

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

ORDER UNDER SECTION 12A OF SECURITIES CONTRACTS (REGULATION) ACT, 1956 READ WITH SECTIONS 11, 11B AND 19 OF THE SEBI ACT, 1992, IN THE MATTER OF COIMBATORE STOCK EXCHANGE LIMITED (CSX).

WTM/GA/MRD/DSA/ 58 /06

1. Coimbatore Stock Exchange Limited (CSX) was established on July 09, 1991 as a joint stock Company limited by guarantee under the Companies Act, 1956. It was granted recognition as a Stock Exchange under Section 4 of the Securities Contracts (Regulation) Act, 1956 on September 18, 1991 initially for a period of 3 years, which was subsequently renewed from time to time under Rule 7 of Securities Contracts (Regulation) Rules, 1957.
2. Securities and Exchange Board of India (SEBI) conducted an inspection of the exchange during August 27-30, 2003 and on the basis of the findings indicating certain deficiencies and irregularities in the functioning of the exchange, granted conditional renewal of recognition for a period of one year commencing on the 18th day of September 2003 and ending on the 17th day of September 2004. The said conditions were as under :
 - a) The Exchange shall commence trading only after obtaining final approval from Securities and Exchange Board of India for establishment of the Settlement Guarantee Fund / Trade Guarantee Fund.
 - b) The Exchange shall ensure that every member of the exchange maintains adequate Base Minimum Capital (BMC), which is free from any encumbrance before they are permitted for trade in the exchange.
 - c) The exchange shall comply with the suggestions stated in the Report of the Inspection of the exchange conducted by the Securities and Exchange Board of India during the period August 27-30, 2003 and communicated to the exchange vide letter no. SRO/SMD/CSX/EIF/2003/1015 dated September 12, 2003.
3. In order to verify the compliance status of the aforesaid renewal conditions and also to check the compliance of various provisions of the Securities Contracts (Regulation) Act, 1956 (SCRA), Securities Contracts (Regulation) Rules, 1957 (SCRR), Securities and Exchange Board of India Act, 1992 (SEBI Act), Rules and Regulations, SEBI Circulars/directives and its own Rules, Byelaws and Regulations by the Exchange, SEBI conducted another inspection of CSX between July 19-21, 2004.
4. The final Inspection Report comprising of 20 observations/suggestions allegedly not complied with by CSX was forwarded to CSX vide letter dated August 11, 2004 advising it to furnish the compliance status and comments. From the Compliance report submitted by CSX, it was observed that out of the 20 observations / suggestions, 4 were not implemented and 10 observations / suggestions were at various stages of implementation.
5. The major observations / suggestions which are not implemented by CSX are as under :
 - a) A sum of Rs. 6,77,976/- was still due from about 73 members towards arrears of Annual Subscription fees (Rs. 3,61,000/-), Investor Protection Fund contribution (Rs. 56,500/-), Service Charges arrears (Rs. 1,25,000/-) and other charges.
 - b) CSX continued to function on deficits consecutively for the third year. Various accounts/funds like Base Minimum Capital ("BMC"), Pay-out Guarantee Fund, Investor Protection Fund, Investor Service Fund, etc. showed huge positive balances in the books of the Exchange, whereas the actual balances were Nil.
 - c) Seven members continued to have shortfall in the BMC, out of which four members had Nil BMC.
 - d) CSX was yet to complete the registration formalities of the Trust for the management and administration of the Investor Protection Fund (IPF) and therefore was yet to obtain exemptions from Income Tax.
6. In spite of the aforesaid deficiencies and failure of CSX to comply with the renewal conditions as above, the recognition of CSX was renewed by SEBI from time to time subject to certain conditions, in the interest of the investing public of the region at large. The recognition of CSX was last renewed for a period of one year commencing on the 18th day of September 2005 and ending on the 17th day of September 2006, subject to the conditions as mentioned at para 2(a) and (b) supra. Further, the renewal of recognition was also subject to the exchange complying with the suggestions stated in the Report of the Inspection of the exchange conducted by the Securities and Exchange Board of India during the period July 19-21, 2004 and communicated to the exchange vide letter no. SRO/SMD/CSX/EIF/2004/1/3864 dated August 11, 2004.
7. As is apparent from the above, the observations / suggestions which were found to be not implemented by CSX included issues which had serious financial implications and non-fulfillment of the basic membership requirement etc. which were detrimental to the smooth functioning of the exchange.

8. Apart from the above non-compliances of observations / suggestions made in the Inspection Report, the various communications exchanged with CSX and the documents submitted by it from time to time, highlighted, inter alia, several other shortcomings as listed below:
- a) Non submission of the revised Corporatisation and Demutualisation Scheme, as suggested by SEBI in the meeting with exchange officials.
 - b) Depletion in the Contribution for Infrastructure Development Fund (CFID).
 - c) Non submission of the report on allegations pertaining to sale of Land & Building, in spite of undertaking given to SEBI.
 - d) Deadlock between Public Representative Directors / SEBI Nominee Director and the Elected Directors of the exchange on the aforesaid issues and various other issues including the removal of Executive Director of the exchange, etc.
9. On the basis of the aforesaid findings indicating violation by CSX of the SCRA, SEBI Act, SEBI Circulars and non-implementation of specific instructions / directives of SEBI issued from time to time, a detailed show cause notice under Section 11 of SCRA, dated November 22, 2005 was issued to the Council of Management of CSX calling upon it to show cause as to why appropriate directions including supersession of the Council of Management should not be passed in order to regulate the functioning of the exchange and orderly development of the securities market.
10. CSX, vide its letter dated December 06, 2005, submitted a detailed reply denying the allegations of irregularities / lapses in the functioning of the Exchange as alleged in the show cause notice and requested for personal hearing.
11. Accordingly a personal hearing was given to the Council on March 09, 2006 before me wherein three Public Representative Directors, one SEBI Nominee Director and five Elected Directors appeared and made submissions on behalf of the Council of Management of CSX.
12. While the proceedings pursuant to the show cause notice dated November 22, 2005 were pending consideration, CSX vide letters dated January 4, 2006 and January 24, 2006 informed SEBI that 19 members of CSX have submitted a requisition under section 169 of the Companies Act, 1956 before the Council of Management of CSX to call for an Extra-ordinary General Meeting (EGM) of the exchange to pass the resolution of voluntary surrendering the recognition granted to CSX by SEBI under section 3 of the SCRA.
13. Thereafter, SEBI received another letter dated February 15, 2006 from CSX informing that all the members of CSX who were present in the EGM of the exchange held on February 15, 2006 have unanimously passed a resolution for voluntary surrender of recognition granted to CSX by SEBI. Vide the same, it was also resolved that the exchange shall cease to function with immediate effect as a recognised stock exchange within the scope and meaning of SCRA and the SEBI Act. It was also mentioned that vide the said resolution, a committee of elected directors of the exchange was formed empowering it to take necessary steps for changing the name of the company, re-writing the Memorandum and Articles of Association, etc. and to exercise all such powers, which would otherwise have been exercised by the Council to give effect to the aforesaid resolutions.
14. Further, it was brought to the notice of SEBI that the Council of Management of CSX, in its meeting held on March 7, 2006, which was attended by the elected member directors only, inter alia considered the draft Memorandum and Articles of Association, the proposed change in the name of the company (exchange) and the draft notice for the EGM scheduled for March 31, 2006.
15. Pursuant to the letter dated February 15, 2006 of CSX informing inter alia about the resolution for voluntary surrender of recognition, SEBI, after examining the issue, issued a letter dated March 17, 2006 to CSX, informing it that "*the Securities Contracts (Regulation) Act, 1956 (SCRA) provides for the scheme of grant of recognition and withdrawal of recognition. Under the statutory mechanism provided in the SCRA voluntary surrender of recognition as resolved in the above mentioned resolution is not provided and not permissible. A recognized stock exchange can cease to function as such if the recognition granted to such stock exchange is withdrawn in accordance with the SCRA. Therefore, it cannot cease to function as a recognized stock exchange pursuant to any resolution passed by its members in this regard. The status of CSX is exclusively governed by the provisions of the SCRA. Therefore, the resolution passed in the EGM held on February 15, 2006 appears to be ultra vires the SCRA. In view of the above, you are advised that the resolutions passed in the EGM held on February 15, 2006 cannot be acted upon by CSX.*"
16. In spite of the aforesaid advice, SEBI was informed by Shri V Selvaraj, Registrar of Companies (ROC), Coimbatore, who is also the SEBI Nominee Director on the Council of CSX, vide his letter dated March 29, 2006, that the members of CSX have resolved to rewrite the Memorandum and Articles of Association of the exchange and to change the name of the company and have also filed Form no. 23 with ROC on March 16, 2006.

17. It has further been brought to the notice of SEBI that after the receipt of the aforesaid SEBI letter dated March 17, 2006, a meeting of Council of CSX was called on March 27, 2006 and it was decided to read out the contents of SEBI's letter in the EGM scheduled for March 31, 2006. It is however noted that CSX did not furnish the minutes of the said meeting either to SEBI or to the Public Representative Directors / SEBI Nominee Director. It is also observed that in spite of the said letter being read over at the EGM on March 31, 2006, the members attending the EGM passed the resolution adopting the new set of Memorandum and Articles of Association, ignoring SEBI's advice.
18. It has also come to the knowledge of SEBI that the member directors of the exchange have changed the method of operation of bank accounts in such a manner that all the cheques for the exchange will be signed by the elected directors only. They have also removed the Consultant of the exchange who was appointed by the Management sub-committee and duly approved by the Council of Management and have appointed an Internal Auditor in his place without the notice of the Public Representative Directors / SEBI Nominee Director.
19. Further, SEBI has received a copy of letter dated April 8, 2006 of CSX addressed to the 6 Public Representative Directors / SEBI Nominee Director, stating that at the EGM of the exchange held on March 31, 2006, the members have unanimously passed a resolution adopting new Articles of Association according to which no person other than a member of the exchange can hold the position of a Director. Consequently, the Public Representative Directors and the SEBI Nominee Director do not find a place in the said Articles of Association. Vide the said letter, the invitation to the said Public Representative Directors / SEBI Nominee Director to attend the Board Meeting of CSX, scheduled for April 10, 2006, was withdrawn.
20. Knowing fully well that SCRA does not permit any voluntary surrender of recognition by any recognized stock exchange, CSX went ahead with the subsequent plan of action on the self-serving assumption that the surrender of recognition by them is legitimate and would in turn legitimize the slew of actions pursuant to the same. However, in law, all these actions are tainted with illegality besides smacking of high-handedness, in as much as the very act of voluntary surrender lacks legal basis and any action based on the same would be legally vitiated in law.
21. It will not be out of place to record that after the resolution dated February 15, 2006, CSX did not inform SEBI regarding any meeting, agenda, resolution and minutes of any of the meetings of CSX. Such egregious and contumacious conduct on the part of the elected broker Directors is subversive of regulatory discipline and what more, treating the SEBI's letter dated March 17, 2006 terming the voluntary surrender of recognition as ultra vires of SCRA, with utmost contempt constitutes an open defiance by a Regulatee. The same cannot be brooked by the Regulator, who is charged with the duty of securing proper management of the stock exchange and to prevent the affairs of such exchange from being conducted in a manner detrimental to the interest of the investors in the securities market. It is equally shocking to know that CSX has chosen to adopt a course of extreme defiance and confrontation, despite being reminded that its actions are illegal and ultra vires of SCRA. The elected broker directors of CSX, in clear defiance of statutory requirements, passed illegal resolutions besides acting on the same, not only undermining the regulatory role of SEBI but also disallowing the Public Representative Directors / SEBI Nominee Director from attending the Board meetings of CSX. By their above actions, the elected broker directors have attempted to seize full control of the administration and control over the movable and immovable properties of the exchange, perhaps in a pre-emptive bid with a view to frustrate the on-going proceedings.
22. It is imperative to mention that the capital market is an integral part of the economy and the stock exchanges play a vital role in the economic growth of the nation. Besides, as has been observed by the Hon'ble Supreme Court of India in K. C. Sharma Vs. Delhi Stock Exchange and others, the stock exchanges are "State" within the meaning of Article 12 of the Constitution of India. The SCRA was enacted to prevent undesirable transactions in securities by regulating business or dealings therein. The stock exchanges are credible building blocks of the economy and fulfill a vital function in the economic development of the nation. The proper working of a stock exchange essentially depends not only on the caliber of the members constituting it but also perhaps, more importantly, on their standing. In carrying out the activities in a stock exchange, the members thereof should be public-spirited men of prudence with equipoise, perspicacity and maturity.
23. It may also be noted that the Public Representative Directors / SEBI Nominee Director are appointed from amongst the persons of integrity, having necessary professional competence and experience in the areas related to securities markets. They are inducted in the Governing Boards of stock exchanges along with the elected broker members in a synergy of sorts, to broaden the governing boards and to make them fully representative of various interests in the securities markets and in order to ensure that the affairs of the stock exchanges are conducted on healthy lines with the highest standards of professional conduct, good governance and transparency to inspire and sustain the confidence of the investing public.
24. SEBI is charged with the duty to protect the interest of the investors and the integrity of the markets as a Regulator and therefore has to make the market place efficient and clean wherein all the participants play their role diligently and professionally within the four corners of the system, without there being any scope for abuse. Where there is an apprehension that certain unscrupulous elements are trying to subvert the system to serve their own interest, it becomes imperative on the part of SEBI to intervene and to curb further mischief and to take necessary action to instill and maintain public confidence in the integrity of the securities market. It has to prevent any loss or damage not only to the property of the stock exchange, which is a public institution, but also to protect the interest of investors and the integrity of the market.

25. Having regard to the duty cast upon the Regulator in the context of the unedifying developments that have taken place in CSX, as brought out above in great detail, I am of the considered view that the conduct of the elected member-directors of CSX is highly unbecoming, contumacious and self-serving, besides constituting an obdurate defiance of not only the Regulator but also of the statutory requirements. In addition, the conduct reeks of a pre-meditation to seize control over the exchange and its assets in a planned move and such deliberateness demonstrates a sordid intention to dismantle the exchange, which is a public institution, in exchange for a private arrangement to serve collateral purposes, which are not in public interest.
26. Considering the sensitivity of the securities market and the possible impact of such pernicious activities of the member directors of CSX on the investors in general and the securities market in particular, it is imperative to take immediate action, pending the proceedings pursuant to the show cause notice dated November 22, 2005, to ensure that the assets and properties of the exchange are not brazenly usurped by a few, in a manner as would constitute a threat to the regulatory discipline and the integrity of the securities market. Unless a stringent preventive and remedial measure is taken immediately, there will be a grave jeopardy to the very functioning and management of the exchange, including the control of its assets, which have been sedulously nurtured over a period of time in the interest of the investing public and orderly development of the market, and such an eventuality is fraught with the grave risk of the control being taken over by a few for their own benefit to the detriment of the larger public cause, the exchange was expected to promote.
27. SEBI has powers under Section 12A of the Securities Contracts (Regulation) Act, 1956 to issue such directions. The said section reads as under:
- 12A.** *If, after making or causing to be made an inquiry, the Securities and Exchange Board of India is satisfied that it is necessary –*
- (a) in the interest of investors, or orderly development of securities market; or*
- (b) to prevent the affairs of any recognised stock exchange or clearing corporation, or such other agency or person, providing trading or clearing or settlement facility in respect of securities, being conducted in a manner detrimental to the interests of investors or securities market; or*
- (c) to secure the proper management of any such stock exchange or clearing corporation or agency or person, referred to in clause (b),*
- it may issue such directions,—*
- (i) to any stock exchange or clearing corporation or agency or person referred to in clause (b) or any person or class of persons associated with the securities market; or*
- (ii) to any company whose securities are listed or proposed to be listed in a recognised stock exchange,*
- as may be appropriate in the interests of investors in securities and the securities market.*
28. I am of the considered view that, in view of the imminent urgency and in order to safeguard the integrity of the securities market, the previous notice to show cause can be dispensed with and it will be in the interest of justice to pass an ex-parte interim order. As the irregularities that have taken place subsequent to the show cause notice dated November 22, 2005 may also call for supersession of the Council of Management of CSX, the allegation mentioned herein may also be treated as a fresh show cause notice in addition to the show cause notice dated November 22, 2005.
29. The CSX may reply to the charges alleged herein within 15 days from the date of this order showing cause as to why any further direction including direction for superseding the Council of Management of CSX may not be passed in the interest of smooth functioning of the exchange. The Council of Management of CSX may also, if so desired, request for a personal hearing in the matter before passing of the final order by SEBI which may include superseding the Council of Management of CSX, in light of the irregularities mentioned in the show cause notice dated November 22, 2005 as well as the subsequent developments mentioned supra.
30. Therefore in exercise of powers conferred upon me under Section 12 A of Securities Contracts (Regulation) Act, 1956, read with Sections 11, 11B and 19 of the SEBI Act, in order to prevent the affairs of CSX being conducted in a manner detrimental to the interests of the investors and also to secure proper management of the stock exchange, I hereby direct as under:
- a) CSX is refrained from taking any action pursuant to the resolutions passed at the Extra-ordinary General Meetings held on February 15, 2006 & March 31, 2006 and any other decisions that might have been taken without the participation of the Public Representative directors /SEBI Nominee director after the EGM dated February 15, 2006 and from transferring or alienating any movable or immovable property of the exchange in any manner whatsoever, till further orders and also not to do anything which would have the effect of or which is likely to have the effect of altering the basic contours of the exchange as well as the character of the exchange.
- b) Pending hearing and final decision in the matter, the day to day functioning of the exchange would be undertaken by a three member Committee consisting of Shri V Selvaraj, SEBI Nominee Director / ROC, who

will be the member chairman of the said committee and Shri C. A. Venkatesan and Shri K. R. Raman, Public Representative Directors.

- c) The said committee is authorized to make such expenditures and operate the bank accounts of the exchange for meeting out the day to day expenses, including salary of staff, etc, till further orders.

31. This order will come into force with immediate effect.

Date : April 17, 2006

Place : Mumbai

G. ANANTHARAMAN

WHOLE TIME MEMBER