BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved on : 23.09.2013
Date of Decision : 28.10.2013

Appeal No. 151 of 2013

1. Grishma Securities Private Limited
92/04, Nirbhay Niwas,
Bhaudaji Cross Road, 10#,
Matunga, Mumbai – 400 019.

2. Mihir Ghelani
92/04, Nirbhay Niwas,
Bhaudaji Cross Road, 10#,
Matunga, Mumbai – 400 019.

3. Ketan Shah
92/04, Nirbhay Niwas,
Bhaudaji Cross Road, 10#,
Matunga, Mumbai – 400 019.

4. Chandrika H. Gandhi
92/04, Nirbhay Niwas,
Bhaudaji Cross Road, 10#,
Matunga, Mumbai – 400 019.

5. Chhabil C. Shah
92/04, Nirbhay Niwas,
Bhaudaji Cross Road, 10#,
Matunga, Mumbai – 400 019. …… Appellants

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. Somasekhar Sundaresan, Advocate with Mr. Ravichandra S. Hegde, Mr. Abishek Venkatraman, Ms. Arti Raghavan, Advocates for the Appellants.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Mihir Mody, Mr. Pratham Masurekar, Advocates for the Respondent.

CORAM : Justice J. P. Devadhar, Presiding Officer
Jog Singh, Member
A. S. Lamba, Member

Per : Jog Singh

The present appeal is preferred by five appellants against the impugned order dated July 31, 2013 passed by the respondent under Sections 11(4) and 11B of the SEBI Act, 1992 read with Regulation 11(1) of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003. By the said order, the learned Whole Time Member (WTM) has restrained the appellants from buying, selling or otherwise dealing in securities in their proprietary accounts, directly or indirectly for a period of five years. A period of one year and seven months of restraint already undergone by the appellants is to be deducted from the period of five years. However, the restraint already imposed by ad-interim ex-parte order dated December 28, 2011 in respect of appellants' stock broking business is to continue till the completion of the enquiry proceedings which are directed to be finalized expeditiously. It is also mentioned in the impugned order dated July 31, 2013 that no observation and/or finding contained in it shall influence the enquiry officer in finalizing the enquiry report.

2. Appellant no. 1, namely, Grishma Securities Pvt. Ltd., hereinafter referred to as "Grishma", is a company incorporated under the Companies Act, 1956 and is registered with the respondent as a stockbroker with effect from February 29, 2000. Appellant no. 2, Mr. Mihir Ghelani, is the Chief Executive Officer of appellant no. 1. Appellant no. 3, Shri Ketan Shah, is the Managing Director of the appellant no. 1. Appellant nos. 4 and 5, namely, Chandrika H. Gandhi and Mr. Chhabil C. Shah are the directors of Appellant no. 1.

3. Briefly stated the facts of the case are that one listed company, namely, Tijaria Polypipes Limited, hereinafter referred to as “TPL”, came out with an Initial Public Offering (IPO) of one crore equity shares of a face value of ₹ 10/- each, issued at a premium of ₹ 50/- per equity share. This appears to have been done by the company with a view to mobilize funds to the tune of ₹ 60 crore for expenses related to expansion and diversification plans of its business. The IPO was opened on September 27, 2011 and closed on September 29, 2011. It was reportedly over-subscribed to the extent of 1.2 times of the offering. TPL allotted about 71 lac shares in the retail individual investors’ category i.e. 71.64 percent of the total IPO shares. Similarly, about 28 lac shares were allotted to Qualified Institutional Buyers (QIBs), i.e. 28.36 percent of the total IPO shares which were listed on the Bombay Stock Exchange (BSE) as well as the National Stock Exchange of India Ltd. (NSE).

4. Finding a steep fall in the share price of the scrip of TPL on the very first day of listing i.e. October 14, 2011, the respondent conducted a preliminary investigation into the trading of the scrip in question which prima-facie revealed that the share price of TPL in NSE fell from ₹ 67.75 to ₹ 16.50 per share while on the BSE it fell from ₹ 67.80 to ₹ 16.05 per share. The preliminary investigation also revealed that TPL through layered transactions diverted a substantial part of its IPO proceeds in order to offset losses sustained by certain investors, who had allegedly purchased shares form retail allottees/QIBs in the IPO at a premium. Appellant no. 1 was found to be the stockbroker for one Mr. Jivraj Zala who alone traded to the tune of ₹ 60 crore on the very first day of the listing of the shares. Grishma was also found to have facilitated such trading by Zala alongwith other investors/entities.

5. Under such circumstances, an ad-interim ex-parte order dated December 28, 2011 came to be passed by the respondent by which several entities including the appellants were restrained from buying, selling or dealing in securities in any manner whatsoever. After affording an opportunity of personal hearing to the appellants on July 31, 2012 and considering their reply, the respondent confirmed the said ad-interim ex-parte order on November 5, 2012.

6. The appellants challenged the ad-interim ex-parte order dated December 28, 2011 by way of Appeal no. 209 of 2012 before this Tribunal which was dismissed by order dated November 19, 2012 as ad-interim ex-parte order had already been confirmed by the respondent by order dated November 5, 2012 under Sections 11 and 11B of the SEBI Act, 1992. The appellants also took a plea regarding discrimination that some other brokers and entities who dealt in the scrip and against whom directions were issued vide ad-interim ex-parte order dated December 28, 2011 was revoked whereas the same was confirmed and continued in respect of appellants. While dismissing the said appeal this Tribunal pertinently observed that :-

> "8. We are of the view that the whole time member has passed the order dated November 5, 2012 after considering the submissions made by the appellants and has recorded sufficient reasons for continuation of the impugned order. **Simply because interim order has been revoked against other brokers, it cannot be a ground for revoking the interim order against the appellants. It depends on the role played by them in manipulation of the scrip of the company.** It is not in dispute that Sections 11/11B of the Act empower the Board to restrain any person from accessing the securities market and prohibit any person associated with the securities market to buy, sell or deal in securities either pending investigation or enquiry or on completion of such investigation or enquiry in the interest of investors or securities market. The appellant company has acted as broker to Zala and Dave in the trading of the scrip of the company done on October 14, 2011 which has allegedly manipulated the market and induced gullible investors to invest in the shares of the company. This conduct is under investigation. After considering the response received from the

> appellants the whole time member of the Board has come to the *prima-facie* conclusion that appellants have failed to act in accordance with the provision of the regulations in its dealings with its clients. The investigation is over and the Board is likely to issue a show cause notice within next two weeks. The whole time member has brought on record sufficient justification for continuation of interim order against the appellants. We are convinced that no case for intervention by the Tribunal at this stage is made out."

7. The case of the appellants is that they have been treated by the respondent in an arbitrary manner which represents a complete break-down of the rule of law inasmuch as they have been deprived of their fundamental right to carry on an economic activity, business, trade and commerce. First, an ex-parte ad-interim order dated December 28, 2011, was passed prohibiting the appellants from acting as a stock broker. This order was confirmed on November 05, 2012, and show cause notices were issued for holding enquiry proceedings, etc. against the appellants. The impugned orders have since been finalized on July 31, 2013 under Sections 11 and 11(b) of the SEBI Act by which the appellants have even been barred from undertaking proprietary trading for five years. In addition, the respondent has also initiated adjudication proceedings as well as enquiry proceedings, which may further lead to some punishment. This is being done on the same set of facts and evidence, therefore, it is not permissible in law. Moreover, firm findings have been given in the impugned order dated July 31, 2013, which vitiates the whole proceedings.

8. The next submission advanced by the appellants is that the only real case against them is that of alleged non-collection of margin as per law. In this connection, the appellants submit that in addition to the allegation of failure to collect margin as a gross misdemeanor, the respondent has also made a passing insinuation that the concerned client of the appellants could be a front for

Grishma. The appellants contend that this is a vague and unambiguous charge and it talks of appellants being facilitators at one place and perpetrators at the other. As for the appellants, these two prepositions cannot co-exist.

9. The appellants' moot defense in this regard is that Grishma merely acted as a Stock Broker for a client, namely – Mr. Jivraj Zala, hereinafter referred to as 'Zala', who traded as a client of Grishma after furnishing post dated cheques to the tune of ₹ 11.36 crore. One Mr. Chetan Dave, a client of Grishma, also acquired some shares of TPL from the allottees in the IPO. However, appellants have not traded at all in the share of TPL on their own account but only for the client. The appellants vehemently contended that the respondent has failed to consider their submission based on SEBI's circular dated February 23, 2005 regarding margin money. The appellants submit that they have the discretion on how much of such margin money should be collected from a client. The form and mode of collection also fall within the domain of appellants' discretion as a broker. Therefore, they have not committed any illegality by not collecting the margin money in advance before Zala was allowed to trade on October 14, 2011, and that the post dated cheques were encashed within next few days of the IPO. Similarly, diversion of the funds from other clients towards payment of margin for Zala's trade can also not be termed illegal. The appellants have also taken a plea that the impugned order is arbitrary to SEBI's own approach in similar other cases. A number of examples have been cited by the appellants to substantiate this contention. Similarly, it is submitted that restraints on those who were allegedly involved in diverting TPL's funds have since been lifted and the appellants have been treated differently and in a discriminatory manner.

10. The respondent contends that the appellants allowed to trade Zala on the very first day of opening of the IPO of TPL in question on October 14, 2011 to the tune of ₹ 66 Crore. In the process, he suffered a loss of ₹ 9.95 crore. No margin money was collected in advance by the appellants, exposing the whole system to a grave risk. The IPO funds received by TPL were transferred through layered transactions to certain persons, who had purchased TPL shares from retail allottees/QIBs on October 14, 2011, and sold them in the market on the same day, thereby sustaining heavy losses. The amounts transferred to these persons by TPL were utilized to offset losses sustained by them on account of their trading in the TPL shares. Such diversion of IPO proceeds constitutes a serious violation of FUTP Regulations and the appellants have played a crucial role in this illegal course of action as facilitators.

11. Appellants did not hold any fund or security of Zala by way of margin. 18 post- dated cheques, stated to have been received by the appellants on October 13, 2011, were realized only between October 15 and 24, 2011. In case of any default or dishonor of the cheque, Grishma was not covered in any way for the enormous risk arising out of such trades by Zala. It is further contended by the respondents that even circular dated February 23, 2005, provides that obtaining of margins is an important element of Risk Management System. Grishma admittedly did not obtain a proper margin prior to the trading by its client Zala. Similarly, said circular cannot be said to authorize the appellants to use securities or funds of a client for the purpose of some other client. This itself is illegal. The respondent has also distinguished other instances where SEBI/SAT is stated to have exonerated the brokers of somewhat similar charges.

12. We have heard the learned counsel for the parties at length and have minutely perused the pleadings and submissions made by the parties before us.

13. First, we may deal with the contention of the appellants that they have been treated in an arbitrary manner violating their Fundamental Right to carry on trade, etc., and that simultaneous enquiry and adjudication proceedings initiated on the same set of facts and allegations are impermissible. In this connection, we may note that Article 19(1)(g) of the Constitution does guarantee to all citizens of India a right to practice any profession, or to carry on any occupation, trade or business. At the same time, sub-clause (6) of Article 19 of the Constitution lays down in clear terms that nothing in Article 19(1)(g) shall affect the operation of any existing law insofar as it imposes reasonable restrictions on the exercise of such a right in the interest of general public. Nothing is pointed out by the appellants to demonstrate before us that the FUPT Regulations or the Broker's Code are in any way violative of Article 19(1)(g) by laying down any unreasonable restrictions on them. The FUTP Regulations and the Broker's Code have been enacted by the respondent only to protect investors' interest and to regulate the capital market which is the underlying philosophy in enacting the SEBI Act, 1992, constituting the Board to achieve these laudable objectives.

14. It is equally true that reasonable and non-arbitrary exercise of discretion is an inbuilt requirement of the law and hence any unreasonable or arbitrary exercise of such a power would violate the mandate of Article 14 of the Constitution of India. In the case in hand, however, we note that the impugned order has been passed by the learned WTM while exercising powers conferred on the Board by Section 11 of the SEBI Act, 1992, read with other provisions of the Act. Section 11 (1) empowers the Board to take such measures as it may deem fit in a given

case in order to protect the investors' interest in securities or to promote and regulate the securities market. Section 11(2)(b) specifically enjoins upon the Board to take appropriate measures for regulating the working of stock brokers, sub-brokers and other players or intermediaries associated with the securities market. Similarly, Section 11(4)(b) confers upon the Board a power to restrain persons from accessing the securities market and prohibit any person associated with the securities market to buy, sell or deal in the securities pending investigation or enquiry or on completion thereof. The only requirement is that such an order has to be in the interest of investors or the securities market. Similar is the tone and tenor of Section 11 (b) of SEBI Act, which deals with the power of the Board to issue directions.

15. Therefore, keeping in view the scheme of the SEBI Act, 1992, we have no hesitation in holding that a subjective decision as to when and where regulatory intervention is required is the sole prerogative of the regulator. Undoubtedly, such a decision has to be rational and is to be based on a prima facie and bonafide satisfaction as to the existence of certain alleged irregular or illegal facts/happenings or circumstances supposedly taking place or prevailing in the affairs of a company. We are convinced that the proceedings initiated against the appellants under Section 11 and 11(b) of the SEBI Act culminating into the impugned order dated July 31, 2013 do not suffer from any such legal infirmity in the peculiar facts of the present case in as much as there is no violation of any of the fundamental rights of the appellants as guaranteed by the Constitution.

16. In addition to these proceedings, the respondent has undertaken inquiry proceedings under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008. Adjudication proceedings as envisaged under Chapter VI-A of

the SEBI Act have also been initiated against the appellants pertaining to the incidents which took place on October 14, 2011, in the issuance of the IPO of TPL and the steep fall in the price of shares on the same day. It is pertinently noted that the adjudication proceedings may lead to monetary penalty or even exoneration of the appellants. Whereas, the enquiry proceedings have the potential of leading to appropriate disciplinary action against the appellants in case the charges are proved in the enquiry. There is no categorical challenge to such parallel proceedings. Therefore, it is purely hypothetical to pre-judge the issue at this stage that the Inquiry Officer or the Adjudicating Officer may be prejudiced by the observations/findings contained in the impugned order dated July 31, 2013.

17. The apprehension of the appellants in this regard is ill-founded inasmuch as the learned WTM, while exercising powers under Section 11 and 11(b) of the SEBI Act, has categorically noted that no observation or finding in the impugned order shall influence the Adjudicating or the Inquiry Officer, who should make an endeavor to finalize those proceedings expeditiously. Once an Inquiry Officer or an Adjudicating Officer is appointed as per law to conduct an enquiry into the alleged misconduct of a company or a market player, as the case may be, he or she acts as an independent, neutral and impartial umpire despite being on the rolls of the SEBI. As long as he holds such responsibility, he or she is supposed to perform a quasi-judicial task dispassionately. However, he or she has to conform to the principles of natural justice and also discharge the said functions within the parameters prescribed by the rules and regulations or an Act of Parliament failing which alone his or her findings or conduct may be questioned and not otherwise. Thus, we do not find any illegality in the impugned order in this regard as well.

18. Next, we may deal with the contention of the appellants regarding margins that as per SEBI's various Master Circulars, including circular dated February 23, 2005, it is the sole discretion of the appellant to decide the amount, form and mode of collection of the amount in this regard. Admittedly, Zala was a walk-in client. His trading account was opened just a week or two weeks before the IPO of TPL was opened for subscription. He was introduced to the Bank for the purpose of his bank account by Mr. Vimal Patel, who is also the client of Grishma. Zala's admitted gross annual income was in the range of ₹ 1 lac to ₹ 5 lac. Zala was permitted by the appellants to trade in the shares in question with such a meager income to the tune of ₹ 66 crore. In the process, he suffered a loss of about ₹ 10 crore on the very first day of trading. Records clearly reveal that appellants went out of their way to facilitate the said trades undertaken by Zala without any margin money. Zala was allowed to trade and use funds and securities belonging to other clients, Grishma itself and Mr. Mihir Ghelani, Grishma's Chief Executive Officer. The reason for showering such liberal favours upon Zala by the appellants only points out a needle of suspicion towards Grishma's conscious and possible role in the whole matter by not taking any margin and by accepting post-dated cheques from Zala and allowing him to trade enormously thereby exposing the capital market to a serious risk. Therefore, the Board, through learned WTM, has rightly intervened in the matter to nip the evil in the bud before it could have turned into a bigger scam.

19. The appellants cannot pick up a line from one of the circulars and interpret it in isolation to their advantage. While elaborating and streamlining a Comprehensive Risk Management Framework for the cash market, the SEBI circular dated February 23, 2005 lays greater importance on advance collection of margin by introducing a more stringent margining structure. This was done in the

light of experience gained in the past under various circulars issued by SEBI from time to time. The circular relied upon by the appellants has to be read in totality and also keeping in view the larger objective which it seeks to achieve. Similarly, there are subsequent Master Circulars by SEBI on the same subject issued on December 31, 2010, April 13, 2012 and April 17, 2013. A minute perusal of these Master Circulars does not suggest that the collection of margin is left to the sweet will of the members or stock exchanges. Margin money is a pre-requisite and the requirements laid down by SEBI from time to time in this regard are mandatory and not merely directory which can be flouted by a member as per his own subjective decision. Any transaction carried out by a member or a stock exchange without due regard to such margin requirement is liable to be interfered and struck down if found unjustified in the facts and circumstances of a given case.

20. Admittedly, when Zala traded in the shares on October 14, 2011, Grishma was not holding funds or securities of Zala by way of margin. According to Grishma, Zala provided on October 13, 2011, 18 or 19 post dated cheques, which were realized on October 15, 17, 19, 20, 21, 22 and 24, 2011. It is not in dispute that had these cheques been dishonoured, Grishma was not at all covered for the enormous risk arising out of the Zala trades. Such a practice or tendency has to be dealt with a heavy hand. Turning to the facts of the present case, we note that in order to provide its margins with the NSE and BSE clearing houses for the Zala trades, Grishma utilized funds and securities not from Zala but from the accounts of Vimal Patel, Ghelani and Grishma's own F&O Accounts. Therefore, even assuming that a broker has discretion to deposit margin money itself without collecting it from client, in the facts of present case, decision of appellant to permit walk in client with meager income to trade before collecting margin money that too to the tune of Rs. 66 crore in one day does not appear to be bonafide.

21. It is evident that the amount of ₹ 2.70 crore transferred by Grishma to NSCCL on October 14, 2011 was funded by Vimal Patel and Grishma. The amounts of ₹ 7,24,951/- and ₹ 1.20 crore transferred by Grishma to NSCCL on October 14, 2011 were funded by Mihir Ghelani. Similarly, the amount of ₹ 2.00 crore transferred by Grishma to NSCCL on October 17, 2011 was funded by Vimal Patel. Further, out of the securities worth approximately ₹ 2,53 crore brought in as part of the margin deposited by Grishma with NSCCL, ₹ 2.46 crore was in the form of 1,50,000 shares of Kwality Dairy Ltd. Those shares were also received by Grishma from Vimal Patel in an off-market transfer.

22. In the case of BSE margins also similar modus-operandi has been adopted by appellants. Cash and securities provided by Grishma by way of margin to cover the trades of Zala were again provided by Grishma, Ghelani and Patel. Two amounts of ₹ 50 lac each transferred by Grishma to the Clearing Corporation on October 14, 2011 were funded from Grishma's own accounts. The amount of ₹ 35,86,814/- transferred by Grishma to the Clearing Corporation on October 14, 2011 was funded by Ghelani.

23. In this respect, it may be pertinent to note that as regards securities of ₹ 1,27,48,297 provided as part of the margin by Grishma, the shares were previously pledged by Grishma with IL&FS Securities Services. These shares were withdrawn from IL&FS on October 12, 2011 and were pledged with the clearing corporation on October 13, 2011. This conduct prima facie shows that Grishma was putting margins in place for the anticipated losses that would be incurred in the Zala trades the next day. Out of these securities, 50,000 shares of Shasun Pharmaceuticals Ltd. and 66,697 shares of DB Realty Ltd. came from the accounts of Patel and two other clients of Grishma.

24. Lastly, cases decided by the SEBI and the SAT referred to by the appellants are distinguishable and are peculiar to their facts and circumstances. We have gone through the SEBI's orders in the cases of **Geojit BNP Paribas Finance and Securities Ltd. and Networth Stock Broking Ltd.** In both cases, the only allegation was that the broker had failed to exercise due care and diligence while permitting his clients to trade. It was observed in both orders that the brokers permitted the clients to trade only after their cheques were cleared and exposure was given only after they had sufficient credit balances. Further, the brokers had given the same level of exposure to all clients who were registered with them during the same period. The exposure provided to the clients was within the range of 8-10 times the margin/credit, which was as per the policy for all other clients and no exception was made for the clients in question. All of these factors clearly distinguish these cases from the present one.

25. In this Tribunal's order in **Bhoruka Financial Services Ltd. vs. SEBI [Appeal No. 18 of 2006 dated May 10, 2006],** SEBI had passed an interim order pending the commencement of investigations and giving findings on all issues against the appellant. It was held that this was not the proper stage for the recording of such findings since the matter was pending investigation. The restraint imposed by SEBI was, in fact, directed to continue pending the passing of a final order and only the detailed findings were set aside. This case has no application whatsoever to the present one where the investigation in the matter is complete and a final order has been passed under Section 11B which contains reasons for its conclusions.

26. It is also noted in this Tribunal's order in **India Capital Markets Pvt. Ltd. vs. SEBI [Appeal No. 124 of 2010 dated December 14, 2010]** that this was a

case where interim restraint from taking new clients had been imposed on a broker pending enquiry. In the facts of that case, the interim order was directed to remain in abeyance pending the conclusion of the enquiry. Again, this order relates to an interim order passed pending enquiry and not a final order under Section 11B.

27. Similarly, the case of **Keynote Capitals Ltd. vs. SEBI [Appeal No. 156 of 2010 dated October 22, 2010],** involves an interim order passed by SEBI pending an ongoing investigation and not a final order passed after a complete consideration of the facts and material on record. This Tribunal's order in **India Capital Markets Pvt. Ltd. vs. SEBI [Appeal no. 124 of 2010 dated July 26, 2010]** is again regarding an interim order pending investigation. The bench also took note the fact that in ongoing inquiry proceedings, the designated authority had submitted a report recommending the penalty of a warning and that the designated member had not agreed with those findings and was proceeding further in the matter.

28. We have, therefore, no hesitation in holding that no discriminatory or arbitrary treatment is meted out to the appellants in passing the impugned order dated July 31, 2013 passed by the learned WTM and the same is hereby upheld. It is further held that various circulars issued by the SEBI from time to time have led to a well developed margining system in India. The collection of margins as a regulatory requirement prescribed by the SEBI is a pre-requisite. Its sanctity cannot be undermined by allowing the appellants to bypass such requirement of margin collection beforehand. Such an act puts the entire system at risk making it a systemic issue which may have serious repercussion on the capital market. Therefore, collection of margin as a risk management tool to cover for counter party risk is an integral part of the regulatory system conceived and implemented

in practice by SEBI consistently. In fact, as per SEBI's approach in this regard, it is to be noted that the members should have a prudent system of risk management to protect even themselves from the client's default. Thus, a robust margin system prevents a Broker or even a stock exchange from taking huge positions without adequate collateral which may generate very high profit or loss. In fact, non-collection of margins at the client level by a Broker and/or its non-reporting, attracts heavy fines and penalties, as is stipulated by SEBI's circular dated August 10, 2011. No circular authorizes the use by a broker of funds and/or securities of clients to cover margin requirements of other clients. Such action is, in fact, prohibited. In fact, under Regulation 26(xiii) of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, a broker using securities of funds of a client for his own purpose or for the purpose of any other clients is liable for a monetary penalty. Therefore, the contention of the appellants in this regard that margin is their prerogative is misconceived and hence rejected.

29. In view of the above discussion of law and fact, the appeal is bereft of any merit and the same is hereby dismissed. No order as to costs.

Sd/-
Justice J. P. Devadhar
Presiding Officer

Sd/-
Jog Singh
Member

Sd/-
A. S. Lamba
Member

28.10.2013
PTM