

**BEFORE THE SECURITIES APPELLATE TRIBUNAL  
MUMBAI**

**Appeal No. 68 of 2011**

**Date of decision: 29.7.2011**

M/s. Mansukh Securities and Finance Ltd.  
Mansukh House, Plot No. 6,  
Opp. Mother Dairy,  
Pandav Nagar,  
New Delhi- 110 092

.....Appellant

Versus

The Adjudicating Officer,  
Securities and Exchange Board of India  
SEBI Bhavan, Plot No. C-4A, G-Block,  
Bandra Kurla Complex,  
Mumbai-400 051

..... Respondent

Mr. Prakash Shah, Advocate for the Appellant.

Mr. Kumar Desai, Advocate with Ms. Harshada Nagare, Advocate for the Respondent.

CORAM : P.K. Malhotra, Member  
              S.S.N. Moorthy, Member

Per : P.K. Malhotra, Member

The appellant before us is a public limited company incorporated under the Companies Act, 1956. It is a member of the National Stock Exchange of India Limited and is registered with the Securities and Exchange Board of India (the Board) as a stock broker as well as participant of National Securities Depository Limited. The Board carried out inspection of books of accounts and records of the appellant during October 6, 2004 to October 13, 2004 for the financial years 2002-2003, 2003-2004 and for 2004-2005 up to the date of inspection and noticed certain irregularities in the maintenance of books of accounts and compliance with the regulations/circulars issued by the Board from time to time. A copy of the inspection report was made available to the appellant on January 3, 2005 asking it to submit its comments together with documents, if any, in support of the comments. Thereafter a show cause notice dated September 14, 2007 was issued to the appellant indicating the irregularities committed by it in the maintenance of records and asking it to show cause as to why an enquiry should

not be held against it in terms of Rule 4 of the Securities and Exchange Board of India (Procedure for Holding Inquiry and Imposing Penalty by the Adjudicating Officer) Rules, 1995 and why penalty should not be imposed under Section 15HB of the Securities and Exchange Board of India Act, 1992. The appellant filed a reply dated November 12, 2007 denying the allegations of irregularities and denying that it had violated any of the regulations/guidelines of the Board with regard to maintenance of its books of accounts. An opportunity of hearing was also provided to the appellant after which the adjudicating officer of the Board passed the impugned order dated February 14, 2011 holding the appellant guilty of the following irregularities:

- (i) Paying and receiving cash to/from clients in lieu of securities thereby violating regulation 26(xv) of the Securities and Exchange Board of India (Stock brokers and Sub-Brokers) Regulations, 1992 (for short the stock brokers regulations) read with Board's Circulars dated November 18, 1993 and August 27, 2003.
- (ii) Allowing unauthorized persons to carry out proprietary account trading besides client based trading thereby violating regulation 26(xv) of the stock brokers regulations.
- (iii) Failing to segregate client's funds with its own thus violating regulation 26(xiii) of stock brokers regulations and Board's circular dated November 18, 2003; and
- (iv) Not mentioning the settlement number in contract notes issued by it thereby violating regulation 26(xvi) of stock brokers regulations.

By the impugned order, the adjudicating officer imposed a penalty of ₹ 5 lacs on the appellant for the aforesaid violations. Hence this appeal.

2. We have heard the learned counsel for the parties who have taken us through the record. It is argued by learned counsel for the appellant that it has furnished satisfactory explanation which has not been accepted by the adjudicating officer. The alleged irregularities are procedural in nature and following the dictum of earlier orders of this Tribunal, no penalty can be imposed on the appellant for the alleged irregularities. Our attention was also drawn to an order of this Tribunal passed on June 16, 2011 in

Appeal no. 23 of 2011 (Religare Securities Limited vs Securities and Exchange Board of India) wherein the Tribunal has observed as under:-

“It must be remembered that the purpose of carrying out inspection is not punitive and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. We also cannot lose sight of the fact that every minor discrepancy/irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and making it compliant. This will, of course, depend on the nature of the irregularity noticed and we hasten to add a caveat that it is not being suggested that if any serious lapse is found during the course of the inspection, the Board should not proceed against the delinquent.”

Learned counsel for the appellant has also drawn our attention to this Tribunal’s order dated May 2, 2008 in Appeal no. 27 of 2008 (SMC Global Securities Limited vs Securities and Exchange Board of India) where observations made in an earlier case of Harinarayan G. Bajaj (Appeal no. 117 of 2003 dated 10.10. 2007) were relied upon and submitted that procedural precautions prescribed in Board’s circular are only guidelines and not mandatory and hence penal provisions are not attracted. This is what the Tribunal has held:

“8.....The learned senior counsel for the appellants referred to the Board circular no.SMD I / 23341 dated 18.11.1993 listing the precautions to be exercised by member-brokers of recognized stock exchanges while trading on behalf of their clients and entertaining new clients. The Board in its wisdom considered it necessary to list these precautions so that they were uniformly followed by the member-brokers as this would protect the interests of member-brokers, instill transparency and discipline in the deal between clients and brokers and would contribute to the healthy working of the secondary capital market. The precautions to be exercised by the member-brokers have been classified into two categories- (a) mandatory; and (b) precautions by way of a guideline. The Board wants member-brokers of the exchanges to compulsorily follow the precautions suggested in part (a) of their operating system, whereas those suggested in part (b) may be treated as guidelines to be followed as and when circumstances warrant. **We have gone through the mandatory precautions laid down by the board and find that there is no requirement of any broker to know from his client the names of other brokers through whom he may be dealing with.....**In view of the aforesaid circular issued by the Board, we have no hesitation in holding that it was not a mandatory requirement for a trader to inform his broker about other brokers through whom he was dealing in the scrip though the form contains a clause requiring a trader to furnish such information.....”.(emphasis supplied).”

Let us now examine the irregularities which have been pointed out by the Board in the impugned order. The appellant is alleged to have paid and received cash to/from clients

in lieu of securities which is alleged to be in violation of Regulation 26(xv) of the stock brokers regulations read with Board's circular dated November 18, 1993 and August 27, 2003. The appellant submitted before the Board that the transactions were made against trading obligation of clients in exceptional circumstances and in the interest of commercial prudence. It was further submitted by it that the number of such transactions is negligible when compared to the total transactions during the period covered by the inspection report. All such cash transactions were of small amount and were not violative of even the requirements of the Income Tax Act. Under the Board's circular dated November 18, 1993, these instructions are only guidelines and not mandatory requirements. It is only under the circular dated August 27, 2003 that the instructions were reiterated that brokers and sub-brokers should not accept cash from the client. The Board has not accepted the reply of the appellant on the ground that the noticee failed to give strict proof of the exceptional circumstances that led noticee to accept or pay to the clients in cash. Learned counsel for the Board submitted before us that even if the cash transactions entered into by the appellant may not be large as compared to the total transactions and irrespective of the fact that these transactions are for an amount of ₹ 20,000/- and less, it will not make any difference as the circular issued by the Board specifically mandates that all payments shall be received/made by the brokers from/to the clients strictly by account payee crossed cheques/ demand drafts or by way of direct credit into the bank account or any other mode allowed by the Reserve Bank of India. It is only in exceptional circumstances that a broker or sub broker may receive the amount in cash to the extent not in violation of income tax requirements as may be enforced from time to time. Even this requirement of making payment in cash in exceptional circumstances was introduced only by the Board's circular dated August 27, 2003. The earlier circular dated November 18, 1993 did not permit even such concession.

3. Regulation 26 of the stock brokers regulations makes a stock broker or a sub broker liable to monetary penalties in respect of the violations mentioned thereunder. Clause (xv) of the said regulation makes failure to comply with the directions issued by the Board under the Act or the Regulations framed thereunder liable to monetary penalty.

The violation in the case in hand is neither of the Act nor of the Regulations framed thereunder but of the two circulars mentioned above. Perusal of the record made available to us shows that the number of transactions which were entered into by the appellant in cash to/from clients in lieu of securities is small as compared to the total number of transactions entered into by the appellant during the inspection report and all such transactions are of amounts less than ₹ 20,000/-. As observed in the earlier decisions of this Tribunal referred to above, the purpose of carrying out inspection is not punitive and every minor discrepancy/ irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and making it compliant. We also notice that while holding the appellant guilty of this irregularity, the adjudicating officer has stated that the noticee failed to give strict proof of what were the exceptional circumstances that led noticee to accept or pay to the client in cash. If that was so, the adjudicating officer could have sought further clarification from the appellant which was not done. We are inclined to agree with the learned counsel for the appellant that in the facts and circumstances of this case the irregularity is not culpable enough calling for monetary penalty.

4. The other irregularity for which the appellant has been held guilty by the adjudicating officer is that the appellant allowed unauthorized persons i.e. the employees of its group company M/s. Uttam Financial Services Limited to carry out proprietary account trading besides client based trading. The appellant had admitted that some persons who operated the proprietary account trading enabled terminals were employees of its group company and those employees were seconded to it by the said group company and were working under the direct control and supervision of the appellant. The proof of secondment of the persons by the group company was also submitted by the appellant which was not accepted by the adjudicating officer on the ground that it is not ascertainable whether the persons who were deputed to the noticee carried out the proprietary trading besides client based trading. The other ground for not accepting the appellant's reply was that the memos of secondment are blanket agreement entered into with a group company. We are unable to accept the logic given by the adjudicating

officer of the Board. In the absence of any bar in the rules or regulations on this subject, we do not find any illegality or irregularity in the procedure adopted by the appellant in this regard. Further the appellant has been held guilty of violating regulation 26(xv) of the stock brokers regulations. The said Regulation makes a stock-broker or sub-broker liable to monetary penalty if he fails to comply with directions issued by the Board under the Act or Regulations framed thereunder. No provisions of the Act or Regulations have been pointed out which have been violated by the appellant in this case. We are, therefore, unable to agree with the findings arrived at by the adjudicating officer in this regard.

5. The next irregularity on which the appellant has been found guilty is failure to segregate the client's fund from its own fund which resulted in client's accounts being used for purposes other than that of clients' transaction. In its response to the adjudicating officer, the appellant had submitted that the amounts alleged to have been withdrawn by it from the client accounts and used for purposes other than client transaction never exceeded the brokerage due to it on the date of such withdrawal. In support, the appellant had submitted summary of funds transferred from client's account to business account which were later on certified by the chartered accountant also that the said amounts represent the brokerage. However, the explanation furnished by the appellant was not accepted by the adjudicating officer stating that from the details furnished, it is not clear that the withdrawals were the actual brokerage earned by the appellant on the said dates. Learned counsel for the respondent Board has placed on record sample of receipts and payments made through the client account which were made available to the appellant also along with the show cause notice which shows receipts and payments even on account of "salary and other benefits," " interest on FD," "FDR," " telephone charges" etc. It was submitted that the expenses/investments made from the clients fund by the appellant as noted above are not permissible under the regulations and hence violative of regulation 26(xiii) of the stock-brokers regulations. We have considered the submissions made by both the parties and also seen the documents relied upon by them. The Board's circular dated November 18, 1993 which prescribes regulation of transactions between

clients and brokers specifically mandates that no money shall be drawn from clients account other than:

- “(i) money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the Member from clients or money drawn on client’s authority, or money in respect of which, there is a liability of clients to the Member, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client:
- (ii) such money belonging to the Member as may have been paid into the client account under para 1 C [ii] or 1 C [iv] given above;
- (iii) money which may by mistake or accident have been paid into such account in contravention of para C above.”

No explanation is forthcoming on records explaining the entries in the sample of receipts and payments made through client’s account with regard to salary, interest on FD, telephone charges, FDR etc. Such withdrawals are not permissible under the Board’s circular referred to above and, therefore, we do not find any infirmity in the findings arrived at by the adjudicating officer in this regard.

6. The last irregularity on which the appellant has been found guilty is that he had not mentioned settlement number and order time in the contract notes and thus, failed to issue the contract notes in the form and manner and this amounts to violation of regulation 26(xvi) of the stock-brokers regulations. The said regulation makes a sub-broker liable to monetary penalty for failure to exercise due skill, care and diligence. The explanation furnished by the appellant was two fold, (i) the date of settlement is duly mentioned in the contract notes issued to the clients and (ii) they were issuing a single contract note to the client for all the transactions during the day. Therefore they were not mentioning the settlement number. It was further clarified by the appellant that after the irregularity was pointed out, it had started incorporating the settlement number and order time in the contract notes. This explanation has not been accepted by the adjudicating officer and the appellant has been found guilty of violating Regulation 26(xvi) of the Stock-Brokers Regulations. After perusing the record, hearing learned counsel for the parties and relying on the principle laid down in earlier orders of the Tribunal referred to above, we are of the considered view that these procedural irregularities for which corrective measures have been taken by the appellant do not call for any punitive action.

7. As stated above, the action to be taken against an intermediary for violation of procedural requirements noted during inspection will depend on the nature of irregularity committed by it. The adjudicating officer found the appellant guilty of four irregularities. However, we are of the considered view that the appellant is guilty of only one irregularity i.e. using client's account for purposes other than client's transactions which is violative of Board's circular dated November 18, 1993 read with regulations 26 (xiii) of the Regulations. In the facts and the circumstances of the present case and keeping in view the earlier orders of this Tribunal referred to above, we are of the considered view that the ends of justice could be met by imposing a penalty of rupees one lakh only.

In the result, the appeal is partly allowed. The penalty imposed by the adjudicating officer is reduced to rupees one lakh with no order as to costs.

Sd/-  
P.K.Malhotra  
Member

Sd/-  
S.S.N. Moorthy  
Member

29.7.2011  
pmb

Prepared & Compared By: Pmb