

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002

AGAINST M/S KODALI SECURITIES PVT. LTD., MEMBER, HYDERABAD STOCK EXCHANGE, (HSE) HAVING SEBI REGISTRATION NO. INB060830035

MO/122/MIRSD/10/04

1.0 **BACKGROUND**

- 1.1 M/s Kodali Securities Pvt. Ltd. (hereinafter referred to as “the member”), is a member of the Hyderabad Stock Exchange (hereinafter referred to as “HSE”) and a Stock Broker registered with Securities and Exchange Board of India (hereinafter referred to as “SEBI”) having SEBI registration no. INB060830035. The member acquired the membership rights of HSE on 22.11.95.

2.0 **INSPECTION**

- 2.1 Vide order dated 13.05.02, SEBI directed an Inspection of the books of accounts, documents and other records of the member for the period from April 2000 to May 2002, to verify the following:

- 1) Whether the books of accounts, records and other documents are being maintained in the manner specified by the Securities Contract (Regulation) Rules, 1957, and SEBI (Stock Brokers and Sub Broker) Regulations, 1992.

- 2) The provisions of SEBI Act, the Rules and Regulations made thereunder and the provisions of Securities Contract (Regulation) Act, 1956 and the rules made there under are being complied with.
- 3) Whether adequate steps for redressal of grievances of the investors are being taken and the conditions of registration as a stockbroker are complied with.

3.0 **ENQUIRY PROCEEDINGS**

3.1 On the basis of the above inspection, vide order dated July 24, 2003, SEBI appointed an Enquiry Officer to enquire into the irregularities arising from the inspection for the period April 2000 to May, 2002 conducted on June 12, 2002.

3.2 The Enquiry officer, after conducting Enquiry as per the procedure, submitted his report on 31.03.04. The following irregularities were observed by the Enquiry Officer:

- 1) That the member could not produce books and documents including duplicate copies of the contract notes, client agreements or any other relevant documents to the inspection team as the same were lost during the course of shifting of its offices. Further, the member obtained auditor's certificate dated August 29, 2002, apparently issued after verification of books of accounts by M/s G. Sambasiva Rao & Co., Chartered Accountants regarding the outstanding dues to its clients as on July 31, 2002. The Chartered Accountants confirmed that they had verified the books of the member before issuing the certificate.
- 2) The member, vide its letter dated June 12, 2002, had applied for cancellation of registration certificate. However, HSE confirmed vide its letter dated August 1, 2002 that the member collected back the registration certificate on January 12, 2002.

3.3 It was concluded by the Enquiry Officer that the member was guilty of furnishing false information to SEBI and had not co-operated with the inspection team, which is in violation of clauses A(5) and C(6) of the Code of Conduct prescribed for Stock brokers under Schedule II to Regulation 7 of the SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992 read with Rule 4 (b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992 and the Bye Laws, Rules and Regulations of HSE.

3.4 Having regard to the gravity of the irregularities established and also considering the fact that the member had surrendered its certificate of registration for cancellation, the Enquiry Officer recommended major penalty of cancellation of certificate of registration of the member.

4.0 **SHOW CAUSE NOTICE AND MEMBER'S SUBMISSIONS**

4.1 A show cause notice dated 30.04.04, (together with a copy of the Enquiry Report) was issued to the member in terms of regulation 13(2) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as 'the said regulations'), advising him to show cause as to why appropriate penalty including the penalty as recommended by the Enquiry Officer should not be imposed on it. It was further stated in the said show cause notice that the reply to the said show cause notice should reach SEBI within 15 days of the receipt of the said notice, failing which it would be presumed that the member has no explanation to offer and SEBI shall be free to take such action in the matter as it deems fit.

4.2 I further note that HSE has confirmed handing over the said show cause notice to the member. However no reply to the said show case notice has been received by SEBI till date. Therefore I note that adequate opportunity had been given to the said broker in terms of Regulation 16 of the Enquiry Regulations. Therefore, I am satisfied that the requirements of natural justice have been fulfilled and I proceed further in the matter.

5.0 **CONSIDERATION OF ISSUES**

5.1 I have carefully examined the facts and circumstances of the case. I have also considered the Enquiry Report and note that the member has not filed any reply to the show cause notice dated 30.04.04. I find that adequate opportunity had been given to the member in accordance with principles of natural justice.

5.2 ***The issue that arises for consideration in the matter is whether the member furnished false information to SEBI and had not co-operated with the inspection team, which is in violation of clauses A (5) and C (6) of the Code of Conduct prescribed for Stock brokers under Schedule II to Regulation 7 of the SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992 read with Rule 4 (b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.***

5.2.1 I note that the member, during the course of inspection, made submissions to SEBI vide the letter dated 12.06.02 that it could not furnish any registers, records and other documents including contract notes, client agreements or any relevant documents due to loss of records in transit while shifting their office. The member also stated that it had already surrendered the certificate of registration vide letter dated 14.06.01 and had already stopped its business with effect from 21.03.01. The inspection team therefore had returned without conducting the inspection.

5.2.2 Further it was informed by HSE vide its letter dated 01.08.02 that the member though had surrendered the certificate earlier had collected back on 12.01.01.

Moreover, the member was advised to furnish a No Dues Certificate in respect of the payments to its clients. In response, the member had furnished an auditor's certificate from its auditors duly certifying that there are no dues by the member to its clients as on 31.07.02. While doing so, it

was stated in the certificate that the auditors have examined the books of accounts of the member for the purpose of verifying the outstanding dues to clients and as per the information furnished and the books of accounts, such a certificate is issued.

It is clear from the foregoing that the member though had the books and records at the time of inspection had failed to produce it to the inspection team whereas it had produced the same to its auditors to obtain the certificate.

I further observe that stock brokers are required, vide regulation 18 of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 to maintain books of accounts and other records specified in Regulation 17 of the Regulations for a period of five years. I agree with the findings of the Enquiry Officer that the reasons adduced by the member for not maintaining the books of accounts and as a consequence not producing the same before the inspection team are not substantial and further it indicates the callous attitude of the member in complying with applicable rules and regulations. This is a clear case of unwarranted non co-operative tactics employed by the member so as to escape the inspection of his books. I note that the member did not produce the books and other records to the inspection team during the inspection, by giving false and misleading information which is in violation of regulation 21 (1) & (2) of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 read with Rule 4 (b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992, Clause A(5) of the Code of Conduct prescribed for Stock brokers under Schedule II to Regulation 7 of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 and the Bye-Laws, Rules and Regulations of HSE.

In so far as the surrender of registration certificate to the exchange and later collecting the same from the exchange, the member had not furnished the factual position to the inspecting officials. The member has clearly misled the inspecting officials on this issue and later on the same had been admitted as a mistake on its part by the member.

Thus it can be said that in order to avoid inspection, the member had furnished a false and misleading information to SEBI and had willfully and deliberately failed to produce the books of accounts and other records to the inspection team thereby violating the provisions of clause A (5) and C (6) of Schedule II under Regulation 7 of the SEBI (Stock Brokers and Sub-Brokers) Regulation, 1992 read with Rule 4 (b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.

5.2.3 I note that Regulation 7 of the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 provides as under:

Stock Brokers to abide by Code of Conduct

7. The stock broker holding a certificate shall at all times abide by the Code of Conduct as specified in Schedule II

I note that Clause A (5) of the Code of Conduct for Sub-Brokers specified in Schedule II to the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 provides that:

“A. General

- (1)...
- (2) ...
- (3)...
- (4)...
- (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.

Further, Clause C (6) of the Code of Conduct for Sub-Brokers specified in Schedule II to the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 provides as under:

C. Stock-Brokers vis-à-vis Other Stock-Brokers

(1)...

(2)...

(3)...

(4)...

(5)...

(6) *False or Misleading Returns*: A stock-broker shall not neglect or fail or refuse to submit the required returns and not make any false or misleading statement on any returns required to be submitted to the Board and the stock exchange.

I note that Regulation 25 of the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 as they stood then provided that:

“Liability for contravention of the Act, rules or the regulations”

25. A stock broker or a sub-broker who contravenes any of the provisions of the Act, rules or regulations framed there under shall be liable for any one or more of the following actions:

(i)...

(ii) Penalties as specified under Securities and Exchange Board of India (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 including suspension or cancellation of certificate of registration as a stock broker or a sub-broker.

6.0 I note that Regulation 13 of the Enquiry Regulations provides for imposition of minor penalties and major penalties. The major penalties include cancellation of certificate of registration.

7.0 I have found in Paragraphs supra, the said sub-broker has violated Para A (5) and C (6) of the Code of Conduct specified in Schedule II to the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 and thereby violated Regulation 7 of the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992. In view of the above, I find that the recommendation of the Enquiry Officer is not disproportionate.

8.0 I am satisfied that this is a fit case to impose a penalty and I agree with the recommendation of the Enquiry Officer regarding cancelling the certificate registration of the member, considering member's admission that it would not like to associate with the business of stock broking in future.

9.0 **ORDER**

Therefore, I, in exercise of powers conferred on me under Section 19 of the SEBI Act, read with Regulation 13(4) of the Enquiry Regulations, do hereby cancel the certificate of registration No. INB060830035, granted to M/s Kodali Securities Pvt. Ltd.

This Order shall come into effect on the expiry of 21 days from the date of this Order.

Place: Mumbai
Date : 28.10.2004

A K BATRA
Whole Time Member
Securities and Exchange Board of India