

**IN THE SECURITIES APPELLATE TRIBUNAL
MUMBAI**

Appeal No.122 of 2007

Date of Decision: 7.1.2008

Active Finstock Private Ltd.

.....Appellant

Versus

Securities and Exchange Board of India

.....Respondent

Present : Shri P.N. Modi, Advocate with Shri Ranjit Bhonsale, Advocate for
the Appellant

Shri Cherag Balsara, Advocate with Shri Mihir Mody, Advocate and
Shri Pushkar Baware, Advocate for the Respondent

CORAM

Justice N.K. Sodhi, Presiding Officer

Arun Bhargava, Member

Utpal Bhattacharya, Member

Per: Justice N.K. Sodhi, Presiding Officer (Oral)

The appellant before us is a stock broker registered with the Securities and Exchange Board of India (for short “the Board”). Its premises were inspected by a team of inspectors appointed by the Board and the period of inspection was from 1.4.2002 to 31.3.2004. During the course of the inspection, the inspecting team found certain deficiencies and short comings in the maintenance of records by the appellant as a stock broker. On the basis of the inspection report, the appellant was served with a notice dated January 9, 2006 calling upon it to show cause why an enquiry be not held against it for

imposing penalties under section 15-HB of the Securities and Exchange Board of India Act, 1992 (hereinafter called “the Act”). Section 15HB provides that “whoever fails to comply with any provision of the Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees”. The four specific charges levelled against the appellant were as under:-

- (1) It had not segregated the client’s funds from its own funds thereby violating the circular of 18.11.1993.
- (2) The appellant had dealt with the following three unregistered sub-brokers thereby violating Regulation 26 (xiv) of the Broker and Sub-broker Regulations.
 - (a) Ashish Chhotaria
 - (b) Wallstreet Capital Markets Pvt. Ltd.
 - (c) M/s. Ketan Shah & Co.
- (3) The appellant was found to have made payments to its clients having debit balances in their accounts and this meant violating Regulation 26(xv) of the Broker and Sub-broker Regulations.
- (4) The appellant had failed to comply with the directions issued by the Board and thereby failed to exercise due diligence, skill and care which meant violation of the Code of Conduct prescribed for the Brokers.

The appellant filed its detailed reply controverting all the allegations. On a consideration of the material collected during the course of the inspection including the inspection report, the adjudicating officer found that the charges

had been established and, therefore, by her order dated January 29, 2007 she levied a penalty of Rs.1,00,000/- on the appellant. It is this order which is now under challenge under section 15T of the Act.

2. We have heard the learned counsel for the parties and shall deal with each charge separately.

Charge No.1.

The allegation levelled against the appellant is that it did not segregate the clients funds from its own funds while trading on their behalf. When this case came up for hearing before us on 5.12.2007, the learned counsel for the appellant relied upon several documents which are exhibits 'K to O' with the memorandum of appeal to contend that the finding was factually incorrect. Reliance was placed on a certificate issued by the auditors of the appellant company to the effect that the funds had infact been segregated. The learned counsel appearing for the Board pointed out that the documents relied upon had been placed before us for the first time and that the adjudicating officer had had no opportunity to look into those documents. Since the documents had some bearing on the merits of the contentions sought to be made on behalf of the appellant, we directed the adjudicating officer to look into those documents and submit a report to us in regard to their authenticity particularly the certificate issued by the auditors and also their effect on the merits of the case. The report was filed on 20th December, 2007 and a copy of the same was furnished to the appellant. We find from the report that it only deals with exhibit K which is the auditor's certificate certifying the amount of brokerage lying in the clients accounts which actually belonged to the appellant. The correctness of this document has not been doubted. The adjudicating officer has not commented on any other document and, therefore, we are proceeding on

the basis that the documents referred to are genuine and authentic. In the report now submitted to us, the adjudicating officer has given a clean chit to the appellant in regard to the first charge except in regard to one item to which we will now refer. It is stated in paragraph 8 of the report that the appellant made a payment of Rs.1,33,81,621/- on August 23, 2002 for borrowing 31,100 shares of Infosys from the Stock Holding Corporation of India. It is admitted in the same paragraph that a total of Rs.1,77,70,555.37 p were lying in the client's account as on August 23, 2002 as unused brokerage earned by the appellant as a stock broker. This being so, the appellant obviously used its own money to pay to the aforesaid Corporation for its proprietary trades. Admittedly, the unused brokerage lying in the clients account was the money belonging to the appellant and it could use the same for its proprietary trades. We do not think that the appellant did anything wrong. Reference is made to the circular dated November 18, 1993 to say that the said circular was violated when the appellant used the aforesaid amount. We do not think so. The learned counsel for the parties have taken us through this circular and it no where debars a broker from using the unused brokerage lying in the client's account for his own proprietary trades. We are therefore satisfied that the part of the charge which the adjudicating officer has upheld against the appellant is also not established. It is, thus, clear that the first charge as a whole is unsubstantiated.

Charge No.2

This charge pertains to the allegations that the appellant had dealt with unregistered sub brokers whose names have been mentioned in the show cause notice. The adjudicating officer has herself observed that the charge that the appellant dealt with Ashish Chhotaria and Wallstreet Capital Markets Pvt. Ltd. as unregistered sub-brokers has not been established. According to her the only

unregistered sub-broker with whom the appellant had dealt with was M/s. Ketan Shah and Co. It is true Ketan Shah & Co. had not been registered as a sub-broker with the Board but it is not in dispute that the sub-broker had applied for registration on August 5, 2002 and pending its application for registration it started business with the appellant and worked for 22 days till it got the registration. The short question is that could the appellant deal with this unregistered sub-broker during the pendency of the application for registration. The answer has to be in affirmative in view of the proviso of Rule 3 of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Rules, 1992. Rule 3 provides that no stock broker or sub-broker shall buy, sell or deal in securities unless he holds a certificate granted by the Board under the Regulations. The proviso to this rule then states that such person may continue to buy, sell or deal in securities if he had made an application for such registration till the disposal of such application. It is common case of the parties that M/s. Ketan Shah & Co. worked as a sub-broker for a period of 22 days during which period its application for registration was pending. This being so, we cannot uphold the finding of the adjudicating officer that the appellant could not have dealt with M/s. Ketan Shah & Co. till it got itself registered.

Charge No.3

The allegation is that the appellant had made payments to clients who had debit balances in their accounts and the charge is that it funded their trades. This, according to the adjudicating officer, was in violation of the Board circular dated May 7, 1997 to which reference has been made in paragraph 31 of the impugned order. This finding of the adjudicating officer cannot be upheld for the reason that it misquoted the circular and omitted the word '**not**'

which otherwise figures in the circular. The circular provides that borrowing and lending of funds by a trading member in connection with or incidental to or consequential upon the securities business would ‘not’ be disqualified under Rule 8(1)(f) and 8(3)(f) of the Securities Contracts (Regulation) Rules, 1957. In view of the circular it is clear that lending of funds by a trading member in the circumstances alleged was not disqualified under the said rules. In this view of the matter the findings recorded by the adjudicating officer on charge no.3 are also set aside.

Charge No.4

This is a general charge levied against the appellant that it failed to comply with the directions issued by the Board through its various circulars. The show cause notice does not refer to any specific direction issued by the Board which the appellant had failed to carry out. While recording findings against the appellant, the adjudicating officer referred to circulars and rules mentioned in the first three charges and held that the directions issued therein had not been complied with and therefore this charge stood established. This is not the way of recording findings on a general charge like this. The first three charges specifically referred to the violation of certain specified circulars and rules and we have found that there was no violation. In view of our findings we cannot uphold the findings on this charge as well. We specifically put it to the learned counsel for the Board as to which are those directions which the appellant has failed to comply with. He, too, could not point out any specific direction except the circulars and rules referred to in charges 1 to 3. The finding of this charge is only imaginary and cannot, therefore, be upheld.

.7.

Since the findings on all the four charges have been reversed, we have no hesitation in allowing the appeal which we hereby do and set aside the impugned order. There is no order as to costs.

**Sd/-
Justice N.K. Sodhi
Presiding Officer**

**Sd/-
Arun Bhargava
Member**

**Sd/-
Utpal Bhattacharya
Member**

RHN
7.1.2008