

**THE GAZETTE OF INDIA
EXTRAORDINARY
PART – II SECTION – 3 SUB-SECTION (ii)
PUBLISHED BY AUTHORITY
SECURITIES AND EXCHANGE BOARD OF INDIA
NOTIFICATION**

Mumbai, the 04th day of April, 2003

ORDER

IN THE MATTER OF SUPERSEDING THE BOARD OF DIRECTORS OF PUNE STOCK EXCHANGE LIMITED UNDER SECTION 11 OF THE SECURITIES CONTRACTS (REGULATION) ACT, 1956.

S.No. 398 (E) 1. The Securities and Exchange Board of India (hereinafter referred to as the SEBI) conducted an investigation into the listing and price-rise of securities of M/s. Home Trade Limited (formerly M/s. Euro Asian Securities Limited) [for brevity's sake referred to as 'HTL']. SEBI also carried out the annual inspection of the Pune Stock Exchange, (hereinafter referred to as 'PSE') during March 2002, with particular reference to the surveillance mechanism of PSE and serious allegations against the Ex-President of PSE, Shri P.C Mutha. The aforesaid investigation and inspection conducted by SEBI revealed that the general functioning and administration of PSE, by the governing board which took over on September 29, 2001 was not carried out in accordance with the provisions the Securities Contracts (Regulation) Act, 1956 (for brevity's sake referred to as the Act) and the Rules made there under. It was also observed that the various circulars / directives/ instructions issued by SEBI under the provisions of the SEBI Act 1992, (hereinafter referred to as the SEBI Act) had not been complied with by the PSE. Further the inspection of the PSE Securities Limited (hereinafter referred to as PSESL) which is the subsidiary of PSE, was

conducted in March 2002. The inspection revealed serious irregularities and interference of members of governing board of PSE in finding of PSESL.

2. The serious irregularities / lapses found during the said investigation and inspection are briefly mentioned below:

In the matter of the listing of the securities of Home Trade Ltd.

- (i) The offer for sale of the shares of Euro Asian Securities Ltd. (name subsequently changed to Home Trade Ltd.) did not receive the minimum public subscription of 25% of post – issue paid up equity capital.
- (ii) PSE failed to exercise due diligence in eliminating the applications made by the promoters Shri Sanjay Agarwal and Shri Subodh Bhandari in the public category in the issue of the offer of sale of the shares of HTL and instead continued to accept the holding by these promoters in the category of Indian Public when the same should have been shown under the category 'promoters holding'. Thus the consideration of the holdings of the promoters under the “public category” was erroneous.
- (iii) In terms of Clause 40A of the Listing Agreement, the company is required to maintain on a continuous basis, the minimum level of non-promoters holding at the level of public shareholding, as required at the time of listing and in case, the same is lesser than the limit at the time of initial listing, the company is required to raise the same to the level of ten percent within one year of the issuance of the SEBI Circular dated May 2, 2001. The PSE failed to ensure the compliance of Clause 40A by HTL which had a public holding of around 3%.

Thus the listing permission granted by PSE was not in accordance with Securities Contract (Regulations) Act, its Rules and listing agreement in as much as the PSE granted permission to HTL for the listing of its shares on the exchange in spite of the irregularities, mentioned above.

Abnormal Price rise of securities of Home Trade Ltd.

- (i) Investigations carried out with regard to the transactions on the PSE, prima-facie revealed that the trading in the scrip of HTL which was listed on PSE, started on November 15, 1999 at a rate of Rs. 250/- and rose to Rs. 800/- during March 2000 i.e. within in a period of 4 ½ months, which indicated that the price rise was very abnormal. It was further noted that, the price of the scrip during the period December 10, 1999 to January 20, 2000 increased from Rs. 320/- to Rs. 720/- within in a span of 40 days i.e. 27 trading days in six settlements of PSE.
- (ii) The order Log and Trade Log analysis for the period mentioned above revealed that certain brokers of PSE namely, Yatin D. Shah (Clg. No. 77), Shobha Investments (Clg. No. 91), Amin Mulani & Co. (Clg. No. 222) and Harish Kadam (Clg. No. 247) had entered orders in the scrip of HTL on PSE with a view to establish a higher price for the scrip during the above period. The transactions by these brokers together constituted around 79-80% of the total purchase as well as total sell transactions in the scrip in PSE, which indicated that only a few brokers mentioned above were actively transacting in the scrip of HTL on the PSE. Thus there was neither a significant number of market participants on the exchange nor was there the possibility of true discovery of price in the scrip.
- (iii) Several instances of counter-party matching system were noticed between the above mentioned brokers. It was noted that, these brokers put buy orders at rates which were higher than the prevailing market price or last traded price in the scrip at the time of entering the orders. It was also seen that the price had moved up significantly with very low volumes.

- (iv) Enquiries conducted with PSE revealed that PSE did not take any risk containment measures such as imposition of special margin, putting the scrip on spot basis, suspension of trading in the scrip, indefinite suspension to curb/check this artificial price rise, etc.

PSE did not conduct any inspection of books of any of the aforesaid brokers, with a view to ascertain the genuineness of the transactions of the brokers and their clients in the scrip of HTL.

Surveillance mechanism

- (i) The inspection team was informed that the elected members of the council indulged in daily interference with the surveillance function, in violation of the SEBI Circular LKS/236/2000 dated May 25, 2000.
- (ii) Trades in HTL on the specific day of inspection indicated the possibility of creation of artificial volumes and circular trading. No steps were taken by PSE to monitor the trading in the scrip or ascertain whether manipulation or circular trading had taken place. This is in violation of SEBI Circular LKS/236/2000 dated May 25, 2000.
- (iii) There was no exclusive staff for surveillance since the surveillance staff was carrying out other activities also. This resulted in the Surveillance Department not having adequate time to carry on the surveillance activities. The same is in violation of SEBI Circular ref IEMI/LKS/MI/2990/95 dated August 8, 1995.
- (iv) There were no restrictions for entry into the surveillance room. As a result everybody including brokers were being given easy access to the surveillance room.

- (v) PSE did not provide training and certification programme to its surveillance staff in accordance with SEBI Circular ref. no. LKS/236/2000 dated May 25, 2000.
- (vi) PSE had not complied with SEBI's circular dated 25.5.2000 regarding benchmarking and prioritisation of alerts generated under the Stock watch system.
- (vii) No proper documentation of surveillance functions as required in accordance with SEBI's circular ref. no. LKS/236/2000 dated 25.5.2000 was done.
- (viii) PSE had not defined any procedure to prevent leakage of information/misuse of information. Further, surveillance department did not monitor the trades related to specific instances like takeovers, insider trading, preferential offers, etc.

Other charges specifically observed in the inspection

- (i) Margin money was collected by way of cheques. There was no documentation for cheque receipt, realization, etc. making it difficult to monitor the receipt and realization of the same. This also resulted in the delay in realisation of the margins. Further the exposures available to a broker were increased the moment the cheque was deposited in the exchange and not when it was realised, leading to a gap of two days and more if the cheque was dishonoured. The said practice was contrary to their claim of having introduced direct debit of member accounts for margins vide circular dated September 20, 2002.

- (ii) Maintenance of Base Minimum Capital was not as per SEBI SMD Circular no. 19 dated July 2,1999. The Fixed Deposits were not fully discharged. Instead a “no objection certificate” of the member was required before the same could be realised by the PSE. As a result the PSE only had a piece of paper, in the event of a member refusing to give the “no objection certificate”.
- (iii) PSE did not monitor the compliance by the various companies as regards the conditions for continual listing on account of the lack of staff.
- (iv) There was sharing of staff with PSE Securities Ltd. (subsidiary of PSE). The staff was withdrawn from vital regulatory functions of PSE such as margin collection, monitoring of the compliance by the companies with the conditions of the listing agreement, inspection of members' books and the follow up action thereto. These staff of exchange were deployed for the work of PSESL. Thereby compromising with the regulatory role of the Stock Exchange.
- (v) The scope and functions of the Disciplinary Action Committee had not been finalised. PSE had failed to implement the suggestions and observations made in the SEBI Inspection Reports of 1999-2000, which again were mentioned in the inspection report of 2000-2001. The PSE confirmed vide their letter dated January 9, 2001 that the practices followed at other Stock Exchanges would be considered and suitable decision would be taken in this regard. Despite the same, the did not take any action in this regard till date.
- (vi) PSE had not maintained a separate account for the implementation of arbitration awards as required by SEBI circular on the grounds of seeking clarification from SEBI. This was a violation of SEBI Circular

no. SMDRP/POLICY/CIR-22/99 dated July 1999 and SEBI Circular no. SMDRP/POLICY/CIR-06/2002 dated March 27, 2002

- (vii) The defaulter's cards had not been auctioned off in the chronological order.
- (viii) It was observed that some of the amendments in the articles, bye-laws and regulations as directed by SEBI had not been incorporated.
- (ix) Profits on account of close outs were not credited to the Investors Protection Fund as stipulated in SEBI circulars. This was a violation of SEBI Circular no. SMDRP/POLICY/10/99 dated May 4, 1999.
- (x) The SEBI restriction on short sales imposed pursuant to events in March 2001 were not implemented by PSE, in violation of SEBI Circular no. 13 dated March 07, 2001.
- (xi) The post of the ED is vacant since 2001.
- (xii) The reports of the inspected members had not been processed for follow up action citing lack of staff as the reason for the same. Action had not been taken against the members who had violated the rules and Bye-laws of PSE.
- (xiii) One of the sub brokers (Sanjay Mantri Securities Pvt. Ltd.) of PSE Securities Limited was allowed to trade as sub broker between August 09, 2001 till October 22, 2001 without SEBI registration certificate which was subsequently obtained only on April, 15, 2002.
- (xiv) No deposit / BMC (for brevity's sake referred to as BMC) was collected from sub-brokers for granting exposures till August 25, 2001.

- (xv) Prior to August 25, 2001 there was no basis for allowing trading exposures amongst the sub brokers.

Allegations Against The Ex-President Shri P.C. Mutha:

- (i) As regards the issue of orders regarding allowing exposure / trading limit and margins to different members, parity was not maintained in exposure/ margin collection. Different exposures were permitted by the said President to different brokers on an arbitrary basis.
- (ii) Trading limits had been fixed by said President issuing a letter to the surveillance dept. , BMC of the members had been shown to have a capital of Rs. 1 lakh, though the said capital had not been actually brought by the member. The exposure limit of different members had been arbitrarily fixed.
- (iii) Directions were given by the President to the effect that margin need not be collected from the members of the PSE Securities Limited. This exemption, upto Rs. 10,000/- towards the mark-to-market margin was granted vide note dated July 6, 2001.

For the allegations against the Ex-President mentioned above, a separate show cause notice was issued vide SEBI letter dated September 27, 2001, and the same is being processed separately.

MAJOR OBSERVATIONS OF THE INSPECTION OF PSE SECURITIES LTD, SUBSIDIARY OF PSE (hereinafter referred to as PSESL) :

- (i) A resolution was passed to the effect that the retiring directors be not re-appointed and the vacancies thus caused may be filled by the Board of Directors as they deem fit. The validity of the above resolution, in light of the provisions of the Companies Act, 1956 was found to be invalid. Further, it was resolved that “ the directors of PSE and PSE Securities should be same ”. this resolution was not implemented (nominated directors of PSE have not been nominated as directors of PSESL)
- (ii) Several discrepancies were observed in the contract notes like not issuing them within the stipulated time, while some of the contract notes issued by PSESL showed a single trade twice and some of the contract notes showed the transactions in single scrip in two different names.
- (iii) With respect to deposits/capital contribution, it was observed that one of the members Mr. A. P. Trimbake, sub-broker no. 86, had not paid up his entire contribution towards the capital and had paid up only Rs.1.00 lakh against Rs.2.00 lakhs. Further several Instances of cheques issued towards deposit being dishonored was observed for which the intimation was being received by PSESL after a period of one month or even more than a month, during which period the sub-brokers terminal were kept active.
- (iv) With respect to, trading and settlement etc., it was observed that one of the sub-brokers (Sanjay Mantri Securities Pvt. Ltd.) of PSESL was not registered with the SEBI as a sub-broker between August 9, 2001 to October 22, 2001 but was allowed to trade as the sub-broker, although the certificate of registration was obtained on August 15, 2002. It was also observed that members registered with SEBI in corporate names were trading in their individual names. Dividends received on behalf of the clients amounting to Rs. 3328/- had not been passed on to the clients.

- (v) Regarding activation of trading terminals the following violations were observed :

The sub-brokers terminals were activated before getting their SEBI registration, no Deposit/Base Minimum Capital was collected from Sub-Brokers for granting exposures till August 25, 2001. Prior to August 25, 2001, there was no basis for allowing trading exposures amongst the sub-brokers, two of the members, Jade Capital Services Pvt. Ltd. and S S Dhamankar have been trading inspite of not bringing in the BMC, the decision regarding reduction in Deposit/BMC was not being taken in any of the Board Meetings. PSESL had taken Security Deposit of Rs.50,000/- from a member who wanted to trade as sub-broker with it and the same was thereafter reduced to Rs.25,000/- for some of the members.

- (vi) There was no formal system of changing the trading/exposure limits of the sub-brokers. The sub-brokers directly deposited the cheques for additional capital with the Surveillance Department for which no record was maintained.

- (vii) It was observed that no margin was collected in case the margin obligation was upto Rs.1.00 lakhs. Margins were collected by way of cheques also. There are instances wherein cheques had been dishonoured and the amount was yet to be collected.

- (viii) No formal procedure was in place for intimation of the securities paid in before the settlement day to the surveillance department for release of the margins. The early pay-in statement was sent to the surveillance department on a plain paper without any authorization/signature of the concerned official.

(ix) In case of default where the obligation was between the sub-brokers themselves there was no system of auction. PSES followed a practice of closing out the deal between the sub-brokers at the highest price for the scrip as on the day of the auction, i.e. the settlement day. This process did not automatically penalize the defaulting sub-broker.

3. In view of the irregularities mentioned above, SEBI issued a notice dated August 22, 2002 under Section 11 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as SCRA) to the Governing Board of the PSE (here after referred to as “the Governing Board”) advising them to show cause as to why the Governing Board should not be superseded in view of the above mentioned instances of mismanagement and irregularities in the functioning of the exchange. The Governing Board was called upon to submit their reply to the show cause notice within 15 days from the date of the receipt of the notice and they were given an opportunity for personal hearing on September 14, 2002.

4. The Governing Board vide its letters dated August 24, 2002 and September 2, 2002 sought time of one month to submit their reply and for appearing before the SEBI Chairman for a personal hearing. Thereupon SEBI, vide its letter dated September 3, 2002 granted extension of time upto September 11, 2002 for submitting the reply and also advised the governing board to be present for a personal hearing before the Chairman, SEBI on September 16, 2002.

5. Thereafter PSE vide its letter dated September 09, 2002 replied to the show cause notice, and inter alia made the following submissions.

Listing of Home Trade Ltd.

- (i) The primary responsibility in the matter of the offer for sale was that of the company / offeror and PSE was to be consulted only for the basis of allocation and that too at the fag end of the process. In view of the same, after checking the usual points in the matter, the PSE gave its approval in the normal course. Thereafter trading in the scrip of M/s. Euro Asian Securities Limited began with effect from 15/11/1999.

The following points were raised which are reproduced hereunder.

(ii) OFFER FOR SALE TO PUBLIC

(1). Issue opened 27-10-1999

(2). Issue closed 30-10-1999

(3). Total No. of Shares 2,39,61,000

Offered to Public – 25% i.e. 59,90,250

(i). Categories -	Less then 1000 shares	More then 1000 shares
50% of (3)	29,95,125	29,95,125

(ii). Subscription received 6,53,900
(after rejection)

shortfall transferred to
next category

23,41,225

23,41,225

53,36,350

(iii). Allotment made	<u>6,53,900</u>	<u>53,36,350</u>
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(4). % of Post-issue public holding 25%

The shares of Home Trade Ltd. (HTL) were also listed on Bangalore Stock Exchange (BgSE) and BgSE pursuant to the grant of listing permission to the HTL.

Public Holding includes, holding by individual Indian public and the private corporate bodies.

(5). Assuming (without admitting) the following allotment may not be classified in public holding:

- Sanjay Agarwal	5,97,000
- Subodh Bhandari	<u>1,30,300</u>
	<u>7,27,300</u>

(6). Total issue size	59,90,250
Less : (5) above	<u>7,27,300</u>
	52,62,950

(7). % Post issue public holding 21.96%

Thus it was clear that even if the applications of Shri Sanjay Agarwal and Subodh Bhandari would not have been considered in the public category, the offeror received subscription to the extent of about 22% from the public.

(iii) The task of sorting of applications and all the incidental work thereto was the responsibility of the Registrars and the overall responsibility of due discharge

of the duties of all the intermediaries as per Rules, regulations and guidelines, lay with the Lead Managers.

The Stock Exchange had a limited role to play in the whole procedure of the listing of securities and relied on the authenticity of various certificates/declarations made by the Intermediaries.

- (iv) HTL did not have a public holding of around 3%". The public holding was 25% / 22%. The requirement laid down by SEBI of having 20 shareholders per one lac of share capital was thus satisfied. Hence the observation in the show cause notice that the company was required to raise non-promoters' holding was not based on correct facts/records. There were hundreds of the companies on the BSE in which entire capital is held by promoters and their associates till date and there is no public holding.
- (v) The Letter issued by SEBI on 18th May, 2001 regarding the Code of Ethics for Directors and Functionaries of Exchanges required that the President and Directors should not interfere in the day to day functioning of the Exchange and should limit their role to decision making on policy issues and to issues that the governing body may decide. Further the President and Directors are required to abstain from influencing the employees of the Exchange in conducting their day to day activities. In pursuance to the same, and due to the well recognized principle of limited accountability of the Board of Directors, as laid down in the Companies Act, 1956, the Board did not involve itself in the day to day working of the Exchange. The responsibility of the Council is limited to exercising overall control over the smooth functioning of the organization as a whole. It is the duty of the council to authorise a qualified and experienced person to supervise and comply with the formalities related to different functions of the working of the stock exchange. The routine matters of the exchange such as listing of a particular company were carried out by the designated officers and were generally not

referred to the council. The concept of “Management by exception” was observed by the PSE and the decisions taken in respect of delegated authorities were only reported to the council.

Investigations into the price rise of HTL

- (i) During the period between Nov 1999 to March 2000, out of an average 80 active brokers, 26 brokers were trading in the scrip of HTL i.e. almost 33% brokers of the Exchange were dealing in the shares of HTL (during the period 15/11/1999 to 31/3/2000). The rise in the scrip of HTL was commensurate with the market trend, in as much as it was a free market where brokers and clients placed orders at their will and price rise was neither suspicious / abnormal considering the prevailing trend of the stock market.
- (ii) The scrip was only listed at PSE and BgSE. In an online trading system it was not possible for a broker to know the identity of the person with whom he had done the business before the order was executed. The orders are matched by the system. The details of the executed transactions between the counter party brokers were known to the brokers after the execution of the trade. Hence the broker did not have any choice of selecting a counter party broker on the anonymous computerised trading system.
- (iii) The Exchange provides the trading platform to the members and investors to the trade and does not comment as to why a broker puts a high or low price, unless it is not within the stipulated bands predefined by the Exchange and SEBI. There was no bar for a broker or a client as to why he cannot offer/bid for a higher or lower price in particular scrip. Their role was to see that the trading was within the stipulated price band norms and no abnormal discrepancy was observed in the price movement of the scrip.

(iv) The contention that the Exchange had not conducted any enquiry / inspection of books, was not true. Pune Stock Exchange had an online surveillance whereby the scrip movement was monitored by the staff deputed for the said work. No abnormal discrepancy was observed in the price movement of the scrip, hence there was no need to impose special margins, putting the scrip on spot basis, suspension of trading in the scrip, etc. Exchange did carry out the inspection of selected brokers through an independent auditor and the said details / information were also submitted to SEBI. Inspection was carried out on a sample basis and for a selective period of time. Out of the three names mentioned in the SEBI notice, inspection of M/s.Shobha Investments was carried out by the Exchange office. As per the practice, the surveillance and monthly development reports are submitted by the Exchange to SEBI wherein the details of the companies share prices are given. The Exchange office informs the Council of Management about any abnormal price movement in a particular scrip as well as high and low prices of the top 5 scrip's traded at the Exchange. Thus the remark that the Exchange had not inspected the books of accounts of the brokers was incorrect. There had been no investor complaint. There was no broker default involving HTL. No complaints were lodged by investors for non receipt of shares purchased by or non receipts of payment for the shares sold. The investors interest has been duly protected and no investor suffered any loss. Accordingly, there was no substantiation as regards the charges related to non-inspection of books and related adverse observations.

(v) Major observations of the surveillance inspection

- (i) The contention by SEBI that the inspection team was informally informed that the Council Members indulged in daily interference with the surveillance function was not correct. Since the Surveillance Department, MoP department and Systems department were on the seventh floor, the

surveillance of PSE and PSESL was looked after by the staff in the said department. At times, due to some technical problems to the brokers, such as their inability to see their exact trading position on their terminal, or their desire to square up the position at the fag end of the day if there was a power failure, or if their machines got logged off / closed, for other reasons like taking the reports, loading the trading software on their machines, depositing letters/cheques etc, members did come to deal with the departments like MoP or systems department, which are the departments, adjoining the Surveillance Department. These activities were not specifically related to the Surveillance Department but were interconnected with other departments, Hence the dealing with the departments near the surveillance department could not be considered as the interference with the surveillance function. As such the brokers / Council members had not interfered with the margins, exposures or knowing positions.

- (ii) The Council members did not indulge in any interference with the surveillance function of PSE. Hence there was no basis to suggest that the Executive Director had shown a casual approach and attitude towards the Surveillance Department. The Executive Director took care of the responsibility given to him and there was no question of him showing ignorance or a casual approach towards the Surveillance Department. The surveillance function was never hampered at PSE.
- (iii) The Officiating Executive Director had pointed to SEBI certain instances about the earlier office bearers (President Shri.P.C.Mutha & Vice President Shri.Ashok Oswal) of the Exchange who had given certain instructions to the staff members. The said office bearers had stepped down and the Council had taken note of the same. The exchange ensured that the operations of the Exchange are carried out in a smooth manner and within the rules and regulations stipulated by SEBI. SEBI is already looking into the complaint matter of the Off. Ex. Director against the office bearer

separately. Hence they did not express their comment on the subject matter.

- (iv) They had already clarified that the trading was within the rules and limits permitted by SEBI and that the Exchange had monitored the scrip movements and taken due care in monitoring the trading activity of the shares of HTL. There was no clear definition as to what is the definition of circular trading in exact terms. In absence of the same, the interpretation of circular trading could vary in many ways. Based on the information and understanding of the words, meaning and subject, the Exchange office had investigated the said matter and submitted a report of the Auditor to SEBI.
- (v) Surveillance Department had an exclusive staff for the its activity. Over the last couple of years, the activity of MoP had decreased, and there was no trading and monitoring for the physical shares, the pay-in pay out had been automated and due to online trading, all the utilities were available at a touch of figure on the machine. Further in the last couple of months, the trading turnover at the local segment of the PSE, had become minimal or almost nil. Exchanges and the departments at the Exchanges should be compared with the Exchanges of the size of PSE.
- (vi) On account of the the surveillance department and market operations (MoP) department adjoining each other, member brokers visited the department for giving the cheques for margins and increasing the capital. This practice had been stopped and now the direct debit authority letters were taken from the members.
- (vii) Upon enquiry with BSE and NSE as to whether they conducted surveillance training, they were informed that no such training module was designed by BSE and NSE for giving training to the surveillance staff of

other Exchanges. In view of the same, the Exchange couldn't send the staff members for training.

- (viii) The Exchange had implemented the SEBI circular dt.25/5/2000 and informed SEBI vide letter No.PSE/121/2000/2770 dt.31/5/2000 that the Exchange has installed Stock Watch System at a cost of about Rs.10 lacs which was applicable to their Exchange. The alerts had been generated off line and the system was fully functional.
- (ix) The Surveillance department was maintaining the documents required to ensure transparency, objectivity and accountability in the functioning of the said department. Improvements if any needed, would be incorporated on priority.
- (x) There was no leakage of any information from the departments of the Exchange.
- (xi) During the period 1/11/1999 to 31/3/2000 there was no trading in the scrips at the stock Exchange where the takeover took place. The monitoring for insider trading activity was looked into by Surveillance Department and the activities of takeover, preferential offers etc. was looked into by the Listing department. PSE flashed relevant BSE/NSE notices as and when received.

Other major observations of the inspection

- (i) The practice of accepting the cheques for margin collection had been stopped. The debit was put directly to the member's bank account and maintenance of BMC is as per circular. Steps had been taken for obtaining the signatures of the members on the F.D. receipts for discharging the

F.D's unconditionally in favour of the Exchange. The necessary notice in this behalf had been issued to the members.

- (ii) The scope and functions of Disciplinary Action Committee as suggested by SEBI were in the process of being implemented on a priority basis.
- (iii) The Executive Director resigned w.e.f.31/7/2001. There was no full time Executive Director w.e.f. 1/8/2001. The Exchange was at an advanced stage of recruitment of the Executive Director and the delay was on account of resignation of members of the Committee and approval of reappointment of new members on the Committee, by SEBI from time to time.
- (iv) PSE Securities Ltd. Had collected an amount of Rs.2.00 lacs from each sub broker towards the paid up capital contribution. On the said basis , it was assumed that exposure could be given to the sub brokers on this amount of Rs.2.00 lacs. PSES had deposited the amount with NSE and based on the same, NSE had given free exposures. These free exposures were distributed to the sub brokers. Thus no BMC / Deposit was collected. However BMC / Deposits were collected from August 2001 onwards. Various observations made during inspection of PSES was of historical significance since the current Council of Management has already rectified and put into place a transparent model system for collecting mark to market margin, VAR margin, allowance of gross exposures, early pay-in etc. on the lines of MABC concept which was implemented by NSE. In fact the operations of PSES were being run as a mini NSE and would be a model for other subsidiaries of the Exchange. These initiatives had been taken even before being pointed out by the inspection team.

Allegations Against The Ex-President Shri.P.C.Mutha

The Council stated that both the ex-president and ex-vice president were no longer the Directors of the Exchange and since separate show cause notices had been issued to them directly by SEBI, they wished to refrain from making any comment in the matter. The current PSE Council of Management was constituted on 29/9/2001. In terms of the principles of double jeopardy, the council could not be held responsible for acts of omission and commission of the previous office bearers who were served separate show cause notice by SEBI.

Major observations of the inspection of PSES

- (i) Section 255 and 256 of the Companies Act provides for the retirement of directors by rotation and the circumstances of their automatic reappointment. In terms of sub section 4(a) the director retiring by rotation shall be reappointed, if it is not expressly resolved not to fill the vacancy and other conditions prescribed therein are fulfilled. In the present case, the AGM expressly passed the resolution to the effect that the vacancy may not be filled up and at the same time it was also resolved that the Board may fill the vacancy as they deemed fit.
- (ii) Initially there were delays in issuing the contract notes, since applicability of the requirement of contract notes was not clear, and PSES itself on its own account was prohibited to trade. Only sub-brokers who necessarily were the members of the Exchange and authorised to issue contract notes, were allowed to trade. Simultaneously they were downloading the soft copy of the contract notes to the sub-brokers terminals through the system. The errors were rectified and the company was now issuing the contract notes in time. Shortly the digital signature concept also would be rectified, which would totally eliminate the error for delayed delivery of contract notes.

- (iii) In some cases, a single trade was shown twice mainly on account of software error. The matter had been taken up with the software vendor SDG Software Technologies P. Ltd. and the error has been rectified even before inspection.
- (iv) Shri.A.P.Trimbake, a sub-broker had contributed Rs.1.00 lacs as the equity contribution as against Rs 2 lakhs and the same was also reflected in the balance sheet of the company in 2000 – 2001 and his application was not forwarded to SEBI for the sub-broker registration. There was no time limit prescribed in the Companies Act for the forfeiture of the partly paid share amount. However the sub-broker paid the balance contribution during the year 2002 – 2003.
- (v) The current Council of Management had rectified and put into place, a transparent model system for collection mark to market margin, VAR margin, allowance of gross exposures, early pay-in etc. on the lines of MABC concept which is implemented by NSE. In fact the operations of PSES was being run on the lines of a small NSE and would be a model for other Exchange subsidiaries also.
- (vi) The practice of increasing the trading limits on receipt of cheques for transfer of funds from sub-brokers was followed initially but had now been completely stopped. The sub-brokers bank account was now first debited, and after ascertaining that the bank had transferred the amount to the company's account, the sub-brokers trading limits were thereafter increased. A specific system, had been implemented which was on the basis of NSE's MABC (Margin Adjustable Base Capital) concept.
- (vii) SEBI's allegation that no margin was collected was incorrect. Margin was collected on T + 1 basis from the sub-broker / member, if the loss was less

than Rs.1.00 lacs. Where the Member -to-Member loss exceeded Rs.1.00 lacs, the sub-broker / member was required to pay the Margin on the same day itself. This was mainly due to the late reporting by the UTI Bank Limited and had been rectified.

6. The Governing board of Pune Stock Exchange (PSE) represented by Shri Manish Rangari, ED (Officiating), Directors -Shri Mahajan, Shri Paresh Mehta, Shri Sanjay Shah, Shri Narendra Palrecha, Shri Sameer Gandhi, Public Representative - Shri Kadlaskar, Advocate - Shri J.J. Bhatt, attended the hearing held on September 16, 2002
7. Shri Bhatt, who made most of the representations, submitted that the show-cause notice was mainly issued in the backdrop of HTL, besides other issues like the lapses observed in inspection and surveillance. In this regard, it was admitted that the written reply had already been submitted and the oral submissions be also considered. He stated that being a small stock exchange, PSE was helping to spread the equity cult in the western region. PSE also has a subsidiary with NSE, where 80 sub-brokers were operational. The following submissions were further made during the hearing.
 - (i) With respect to Home Trade, it was submitted that it had a high pitched ad-campaign. It was an offer for sale and the money was to go to the offerors. It was submitted that the PSE had complied with the normal requirements of Rule 19(2) (b) of the SC®R at the time of listing. The company's share price did not hit the circuit filter and the price was commensurate with the market. The settlements were smooth and there were no defaults. The charge that Home Trade had public holding of only 3 % was refuted and it was submitted that HTL had a holding of 22%.

- (ii) With respect to the issue regarding the allegations against the Ex-President and Ex-Vice President, it was submitted that they were no longer the Directors of the Exchange. As SEBI had already initiated action against both of them, they did not wish to make any comment in the matter.
- (iii) With respect to surveillance related functions, it was stated that the Council came into power subsequently while all acts of omission and commission were observed prior to 31/8/2001.
- (iv) It was reiterated that there was no interference in surveillance. It was just a case where they were sharing the floor and other departments were adjoining the surveillance. Hence there was some movement near by the surveillance department.
- (v) It was stated that although the PSE did not have a stock watch system, an alternate offline system was operational since 1999-2000 and was adequate to meet the requirements. The stock watch would cost Rs. 3.00 crs. The exchange was a small stock exchange and was in the process of strengthening and consolidating itself.
- (vi) With respect to the lapses in the functioning of the PSES, it was submitted that the subsidiary commenced trading on June 14, 2001, and no sub-brokers had defaulted as on date.
- (vii) It was submitted that the subsidiary was a new baby and there was a possibility that mistakes such as lapses of printing of contract notes etc. might have taken place but no punishment ought to be issued for the same. Adequate care had been taken to implement the MABC system - an NSE based system. PSE was the only subsidiary to adopt the system and they had moved a step ahead of T + 1 basis, that of

pre-paid system. There had been no defaults and only as few arbitration matters were filed.

- (viii) As regards the issue of HTL, and the issue of the exchange enforcing the listing norms when a company failed to comply with the same, it was submitted that at the time of listing, no harm was caused to the exchange or to the public and most of the issues had been raised only post facto. As regards the issue of whether the stock watch system was potent enough to detect abnormalities, since an amount of Rs. 2000 crores was at stake, the issue of 99% trading on the scrip and concentration of trades by a few brokers, it was submitted that the issue was discussed by the Governing Board. All the technology shares at that time were skyrocketing. 26 brokers out of 80 active brokers were trading in the scrip. The concentration of trading in the scrip, if any was not unusual. The normal distribution curve was being followed. The movement was in tune with the market and there was nothing to create suspicion.
- (ix) As regards the contention that not many changes in the systems, sufficient for the smooth functioning of stock exchange, had been observed even after the governing board had taken charge on 29/9/2001, it was submitted that the Board had ordered an inspection into Home Trade by an auditor. The report had been submitted to the BSE and SEBI, but nothing untoward was observed. It was further submitted that it was not the role of the Board to check the day-to-day activities of the Exchange.
- (x) As regards the issue of complaints made by the staff of the exchange regarding interference in the functioning of the surveillance of the exchange by the office bearers, the same were vehemently denied. It was submitted that steps such as segregating the surveillance

department, depositing margins directly into the banks and the deployment of staff to the subsidiary had been taken.

- (xi) As regards the issue that the Board has failed to perform its job properly or that the SEBI directives had not been adhered to, it was submitted that systems were in place. There were no major defaults or complaints. In view of the same, the extreme measure of supersession was too strong. It was submitted that on behalf of the Board that all steps would be taken to ensure that lapses were complied with within a period of 3 months. Exchanges were moving towards demutualization, which would ensure that interference would be minimal. It was also submitted that the spirit of the exchange had always been one of compliance and not of defiance and therefore they should be given an opportunity for improvement.

8. Consideration of the issues: -

I have taken into consideration the facts and circumstances of the case including the material available on record. From the reply made on behalf of the PSE dated September 09, 2002 I have noted that there have been several instances where the exchange has failed to maintain systems in accordance with the statutory requirements. I would like to reproduce some of the instances from which it is evident that the systems of the exchange are not in place

1. The offer for the sale of Euro Asian Securities Ltd. (name changed to Home Trade Ltd.) did not receive the minimum subscription of 25% of post – issue paid - up equity capital of the company. Further the exchange failed to carry out due diligence in eliminating applications made by the promoters i.e Shri Sanjay Agarwal and Shri Subodh Bhandari in the public category, although Shri Sanjay Agarwal had

been shown as a promoter in the prospectus, holding 10 shares and who had signed the listing agreement on behalf of HTL with the PSE. It is apparent that the Exchange has failed to rectify this irregularity or take appropriate action for the wrong declaration made by the company.

- (i) I have noted the price rise in the scrip of HTL during the period between December 10, 1999 to January 20, 2000 wherein the price of the scrip increased from Rs. 320/- to Rs. 720 in a span of 40 days i.e. i.e. during 27 trading days in six settlements of PSE. I have noted that several brokers had put buy orders at rates which were higher than the prevailing market price or last traded price in the scrip at the time of entering the orders. The significant price rise despite very low volumes clearly indicates that the exchange had failed in effecting appropriate surveillance measures in order to check whether the rise was on account of a true discovery of price in the scrip or otherwise. I refuse to accept the argument that the price rise in HTL scrip was commensurate with the market trend particularly in the light of the findings of the investigation.
- (ii) I am also of the opinion that the surveillance functioning of an exchange should be independent of other functional organs of the exchange. Strict restrictions should be in place for entry and access into the surveillance room. It is also imperative that the staff manning the surveillance department be adequately trained for carrying the surveillance activities properly. In view of the fact that the surveillance mechanism of the exchange has been found to lack these aspects, there has been a blatant violation of the SEBI circular LKS/236/2000 dated May 25, 2000.

- (iii) I also believe that collection of margin money and maintenance of base minimum capital are required to ensure that the transactions in the exchange take place safely without any defaults and without causing any loss to the investors who trade through the exchanges. Despite the same, I have noted that the exchange has been found to collect margin money by way of cheques. Further, the base minimum capital has not been maintained as per SEBI SMD Circular no. 19 dated July 2, 1999. The circular issued by the exchange on September 20, 2002, with respect to the direct debit of members account for the purpose of margins, has been done only pursuant to the personal hearing held before me.
- (iv) I have also noted that the scope and functions of the Disciplinary Action Committee of the exchange have not yet been finalized despite suggestions given by SEBI in the inspection report of 1999-2000. I have also noted that PSE has failed to maintain a separate account for the implementation of arbitration awards as required by SEBI Circular no. SMDRP/POLICY/CIR-22/99 dated July 1999 and Circular no. SMDRP/POLICY/CIR-06/2002 dated March 27, 2002. These two measures, among others, ensure proper protection to the interests of investors at large. Failure of PSE on these counts cannot be taken lightly.
- (v) With respect to inspection of PSES, I have noted that admittedly there have been several functional irregularities unbecoming of a stock exchange such as defects in the issuance of contract notes, irregularities in the maintenance of deposits/capital contribution, indiscretion in trading and settlement etc. to mention only a few such irregularities .

9. It is thus clear that the exchange has committed serious irregularities and that there have been several lapses in the matter of listing and surveillance functions. Effective and preventive steps as regards the general functioning and administration of the exchange have not been carried out in terms of the provisions of SCRA and the rules made thereunder. The various circulars /directives/instructions issued by SEBI under the provisions of the SEBI Act, 1992 have not been complied with by the exchange. Apart from a non compliance of SEBI circulars, there also appears to be a disregard for complying with the same. This is apparent in the areas of the regulation of the broker members and the exchange. I believe that it is imperative that an exchange should not only comply with the SEBI 's directives and the provisions of law , but also ensure that in the smooth functioning of the exchange, the risk management should be carried out smoothly in accordance with law and in tune with the securities market.. However, instances of permitting brokers to have easy access to the surveillance department, not monitoring the steps or having a desired stock watch system are just some of the indicators of a stock exchange functioning in a manner against the interest of the brokers, the investors and the public at large.

10. When the activities of the exchange are carried out against the interest of the investing public and in a manner which is adverse to the interest of the investors, brokers and the public; the same is bound to result in the lack of protection of the interest of the investors. I have noted that the subsidiary of the exchange i.e. PSES which has been promoted by PSE itself, does not maintain the Customer Grievance Register in a proper manner such that there is no proper format in which the grievances are written in the register. Thus, the exchange has failed to exercise due diligence in respect of PSES, which is apparent in the deficiencies noted in the subsidiary.

11. The failure of the exchange to ensure proper governance and implementation of the provisions of the SCRA, Bye-Laws of the Exchange and the SEBI

directives, could erode the confidence of the investors in a transparent and impartial working of the stock exchange. The reported instances of interference from the elected directors and brokers in the day-to-day functioning of PSE are bound to make it difficult for the exchange to function in accordance with the byelaws of the exchange and the SEBI directives. The failure on the part of the surveillance mechanism of the exchange in checking the price rise in the scrip of HTL and the manner of functioning of the surveillance department, is bound to lead to the inevitable conclusion that the surveillance department is not independent and the non-interference with the surveillance mechanism has not been ensured. Further, from the failure to carry out several statutory requirements like ensuring proper functioning of Disciplinary Action committee, maintenance of BMC and collection of margin money, appointment of directors etc it is evident that a proper system to ensure the smooth functioning of the various activities of the stock exchange, is not in place.

12. As regards the duties of directors, I would like to quote the decision of the Supreme Court taken in the case of the Official Liquidator vs. P.A. Tendolkar, reported in (1973) 43 Com Cases 382 : AIR 1973 SC 1104. in the said case wherein, it was inter alia stated that “while observing that it is a question of fact to be determined on the evidence in each case, “a director may be shown to be so placed and to have been so closely and so long associated personally with the management of the company that he will be deemed to be not merely cognizant of but liable for fraud in the conduct of the business of the company even though no specific act of dishonesty is proved against him personally. ***He cannot shut his eyes to what must be obvious to everyone who examines the affairs of the company even superficially.*** If he does so he could be held liable for dereliction of duties.....even if he is not shown to be guilty of participating in the commission of fraud”.

13. SEBI is mandated to ensure that the systems and the procedures on an exchange are such that transactions are carried on in a lawful manner and without adversely affecting the interest of investors. In order to ensure that such systemic improvements take place on the exchange, the persons who have prevented transactions from being carried on in a lawful manner need to be excluded from the governance of the exchange. Further, In order to ensure that systemic improvements take place on the exchange, it is necessary that independent and impartial persons are appointed.

14. Therefore, I am of the opinion that it is essential that immediate measures are adopted to ensure the safety and integrity of the stock exchange and to ensure that the transactions on the exchange are carried out as per the regulatory framework and that the interest of investors are not further jeopardized.

15. In view of the above, and in exercise of the powers conferred on me under Section 11 of the Securities Contracts (Regulation) Act, 1956 read with the Government of India Notification number S.O. 573 dated July 30, 1993 and Section 4 (3) of the SEBI Act, 1992, the Board of the Pune Stock Exchange is hereby superseded for a period of one year with effect from April 4, 2003 and Shri B.D. Banerjee is hereby appointed as an Administrator to exercise and perform all the powers and duties of the Governing Board. Shri Banerjee may take assistance of such persons, as he thinks it necessary.

Dated this 4th day of April , 2003

File No. SEBI/LE/ 6668 /2003

**G. N. BAJPAI
CHAIRMAN
SECURITIES AND EXCHANGE BOARD OF INDIA**