BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No.58 of 2012

Date of Decision: 1.10.2012

India Infoline Securities Limited
(merged with India Infoline
Limited w.e.f. February 02, 2007)
IIFL House, Sun Infotech Park,
Road No.16V, Plot No.B-23,
MIDC, Thane Industrial Area,
Wagle Estate, Thane – 400 604. …… Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. …… Respondent

Mr. Joby Mathew, Advocate for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Mobin Shaikh, Advocate for the Respondent.

CORAM : P. K. Malhotra, Member & Presiding Officer (*Offg*.)
S.S.N. Moorthy, Member

Per : S.S.N. Moorthy

The appellant is a public limited company incorporated under the Companies Act, 1956. It is a corporate member of the Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE) and is registered with the Securities and Exchange Board of India (for short the Board) as a stock broker. The present appeal arises out of an order passed by the adjudicating officer of the Board imposing a penalty of ` 5 lacs under section 15HB of the Securities and Exchange Board of India Act, 1992 (the Act). The appellant was found guilty of violating the provisions of clause A(1) and A(2) of the code of conduct as specified under schedule II read with regulation 7 of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations 1992 (hereinafter referred to as Brokers Regulation). The adjudicating officer concluded that the appellant, a broker, failed to maintain integrity and exercise due skill and care

by allowing one Sunil Mehta to trade on behalf of his mother Usha Mehta without due authorization.

2. The Board conducted investigation in the dealings in the scrip of Asia Star Company Limited (the company) for the period October 10, 2008 to November 20, 2008. The rise in the price of the scrip of the company during the investigation period as against the general fall in sensex generated suspicion in the trades. The investigation revealed that certain entities of one Mehta group were indulging in circular/reversal/synchronized trades to create artificial volumes in the scrip and the kingpin of the trades was one Sunil Mehta. Usha Mehta, mother of Sunil Mehta, was a client of the appellant broker. During the impugned period the appellant broker allowed Sunil Mehta to operate the account of his mother and engage in the transactions in the scrip of the company which resulted in manipulation of the price of the scrip. So the Board alleged that the appellant had acted in violation of the code of conduct prescribed for stock brokers and for that penal action was warranted. A show cause notice was issued on December 9, 2010. The appellant filed a reply denying all the allegations. This was followed by a personal hearing in which the request regarding statements obtained from Sunil Mehta and other similar documents was sorted out. The appellant filed further written submissions defending its stand claiming that there was no foul play in the operation of Usha Mehta's account by her son and the appellant had taken all possible care and diligence in the operation of the account after obtaining necessary credentials about the identity of the client. The adjudicating officer, after careful consideration of the submissions put forward by the appellant, held the appellant guilty of violating the code of conduct for stock brokers and imposed a sum of ` 5 lacs as penalty. Hence this appeal.

3. We have heard Shri Joby Mathew, counsel for the appellant, and Shri Shiraz Rustomjee, learned senior counsel for the respondent, who took us through the records of the case.

4. It is submitted by the appellant's learned counsel that as a stock broker the appellant has exercised proper due diligence at the time of registration of the client by verifying the credentials of Usha Mehta after taking all precaution as excepted in the

regulations. The identity of Usha Mehta was properly verified from necessary and valid documents and the appellant had no reason to suspect the trades carried out by Usha Mehta. There was no default in any of the transactions in her account and the trades were conducted in the normal course after providing for sufficient margin and observing the pay out details in time. It is contended that the appellant has allowed Sunil Mehta, son of Usha Mehta, to trade on her behalf in a truthful and bonafide manner since all the transactions were in the normal course of trade and no default or foul play was noticed in the dealings of Sunil Mehta. It is submitted that the son was acting on the behalf of the client as duly authorized by her, though verbally. According to the appellant, the only wrong doing, if any, in this case is the failure to obtain written authorization from Usha Mehta in favour of her son. The appellant had no knowledge about the hidden agenda of Sunil Mehta since the obligations on the trades were discharged duly without giving room for any suspicion. According to the appellant's learned counsel, the adjudicating officer has singled out the scrip of the company for investigation even though the client of the appellant traded in 17 other scrips and no wrong doing was noticed in any of the cases. It is submitted that all trades were accepted by the client, Usha Mehta, and no damage has been done to the market. The appellant's learned counsel observed that there is no statutory mandate for obtaining written authorization and this cannot be made a ground for questioning the integrity of the stock broker when it had no knowledge about the activities of the Mehta group. It is submitted that Usha Mehta, a resident of Udaipur, after opening a trading account with the appellant gave an oral authorization in favour of her son Sunil Mehta, who was based in Bombay. The bank account was in the joint names of Usha Mehta, her son Sunil Mehta and her husband Gyan Chand Mehta. Being family members and finding no deficiencies in the trading pattern of the client the appellant considered the oral authorization to be adequate and appropriate. With reference to the direction given by the appellant to Usha Mehta for providing written authorization in favour of Sunil Mehta, it is contended that the appellant had taken due care in complying with the provisions of the regulations. It is admitted that written authorization was not filed by the client inspite of reminders. It is argued that there was no ground for alleging lack of due care and skill against the

appellant in the background of the facts that the trades of the client were normal and the appellant had acted in good faith accepting the oral authorization of the client.

5. The learned senior counsel appearing for the Board submitted that there was breach of the fundamental duty of due care and diligence as envisaged from a broker. The failure to obtain written authorization on behalf of Sunil Mehta is a vital deficiency and the appellant has acted in violation of the regulations provided for member-client agreement. Member-client agreement is backed with the statutory force contained in the regulations and any failure to observe the norms laid down in the member-client agreement should be regarded as a gross failure on the part of the broker. It is essential for a broker not only to know the client but also to ensure that the trades are put in by the client as per the provisions of the regulations and one cannot be allowed to trade on behalf of a registered client without written authorization and any such lapse cannot be brushed aside as a minor technical breach. With a reference to the structured deals engineered by Sunil Mehta in the present case it is argued that the appellant failed to observe the mandate of the code of conduct and the structured deals could have been detected if the appellant had acted with due care and diligence. According to the learned senior counsel for the respondent, there is a fundamental breach of the code of conduct prescribed for brokers and penalty must follow. A reference is made to the decision of the Supreme Court in the case of SEBI vs. Shri Ram Mutual Fund [2006] 68 SCL 216 (SC).

6. We have considered the rival submissions. For a proper appreciation of the contentious issue in this matter a reference to provisions of the regulations as contained in the Brokers Regulation is necessary. The relevant provisions of the regulation are extracted below for ease of reference:

> **"Stock-Brokers to abide by Code of Conduct.**
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> **7.** The stock broker holding a certificate shall at all times abide by the Code of Conduct as specified in Schedule II.
>
> **SCHEDULE II**
>
> **Code of Conduct for Stock Brokers**
>
> **A. GENERAL**
> (1) INTEGRITY: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

> (2) EXERCISE OF DUE SKILL AND CARE: A stock-broker shall act with due skill, care and diligence in the conduct of all his business."

7. The role of a stock broker is significant in maintaining the integrity of the stock market. So it is essential to abide by the mandate in the code of conduct prescribed for stock brokers.

8. In the present case, the trading account of Usha Mehta was admittedly operated by her son Sunil Mehta. It is not in dispute that there was no written authorization from Usha Mehta allowing her son to operate the trading account. The appellant has admitted that it has acted on the verbal authorization of Usha Mehta. It is not a case where the appellant is not conscious of the need for a written authorization for trades to be done on behalf of another person. The only defense of the appellant is that it acted in good faith taking into account mother son relationship of the family and timely settlement of accounts by the client without giving room for any doubt in his conduct. However, the reply given by the appellant as regards the authorization reveals the fact that the appellant was conscious of the requirement of a written authorization. In this context, it is necessary to refer to the reply furnished by the appellant which is part of the impugned order.

> "b) Account of Ms. Usha Mehta was opened in August 2008 after completing all the KYC formalities. At the time of account opening, Ms. Usha Mehta gave a verbal authorization in favor of her son Mr. Sunil Mehta to place and execute orders on her behalf in her trading account with us. Later as per the internal policy, the client was requested to provide written authorization in favor of her son, which the client had verbally
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> confirmed to provide. Several follow-ups were have been done with the
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> client since then for the written authorization by our Relationship Manger, however the client has failed to submit the same. We reiterate that the client's account was opened by us after completing all the KYC requirements and we had continuously followed up with the client for submitting the written authorization in favor of her son Mr. Sunil Mehta as per our internal requirements. There was no exception granted to the client we had repeatedly tried to get 'authorization to place and receipt of document' letter from the client which the client failed to provide."

9. The learned senior counsel appearing for the Board drew our specific attention to the Know Your Client (KYC) documents filed by Usha Mehta and the member client agreement. Admittedly, the appellant has insisted on necessary KYC documents for

establishing the identity of Usha Mehta. However, in the declaration attached to the account opening form of Usha Mehta it is declared that "the first holder is the sole signatory or authorized to operate the trading account". The appellant has, obviously deviated from this declaration of the appellant. It may be true that the appellant was guided by family relationship and oral authorization given by Usha Mehta. The broker client agreement issued by the Board in conformity with the requirements of the regulations relating to conduct of stock brokers lays down the following two clauses which are relevant to the issue at hand:-

> "The stock broker and the client declare and agree that the transactions executed on the Exchange are subject to Rules, Byelaws and Regulations and circulars issued thereunder of the Exchange and all parties to such trade shall have submitted to the jurisdiction of such court as may be specified by the Byelaws and Regulations of the Exchange for the purpose of giving effect to the provisions of the Rules, Byelaws and Regulations of the Exchange and the circulars issued thereunder.
>
> The instructions issued by an authorized representative, if any, of the client shall be binding on the client in accordance with the letter authorizing the said representative to deal on behalf of the said client."

The broker client agreement has got a statutory force since it is meant for observing the rules, bye-laws, regulations and circulars issued by the Exchange. In respect of instructions issued by an authorised representative specific reference is made to the letter authorising the said representatives. Therefore, it cannot be held that there is no requirement to obtain a written authorisation. In other words, a written authorisation is necessary to allow a third person to trade on behalf of the client of the broker. Facts contained in the reply quoted hereinabove would also show that the appellant was aware of the requirements to obtain written authorisation and it continuously followed up with the client for submitting the same. This was not complied with by the client. The adjudicating officer, after verification of the records of the case and the reply filed by the appellant, held that the appellant failed to follow the standard policy of obtaining written authorisation for allowing Sunil Mehta to trade on behalf of his mother. In the show cause notice also while framing the allegation against the appellant it is has been brought on record that the appellant failed to submit before the investigating authority any authority letter from Usha Mehta authorising her son Sunil Mehta inspite of specific

undertaking to submit the same. It may be true that the appellant has taken on record all documents on the basis of KYC norms for opening the trading account of the client. But, however, in allowing Sunil Mehta to trade on behalf of his mother who is the client, the appellant has not complied with the requirements of due diligence, skill and integrity required of a broker. We cannot accept the view of the appellant that by verifying the credentials of the client the appellant had discharged the onus of acting with care, due diligence and skill. The submission of the appellant in the grounds of appeal that verbal authorisation is a valid authorisation cannot be accepted especially in the light of the clause in the member client agreement referred to hereinabove. According to the appellant's learned counsel, written authorisation is a requirement between the client and the broker and it has no relevance to the market. In other words, it is not meant for protection of the market but to regulate the relationship of the broker and the client. Be that as it may, the requirement of written authorisation when the trades are undertaken by a third person cannot be wished away. It has the backing of the rules and regulations and so the broker is bound to abide by the requirements.

10. We had occasion to peruse the statement recorded from Shri Dinesh M. Tanwar of the appellant company on March 22, 2010 in connection with the dealings of Usha Mehta and Sunil Mehta. To a specific question regarding authority letter from Usha Mehta the following reply is given:

> "Q7. Have you taken authority letter for placing of order by Sunil Mehta from Usha Mehta? If yes provide a authenticated copy.
>
> A.7 We had taken authority letter for placing order by Sunil Mehta from Usha Mehta, further the authenticated copy provided by March 29, 2010."

Further, from the records it is clear that no such authority letter was filed as undertaken.

11. The appellant's learned counsel referred to the decisions of this Tribunal in the case of Networth Stock Broking Ltd. vs. Securities and Exchange Board of India Appeal no.5 of 2012 decided on June 19, 2012 and Saroj and Company vs. The Adjudicating Officer, Securities and Exchange Board of India Appeal no.213 of 2011 decided on May 18, 2012. It was submitted that the broker cannot be held responsible for the wrong doings of the client. The present case is not in pari materia with the decision cited by the appellant's learned counsel and so it is not necessary to consider the decision in those

cases. The appellant's learned counsel also submitted a few cases passed by the whole time member of the Board. In those cases also the facts are not strictly comparable to the facts of the present case.

12. In the grounds of appeal the appellant has made a reference to the judgment of the Bombay High Court in Tri-Sure India Ltd. vs. A.F. Ferguson and Co & Others. M.L. Pendse October 24, 1985 to substantiate the degree of skill and due diligence. However, the judgment may not be strictly relevant to the facts of the case since it relates to the responsibility of an auditor.

13. Since the appellant did not comply with one of the fundamental requirements of member client relationship we hold that the appellant has failed to exercise due diligence and failed to act with integrity, care and skill as laid down in the stock brokers regulations. So the appellant has defaulted in complying with the stock brokers regulations and penalty is called for. As held in the case of SEBI vs. Shri Ram Mutual Fund [2006] 68 SCL 216 (SC) by the Hon'ble Supreme Court penalty must follow once the guilt stands established.

In view of the discussion above, the order of the adjudicating officer is upheld. Appeal dismissed. No costs.

Sd/-
P.K. Malhotra
Member &
Presiding Officer (*Offg*.)

Sd/-
S.S.N. Moorthy
Member

1.10.2012
Prepared and compared by
RHN