 days. Addition of the words "but not later than 30 days" disables the authority to stretch the time limit beyond the prescribed time. In this case it is also to be noted that the

suspension or cancellation order of a market intermediary in the event of proven charges of default / misconduct is not a matter to be delayed inordinately from the investors protection angle, as to allow such a person to carry on business activity as intermediary unpunished, even after a finding of fault, is not a matter to be considered healthy for the development of the securities market. The requirement of quick decision within a month is in public interest. It is for this reason that the Regulation has specifically put the time limit to pass the order of suspension or cancellation. It is a mandatory requirement, which the Respondent cannot ignore, but adhere to. There is no provision for condonation of delay in this regard in the Act or the rules or regulation.

According to Blacks Law Dictionary the word ‘mandatory’ means –‘ containing a command, preceptive, imperative, peremptory, obligatory"-. "Mandatory statutes – General term describing statutes which require and not merely permit a course of action. They are characterised by such directives as shall and not "may". A mandatory provision in a statute is one the omission to follow which renders the proceedings to which it relates void, while a directory provision is one the observance of which is not necessary to validity of the proceeding. It is also said that when the provision of the statute is the essence of the thing required to be done, it is mandatory, Kavanaugh V Farh, CCA .Okl; 74 F.2d 435, 437; otherwise when it relates to form and manner, and where an act is incident, or after jurisdiction acquired, it is directory merely". "Mandatory statutory provision is one which must be observed, as distinguished from "directory" provision which leaves it optional with department or officer to which addressed to obey it or not".

An act done in breach of a mandatory provision will be invalid but if the provision is directory the act will be valid although the non-compliance may give rise to some other penalty if provided by the statute (Rubber House

Vs. Excellsior Industries Pvt.Ltd – AIR 1989 SC 1160 p. 1165).

The use of the word "shall" in the sub regulation also strengthens the view that the requirement is mandatory. In this context it is to be noted that in regulation 26, dealing with the Boards power to grant penalty, discretion has been given for imposing the penalty as the regulation stipulates that "a penalty of suspension of registration of a stock broker may be imposed". So is the case with reference to awarding penalty of cancellation also. But in contradistinction to this, sub regulation 3 of regulation 29 has used the word shall. The legislative intent is thus clear. Hon'ble Supreme Court has held in several cases (see, T.R. Sharma v. Prithipal Singh AIR 1976 SC 367 p. 370) that the use of the word "shall" with respect to one matter and use of the word "may" with respect to another matter, in the same section of a statute, will normally lead to the conclusion that the word "shall" imposes an obligation whereas the word "may" confers a discretionary power. The Hon'ble Supreme Court in Sainik Motors v. State of Rajasthan (AIR 1961 SC 1480 p. 1485) had observed that the word "shall" is ordinarily mandatory, but it is not so interpreted, if the context or the intention otherwise demand". In the context and intention of sub regulation 3 of regulation 29 it is difficult to view that the word "shall" in the regulation should be interpreted to mean "may".

The mandate in regulation 29(3) is clear and unambiguous. The order required to be issued under regulation 29(3) is in public interest. The inquiry envisaged therein is an adversarial one. The effect of the order is also clear. It adversely affects the rights and obligations of the Stockbroker. In this context the legislative intent is manifest in the words requiring the order to be passed as soon as possible but not later than thirty days. The emphasis to adhere to the requirement of issuing early order comes from the words 'but not later

than 30 days' used in the regulation. If there was no such intention, these words would not have been put in there, as is seen in the regulations relating to Mutual Funds, Venture Capital Funds etc. By providing the outer time limit specifically, the legislature wanted the order to be passed in any case within 30 days if not possible at an early date. In this context it is also to be noted that an order under regulation 29(3) is of serious consequences affecting the right to carry on business by stockbrokers. It is also important from the angle of investor protection. In this context the provisions of regulation 31 is also to be noted which requires the order of suspension or cancellation of certificate passed in sub regulation (3) of regulation 29 to be published in at least two daily news papers by the Board. This requirement is indicative of the importance of the order making it known to the public. The Respondent has not made any submission as to in what way the order passed beyond the prescribed time limit is protected, which is against the specific requirement in the regulations. The main thrust of the Respondent's submission was that the order was passed within the time limit. But this submission is contrary to the facts available on record. There is no explanation from the Respondent's side as to in the light of the Appellant's letter dated 22.10.2001 and non-appearance of the Appellant for hearing on 24.10.2001, why the order was not made within the time limit of 30 days therefrom. Even for argument sake, 22.10.2001 or still 24.10.2001 is taken as the date of hearing, still the order should have been issued by 24.11.2001 whereas the order was actually issued only on 26.12.2001. Taking into consideration the strictly binding mandatory provisions of regulation 29(3) and the fact that the impugned order was passed beyond the prescribed time limit of 30 days I am inclined to agree with the submission made by Shri Merchant that the order is bad and cannot survive. Therefore the order deserves to be set aside.

Since the appeal can be disposed of on the sole ground

discussed above, it is felt not necessary to consider other grounds on which the impugned order has been assailed.

For the reasons stated above, the appeal is allowed and the impugned order is set aside.

(C.ACHUTHAN)
PRESIDING OFFICER

Place: Mumbai
Date: January 24, 2002