WTM/AB/IVD/ID10/12470/2021-22

SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: ANANTA BARUA, WHOLE TIME MEMBER

ORDER

Under Section 12(3) of Securities and Exchange Board of India Act, 1992 read with Regulations 27 of Securities and Exchange Board of India (Intermediaries) Regulations, 2008

In respect of:

Sr. No.	Name of the Intermediary	Registration Number[1]
1.	**M/s. Rajat Shares & Stock Brokers Pvt Ltd**	INB151030138
2.	**M/s. Jhunjhunwala Binod & Co.**	INB150431614

In the matter of Magadh Stock Exchange Association

1. The present proceedings have emanated from two identical show cause notices both dated October 28, 2020 (hereinafter referred to as **"SCNs"**) which were issued by Securities and Exchange Board of India (hereinafter referred to as "**SEBI"**) to M/s. Rajat Shares & Stock Brokers Pvt. Ltd. (hereinafter referred to as "**Noticee no. 1**" / "**Rajat Shares**") and M/s. Jhunjhunwala Binod & Co. (hereinafter referred to as "**Noticee no. 2**" / "**JBC**"), the two stock brokers. The Noticee no. 1 and 2 were the members of erstwhile Magadh Stock Exchange Association (hereinafter referred as "**MSEA**") which was a recognized stock exchange under Securities Contracts

[1] *At the time of alleged violations. Presently, Noticees are not registered as Stock Broker with SEBI.*

(Regulation) Act, 1956 (hereinafter referred to "**SCRA**"). The SCNs forwarded therewith copies of an Enquiry Report dated August 31, 2020 (hereinafter referred to as "**ER**") submitted by the Designated Authority (hereinafter referred to as "**DA**") and called upon the Noticee nos. 1 and 2 to show cause as to why action as recommended by the DA or any other action including passing of appropriate other directions, as deemed appropriate by the competent authority should not be taken against them in terms of Regulation 27 read with Regulation 28 of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as "**Intermediaries Regulations**"). In the ER, the DA had recommend that the Noticees be prohibited from registering fresh/new clients for a period of 3 years.

2. The background of the matter is as follows:

2.1. MSEA was recognized as a Stock Exchange under Section 4 of the SCRA by Central Government vide Notification no. S.O. 899(E) dated December 05, 1986 for a period of 5 years commencing on December 11, 1986. The recognition was subsequently renewed from time to time under Rule 7 of Securities Contracts (Regulation) Rules, 1957. Due to breakdown of internal administration and persistent malfunctioning of the Council of Management of MSEA, the Council of Management of MSEA was superseded by SEBI vide Notification No. S.O. 822(E) dated December 05, 1997 and an Administrator had also been appointed to exercise and perform all the powers and duties of the Council of Management (CoM). Thereafter, SEBI granted renewal of recognition to MSEA for a period of 3 years on December 09, 2000. The recognition was further renewed for a period of one year, vide a Notification dated February 19, 2004 subject to following conditions:

(i) Setting of Trade Guarantee Fund /Settlement Guarantee Fund by the Exchange after final approval by SEBI.

(ii) Trading shall commence only after setting up of Settlement Guarantee Fund or Trade Guarantee Fund, duly approved by SEBI.

(iii) Payment of balance amount of Rs. 11,31,768/- on or before December 1, 2004 towards refundable financial support extended by SEBI to the Exchange.

2.2. MSEA failed to comply with the said conditions. It was however observed that some trades were conducted on the stock exchange with a turnover of Rs.13.26 lakhs in year 2003-04. Since, the turnover was very negligible, though the exchange was not legally permitted to conduct such trades on the exchange without complying with the conditions of renewal, MSEA was counseled and further renewal was granted for a period of one year vide Notification No. S.O. 1354 (E) dated December 6, 2004 commencing from 11th day of December 2004 and ending on December 10, 2005 subject to the conditions stated below:

(i) The Exchange shall set up Settlement Guarantee Fund in compliance with SEBI Circular SMD/POLICY/SUB BROKER /Cir-12/97 dated June 09, 1997, after final approval by SEBI.

(ii) Trading shall commence only after setting up of Settlement Guarantee Fund, duly approved by SEBI.

(iii) The Exchange shall repay the balance amount of RS 7, 50,000/-(Seven Lakhs fifty thousand only) towards refundable financial support extended by SEBI to the Exchange.

2.3. MSEA did not comply with the aforesaid conditions and commenced trading on August 01, 2005 without complying with the aforesaid conditions. It was alleged that Noticees undertook trading in 20 scrips, aggregating to a value of Rs. 90.06 crore on MSEA, during the period August 01, 2005 to August 12, 2005 (hereinafter referred to as "**relevant period**"). Out of these, the traded value in the scrip of

Bhoruka Financial Services Ltd. (hereinafter referred to as "**BFSL**") alone accounted for Rs. 89.28 crore or 99.13% of the total traded value of all the stocks. The remaining 19 scrips were traded between the two Noticees for their respective 'clients' for a value of Rs. 0.78 crore, constituting 0.87% of the traded value. It was alleged that all the trades (except in the scrip of Hindustan Liver Limited) executed by the Noticees as brokers on behalf of their clients and in their proprietary accounts were observed to be circular trades and reversal trades.

2.4. In view of the above, SEBI initiated enquiry proceedings against the Noticees, who at that time were stock brokers registered with SEBI and members of MSEA, under Regulation 5(1) of the SEBI (Procedure for Holding Enquiry by Enquiry Officer and imposing Penalty) Regulations, 2002 (hereinafter referred to as "**Enquiry Regulations**") (*Since Repealed*) for alleged violation of the provisions of Section 19 of the Securities Contracts Regulation Act, 1956 (hereinafter referred to as the "**SCRA**"), Clauses A(1), A(2), A(3), A(4) and A(5) of the Code of Conduct for Stock Brokers specified under Schedule II of Regulation 7 of the SEBI (Stock Brokers) Regulations, 1992 (hereinafter referred to as the "**Stock Broker Regulations**"), Regulation 4(1) and 4(2)(a) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as the "**PFUTP Regulations, 2003**") and the SEBI Gazette Notification dated December 06, 2004.

2.5. Vide order dated September 20, 2006, an Enquiry Officer in this matter was appointed under Regulation 5(1) of the Enquiry Regulations (*since repealed*) to conduct an enquiry in the matter with respect to the alleged violation by the Noticees.

2.6. A common show cause notice dated April 13, 2007 (hereinafter referred to as "**DA SCN**") was issued to Rajat Shares and JBC, respectively, under the provisions of the Regulation 6 of the Enquiry Regulations (*since repealed*) as to why the

recommendation for imposition of penalties as specified under Regulation 13(1) of the Enquiry Regulations, should not be made against them.

2.7. In response to the DA SCN, Noticee no. 1, vide its letter dated May 29, 2007, filed its reply. The Noticee no. 2 submitted its reply to DA SCN vide its letter dated June 07, 2007 and August 22, 2010.

2.8. The Notice no. 2 appeared for a personal hearing before the DA on August 23, 2010. However, Noticee no. 1 did not appear for hearing granted to it vide hearing notice dated September 27, 2010. However, on October 17, 2010, Noticee no. 1 informed the DA that they had preferred a writ application vide C.W.J.C No. 16393 of 2010 before the Hon'ble Patna High Court and Hon'ble High Court vide its order dated October 04, 2010 had issued an interim stay on the Enquiry Proceedings with respect to violation of Section 19 of the SCRA. In view of the interim stay issued by the High Court in relation to proceedings for alleged violation of Section 19 of the SCRA and in view of the fact that the other allegations against the Noticees were also related with the alleged violation of Section 19 of SCRA, as well as commonality between the facts and circumstances with respect to both the Noticees (wherein Noticee no. 2 was the counterparty to Noticee no. 1 in the impugned trades), it was decided by the DA not to proceed in the matter until a final order is passed by the Hon'ble High Court in the matter. Thereafter, C.W.J.C No. 16393 of 2010 was dismissed for default on June 22, 2018.

2.9. As the concerned C.W.J.C No. 16393 of 2010 was dismissed by the Hon'ble Patna High Court vide order dated June 22, 2018, thereafter, the enquiry proceedings were concluded by the DA and ER dated August 31, 2020 was submitted by the DA.

2.10. The ER observed that the Noticees had traded on the MSEA at a time when trading had not commenced on MSEA and that the majority of the trades executed

by the Noticees as stock brokers during the relevant time, on behalf of their clients and in their proprietary accounts on the MSEA were circular/ reversal trades. Based on the same, the ER concluded that the Noticees have violated Clauses A(1), A(2), A(3), A(4) and A(5) of the code of Conduct for Stock Brokers specified under Schedule II of Regulation 7 of the Stock Broker Regulations and Regulation 4(1) & 4(2)(a) of the PFUTP Regulations, 2003.

2.11. In the ER, the DA made the following recommendation:

> *"In view of the above observations and the gravity of the violations committed by the Noticees viz. M/s Rajat Shares & Stock Brokers Pvt. Ltd and M/s Jhunjhunwala Binod & Co., as registered stock brokers of MSEA, the Noticees have functioned in an unprofessional manner in their conduct as stock brokers. I cannot lose sight of the fact that the trading by the Noticees on unrecognized exchange MSEA were not on account of being misled by the notification dated July 27, 2005 of MSEA as claimed by them but were done intentionally to portray an artificial picture of trading on MSEA. The pattern of trading conducted by the Noticees on MSEA also establishes the fraudulent intentions of the Noticees for trading on MSEA during the relevant period. Such activities of the Noticees as registered stock brokers cannot be condoned and deserves appropriate penalty for the wrong doing. Therefore, in terms of Regulation 27 r/w Regulations 38(1) and (2) of the Intermediaries Regulations, I hereby recommend that the Noticees. viz. M/s Rajat Shares & Stock Brokers Pvt. Ltd and M/s Jhunjhunwala Binod & Co., as stock brokers of MSEA may be prohibited from registering fresh/new clients for a period of 3 years."*

3. Thereafter, the SCNs were issued on October 28, 2020 to the Noticees and Noticee no.2 submitted its reply to the SCN dated November 17, 2020 and Noticee no. 1 submitted reply to the SCN dated November 19, 2020 which were both on similar lines. The Noticees have, *inter alia,* submitted as follows:

3.1. They denied all allegation/observation made in the ER.

3.2. SEBI (Intermediaries) Regulations, 2008 was brought into effect on 26.05.2008 i.e. date of Gazette notification, much after initiation of enquiry proceeding of this case against the Noticees and therefore, it is not applicable to the case of the Noticees as it cannot be made retrospectively. In light of the above submission, the instant enquiry proceeding as well as SCN issued under Regulation 28(1) of the SEBI (Intermediaries) Regulations, 2008 by the SEBI is not maintainable.

3.3. MSEA was granted renewal by SEBI vide a letter notification no. S.O. 1354 (E) dated 06.12.2004 commencing from 11.12.2004 and ending 10.12.2005 subject to certain conditions. It is also apparent from the records of MSEA, Rs. 13.26 lacs turnover was done in the F.Y. 2003-2004.

3.4. The Noticees were unaware in regards to non-fulfillment of the certain conditions imposed by the SEBI notification for carrying on the businesses at Magadh Sock Exchange Association. Under the doctrine of Indoor management, the person contracting with the company cannot and will not be prejudiced by the irregularities that may beset the indoor working of the company. It is to be noted here that SEBI had not issued any Public Notice declaring that MSEA cannot commence trading. At the relevant time the Noticees were under *bona fide* impression that MSEA had fulfilled all required conditions Imposed by SEBI and had availed approval from SEBI to start trading. The Noticees were not aware that stock exchange who is their primary level regulator would engage in some acts which are in violation of the law of land.

3.5. There is no material/ evidence either in the show cause notice or otherwise to show that Noticees were not acting under a *bona fide* impression that MSEA was recognized as a Stock Exchange by SEBI. It is therefore submitted that trades carried out by the Noticees was not prohibited under Section 19 of SCRA.

3.6. If the contention of SEBI is that the trades carried out during the period August 01, 2005 to August 12, 2005 were prohibited under Section 19 of SCRA, then all

trades become void ab-*initio* since as per Section 24 of the Indian Contract Act, 1872, illegal contracts are void from very beginning. However, SEBI has taken no steps to make all the contracts made on the floor of the exchange of MSEA during the aforesaid period to be made as void.

3.7. The alleged violation is of Section 19 of SCRA, penalty of which are under Section 23H of SCRA. The SEBI has power to adjudicate the matter by appointing an Adjudication Officer and not through Enquiry Officer as provided under Section 4 of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 and Regulation 4 speaks of the offences for which as such Enquiry can be held and which does not include violation of Section 19 of the SCRA and as such the present Enquiry by Enquiry officer/Designated Authority is without jurisdiction.

3.8. For violation of Regulation 4(2) (a) of PFUTP Regulations, 2003, investigation under Chapter III is provided and as such the present Enquiry by the Enquiry officer/Designated Authority is without jurisdiction.

3.9. Main allegation against the petitioner is that of violation of Section 19 of SCRA, for doing illegal trading under Magadh Stock Exchange, which was not recognized stock exchange at that point of time but it is not out of place to state here that for this alleged violation of trading in shares of BFSL, several persons were adjudicated and were found guilty by the concerned Adjudicating Officer and against which all of them went in appeal before Securities Appellate Tribunal, Mumbai in Appeal No. 94 of 2007 and SAT in its decision dated 01.07.2008 clearly held that trading on Magadh Stock Exchange at that particular period was not in violation of Section 19 of SCRA and appeal was allowed and the penalty imposed by the Board was set aside holding: *"From the discussions above , we are satisfied that the appellants cannot be held to have violated section 19 of SCRA, which is the charge against them. Accordingly,*

we allow the appeal and set aside the impugned order of the Board, No order as to cost."

3.10. Regarding the trades executed by the Noticees, as alleged by SEBI, were circular trades/ reversal trades in nature, one of the investor namely Ramod kumar Agarwal (HUF) & others preferred appeal vide Appeal no.105 of 2005 before SAT and the Hon'ble SAT while dealing with the same set of transactions of counter parties held that: "*Considering the facts and circumstances of the case, we do not think that the Appellants executed the impugned trades knowingly. A unique feature of the screen-based trading system is that it maintains anonymity of the buyer and the seller, and it is not possible for either of them to know at the time of the execution of the trades as to who the counterparty is. This fact can be discovered by the Board or the exchange on an enquiry after the execution of the trade. The trades of the Appellants in this case had to necessarily reverse because when they traded on MSEA on the asking of Bimal, there were only two trades- one on either side and this knowledge cannot be attributed to the Appellants particularly In the absence of any material that could lead one to believe otherwise.*

Considering the findings of the Hon'ble Tribunal, it can be said that since allegation is creation of artificial volumes, which necessarily involves two parties and if one party has been exonerated, the second party cannot be held liable. Especially in light of the fact that the material on record is the same as existed while considering the transactions of the counterparties.

3.11. The Noticee no.1 has preferred Miscellaneous application for restoration of C.W.J.C.No.16393 of 2010 after serving the copy of the said application to the learned lawyer of SEBI at Patna High court vide M.J.C.No.4300 of 2018 which is still pending before Hon'ble High Court Patna and in that case the matter is still subjudice.

3.12. Noticee no.1 being a member of COM do not know the day-to-day development/ functioning of Stock Exchange. It is stated that being a member of COM, he only know the Agenda of meetings and its discussions.

3.13. It is stated that OED is senior most officer of Exchange and he is duty bound to report SEBI every matter and his approval of transfer of shares in buyers a/c clearly shows that transactions were made legally and bonafidely.

3.14. In this proceeding itself by an ex parte order dated 19.08.2005 passed by Sri G. Ananthraman, Whole Time Member, SEBI, SEBI has already prohibited Rajat Share & Stock Broker's Pvt. Ltd, from dealing in securities or undertake any transaction in securities as broker registered with SEBI and since last 15 years, the Noticee no.1 has not made any transaction in share/securities, in this view of the matter the proposed punishment debarring the notice from registering fresh/new client for a period of 3 years as stock broker of MSEA becomes totally redundant.

4. An opportunity of hearing was granted to the Noticees on March 08, 2021. On the said date the Authorized Representative (hereinafter referred to as "**AR**") of the Noticees appeared through video conference and made submissions, reiterating their replies.

Consideration of submissions and findings:

5. I have considered the ER, the replies submitted by the Noticee, and the submissions made before me during the personal hearing. At the outset it would be appropriate to refer to the provisions of law alleged to have been violated by the Noticees:

Relevant Extract of PFUTP Regulations, 2003:

> "**4 (1)** Without prejudice to the provisions of regulation 3, no person shall indulge in a fraudulent or an unfair trade practice in securities.
> **(2)** Dealing in Securities shall be deemed to be fraudulent or an unfair trade practice if it involves fraud and may include all or any of the following, namely:

(a) indulging in an act which creates false or misleading appearance of trading in the securities market."

Relevant Extract of Stock Broker Regulations:

"SCHEDULE II
CODE OF CONDUCT FOR STOCK BROKERS
Regulation 7

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.

(3) Manipulation: A stock-broker shall not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumours with a view to distorting market equilibrium or making personal gains.

(4) Malpractices: A stock-broker shall not create false market either singly or in concert with others or indulge in any act detrimental to the investors' interest or which leads to interference with the fair and smooth functioning of the market. A stockbroker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.

(5) Compliance with statutory requirements: 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 Exchange from time to time as may be applicable to him……."

6. The Noticees have raised some preliminary issues related to jurisdiction and type of proceedings. The Noticees have submitted that Intermediaries Regulations was brought into effect on May 26, 2008 i.e. date of Gazette notification, much after initiation of enquiry proceeding of this case against the Noticees and therefore, it is not applicable to the case of the Noticees as it cannot be applied retrospectively. In this regard, I note that the enquiry proceedings in the matter was initiated on September 19, 2006, under the provisions of the erstwhile Enquiry Regulations (since repealed) and show cause notice dated April 13, 2007 was issued under Regulation 6 of the Enquiry Regulations (since repealed). During the pendency of the enquiry proceedings, the Intermediaries Regulations was introduced and the Enquiry Regulations were repealed. Regulation 38 of the Intermediaries Regulations states as follows:

"Repeal and savings

> 38. (1) With effect from publication of these regulations in the Official Gazette –
>
> (a) the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and imposing Penalty) Regulations, 2002; and
>
> (b) the Securities and Exchange Board of India (Criteria for Fit and Proper Persons) Regulations, 2004 shall be repealed.
>
> (2) Notwithstanding such repeal, anything done or any action taken under those regulations including an enquiry commenced or notice issued under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and imposing Penalty) Regulations, 2002, before the publication of these regulations in the Official Gazette, shall be deemed to have been done or taken or commenced under the corresponding provisions of these regulations…."

Thus, I observe that Regulation 38 (2) of the Intermediaries Regulations has expressly provided that enquiry proceedings initiated under the erstwhile Enquiry Regulations (since repealed) and wherein notices had been issued shall be deemed to have been initiated under the corresponding provisions of the Intermediaries Regulations. In view of the same, I find that the present enquiry proceedings can continue under the Intermediaries Regulations and the contention of the Noticees in this regard is not tenable.

7. The Noticees have also submitted that SEBI should have initiated adjudication proceedings in this matter and not enquiry proceedings and there are no reasons provided by SEBI as to why enquiry proceedings have been initiated. In this regard, I note that the SEBI Act, 1992 and SCRA gives power to initiate three kinds of proceeding such as adjudication- for imposition of penalty, enquiry proceedings and proceedings under 11B of the SEBI Act, 1992 as well as prosecution before a criminal court. As per the legislative scheme, these powers are concurrently available to SEBI and the discretion to take all or any action in this regard lies with SEBI. In my view, in a given case, having regard to facts and circumstances of a case, if SEBI has initiated a particular proceeding, it is not open to the Noticees to agitate that those other proceedings should have been initiated.

8. I observe that the ER has mainly found the two Noticees liable for the following defaults which are discussed below:

A. Allegation related to execution of trades by the Noticees on MSEA when trading was not permitted on the said exchange:

9. Regarding this allegation, the Noticees have submitted that MSEA was granted renewal by SEBI vide a notification no. S.O. 1354 (E) dated December 06, 2004 commencing from December 11, 2004 and ending December 10, 2005 subject to certain conditions and that Rs.13.26 lac turnover was done previously in the F.Y. 2003-2004. In view of the same, the Noticee have submitted that they were unaware with regard to non-fulfillment of the certain conditions imposed by the SEBI notification for carrying on the business at MSEA. The Noticees have stated that under the doctrine of indoor management, the person contracting with the company cannot and will not be prejudiced by the irregularities that may beset the indoor working of the company and since, SEBI had not issued any public notice declaring that MSEA cannot commence trading, at the relevant time the Noticees were under *bona fide* impression that MSEA had fulfilled all required conditions imposed by SEBI and had availed approval from SEBI to start trading. The Noticees have submitted that approval for the impugned trades were granted by the OED of MSEA and OED is senior most officer of exchange and his approval of transfer of shares in buyers account clearly shows that transactions were made legally. The Noticee no. 1 has stated that although he was a member of Council of Management (CoM) of MSEA, he did not know the day-to-day development/ functioning of Stock Exchange and only knew the Agenda of meetings and its discussions.

10. From the ER, I note that, MSEA was recognized as a Stock Exchange on December 05, 1986 for a period of 5 years commencing on December 11, 1986. The recognition was subsequently renewed from time to time under Rule 7 of Securities Contracts (Regulation) Rules, 1957. Due to breakdown of internal administration and persistent malfunctioning of the Council of Management of MSEA, the Council of Management

of MSEA was superseded by SEBI vide Notification No. S.O. 822(E) dated December 05, 1997 and an Administrator had also been appointed to exercise and perform all the powers and duties of the Council of Management (CoM). Thereafter, SEBI has granted renewal of recognition to MSEA for a period of 3 years on December 09, 2000. The recognition was further renewed for a period of one year, vide a Notification dated February 19, 2004 subject to certain conditions. MSEA failed to comply with the said conditions. A further renewal was granted for a period of one year vide Gazette Notification No. SO 1354 (E) dated December 6, 2004 commencing from 11th day of December 2004 subject to the following conditions:

(i) Setting of Trade Guarantee Fund /Settlement Guarantee Fund by the Exchange after final approval by SEBI.
(ii) Trading shall commence only after setting up of Settlement Guarantee Fund or Trade Guarantee Fund, duly approved by SEBI.
(iii) Payment of balance amount of Rs. 11,31,768 on or before December 1, 2004 towards refundable financial support extended by SEBI to the Exchange.

Subsequently, MSEA forwarded its revised proposal to fulfill the aforesaid pre conditions, vide e-mail dated July 11, 2005, as its previous proposals were rejected by SEBI for being incomplete.

11. I note that before this proposal was approved by SEBI, trading took place in MSEA during the period August 01, 2005 to August 12, 2005, in twenty scrips, aggregating to a value of Rs. 90.06 crore wherein the Noticees acted as stock brokers. Out of this, the traded value in the scrip of BFSL accounted for Rs. 89.28 crore or 99.13% of the traded value. In the scrip of BFSL Noticee no. 1 was the stock broker on both the buyer as well as the seller side. The buyer was DLF Commercial Developers Ltd. and the sellers were the promoters of BFSL. It is observed that although, BFSL scrip was listed only in the Bangalore Stock Exchange (BgSE), it was traded on MSEA during the relevant period under the 'permitted category' based on an application dated

August 01, 2005 made by the Noticee no. 1 as the member broker of MSEA. The Noticee no. 1 also acted as broker to both the sellers and the buyer of the scrip of BFSL. The promoters of BFSL held 198,850 shares in BFSL, constituting 98.73% of BSFL's equity. They sold their entire holding in BFSL at Rs. 4,490/- per share for an amount of Rs. 89.28 crore. I observe that apart from the shares of BFSL, there were 19 other scrips in which trading was done by only Noticee nos. 1 and 2 during the relevant period, on MSEA. The trading done by the Noticee no. 1 was either in its own proprietary account or on behalf of its clients viz. Ramod Agarwal & Family. The trading done by the Noticee no. 2 during the same period was on behalf of its clients Mr. Gopal Kumar. The remaining 19 scrips were traded between the two Noticees only for a value of Rs. 0.78 crore, constituting 0.87% of the traded value, during the relevant period.

12. I further note that from the ER that during the relevant period Mr. Siddhartha Agarwal was the promoter of BFSL. In the month of June 2005, Mr. Siddhartha Agarwal approached his cousin and one of the directors of Noticee no. 1 viz. Mr. Bimal Kumar Agrawal (hereinafter referred to as "**Bimal**") in relation to trading in the shares of BFSL. It is further observed that Bimal was also a member of CoM of MSEA during the period of October 2004 to September 2005. Bimal, vide letters dated July 18 and 25 of 2005 sought permission from the OED of MSEA one Mr. C. M. Pandey to permit to deal in the shares of BFSL on MSEA. Thereafter, on July 27, 2005, Mr. C. M. Pandey issued a 'notification' that trading in MSEA would commence shortly. However, the aforesaid notification of MSEA did not make a mention of the specific timeline for commencement of trading on MSEA. The said 'notification' was faxed to Mr. Siddhartha Agarwal on the same day viz. July 27, 2005 and next day on July 28, 2005, the sellers and DLF Commercial Developers Ltd. entered a share purchase agreement for transacting in the shares of BFSL shares at MSEA through Noticee no. 1. Thereafter, the sellers transferred the first lot of demat shares to the account of Noticee no. 1 and on August 01, 2005 DLF Commercial Developers Ltd, transferred corresponding funds to the account of Noticee no. 1.

13. I observe that the Noticees have not denied any of the facts found in the ER which are mentioned above, but have stated that they were unaware that trading was not allowed on MSEA since, trading had been specifically allowed by the OED of MSEA. I cannot accept such a contention for the following reasons:

(i) I note that the notification dated December 06, 2004 clearly stated the conditions which the recognition of MSEA was subjected to. Thus, being a member of the said exchange, both the Noticees should have known that the recognition granted by SEBI to the exchange was not absolute and that trading could commence only after setting up of the Settlement Guarantee Fund duly approved by SEBI. The notification was very clear that trading on MSEA was not allowed as on the date of notification, nor on the date of commencement of conditional recognition of MSEA.

(ii) Bimal who was a director of Noticee no.1, being part of the CoM of MSEA was expected to be aware of the fact that trading cannot take place on the platform of MSEA, as the recognition granted to MSEA by SEBI vide the Gazette notification dated December 06, 2004 was conditional and the conditions specified in the aforesaid notification had not been fulfilled by MSEA. I am of the view that whether trading is permitted on a stock exchange, does not qualify as a matter of 'day to day' functioning of the said stock exchange but it is a matter of the fundamentals of the said exchange which will be known to the CoM of the exchange. Therefore, I am unable to accept the contention that Noticee no.1 was unaware that trading was not permitted on MSEA during the relevant period.

(iii) Bimal, who was director of Noticee no. 1, vide letters dated July 18 and 25 of 2005 sought permission from the OED of MSEA to permit to dealing in the shares of BFSL on MSEA which shows that Noticee no. 1 was aware that trading on the platform of MSEA was not allowed. This fact is not disputed by both the Noticees.

(iv) I note that on July 27, 2005, the OED of MSEA had issued a 'notification' that trading in MSEA would commence "shortly". However, the aforesaid notification of

MSEA did not make a mention of the specific timeline for commencement of trading on MSEA. It is clear from the text of the notification of OED that it doesn't specify the period from when the commencement of trading would take place on MSEA. It is clear from the language that the OED had used the word 'shortly' for the possible period for commencement of trading on MSEA. Therefore, it is clearly unacceptable on the part of the Noticees, who were registered intermediaries at that time, to start trading on MSEA just two trading days after such a vague notification of MSEA which doesn't say it in clear terms that trading has been allowed on MSEA platform.

(v) The pattern of trading of shares between the Noticees on MSEA indicates that the trades were being reversed by the Noticees and all the positions taken during the day were squared off. The findings in the ER, is that it can not be a mere coincidence that the clients of the Noticee no. 1 and the Noticee no. 1 itself (as it had traded in its own account also) were placing their orders in exactly same scrips on same date and the order price was also matching. Further, the facts that both Noticee nos.1 and 2 traded on the MSEA platform during the same period on the basis of a so called notification dated July 27, 2005 of MSEA, the trading by both the Noticees was done in the same scrips and on the same days, shows that Noticee no. 1 and 2 knew that who were the counter party brokers to their buy/sell orders. It further indicates that not only Noticee no. 1 but also the Noticee no. 2 was aware that MSEA was not having trading permission.

In view of the above, I cannot accept the plea of the Noticees that they executed the impugned trades without being aware that trading was not permitted on MSEA at the relevant time.

14. The Noticees have taken recourse to the doctrine of indoor management to argue that since they were outsiders to the MSEA they cannot be punished for the irregularities that may beset the indoor working of the company. In this regard, I find that the director of Noticee no. 1 was a member of the CoM of MSEA and therefore Noticee no. 1

cannot be held to be an outsider to MSEA. Moreover, I note that a recognized stock exchange cannot be treated at par with any other company since, with respect to a stock exchange, in addition to the provisions of the Companies Act, 1956, the provisions of the SCRA also applies. In terms of Section 4 of the SCRA the recognition granted to stock exchanges is required to be notified in official gazette of the state wherein the stock exchange is located as well as India. In the present case, vide a notification dated December 06, 2004 published in the Gazette of India, the recognition of MSEA was renewed for a period of one year with effect from December 11, 2004, subject to certain conditions and the said notification clearly stated that trading would not commence on MSEA till certain conditions were not fulfilled. In view of this, I find that the conditionality of such a recognition cannot be said to be a matter of 'indoor workings' of the stock exchange since it was notified nationally. Moreover, as found in the preceding para, Noticee no. 1 through its director – Bimal was aware of the fact that trading on the platform of MSEA was not permitted during the relevant period. Thus, in my view, the plea of doctrine of indoor management cannot be raised *qua* the issue of knowledge related to recognition of MSEA, under the facts and circumstances of the present case.

15. The Noticees have also submitted that if the contention of SEBI is that the trades carried out during the period August 01, 2005 to August 12, 2005 were prohibited under Section 19 of SCRA, then all trades become *void ab-initio* since, as per Section 24 of the Indian Contract Act, 1872, illegal contracts are void from very beginning, however, SEBI has taken no steps to make all the contracts made on the floor of the exchange of MSEA during the aforesaid period to be declared as void. In this regard, I note that Section 19 of the SCRA contains a prohibition from organizing or assisting in organizing or being a member of any stock exchange (other than a recognized stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities. Unlike Section 16(2) of SCRA, Section 19 of SCRA does not declare that any contract executed in violation of Section 19 shall be illegal and thus, rendering the same void under Section 24 of the Indian Contract Act, 1872 read with Section 23

thereof. Therefore, the submission by the Noticees is untenable. It is a matter of fact that at the time the trades were executed by the Noticees on MSEA, trading was not allowed on the said platform. As discussed above, the Noticees were aware of the said prohibition and in spite of the same, traded on MSEA during the relevant period.

16. The Noticees have also submitted that trades had taken place on MSEA in 2003-04 when the MSEA was not having trading permission in view of the conditional recognition. In this regard, from the ex parte ad interim order dated August 19, 2005 passed by SEBI the matter of "Bhoruka Financial Services Ltd. on Magadh Stock Exchange Association", I observe that after the conditional recognition of MSEA was renewed for a period of one year, vide a Notification dated February 19, 2004, MSEA failed to comply with the said conditions. However, some trades were conducted on the stock exchange with a turnover of Rs.13.26 lakhs in year 2003-04. Since, the turnover was very negligible, though the exchange was not legally permitted to conduct such trades on the exchange without complying with the conditions of renewal, MSEA was counseled and further renewal was granted on December 06, 2004 w.e.f December 11, 2004 for a period on one year, subject to the conditions as mentioned above. Thus, the trades in year 2003-04 on MSEA cannot be taken as a defense by the Noticees to justify their trades on MSEA at the relevant time when trading was not permitted on the exchange.

17. The Noticees have also referred to the order dated July 01, 2008 passed by Hon'ble Securities Appellate Tribunal, Mumbai (hereinafter referred to as "**Hon'ble SAT**") in *Satyanarayana Agarwal Vs. Adjudicating Officer, SEBI* (Appeal No. 94 of 2007) to submit that the Hon'ble SAT has held that trading on MSEA during the relevant period was not in violation of Section 19 of SCRA. I have perused the said decision of the Hon'ble SAT and note that in the said order the Hon'ble SAT exonerated the clients of the Noticee no. 1 on the ground that they could not be expected to know about trading not being allowed on the floor of MSEA despite it being a recognized stock exchange. However, in the facts of present case, particularly, as discussed in para 13 above, I

find that enough material is available to show that the Noticees, who were the stock brokers for the impugned trades, were aware that trading has not been permitted on MSEA during the relevant time and in spite of the same, they undertook the impugned trades. Thus, in my view, the order of the Hon'ble SAT mentioned by the Noticees may not be applicable to the facts and circumstances of the present proceedings, as being factually different.

18. I find that the action of the Noticees of having executed trades on MSEA during a period wherein trading was not allowed on the exchange, shows that the Noticees have not acted with due diligence and prudence as expected of them as the stock brokers. Therefore, I agree with the finding of DA that these acts of Noticees have resulted into violation of Clauses A(1), A(2), A(3), A(4) and A(5) of the Code of Conduct for Stock Brokers specified under Schedule II of Regulation 7 of the Stock Broker Regulations.

B. Allegation of fraudulent trades executed by the Noticees in violation of the PFUTP Regulations, 2003 on MSEA during the relevant period:

19. I note that during the relevant period, trading took place on MSEA in 20 scrips. One of the scrip was BFSL wherein both buyer and seller broker was Noticee no. 1 only. In other 19 scrips, apart from BFSL, Noticee no. 1 and 2 acted as counter party brokers to all the trades. The trading done by the Noticee no. 1 was either in its own proprietary account or on behalf of its clients viz. Ramod Agarwal and Family, who again are related to the Noticee 1. The trading done by the Noticee no. 2 during the same period was on behalf of its clients Mr. Gopal Kumar.

20. In this regard, ER states that the clients of the Noticees were connected to the respective Noticees as follows:

(i) The director of the Noticee no. 1 viz. Bimal is the younger brother of the client Ramod Kumar Agarwal.

(ii) The address of the client of the Noticee no. 2 viz. Mr. Gopal Kumar, is same as of Smt. Barkha Jhunjhunwala, who is wife of Shri Binod Jhunjhunwala, who is the proprietor of the Noticee no. 2. ER states that Mrs. Barkha Jhunjhunwala had leased out her premises to Shri Gopal Kumar on April 12, 2005.

21. I note that aforesaid connection has not been disputed by the Noticees.

22. The details of the trading done by the Noticees on MSEA during the relevant time (except for trades in BFSL) is given in the table below:

S. No.	Scrip	Buying Broker	Buying Client	No. of shares	Selling Broker	Selling Client	No. of Shares
1	ACC	JBC	Gopal Kumar	250	Rajat Shares	Prop	125
		Rajat Shares	Prop	125	Rajat Shares	Ramod Agarwal & Family	100
		Rajat Shares	Ramod Agarwal & Family	125	JBC	Gopal Kumar	-250
2	BANK OF INDIA	JBC	Gopal Kumar	200	Rajat Shares	Prop	200
		Rajat Shares	Prop	200	JBC	Gopal Kumar	200
3	Bhoruka Gas	JBC	Gopal Kumar	8000	Rajat Shares	Ramod Agarwal & Family	8000
		Rajat Shares	Ramod Agarwal & Family	8000	JBC	Gopal Kumar	8000
4	Bhuwalka Steel	JBC	Gopal Kumar	7500	Rajat Shares	Ramod Agarwal & Family	7500
		Rajat Shares	Ramod Agarwal & Family	7500	JBC	Gopal Kumar	7500
5	CHAMBAL FERT	JBC	Gopal Kumar	1100	Rajat Shares	Prop	800
		Rajat Shares	Prop	800	Rajat Shares	Ramod Agarwal & Family	300

		Rajat Shares	Ramod Agarwal & Family	300	JBC	Gopal Kumar	1100
6	CSS INFOTECH	JBC	Gopal Kumar	10500	Rajat Shares	Ramod Agarwal & Family	10500
		Rajat Shares	Ramod Agarwal & Family	10500	JBC	Gopal Kumar	10500
7	ESSAR GUJARAT	JBC	Gopal Kumar	2500	Rajat Shares	Ramod Agarwal & Family	2500
		Rajat Shares	Ramod Agarwal & Family	2500	JBC	Gopal Kumar	2500
8	G V Film	JBC	Gopal Kumar	85000	Rajat Shares	Ramod Agarwal & Family	85000
		Rajat Shares	Ramod Agarwal & Family	85000	JBC	Gopal Kumar	85000
9	GUJ HEAVY CHEMICAL	JBC	Gopal Kumar	4000	Rajat Shares	Ramod Agarwal & Family	4(XX)
		Rajat Shares	Ramod Agarwal & Family	4000	JBC	Gopal Kumar	4000
10	HIND LIVER	JBC	Gopal Kumar	300	Rajat Shares	Prop	100
		Rajat Shares	Prop	100	JBC	Gopal Kumar	300
		Rajat Shares	Ramod Agarwal & Family	150	Rajat Shares	Ramod Agarwal & Family	150
11	HMT LTD	JBC	Gopal Kumar	5500	Rajat Shares	Ramod Agarwal & Family	5500

23. It is observed from the details given in the table above that the all the trades executed by the Noticees during the relevant period in aforementioned 19 scrips matched with each other. It is observed from the pattern of trading of shares that happened between

the Noticees on MSEA that the trades were being reversed by the Noticees and all the positions taken during the day were squared off.

24. It is the submission of the Noticees that they were totally unaware of the identity of their counterparty broker and the only reason that the trades between them matched is that they were the only traders to have dealt in the shares on the MSEA platform. In this regard, I agree with the view of the DA that for reversal of trades to happen in stock market there are several other elements required and that it is difficult to believe that it was a mere coincidence that the clients of the Noticee no. 1 and the Noticee no. 1 itself (as it had traded in its own account also) were placing their orders in exactly same scrips on same date and the order price was also matching. I also agree with the DA that it is too much coincidence that Noticee nos.1 and 2 traded on the MSEA platform during the same period on the basis of a vague notification of MSEA, the trading by both the Noticees was done in the same scrips and on the same days.

25. In this regard, I note that the Noticees have drawn reference to the order dated September 29, 2008 of Hon'ble SAT in the matter of *Ramod Kumar Agrawal (HUF) & others Vs. SEBI* (Appeal No. 105 of 2007), wherein Hon'ble SAT has held that:

> *"Considering the facts and circumstances of the case, we do not think that the Appellants executed the impugned trades knowingly. The trades of the Appellants in this case had to necessarily reverse because when they traded on MSEA on the asking of Bimal, there were only two traders - one on either side and this knowledge cannot be attributed to the Appellants particularly in the absence of any material that could lead one to believe otherwise."*

26. I note that although the abovementioned order is with respect to the same set of transactions that are under consideration in the instant matter, however, the aforesaid findings of the Hon'ble SAT are only specific to the knowing participation of the clients of the Noticee no. 1 in the execution of trades. In my view, it may be the case that the clients of the Noticees were not aware that the trades were getting reversed, however, the same consideration may not be adopted in the case of the stock brokers especially

when it has been found that they were aware that MSEA was not having trading permission and they traded with the knowledge that they were the only brokers trading on MSEA during the relevant period. Noticee no.1, who was the stock broker executing the trades and who was also the counter party in the trading system for both the buy and the sell trades in some of the trades (proprietary trading), cannot take the same plea. Moreover, I also note that it cannot be a coincidence that both the Noticees decided to trade during the relevant time on MSEA (when trading was not permitted on the platform) and both of them decided to trade on the same scrips on the same dates and did not detect anything amiss when they observed that only one buyer and seller was available for all scrips. Also, I find that in the Ramod Kumar Agarwal matter (supra) the Hon'ble Tribunal has also held as under:

> *"Of the trades executed on MSEA during that period, those involving shares of BFSL were clearly genuine in nature where ownership of the shares actually passed from the promoters of BFSL to the purchaser. The trades executed by the Appellants were, however, of a different nature. As brought out in the show cause notice issued to the Appellants by the Board, every single trade executed by the former, with the exception of only a few shares of ACC, were actually reversed and the net position of the Appellants in 18 out of 19 scrips in which they traded was nil. We, therefore, agree with the learned counsel for the Board that these trades were really meant to create an impression that not BFSL shares alone but many other scrips were trading on MSEA and such trading was normal and legal."*

27. From the above, I find that the Hon'ble SAT has stated that the impugned transactions in the 19 scrips executed by the Noticees on MSEA during the relevant period were done with an intention to portray an artificial picture of trading on MSEA. I also find that, the preponderance of probabilities based on the attending facts and circumstances of the present matter, is strong enough to infer that the trading by the Noticees in the 19 scrips on MSEA detailed in para 22 were fraudulent in nature and reversal trades were carried out by the Noticees in order to portray artificial picture of trading on MSEA during the relevant time.

28. In view of the discussion above, I agree with the finding of the DA that the Noticees entered into fraudulent and manipulative trades on MSEA for creating false and misleading appearance of trading on MSEA during the relevant period, thereby violating provisions of the Regulation 4(1) and 4(2)(a) of the PFUTP Regulations, 2003. Further, I agree with the findings of the DA that by indulging in such fraudulent trades, the Noticees have also violated the provisions of the Clauses A(1), A(2), A(3), A(4) and A(5) of the Code of Conduct for Stock Brokers specified under Schedule II of Regulation 7 of the Stock Broker Regulations.

29. I note that that the DA has recommended, in terms of the erstwhile Regulation 27 of the Intermediaries Regulations read with Regulations 38(1) and (2) of the Intermediaries Regulations, that the Noticees, as stock brokers of MSEA, be prohibited from registering fresh/new clients for a period of 3 years. In view of the above, I find that Noticees, as member of MSEA and acting as stock brokers, have violated Regulation 4(1) and 4(2) (a) of the PFUTP Regulations, 2003 and Clauses A (1), A (2), A (3), A (4) and A (5) of the Code of Conduct for Stock Brokers specified under Schedule II of Regulation 7 of the Stock Broker Regulations during the relevant period and liable for action as recommended by DA in the ER. However, I note that the two Noticees are currently not registered with SEBI as Stock Brokers. MSEA, by virtue of whose membership and recommendation the Noticees were registered as stock brokers, has ceased to be a recognized stock exchange as SEBI has passed an order on May 08, 2019 allowing exit of MSEA as a stock exchange. In view of this, direction for action, as recommended by the DA, may not be feasible, at this point of time. I also note that monetary penalties, as provided under SEBI Act, 1992 and/or SCRA cannot be *suo moto* imposed upon the Noticees, in the present proceedings, for the reasons that firstly, there is no show cause notice to this effect to the Noticees and secondly, present proceedings are disciplinary proceedings against the Noticees wherein monetary penalty is not one of the action which can be taken against the Noticees. Also, Hon'ble Supreme Court in ***SEBI Vs. Saikala Associates Ltd. (2009)***

7 SCC 432, held that in disciplinary proceeding under Section 12(3) of the SEBI Act, 1992 monetary penalty cannot be imposed.

30. I note that the SCNs called upon the Noticees to show cause as to why action as deemed appropriate by the competent authority should not be taken against them in terms of Regulation 27 read with Regulation 28 of Intermediaries Regulations. I note that by the amendments made to Intermediaries Regulations on January 21, 2021, Regulation 27 which dealt with recommendations for actions which could be made by DA in case of default, has been substituted and Regulation 28 which dealt with procedure for action on receipt of the recommendation from DA, has been omitted and these matters now stand governed by the Regulations 26 and 27, respectively. In this regard, reference may be made to the judgment of Hon'ble Supreme Court in ***CIT, Bangalore Vs. Venkateshwara Hatcheries (P) Ltd. and Ors. (1999) 3 SCC 632*** wherein it was held as under:

> *"……15. As noticed earlier, the omission of Section 2(27) and re- enactment of Section 80JJ was done simultaneously. It is a very well recognized rule of interpretation of statutes that where a provision of an Act is omitted by an Act and the said Act simultaneously re-enacts a new provision which substantially covers the field occupied by the repealed provision with certain modification, in that event such re-enactment is regarded having force continuously and the modification or changes are treated as amendment coming into force with effect from the date of enforcement of re-enacted provision. Viewed in this background, the effect of re-enacted provision of Section 80JJ was that profit from the business of livestock and poultry which enjoyed total exemption under Section 10(27) of the Act from assessment years 1964-65 to 1975-76 became partially exempt by way of deduction on fulfilment of certain conditions……."*

The aforesaid judgment has been quoted with approval by Hon'ble Supreme Court in its subsequent judgment in ***Fibre Boards (P) Ltd., Bangalore Vs. CIT, Bangalore (2015) 10 SCC 333***. In the present case, I note that prior to the aforesaid amendment, procedure for conduct of enquiry proceedings before designated authority (DA) and designated member (DM) was provided under Regulations 25 to 28 of the

Intermediaries Regulations wherein Regulation 25 dealt with issue of SCN by DA, Regulation 26 dealt with reply of SCN by the Noticee, Regulation 27 dealt with recommendation for actions which could be made by the DA and Regulation 28 dealt with conduct of proceedings before DM like issue of SCN, hearing and passing of final order. After the amendment, Regulation 25, as substituted deals with holding of enquiry proceedings before DA, Regulation 26 deals with recommendation for actions which can be made by DA and Regulation 27 deals with conduct of enquiry proceedings before DM and passing of order by DM. Thus, the proceedings before DM which were earlier governed by the provisions of Regulations 28 are now governed by the provisions of Regulation 27 with certain modifications. Therefore, by virtue of the judgment of Hon'ble Supreme Court in *Venkateshwara Hatcheries case* (*supra*), the new Regulation 27 is regarded having force continuously (by virtue of pre-existing Regulation 28) and the modification or changes are treated as amendment coming into force with effect from the date of enforcement of new Regulation 27 i.e. January 21, 2021. Accordingly, the present proceedings can be concluded under the amended provisions of the Intermediaries Regulations.

31. Therefore, the present order can be passed under Regulation 27 of the Intermediaries Regulations. However, as observed above, Noticees have ceased to be member of any recognized stock exchange, as MSEA, of which Noticees were member, has ceased to be a recognized stock exchange as SEBI has passed an order on May 08, 2019 allowing exit of MSEA as a stock exchange. Consequently, Noticees cease to be a registered stock broker.

Direction:

32. In view of the above, I, in exercise of the powers conferred upon me in terms of Section 12(3) and Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulation 27 (5) of the Intermediaries Regulations, hereby dispose of both the

show cause notices dated October 28, 2020 issued to the Noticees, without any direction.

33. The order comes into force with immediate effect.

34. A copy of this order shall be served on the Noticees and all recognized Stock Exchanges.

-Sd-

Place: Mumbai **ANANTA BARUA**

Date : July 06, 2021 **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA