

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

AGAINST DEEPAK JHUNJHUNWALA & CO., MEMBER, CALCUTTA STOCK EXCHANGE, SEBI REGISTRATION NO. INB031070411 UNDER REGULATION 13(4) SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002.

1.0 BACKGROUND

- 1.1 Deepak Jhunjunwala & Co. (hereinafter referred to as the 'broker') is a member of the Calcutta Stock Exchange (hereinafter referred to as 'CSE') 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 INB031070411.
- 1.2 An Inspection of the Books of Accounts, Documents and other records maintained by the broker for the period 2001-2002 was carried out by SEBI. During the inspection, certain irregularities found to have been committed by the broker were observed.

2.0 APPOINTMENT OF ENQUIRY OFFICER

- 2.1 On completion of inspection, the Report was forwarded to the broker vide letter dated September 11, 2002. After considering his reply dated 16.9.2002, an Enquiry officer (hereinafter referred to as "EO") was appointed vide order dated December 4, 2003 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 Show Cause Notice dated January 12, 2004 was issued to the broker under Regulation 6 (1) of the said regulations. The broker submitted its reply dated January 28, 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 The broker was granted hearing before the enquiry officer on 23.2.2004. However, the broker failed to appear before the enquiry officer. After considering the reply dated January 28, 2004 of the broker, the Enquiry officer submitted his report dated 15.7.04 recommending suspension of certificate of registration of the broker for a period of six months.

3.0 SHOW CAUSE NOTICE AND THE BROKER'S SUBMISSIONS

- 3.1 A copy of the Enquiry Report was sent to the broker along with a show cause notice dated July 22, 2004, in terms of Regulation 13(2) of the said Regulations calling upon it to show cause as to why appropriate penalty including the penalty as recommended by the Enquiry Officer should not be imposed on it. The broker replied vide letter dated 10.8.04 and stated that a major penalty of suspension of certificate of registration was already levied on it and the suspension came into effect from March 1, 2004 till August 31, 2004 and hence its case may be considered sympathetically. The broker further submitted that it is making arrangements to pay the registration/turnover fees under the SEBI (Interest Liability Regulation) Scheme 2004.

4.0 CONSIDERATION OF THE ENQUIRY REPORT

- 4.1 I have carefully considered the findings of the Inspection, Enquiry and the submissions made by the broker and my observations are as under :

4.2 a) Non-maintenance of Order Book

The EO found that as per SEBI Circular No.SMD/POLICY/IECG/1-97 dated February 11, 1997, the broker should maintain record of time when the client has placed order. This information is to be maintained by the broker in the order book. This helps in audit trail in case of investigation or complaint of any client in respect of time of placing order and execution and the price charged etc. The member did not maintain any Order Book. Noting of the order as claimed by the broker is not a substitute for the same. The EO, therefore, held the broker guilty of violation of the above circular and sub-regulation 17(1)(k) of Brokers Regulations. The broker stated that though the order book is not maintained in the literal sense, they make a noting of all orders when they are placed and after execution, they inform the client. However, the broker did not produce any evidence in support of his contentions. Maintenance of order book must be strictly complied with as it helps in audit trail and hence cannot be a matter of convenience of the broker. I, therefore, agree with the findings of the EO.

However, I don't find any violation of Regulation 17(1)(k) of the Broker regulations, as the enquiry did not give any adverse finding regarding maintenance of margin deposit book.

b) Non-issuance of Contract Notes

The EO found from the inspection report that the broker transacted with NSE Member, Baljit Securities Pvt. Ltd. on behalf of his clients and issued memo of confirmation in lieu of contract notes. The EO found that confirmation notes can be issued only by a sub-broker. The same may be possible only if the member was registered as a sub-broker of a member of NSE and not otherwise. The EO, therefore, held the member guilty of violation of regulation 17(1) of SEBI (Stock Brokers and Sub-brokers) Regulations and the Bye laws of the stock exchange. The broker stated that the transaction with NSE member, Baljit Securities Pvt Ltd. was on the basis of being the clients of Baljit Securities Pvt Ltd. for which they were not authorized to issue contract notes and as such memo of confirmation had been issued. I do not find the explanation of the broker tenable. If the broker had themselves acted as clients, then the question of the broker issuing confirmation notes does not arise. It is only when the broker transacts with a member of another stock exchange on behalf of his clients that he is obliged to issue confirmation notes. As there is no material to suggest whether the broker was registered as a sub-broker, I am inclined to agree with the findings of the EO.

c) Discrepancies in Client Registration Forms

The EO found that the client-member agreements and client registration forms maintained by the broker were not filled in properly, which is in violation of circular dated 11.2.97. The broker stated that client registration forms were maintained except in some isolated cases. It was stated that the staff maintaining these documents had suddenly left and the new appointee took some time to perfect the requirement. I find the broker's explanation untenable as the broker cannot absolve from being responsible for the actions of its staff. It is the bounden duty of the broker to supervise and ensure smooth functioning of its operations and ensure strict compliance of regulatory requirements.

d) Acting as unregistered sub-broker

The EO found that the broker had done transactions with Baljit Securities Pvt, Ltd. in NSE as their client but the broker was not registered as the sub-broker of this member and hence the EO found the broker guilty of violating SEBI Circulars dated 31.3.97 and 15.1.01. I find that both the Inspection and Enquiry Reports state that the broker had done transactions with Baljit Securities as their client. It is, therefore, not clear as to whether the broker dealt with Baljit Securities as clients for their own proprietary trades or whether they acted as sub-brokers and in turn traded for their clients. There are no details of transactions and the broker has also remained silent on this issue in his reply dated 18.9.02 and 28.1.04. In the absence of clear evidence, it is difficult to ascertain whether the broker dealt for his clients as unregistered sub-broker. In view of this, a benefit of doubt may be given to the broker.

e) Delayed Payment to Clients

The EO found that the broker is required to deliver the securities/make payment to the clients within 48 hours of the pay-out declared by the exchange for the relevant settlement. However, in ten cases, payments to the clients had been delayed much beyond the stipulated period and in about 5 cases the period of delay was over 78 days. The EO, therefore, held the broker guilty of violation of SEBI Circular dated 18.11.93. The broker admitted that in very few cases payments were delayed and this was done to remove the financial crunch due to market crisis in March 2001. The broker further stated that the clients did not have any objection. I find that the broker has not submitted any documentary evidence in support of its claim that the clients did not have any objection. In view of this, I have no reason to differ with the findings of the EO.

f) Non-segregation of client's money and own funds

The EO found that as per SEBI Circular No.SMD/SED/Cir/93/23321 dated November 18, 1993, it is compulsory for stock brokers to keep the money of their clients and their own money in separate accounts. The broker maintained an account with Indusind Bank where all client related transactions were routed. The EO found that the broker had transferred money from client account to Fixed Deposit and to his self Account. The broker also used clients' money to pay default in margin payment. The EO, therefore, found that the broker has violated SEBI Circular dated 18.11.93 and byelaws of the exchange on client-member relationship. The broker stated that the non-segregation happened in isolated cases and the amount involved were meagre in proportion to volume of transaction. It was stated that after stock market crisis their endeavour was survival and due to severe financial crunch, such isolated instances have happened. I find that the broker has not refuted the charge but has admitted to having made a mistake. I find that the amounts to the credit of clients' accounts are in the nature of trust. The funds in the clients' accounts cannot be applied for any purpose other than what is permissible under SEBI Regulations. The objective of opening and maintaining a separate account for the clients' funds is to segregate and identify them separately and to prevent its misuse so that they are beyond the reach of the broker.

g) Non-payment of turnover fees to SEBI

The enquiry officer has found that the broker has not paid the turnover fee to SEBI other than the initial fee of Rs.5000/-. As per the regulations, the broker is required to pay Rs.5,000/- for the first one crore of turnover plus 0.01% of turnover in excess of one crore. The broker stated that the fee was not paid as the matter is subjudice. The EO, however, found that the matter has now been decided by the Supreme Court vide its judgement dated 1.2.2001 (2001) 3SCC 482 and Kolkata High Court vide its judgement 22 of 2004 in WP 548/2004 in Lalit Marodia vs. SEBI. Therefore, the broker was required to pay the fees as per the regulations. The EO found that payment of fee is a pre-condition of registration and non payment of the same is in violation of Rule 3 and Regulation 10 of the Broker Regulations. I note from the material on record that the broker vide letter dated 9.11.2004 had enclosed DD No.456171 dated 9.11.04 for Rs.11,87,453 being full and final settlement of all its dues on account of registration fees. The broker has furnished copies of the above letter and DD. In case there is a shortfall in payment, separate action may be initiated as per the provisions of Regulations

h) Off the floor/cross deals

The EO found that since the broker admitted the violation that it had indulged in off the floor deals and stated that the same had taken place unknowingly, it has contravened SEBI Circular dated 14.9.99. I note that the broker vide letter dated August 10, 2004 stated that the lapses/ violations mentioned in the Enquiry Report under discussion are similar to that of Report dated September 30, 2003 of AEO(S.V.Krishna Mohan) and that a major penalty of suspension for 6 months has already been levied upon it which came into effect from March 1, 2004 to August 31, 2004. However, it is pertinent to note that pursuant to the aforementioned Enquiry Report, an order dated February 9, 2004 was passed by suspending the broker for a period of 6 months. A perusal of this order reveals that the charges held against the broker in this order was that of indulging in large scale off the floor transactions and receiving and paying funds to fellow brokers of the exchange without there being corresponding transactions in the exchange. I, therefore, find that the transactions in the aforesaid order and the current are not same. However, since the charge is same, I am inclined to consider the submission of the broker while deciding the quantum of penalty in this order.

4.3 In the facts and circumstances of the case and the mitigating factors, I am of the view that suspension of registration of the broker for a period of two months would be adequate.

5.0 **ORDER**

5.1 Now, therefore, in exercise of powers conferred upon me in terms of Section 19 of SEBI Act, 1992 read with Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulation 2002, I hereby suspend the certificate of registration of Deepak Jhunjhunwala & Co., member Calcutta Stock Exchange (INB031070411) for a period of two months.

5.2 This order shall come into force on the expiry of 21 days from the date of this order.

Place: Mumbai

Date: 16.6.06

T.C. NAIR

Whole Time Member

Securities and Exchange Board of India