

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF THE OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002, AGAINST C. MACKERTICH LTD., MEMBER, CALCUTTA STOCK EXCHANGE ASSOCIATION LTD., NATIONAL STOCK EXCHANGE OF INDIA LTD., OTC EXCHANGE OF INDIA LTD. AND THE STOCK EXCHANGE MUMBAI, HAVING SEBI REGISTRATION NO. INB030879337, INB230769433, INB200769439 AND INB010769439.

1.0 BACKGROUND

- 1.1 C Mackertich Ltd. (hereinafter referred to as “CML”) is a broker registered with the Securities and Exchange Board of India (hereinafter referred to as “SEBI”) under certificate of registration no. INB030879337, INB230769433 INB200769439 and INB010769439. CML acquired membership of The National Stock Exchange of India Ltd. (NSE), The Stock Exchange, Mumbai (BSE) Calcutta Stock Exchange (CSE) and Over the Counter Exchange of India (OTCEI).

2.0 ENQUIRY PROCEEDINGS

- 2.1 On receipt of information from CSE that the business of CML had been suspended consequent to the declaration of Shri Ajay Kayan, promoter

director of CML, as notified person by the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992, Enquiry Proceedings under Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as the “said regulations”) were initiated against CML vide an order dated July 15, 2003.

- 2.2 The Enquiry Officer after conducting the Enquiry Proceedings as per the said regulations submitted his Enquiry Report dated February 27, 2004 finding that the paid-up capital of CML was increased from Rs. 24,35,40,700 to Rs. 34,60,40,700 and no prior permission from SEBI was obtained before issuing fresh shares worth Rs. 10 crores (approx.) to SMIFs Capital Markets Ltd.
- 2.3 The Enquiry Officer further found in his report that CML had not obtained prior permission of SEBI either for change in shareholding pattern or for change in Directorship whereby Smt. Lalita Kayan, a Director who had become whole time Director subsequent to the resignation of Shri Ajay Kayan thereby, contravened the provisions of Rule 4(c) of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.
- 2.4 The Enquiry Officer found that the notification issued by the Custodian under the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992 in respect of Shri Ajay Kayan would show that the same was issued in terms of section 3(2) of the said Act on being satisfied based on information received that a person is involved in an offence relating to transaction in securities. Hence it was found by the Enquiry Officer that CML was not a fit and proper person in terms of Regulation 5(e) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 read with Regulation 25 (a) of the said Regulations.

Hence the Enquiry Officer recommended that the certificate of registration granted to CML as a broker be kept in suspended animation so long as the notification by custodian against Shri Ajay Kayan in terms of section 3(2) of Special Court(Trial of offences Relating to transactions in Securities) Act, 1992, subsists.

3.0 SHOW CAUSE NOTICE AND CML'S REPLY

- 3.1 A show cause notice dated March 25, 2004 under Regulation 13(2) of the said regulations was issued to CML. CML replied to the said show cause notice vide its letter dated April 9, 2004.

4.0 PERSONAL HEARING AND CML'S SUBMISSIONS

- 4.1 A personal hearing before the Chairman, SEBI was granted on May 13, 2004, to CML which was communicated to CML vide letter dated April 28, 2004. Shri Pawan Kumar Saraf, Director, Shri Arif Bookwala, Counsel and Mohd. Himayatullah of Negandhi Shah & Himayatullah appeared on behalf of CML during the hearing.

CML, besides reiterating what it had submitted in the reply dated 09.04.04 to the show cause notice, stated in its letter dated 14.06.04 as under:

- 1) that the show cause notice proceeds on the footing that CML had not obtained any prior permission of SEBI for issuing fresh shares worth Rs. 10 crores and has thus violated provisions of Rule 4(c) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992.

That it is clear from the bare perusal of the aforesaid Rule that CML was under no obligation to obtain any prior permission of SEBI for issuing fresh shares worth Rs. 10 crores and that the show cause notice is not maintainable in as much as CML was under no obligation to obtain any prior permission of SEBI for issuing fresh shares worth Rs. 10 crores as provided in Rule 4(c) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992. As there is no prior permission necessary for any change in the status and constitution of the stock broker the question of CML violating the provisions of Rule 4(c) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 does not arise.

- 2) that the Enquiry Report submitted by the Enquiry Officer under Enquiry Regulations in respect of CML – Member CSE, SEBI Registration No. 030879337 relates to the Enquiry conducted in relation to the membership of CML of CSE based on the information and/or facts submitted by the said CSE. Any order proposed to be passed in relation to membership of CML of BSE and NSE would be against the principles of natural justice as the /said membership of CML were not the subject of the Enquiry Officer.

5.0 FINDINGS

- 5.1 I have taken into consideration the material available on record, including the show cause notice issued to CML, the Enquiry Report, the submissions made by CML in its reply to the show cause notice as well as the oral and written submissions made during the personal hearing. I proceed to deal with the submissions of CML and my findings are as under:

- 5.2 I note that CML had contended that the sub-regulation (2) of regulation 13 of the said regulations came into force from September 27, 2002 and the alleged violation on which the show cause notice was issued related to transaction in question prior to the date on which the amended regulations came into force. In view of the said circumstances, the said provisions were not applicable to the present inquiry initiated by SEBI and therefore the report submitted by the Enquiry Officer was non est. Further the said regulations under which SEBI has directed CML to show cause was not maintainable as the said regulations were not in existence at the time when the alleged violation was committed by the company.

In this regard I observe that the Enquiry Regulations came into effect on September 27, 2002. These regulations are procedural in nature. Regulation 13 of the said regulations reads as under:

Imposition of penalty

13. (1) The enquiry officer shall, after considering the written statement and the oral submissions, if any, of the intermediary and the provisions of the relevant Regulations, submit a report to the Chairman or a member designated in this behalf and recommend for the imposition of any of the following penalties by the Chairman or the member, as the case may be, with the justification for the imposition thereof:-

(a) Minor penalties –

- i) warning or censure;

- ii) prohibiting the intermediary to take up any new assignment or mandate or launch a new scheme for a period upto six months;
- iii) debarring a partner or a whole time director of the intermediary from carrying out the activities as intermediary in the intermediary firm or company and other capital market related institutions for a period upto six months ;
- iv) suspension of certificate of registration for a period upto three months;
- v) debarring a branch or an office of the intermediary from carrying out the activities for a period upto six months.

(b) Major penalties -

- i) cancellation of certificate of registration;
- ii) suspension of certificate of registration for period exceeding three months;
- iii) taking of action under sub-clause (ii), (iii) or (v) of clause (a) for a period exceeding six months.

(2) On receipt of the report from the enquiry officer, the Chairman or the member, as the case may be, shall consider the same and issue a show-cause notice to the intermediary as to why the action as it considers appropriate should not be taken.

5.3 I further note that Regulation 23 of the said regulations reads as under:

Savings of actions

23(1) Notwithstanding amendment of the regulations as specified in regulation 21, anything done or any action taken including any proceeding for inspection or investigation or enquiry commenced or any notice issued under the said regulations before the commencement of these regulations shall be deemed to have been done or taken under the corresponding provisions of these regulations.

(2) In particular and without prejudice to the generality of the provisions of sub-regulation (1),-

- (i) an enquiry proceeding initiated by the Board under the relevant Regulations and pending before the Board before the commencement of these regulations shall be conducted and completed under the relevant Regulations as if those are not amended as specified in regulation 21;
- (ii) any order appointing an enquiry officer under relevant Regulations and pending before such enquiry officer immediately before the commencement of these regulations shall be deemed to have been ordered under the corresponding provisions of these regulations.

In view of the above provisions of law, I do not find merit in the contentions of CML and hold that the show cause notice which was issued under the provisions of said regulations is valid and tenable in the eye of law.

5.4 The next issue that CML had raised in its reply to the show cause notice is that Regulation 8 of SEBI (Stock Brokers and Sub-Brokers) Regulations 1992 provides that when an application for grant of certificate under Regulation 3, does not fulfill the requirements mentioned in Regulation 5, the Board may reject the application after giving a reasonable opportunity

of being heard. CML contended that after fulfilling the requirements of Regulation 5 of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, they were granted certificate of registration under Regulation 6 of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992. CML therefore argued that finding of the Enquiry Officer that CML cannot be fit and proper person had been arrived at without any basis and the same should be set aside and the aforesaid show cause notice be withdrawn on this ground alone and that the Regulation 5(e) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 came into force on 05.01.1998 and the certificate of registration of CML is prior to the date on which the said regulation came into force, therefore it cannot be concluded that CML had violated the terms and conditions on which the certificate of registration was granted by SEBI. As regulation 5(e) of (Stock Brokers and Sub-Brokers) Regulations, 1992 was not in existence at the time when the certificate for registration was obtained by CML and therefore the question of CML violating the said regulation which was introduced in the year 1998 does not arise.

I do not agree with this argument of CML. The fit and proper criteria is inherent in the regulations even before 1998 and the same was made express vide amendment dated 05.01.98. The fit and proper criteria is a continuous requirement. The argument that the violation by CML of the fit and proper criteria was subsequent to 05.01.98 is misplaced and untenable. I observe that the certificate of registration is granted to a broker after he fulfills the requirements mentioned in Regulation 5 of SEBI (Stock Brokers and Sub-Brokers) Regulations 1992, but that certificate of registration will not hold good if the said broker fails to remain a fit and proper person in the future. As and when some irregularity on the part of the broker is observed, its certificate is liable for suspension or cancellation as the case may be as per law.

5.5 The third issue that CML raised was that the regulation 5(e) of (Stock Brokers and Sub-Brokers) Regulations, 1992 was introduced in the year 1998 and “fit and proper person” is not defined under the provision of SEBI Act nor in the Rules and Regulations framed by SEBI from time to time. In the absence of any definition, the Enquiry Officer is not permitted to interpret the said term “fit and proper person” to suit the requirement of Enquiry Officer. The term “fit and proper person” is required to be given the ordinary dictionary meaning. As CML who is certificate holder issued by SEBI is different entity from that of Shri Ajay Kayan, the question of Enquiry Officer arriving at a finding that CML cannot be a fit and proper person is without any basis. As far as CML is aware, Shri Ajay Kayan was not convicted of any offence by any courts in India, nor any proceedings relating to any violation of SEBI Act, Rules and Regulations were pending against Shri Ajay Kayan. CML is also not convicted of any offence by any courts in India nor are any proceedings pending against CML initiated by SEBI. In view of the aforesaid circumstances, it cannot be concluded that CML cannot be a fit and proper person as per Regulation 5(e) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992.

In view of the foregoing, I agree with the finding of the Enquiry Officer that Shri Ajay Kayan continues to be a major shareholder with 68.93% of the paid up capital. Smt. Lalita holds another 1.49%. SMIFS Capital which holds 29.62% is an associate of Shri Ajay Kayan. It is a closely held company, if the corporate veil is lifted, the shareholding and control of Shri Ajay Kayan is all pervasive. Therefore CML cannot be said to be a “fit and proper” person to continue in the capital market in terms of Regulation 5(e) of SEBI (Stock Brokers and Sub-Brokers) regulations 1992 in view of the notifications issued by the Custodian under section 3(2) of Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992 in respect of Shri Ajay Kayan who was a whole time director and continues to be a majority shareholder and the fact that all movable and

immovable properties of Shri Ajay Kayan stands attached simultaneously with the issue of the said notification. The liabilities and the financial ability of Shri Ajay Kayan, the majority shareholder, to meet the liabilities is uncertain and not crystallized rendering in turn the continuation of CML as a broker in the capital market vulnerable and prejudicial to the interest of the investors.

- 5.6 The next issue arising out for consideration is whether CML had not obtained any prior permission of SEBI for issuing fresh shares worth Rs. 10 crores and thus violated provisions of Rule 4(c) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992. CML contended that the provisions of Enquiry Regulations empower SEBI to conduct an Enquiry for the purpose of passing an order under the said Enquiry Regulations and may be held for contravention of any of the provisions of the Regulations as set out in Regulation 4 of the said Enquiry Regulations and not relating to any other Regulations/ Rules which are not set out in the said Regulation 4. As the allegation pertained to the violation of the provisions of Rule 4(c) of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992, which is apparently not covered under the said Regulation 4 of the Enquiry Regulations, and thus they did not deal with the said allegation and reserved their right to make additional submission if necessary at a later stage.

Regarding this, I observe that Rule 4(c) requires a broker in case of change in status and constitution, to obtain prior permission of SEBI to continue to buy, sell or deal in securities in any stock exchange. Regarding this violation, CML, during the hearing had vehemently argued that prior permission is required only for dealing in securities and not for change in constitution or shareholding. Whereas CML, in its written submissions, merely stated that it was under no obligation to obtain prior permission of SEBI for issuing fresh shares worth Rs. 10 crore and

sidestepped the issue relating to prior permission for continuing to deal in securities.

I observe that the trade details of CML were called for from BSE and NSE to check up whether it had continued to deal in securities subsequent to the change but before the permission of SEBI in terms of Rule 4(c). Details received in this regard from NSE and BSE revealed that CML continued to trade in NSE after the date of change. The volume of trade on the trading system of NSE from June 15, 2001 (i.e. date of change in shareholding) till December 05, 2001 (i.e. date on which the trading facility was withdrawn) was Rs. 246.39 crore and in BSE the turnover was to the tune of Rs. 41.85 crore during the period from 15.06.01 to 26.11.01.

- 5.7 the next issue that arises out for consideration is that CML had contended that the penalty recommended by the Enquiry Officer that the certificate of registration granted to CML as broker be kept in suspended animation so long as the notification by Custodian against Shri Ajay Kayan in terms of Section 3(2) of Special Court (Trial of Offences Relating to Transaction in Securities) Act 1992 subsists, is beyond the powers vested to the Enquiry officer and therefore the entire show cause notice is vitiated and the same should be set aside on this ground alone.

In this regard, I observe that recommending suspension of the certificate of registration for a specified period of time is within the powers of the Enquiry Officer and the argument of CML is misplaced and devoid of merits.

- 5.8 The next issue that arises for consideration is the contention of CML that matter pertaining to the involvement of Shri Ajay Kayan is sub-judice before the Hon'ble Special Court – Bombay and the matter was likely to be taken up for hearing in due course. In view of the same, the action of

the Enquiry Officer to keep the membership of CML in suspended animation so long as the notification by the Custodian against Shri Ajay Kayan subsists, amounts to interference with the justice.

In this regard, from the letter dated 09.04.04, I observe that no stay has been granted by the Hon'ble Special Court – Bombay in the said matter and hence there is no bar in proceeding with the matter. Merely for the reason that the matter is before the Hon'ble Special Court – Bombay, does not prevent SEBI from taking action against CML as per law.

- 5.9 The next issue that arises out for consideration is the contention of CML that there is no allegation that CML had committed any illegality or defrauded any person or entity and therefore the question of the Chairman lifting the corporate veil and looking at the reality behind the corporate veil does not arise.

In this regard, I observe that it has been held by courts in many cases that the corporate veil can be lifted in the interests of justice, SEBI is the Regulator of the Securities Market and its primary objective is to protect the interests of the shareholders, Ajay Kayan being the majority stakeholder and the major control of CML being with him, it is necessary in the interest of the investors that if he is no longer a fit and proper person then the steps should be taken to keep the entity, in which his control is all pervasive, away from the market.

- 5.10 I further note that CML in its letter dated 14.06.04, stated that the Enquiry Report submitted by the Enquiry Officer under Enquiry Regulations in respect of CML – Member CSE, SEBI Registration No. 030879337 relates to the Enquiry conducted in relation to the membership of CML of CSE based on the information and/or facts submitted by the said CSE. Any order proposed to be passed in relation to membership of CML of BSE

and NSE would be against the principles of natural justice as the said memberships of CML were not the subject of the Enquiry Officer.

The above contention of CML is not tenable considering the fact that CML has ceased to be a “fit and proper” person to continue in the securities market in terms of Regulation 5(e) of SEBI (Stock Brokers and Sub-Brokers) regulations 1992 and has also violated other provisions of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992 and SEBI (Stock Brokers and Sub-Brokers) Regulations 1992. The show cause notice dated 25.03.04 was issued to CML for all its registrations i.e. CSE, BSE, NSE and OTCEI and the same was replied by CML and a personal hearing was also granted. Therefore it is not correct to state that order proposed to be passed in relation to membership of CML of BSE and NSE would be against the principles of natural justice. Moreover, violation of the provisions of the Rules and Regulations on the basis of which registration is granted to a broker will have equal affect on all the memberships since the violations have been committed by the same entity. Suspending the certificate of registration of CML for one stock exchange will serve little purpose if it is allowed to continue trading in other Stock Exchanges. In view of the above findings, I am convinced that this is a fit case to impose a penalty of suspension against CML. I do not see any reason to differ with the findings and recommendation of the Enquiry Officer.

6.0 ORDER

- 6.1 Therefore, I, in exercise of powers conferred on me under Section 4(3) of the SEBI Act, read with Regulation 13(4) of the said Regulations, do hereby pass an order suspending the certificates of registration No. INB030879337, INB230769433, INB200769439 and INB010769439 granted to C Mackertich Ltd. so long as the notification issued by

custodian against Shri Ajay Kayan in terms of section 3(2) of Special Court(Trial of offences Relating to transactions in Securities) Act, 1992, subsists.

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

G. N. BAJPAI

PLACE : MUMBAI

CHAIRMAN

DATE : 20.01.2005

SECURITIES AND EXCHANGE BOARD OF INDIA