

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA**

**CORAM: DR. T.C.NAIR, WHOLE TIME MEMBER**

**IN THE MATTER OF P.K. KHANNA & CO. BROKER OF LUDHIANA STOCK  
EXCHANGE, INB120592219**

**WTM/TCN/MIRSD/ /06**

**DATES OF HEARING :** 27.04.2006, 13.07.2006, 10.08.2006

**APPEARANCES:**

**FOR NOTICEES:** None appeared

**FOR SEBI :** Shri P.K.Kuriachan, General Manager  
Shri Rajesh Gujjar, Asst. General Manager

**ORDER**

**(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 P.K. Khanna & Co. (hereinafter referred to as "the broker") a proprietary concern is a member of the Ludhiana Stock Exchange Ltd. (hereinafter referred to as "the LSE") and is registered with the Securities and Exchange Board of India (hereinafter referred to as "SEBI") as a stock broker under Section 12 of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "the Act") with registration number INB120592219.

1.2 During December 2002, SEBI conducted an inspection of the books of accounts, documents and other records maintained by the Broker for the

period from 2000 till date of inspection under Regulation 19 of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as “the Stock Broker Regulations”) and the same was carried out by M/s. Nanda & Bhatia, Chartered Accountants on behalf of SEBI.

- 1.3 Certain irregularities / contraventions of SEBI Regulations were observed during the said inspection. A copy of the findings of the Inspection Report was sent to the broker for his comments on July 29, 2003. However, no reply thereto was received by SEBI.

## **2.0 Appointment Of Enquiry Officer**

- 2.1 On completion of the inspection, SEBI appointed an Enquiry Officer, 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 to as “the Enquiry Regulations, 2002”) to enquire into the alleged irregularities/violations committed by the broker. The Enquiry Officer issued a show cause notice dated February 23, 2004 in terms of Regulation 6(1) of the said Regulations to the broker.
- 2.2 The said notice provided the details of the provisions of law and the violations alleged to have been committed by the broker and also calling upon it and explain why the penalty should not be recommended for the aforesaid violations. The broker was also advised that if it desired a personal hearing it may indicate the same. However, the broker failed to submit its reply to the show cause notice within stipulated time of 14 days.
- 2.3 A reminder dated March 31, 2004 was issued to the broker advising it to submit its reply within a week. Since, no reply was received another reminder dated May 24, 2004 was issued to the broker advising to appear before the enquiry officer on June 8, 2004 along with its reply. The said personal hearing was rescheduled to June 15, 2004 and the broker was advised accordingly vide letter dated June 3, 2004. The broker vide fax

dated June 14, 2004 sought an adjournment of personal appearance to another date which was granted vide letter dated June 14, 2004 and the personal hearing was re-scheduled to June 22, 2004. However, the broker again failed to appear before the Enquiry Officer.

- 2.4 Vide letter dated June 23, 2004 the Enquiry Officer gave a final opportunity of personal hearing/submission of reply to the show cause notice on June 30, 2004. Shri Prdeep Khanna, proprietor of the broker, appeared before the Enquiry Officer on the said date and informed that he had been unable to furnish the reply to the aforesaid show cause notice due to various domestic problems including his persistent sickness and hospitalization of his son and requested for grant of time to July 12, 2004 to make his submissions. On the said date the broker vide letter dated July 9, 2004 informed that he was unable to appear due to hospitalization of his son and again requested for grant of time upto July 28, 2004 to make his submissions. However, the broker again failed to appear on the above date and no reply has been received from him since then.
- 2.5 The Enquiry Officer vide his report dated October 05, 2004 recommended for a minor penalty of suspension of the certificate of registration granted by SEBI to the broker for a period of three months under regulation 13(1) (a) (iv) of the Enquiry Regulations, 2002.

### **3.0 Show Cause Notice and Brokers' submissions**

- 3.1 Based upon recommendation of the Enquiry Officer, a show cause notice dated October 14, 2004 was issued to the broker under regulation 13(2) of the Enquiry Regulations 2002 asking it to show cause as to why the penalty as considered appropriate should not be imposed upon him. A copy of the enquiry report was also forwarded to the broker with the said show cause notice. The said show cause notice was served on the broker through LSE and the LSE has confirmed having delivered the notice to the broker on October 18, 2004.

- 3.2 Since no reply was received, a reminder dated November 17, 2004 was issued to the broker advising him to make its submissions latest by November 24, 2004 failing which it would be presumed that they have no explanation to offer and the Board shall be free to take such action in the matter as it deems fit on the basis of the available information/records. The letter was sent by LSE to the broker on November 22, 2004. However, the broker failed to submit any reply to the said show cause notice and instead requested for granting some time on November 16, 2004 where the broker assured that he would come to Mumbai and explain the matter in person.
- 3.3 Vide letter dated June 14, 2006, an opportunity of personal hearing was granted before the Whole Time Member on July 13, 2006 at 11.45 a.m. at New Delhi, Northern Regional Office of SEBI. However, the broker sought an adjournment vide his letter dated July 11, 2006 and requested for another date of hearing. The next hearing was fixed on August 10, 2006 at 4.30 p.m. at SEBI Head Office, Mumbai and the broker vide letter dated July 28, 2006. However the broker didn't avail this opportunity of personal hearing too.

### **Consideration of Issues**

- 4.0 I have carefully considered the enquiry report, the show cause notice issued to the broker and the replies seeking adjournment by the broker on various dates. From the above it appears that the broker has neither furnished a reply to the show cause notice nor appeared for personal hearings granted to it. I have also observed that the broker has been seeking adjournments and even after granting reasonable opportunity of hearing the same has not been availed of. It appears that the broker is adopting dilatory tactics. In view of this and considering the facts and circumstances, I am proceeding ex-parte against the broker.

4.1 In the absence of submissions of the broker, I have considered the report of the Enquiry Officer and my observations are as follows :-

**(a) Non-maintenance of books of accounts :**

The Enquiry Officer has found the broker guilty of violating the provisions of Regulation 17 (1) of the Stock Broker Regulations, 1992 for not maintaining the following books of accounts in prescribed manner :

- (i) Contract Books
- (ii) Counter Foils / Duplicates of Counter Notes issued
- (iii) Written consent of clients in respect of contract entered in to Principal.
- (iv) Document Register

The Enquiry Officer further found that the margin deposit book was maintained only in the shape of ledger account in the general ledger and no separate book was maintained. I have noted that the above books of accounts were not been produced for inspection to the inspection team. The Enquiry Officer found that the broker has violated the provisions of Regulation 17 of Broker Regulations, 1992 and Rule 15 of SCRR, 1957 for not maintaining the aforesaid books of accounts in the prescribed manner. I am therefore, not inclined to take a lenient view.

**(b) Non maintenance of client database**

With regard to the findings of the Enquiry Officer regarding non maintenance of client database, it is alleged that many of the clients including some of the top 20 clients of the broker had not been registered. It was also found that the permanent account number (PAN) and proof of identities of the clients were not on record. Further, introduction to the clients had not been given on the registration form. I am of the view that the broker has not complied with the directions of Circular no. SMD/Policy/IECG/1-9 dated February 11, 1997 and SMD/Policy/Cir/5-97 dated April 11, 1997,

and the provisions of Rule 4(b) of the SEBI (Stock Brokers and Sub Brokers) Rules, 1992 (hereinafter referred to as “Stock Broker Rules”) and provisions of para A (5) of Schedule II of the Code of Conduct under the Stock Broker Regulations.

**(c) Irregularities with respect to Contract Notes**

The broker had not issued contract notes for any transaction as duplicates / counter foils of contract notes were not made available / provided for inspection. I have considered the submission made by the broker to the inspection team that the contract notes were on hard disc of computer and the same were not printed. I am of the view that Regulation 17 of the Stock Broker Regulations casts a general obligation on the broker to keep and maintain the books of accounts, records and documents. Further regulation 17(1)(h) of the Stock Broker Regulations provides that *every stock broker shall keep and maintain contract notes showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members*. I find that the broker has apparently violated the directives of SEBI Circular no. SMD/MDP/CIR/O43/96 dated August 5, 1996 and provisions of para B(2) of Schedule II under Regulation 7 of the Stock Broker Regulations which specifically provides that a stock broker shall issue without delay to its client a contract note for all transactions in the form specified by the stock exchange.

**(d) Non segregation between client funds and own funds**

It was found that though the broker had maintained accounts with State Bank of India and Vysya Bank Ltd., and was unable to explain to the inspection team as to which is the main clients' accounts. It was also found that the broker deposited the cheques received from his clients' in his accounts instead of clients' main account. Moreover there were instances of self withdrawal too from

the funds of clients' accounts. I have noted the submission of the broker made at the time of inspection that these funds were deposited in other bank accounts or taken to books of accounts to meet out the obligation of the clients and margin payment. I agree with the findings of the Enquiry Officer and find that the broker has contravened the provisions of SEBI Circular No. SMD/SED/CIR-93/23321 dated November 18, 1993 and provisions of para A (5) of Schedule II specified under regulations 7 of the Stock Broker Regulations by not maintaining proper segregation of own and client's funds.

**(e) Delay in delivery of securities / Payment of sale consideration**

It was observed that the broker had kept the payments due to the clients for more than the stipulated time. I have noted the broker's submission that the same were kept as margin and that the broker had written consent of clients in this regard. I have noted that the broker did not submit any such written consent to the inspection team when the same was asked for. I have also noted that in few cases, some deliveries have been kept for more than stipulated time to be sold in few days or to be treated as margin. The member can maintain a running account or keep the shares as margins only if in respect of such accounts, he has obtained general authority from the clients. As per the SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993, delivery of securities is done within two working days of the pay-out. It is evident that the broker has failed to meet his obligation of delivering securities to the clients within two days of the pay-out. The broker has thus violated the provisions of SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 and SMDRP/POLICY/CIR/05/2001 dated February 1, 2001 and provision of Rule 4(b) of the Stock Broker Rules and Para A(5) of Code of Conduct specified under Regulation 7 of the Stock Broker Regulations.

**(f) Dealing with clients**

The Enquiry Officer found that the broker has violated the provisions of Rule 4(b) of the Stock Broker Rules and Para A(5) of the Code of Conduct specified under Regulation 7 of the Stock Broker Regulations by changing different rates of brokerage to different clients and in some instances it was not charged at all.

**(g) Execution of Off the floor transactions**

I have noted the findings of the Enquiry Officer as regards the brokers dealings with M/s Master Share and Stock Brokers on the National Stock Exchange (NSE). I have also noted that these transactions were not reported to the exchange. I have also noted that some of the spot transactions too were not reported to the stock exchange. I agree with the Enquiry Officer who has held the broker guilty of the directions of SEBI Circular no. SMD/RCG/CIR/BKG/293/95 dated March 14, 1995 and the provision of Rule 4(b) of the Stock Broker Rules and Para A(5) of the Code of Conduct specified under Regulation 7 of the Stock Broker Regulations. Moreover as per circular dated September 14, 1999, *"All negotiated deals (including cross deals) shall not be permitted in the manner prescribed in circulars mentioned above and all such deals shall be executed only on the screens of the exchanges in the price and order matching mechanism of the exchanges just like any other normal trade"*. The screen based trading was introduced so that there may be greater transparency, better price discovery, reduction in transaction cost and benefits the investors. The off the floor transactions tends to avoid transparency requirements, do not contribute to price discovery and some investors do not have benefit of the best possible price and militate against the basic concept of stock exchanges, which are meant to bring together a large number of buyers and sellers in an open manner. It is clear from the above circular that the

issue is not of reporting to Stock Exchange as such but execution of such transactions on the Stock Exchange only and not off the Stock Exchange.

**(h) Unique Client Code**

The broker has not entered the Client Code at the time of order entry into the system in respect of the transactions undertaken on behalf of clients. I have also noted the submission made by the broker that it was not possible to allot the unique client code to all the clients as there was no provision in the software available with him. The Enquiry Officer found the broker guilty of violating the directions of SEBI Circular no. SMDRP/POLICY/CIR/39/2001 dated July 18, 2001 and the provisions of the Rule 4(b) of the stock broker rules and Para A(5) of the Code of Conduct specified under Regulation 7 of the Brokers Regulations. Unique Client Code had to be allotted to the clients as per the above circular and that the broker cannot escape from the liability by submitting that it was not possible because of non-provision in the software. I agree with the findings of the Enquiry Officer.

- 4.2 I have considered all the facts and circumstances of the case. I am in agreement with the recommendations of the Enquiry Officer who has observed that the broker has failed to offer any comments on the findings of the inspecting authority. During the enquiry proceedings also, despite numerous opportunities given to the broker, the broker has failed to make any oral or written submissions to the show cause notice. It appears that the broker has been avoiding to appear or make his submissions on one pretext or the other. I am, therefore constrained to proceed ex-parte based on the material facts placed before me by the enquiry officer. I have also considered that the broker has not contested any of the violations brought out by the inspection team.

- 4.3 I therefore, agree with the recommendations of the enquiry officer who has recommended a penalty of suspension of certificate of registration of the broker for a period of three months.

## **5.0 ORDER**

Having regard to the gravity of the charges established and in the absence of mitigating factors, I agree with the findings and recommendations of the enquiry officer. Now, therefore, in exercise of powers conferred vide Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby impose a minor penalty of 'Suspension of the Certificate of Registration for a period of three months' in terms of Regulation 13(1)(a)(iv) SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, on M/s. P. K. Khanna & Co. (INB120592219), member, Ludhiana Stock Exchange.

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

**Place : Mumbai**

**Date : 23.10.2006**

**T.C.Nair**

**Whole Time Member**

**Securities and Exchange Board of India**