

SECURITIES AND EXCHANGE BOARD OF INDIA**ORDER**

AGAINST M/s. ESHA SECURITIES LTD., MEMBER DELHI STOCK EXCHANGE, SEBI REGISTRATION NO. INB050719038 UNDER REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002.

1.0 BACK GROUND

- 1.1 M/s Esha Securities Limited (hereinafter referred to as the 'broker') is a member of the Delhi Stock Exchange (hereinafter referred to as 'DSE') and is registered with the Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a Stock broker under Section 12 of SEBI Act, 1992 with Registration Number INB050719038.
- 1.2 An Inspection of the Books of Accounts, documents and other records maintained by the broker for the period 1.4.2000 to 30.11.2002 was carried out by M/s. G. Jai & Associates, Chartered Accountants appointed by SEBI vide Order dated October 3, 2002 under Regulation 19(1) of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992.
- 1.3 During the Inspection, certain irregularities committed by the broker were observed.

2.0 APPOINTEMENT OF ENQUIRY OFFICER

- 2.1 Inspection Report was forwarded to the broker on completion of inspection. After considering its reply, an Enquiry Officer was appointed vide order dated January 3, 2004 under Regulation 5(1) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred as the 'said regulations') to enquire into the alleged irregularities committed by the broker which were observed during the inspection.
- 2.2 A Notice dated March 23, 2004 was issued to the broker under Regulation 6 (1) of the said regulations. The broker replied to the notice vide its letter dated May 11, 2004 and sought a personal hearing. The broker was granted hearing before the Enquiry Officer on August 2, 2004. The Enquiry Officer conducted the enquiry in terms of the said Regulations and the broker was given a fair and reasonable opportunity to make its submissions.
- 2.3 After considering the submissions of the broker, the Enquiry Officer submitted his Report dated August 25, 2004 recommending a major penalty of suspension of certificate of registration of the broker for a period of six months.

3.0 SHOW CAUSE NOTICE AND REPLY

- 3.1 Based upon the Enquiry Report and recommendation of the Enquiry Officer, a show cause notice dated September 9, 2004 under Regulation 13(2) of the said regulations was issued to the broker enclosing therewith a copy of the Enquiry Report. On its failure to submit the reply within the prescribed time, a further opportunity was granted to it to file the reply vide letter dated October 1, 2004.
- 3.2 The broker submitted its reply vide letters dated November 8, 2004 and March 21, 2006.

4.0 PERSONAL HEARING

- 4.1 The broker was granted an opportunity for personal hearing before me on March 21, 2006. The broker appeared through Shri G.C. Agarwal Chartered Accountant and reiterated its earlier submissions.

5.0 CONSIDERATION OF ISSUES AND FINDINGS

- 5.1 I have carefully considered the findings of the Inspection, Enquiry and the submissions made by the broker and observe as under
- 5.2 Enquiry Officer found that the broker had not entered into member Client agreements with any of the 900 clients who had traded during the period 1.4.2000 to 30.11.2002, broker had failed to obtain client registration forms from any of the said 900 clients, and the broker failed to maintain the basic details of clients such as clients address, telephone numbers, PAN No. of clients, authorized signatories names, depository account (beneficiary) of the client, bank details of clients etc. The broker submitted that in most cases agreements were entered into initially but some of their employees who were sacked had destroyed or may have taken away these documents. The broker admitted that these documents were not produced at the time of inspection. The reason given by the broker is untenable as the broker continued his transactions with the aforesaid clients in the absence of such documents and agreements. Hence, the broker has contravened SEBI Circular No.SMD/POLICY/IECG/1-97 dated 11.2.97 and SMD/POLICY/CIR/5-97 dated 11.4.97. The broker has also violated DSE

circular Nos.30/97 and 40/97 dated 17.3.97 and 28.5.97 as also Rule 4(b) of SEBI Stock Brokers and Sub brokers) Rules, 1992 para A(5) of Code of Conduct as specified in Schedule II under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

5.3 Enquiry Officer found that on a number of occasions the broker had allowed clients to trade without obtaining any sufficient margin. The broker submitted that in general, margin was available in the form of securities and / or funds lying in the client's account. However, the broker permitted his trusted and old clients to trade without sufficient margins in some cases. Since the broker has admitted that he has permitted clients to trade without obtaining sufficient margin, it has violated SEBI Circular No.SMD/Policy/Cir-12/2002 dated 17.5.02 and provisions. of para A(5) of Code of Conduct as specified in Schedule II under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

5.4 Enquiry Officer found that there had been several instances of delay in payments to clients. In this connection, the broker has submitted that the delay in payment was with oral approval/consent of the concerned clients and stated that it shall obtain prior approval from clients in writing in future if there are any delays in payments. It has also submitted that there was no complaint from clients. I find the submissions of the broker unacceptable due to the following reasons.

a) there are 86 such instances of delayed payments within a span of 2 years.

b) the period of delay ranges from 4 days to 487 days

c) the amount involved runs into crores of rupees

d) no proof has been furnished in support of its contention that clients consented for withholding of payments.

Therefore, I find that the broker has violated provisions of SMD/SED/CIR/93/23321 dated 18.11.93 and SMDRP/Policy/Cir-05/2001 dated 1.2.2001 as well as bye law 246(A) of Delhi Stock Exchange as also provisions of para A(5) of Code of Conduct as specified in Schedule II under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

5.5 Enquiry Officer found that the broker had failed to deliver securities to the clients within the prescribed time limit. There were 33 instances of delay of securities and in some cases there were 53 days' delay. I note that the broker has neither addressed the finding nor produced any authorization letter from its clients to hold securities for more than 48 hours. Therefore, I find that the broker has violated SEBI Circular SMD/SED/CIR/23321 dated November 18, 1993, SMDRP/Policy/Cir-05/2001 dated February 1, 2001, bye-law 246(A)3 of DSE and para A(5) of Code of conduct as prescribed in Schedule II under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

5.6 Enquiry Officer found that there were many cases of cheques issued to clients dishonoured and reversed in the accounts of clients. In 34 instances cheques issued by the broker had returned unpaid. The bouncing of cheques also led to violation of the requirement of making payment to client within 48 hours of payout. The broker has submitted that generally, all cheques issued to the clients were passed on first clearing except for a few cases of bouncing of cheques which occurred due to reasons beyond its control. When the broker is managing its own financial affairs, its claim that the cheques were bounced due to reasons beyond his control is an unreasonable claim.

5.7 Enquiry Officer found that the contract notes issued by the broker did not bear running serial numbers. The broker submitted that the serial number was computerized and manual interference was not possible. The submission of the broker is unacceptable as the number provided by the broker is computer generated and not in fact 'serial' in nature. Therefore, the same is in violation of SEBI Circular NO.SMD/MDP/CIR/043/96 dated 5.8.96 and DSE Circular dt. 13.8.96 is apparent. The broker has also violated provisions of Para A(5) of Code of Conduct as specified in Schedule II under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

5.8 Enquiry Officer found that stamps were not affixed on the contract notes. The broker has submitted that it was not aware about this requirement and that it had issued instructions to the concerned officials not to repeat this mistake in future. Since the ignorance of law doesn't exonerate the broker, its conduct is in violation of provisions of Article 5(b) of Schedule 1(B)(UP) of Indian Stamps Act, 1899 as well as provisions of Paragraph A(5) of Code of Conduct as specified in Schedule II under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

5.9 Enquiry Officer found that no dispatch records were maintained by the broker and the broker failed to issue contract notes to clients within 24 hrs. The broker submitted that most of the contract notes were hand delivered and others were sent through post. It was further submitted that the broker is now maintaining a dispatch register. Since the broker has started to maintain the dispatch register and in the absence of investor complaints I am inclined to take a lenient view with regard to aforesaid charge.

5.10 Enquiry Officer found that the broker had failed to submit copies of contract notes to the inspection team. In this regard, broker submitted that except for a few cases, all the hard copies of the contract notes were in the records and existence of soft copies of the contract notes clearly showed that they were duly generated. I find from the Inspection Report that there are 200 such instances where the broker had failed to produce the copies of contract notes. In the absence of hard copies

of contract notes, it is impossible to accept the broker's contention that it had issued contract notes in all the above 200 cases. Therefore, the conduct of the broker is in violation of Bye-Laws of stock Exchange and Regulation 7(B)(2) of Schedule II of Code of Conduct of SEBI (Stock Broker and Sub Brokers) Regulations, 1992.

- 5.11 Enquiry Officer found that contract notes issued by the broker did not provide for the order time. The broker has submitted that format of contract note prescribed by DSE did not provide for the column of order time. In view of the said contention, it is felt that fastening the liability on the broker in the absence of a specific space for the same in the prescribed DSE contract note format is unwarranted.
- 5.12 Enquiry Officer found that the broker had executed a large number of off market transactions which were not reported to the exchange. The broker submitted that the violation occurred due to oversight and that it had taken steps to comply in the future. The contention of the broker cannot be accepted as substantial volume of shares was traded for more than 1700 instances over a period of 45 days. Therefore, I find that the broker has violated SEBI Circular No. SMD/RCG/CIR/(BKG)/293/95 dated 14.3.95 and DSE Circular No.37/95 dated 15.6.95 as well as Rule 4(b) of SEBI (Stock Brokers and Sub Brokers) Rules, 1992 and provisions of Paragraph A(5) of Schedule II specified under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.
- 5.13 Enquiry Officer found that on a number of occasions, trades of one client were transferred to another client without written authorization reflecting that the broker was not following the system of unique client code for trading on behalf of clients and was indulging in transfer of trades. The broker has submitted that it received shares in its pool account on net basis in case of one client selling and the other purchasing the same scrip. It further submitted that in those cases shares could be transferred from one client to the other and this was done with consent of the clients. Transfer of securities from one client to another even in the absence of authorization letters from clients cannot be termed as absence of maintenance of unique client code. Such a conclusion will be far fetched as the inspection team could have verified the existence of the UCC of the clients named in Annexure 14 of the Inspection Report dealing with such transfers. Therefore, I am of the view that the broker is entitled to benefit of doubt with regard to the aforesaid charge.
- 5.14 Enquiry officer found that the broker had permitted some persons to trade through as sub brokers without agreement and registration with SEBI. The broker submitted that agreements with these persons as sub brokers were entered into initially. However, some of its employees who were sacked had destroyed or may have taken away these documents. In view of the fact that there was no application for registration as sub-broker by these persons which has to be routed through the broker, I find that the contention of the broker is untenable. Therefore, the broker has violated SEBI Circular No.SMD/MDP/CIR/043/96 dated 5.8.96 and SMD/Policy/Circulars/3-97 dated 31.3.97 and DSE Circular dt.13.8.96 alongwith provisions of para A(5) of Schedule II specified under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.
- 5.15 Enquiry Officer found that the broker had acted as unregistered sub broker. The broker submitted that he had done some transactions on requests of clients due to genuine oversight and that they have now stopped any transactions for clients on other exchanges. It is learnt from the Inspection Report that the broker had traded in National Stock Exchange, Bombay Stock Exchange and Calcutta Stock Exchange as a sub broker through 11 different brokers who are members of those stock exchanges. Such a huge operation involving three stock exchanges and eleven brokers cannot be termed as an oversight, therefore, I find the broker violated SEBI Circular No.SMD/Policy/CIR-3/98 dated 16.1.98 and SEBI Circular No.SMD/OPG/AA/1020/96 dated 14.3.96 alongwith Rule 3 of the SEBI (Stock broker & Sub broker) Rules, 1992 and Section 12(1) of SEBI Act, 1992 as well as provisions of para A(5) of Schedule II specified under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.
- 5.16 Enquiry Officer found that a system of maintaining unique client codes was not followed by the broker. The broker submitted that only one code was given to one client except in a few cases where a new operator wrongly punched/allotted wrong / new code to the client because of mistake / confusion and assured that steps were being taken so that the mistake would not be repeated in future. I find from Annexure 7 of the Inspection Report that there are more than 50 such instances of defaults in maintaining the unique client code. The broker should have taken care to ensure correct punching in of Orders and usage of correct code in respect of each individual client. I am inclined to take a lenient view on the basis of broker's assurance that corrective measures are taken and the mistake will not be repeated in future.
- 5.17 Enquiry Office found that the broker had no compliance officer at the time of inspection. The broker submitted that it has appointed a compliance officer after the inspection. Non appointment of compliance officer is a serious violation as the compliance officer is the person responsible for monitoring the compliance of SEBI Act, 1992, rules and regulations, notifications, guidelines, instructions etc; issued by the Board or the Central Government and for the redressal of investor's grievances. I note that the broker was carrying on the business without a compliance officer from May 29, 2001 to November 30, 2002. Therefore, the broker has violated Regulation 18A of SEBI (Stock Broker & Sub Broker) Regulations 1992 and provisions of para A(5) of Schedule II specified under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992.

- 5.18 Enquiry Officer found that the broker had failed to submit information about itself as sought by SEBI in the prescribed format within the prescribed time period. The broker replied that it had submitted the broker database to the inspecting authority with a delay of few days which was due to the absence of the concerned officials. Though, there is default on the part of the broker, it had managed to submit the information belatedly. Therefore, I am inclined to take a lenient view in this regard.
- 5.19 Enquiry Officer found that shares were sold from trading account to some fictitious clients with whom settlement of funds had been made in cash and deliveries had not been made to such clients. The broker submitted that there was no fictitious transaction. Cash received from clients was duly deposited in the client account on a periodical basis and all the deliveries were given to the clients. Considering the value of shares involved i.e. Rs.58 lacs and lack of evidence to support broker's submissions that deliveries were given to clients and failure to establish the antecedents of the clients, I am of the view that there is reasonable suspicion of broker's involvement in trading in the names of fictitious clients as found by the Enquiry Officer in his report. Therefore, the conduct of the broker is in contravention of code of conduct under SEBI (Stock Brokers and Sub brokers) Regulations, 1992.
- 5.20 Enquiry Officer found that the broker made changes in the dominant and non-dominant group share holding pattern and changes in the constitution of Board of Directors without the prior approval of the exchange. Further, the broker did not even intimate the exchange regarding the said changes. However, the broker submitted that the change in shareholding pattern was within the permissible limits of the exchange and was intimated to the exchange. I have perused the evidence submitted by the broker and I find that vide letter dated July 19, 2003 the broker had intimated DSE about the change in the share holding pattern. In the said letter, it was claimed by the broker that it had already intimated DSE the change in the share holding pattern in 2001 itself. But the aforesaid letter is silent on the reconstitution of the Board and I do not find any proof of prior approval obtained by the broker to change its status and constitution. Therefore, I find that the broker has violated Rule 4 (c) of SEBI (Stock Brokers and Sub- Brokers) Rules, 1992.
- 5.21 It is mandated vide SEBI Circular No.SMD/SED/Cir/93/23321 dated 8.11.1993 that the broker should maintain separate bank accounts. On examination of the findings of the Enquiry Officer and the broker's reply with regard to the charge of non segregation of bank accounts, I note the following relevant admissions by the broker,
- a) It had made payment to clients from Business account.
 - b) Loan transactions were routed through client accounts.
 - c) Receipts from clients deposited in own fund account of the member.
 - d) Own Trading Obligations met from client accounts.
 - e) Utilization of client funds by the broker.

Though, the broker had maintained separate accounts, the same was only for the name sake as funds were found flowing in violation of the aforesaid SEBI Circular. As regards point a) above, the broker submitted that this was done due to shortage of funds as clients delayed payment on a number of occasions. Payment to clients out of business account was not aimed at any violation, but rather to provide immediate payment to the client at the time client demanded. I find the justification given by the broker acceptable as its motive was to ensure good service to the clients. With regard to point b) above, I find the submission of the broker unacceptable as the volume of transactions runs into crores of rupees and there are more than 160 such instances and the broker has not provided any reason for conducting such transactions. With regard to point c) above, broker submitted that these receipts are deposited against own funds / loan funds utilized earlier to meet client's obligation on the exchange due to delay in payment by some clients. The submission of the broker is unacceptable as there is no proof of right to lien, set-off or charge, counter-claim charge or otherwise against these receipts. As regards point d) above, broker's payout obligations arising out of his proprietary trades are met from client account which in clear violation of the aforesaid Circular. The Circular prescribes the monies which can be withdrawn from the clients account. Accordingly, the pay out obligations of the broker cannot be withdrawn from the said account. With regard to point e) above, broker's contentions are unacceptable as there are more than 240 such instances of payments out of client account to meet the business expenses of the broker.

- 5.22 I note that the broker is already penalized for exceeding the permissible turnover limits at the exchange. The penalty imposed by the exchange *per se* will not absolve the broker from this charge as SEBI is competent to impose penalty on the broker irrespective the fact that the exchange has already penalized the broker for the same violation. However, taking into account the payment of penalty to the exchange and the fact that the default was not willful, a lenient view is taken as regards this allegation.
- 5.23 I find from the above that most of the violations discussed above are serious in nature. The conduct of the broker is in gross disregard to the relevant Act, rules regulations, notifications, circulars and guidelines. Therefore, I have no reasons to differ with the recommendation of the Enquiry Officer.

6.0 ORDER

6.1 Now, therefore, in exercise of powers conferred under upon me in terms of Section 19 of SEBI Act, 1992 read with Regulation 13(4) of the said Regulations, I hereby impose a major penalty of suspension of certificate of registration for a period of six months on M/s Esha Securities Ltd. (INB050719038), member Delhi Stock Exchange.

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

Place: Mumbai	T.C.Nair
Date: 30.5.2006	Whole Time Member Securities and Exchange Board of India