

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: Dr. T.C.NAIR, WHOLE TIME MEMBER

IN THE MATTER OF MADHYA PRADESH STOCK EXCHANGE LTD.

Date of hearing : October 3, 2006; July 24 , 2007

Appearances

For Noticees : Shri Vinay Chauhan, Advocate
Justice P.D. Mulye
Shri Ashok Mehta
Shri J.C. Baheti
Shri Sandesh Yashlah
Shri Mohan Somani

For SEBI : Shri D.Ravikumar, Chief General Manager
Ms. S. Jayamanju, Asst. General Manager
Shri Naveen Sharma, Asst. General Manager
Ms. Kshama Chavan, Legal Officer

ORDER

Under Section 11 of SEBI Act, 1992

1. Madhya Pradesh Stock Exchange Ltd. (hereinafter referred to as “MPSE” or “the Exchange”) is a company limited by shares and was granted permanent recognition in the year 1988. The Exchange was granted recognition by the Government of India under Section 4 of the Securities Contracts (Regulation) Act, 1956 (SC(R)A) on December 24, 1958 initially, and permanent recognition was granted on December 22, 1988 vide its notification no. F1/101/SE/88. Securities and Exchange Board of India (hereinafter referred to as “SEBI”) had issued three show cause notices to

MPSE. The first show cause notice was issued to MPSE on February 16, 2006 for its role in listing the preferential allotment of M/s Design Auto Systems Ltd., the second show cause notice was issued on November 14, 2006 for non implementation of Corporatisation and Demutualization Scheme and the third show cause notice was issued on May 07, 2007 for violations, irregularities and non-compliances on the part of MPSE. Replies were filed by MPSE vide letters dated March 03, 2006, November 30, 2006 and June 01, 2007. Personal hearing was sought in the case of the first and third show cause notice and accordingly hearing was granted before me on October 03, 2006 and on July 24, 2007, respectively. I have carefully considered the show cause notices issued to MPSE, its replies and the submissions made by MPSE during the personal hearings and my findings are as follows.

2. An inquiry was ordered by SEBI under powers conferred on it by sub-section 3 of section 6 of the SC(R)A vide order dated February 20, 2002, into the affairs of MPSE for its role in irregularities that occurred in the listing process of the preferential allotment of shares by M/s Design Auto Systems Ltd. (hereinafter referred to as 'DASL/ the company'). To put it briefly the following irregularities/lapses were observed:
 - i. The Exchange processed the listing application for shares allotted on preferential basis with utmost laxity, undue haste and without exercise of proper due diligence.
 - ii. The Exchange ignored a crucial lapse by the company regarding the furnishing of a false undertaking.

- iii. The Exchange also ignored lack of certain crucial compliances like the in-principal listing approval, filing of Forms 2 & 5, listing of existing issued capital etc.
3. It was found that DASL had submitted application for listing of its preferentially allotted shares to the Exchange on November 3, 2001 and listing permission was granted by the Exchange within two days i.e. on November 5, 2001. The Exchange appears to have cleared the listing application with undue haste without questioning the company on the rationale for expansion of capital by such high magnitude of over 13 times. The Managing Director of the company vide his letter dated October 31, 2001 submitted listing application to the Exchange along with an undertaking on the legal compliances. However, in the said inquiry, it was prima facie found that the undertaking furnished by the Managing Director was false. The Exchange failed to call for any explanation from the company for furnishing false undertaking. It was also observed that Form-5 required under the provisions of the Companies Act, 1956, for increase in authorized share capital, was not filed with the Registrar of Companies (ROC). The Exchange should have insisted on filing of Form-5 before granting permission to list the shares of the company. It was also observed during the inquiry that the Exchange failed to exercise due diligence since no formal follow up was done during the 3 months period. In addition to the above, during the said inquiry, it was also revealed that the Exchange was not even aware whether Form 2 for allotment of shares had actually been filed by the company with the ROC. This shows complete laxity on the part of the Exchange. As per the Listing Agreement it is mandatory for all listed companies to obtain an in-principle approval for listing from the

exchanges before issuing further shares or securities. The company while issuing 10 crore shares to Bonanza Biotech Ltd. (BBL) on swap basis, did not obtain the in-principle approval from the Exchange. MPSE also did not call for an explanation from DASL for not obtaining in-principle approval as admitted vide letter dated January 22, 2004. The Exchange explained in its statement during inquiry that this escaped their attention at the time of processing of the listing application. This is a case of gross negligence and lack of due diligence. It was also revealed during the inquiry that the Exchange did not, after grant of listing to an issue of shares, check with other stock exchanges whether the listing had also been granted by them. Even at the time of receipt of a new listing application of preferentially allotted shares, MPSE did not verify whether all the existing issued capital has been listed on all the stock exchanges on which the shares of the company are listed. This has resulted eventually in the said shares of DASL, which were irregularly allotted, being dematerialized and delivered in the BSE, where they were not listed. This further led to suspension of trading in the scrip by the BSE and substantial loss to other investors holding shares of DASL. It has also resulted in innocent investors being saddled with unlisted shares on the BSE floor. Thus the role of the Exchange in handling listing application of the company was found to be highly irregular and flawed.

4. From the inquiry conducted, it is clear that serious irregularities/ lapses were committed in the process of listing. These actions/ omissions were adverse to the interest of investors and the public. It appears that the Governing Board of MPSE had failed to supervise the functioning of the

Exchange and discharge its duties in an effective manner as mandated under the SC(R)A and Rules, Regulations and Bye-laws of the Exchange.

5. In addition to the findings of the inquiry, it is noted that as prescribed under Clause 40A of the Listing Agreement prescribing condition for continued listing, the Exchange has failed to ensure the compliance by the company before listing as the public shareholding went below the limit prescribed because of the preferential allotment. Clause 40A (iii) of the Listing Agreement requires the company not to make preferential allotment or an offer to buy back its securities, if such allotment or offer results in reducing the non-promoter holding below the minimum limit of public shareholding as specified under the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, as per limits stated in Clause 40A (ii). The Exchange, inspite of this non-compliance, granted permission for listing of shares of DASL.
6. On account of the above mentioned irregularities in the listing process which were violations of the provisions of the SC(R)A and the SC(R)R, a show cause notice dated February 16, 2006 was issued by SEBI to the Governing Board of MPSE calling them to show cause as to why appropriate directions including directions under Section 11 of the SC(R)A for supersession of the Governing Board of MPSE should not be passed. Further, MPSE was advised to reply to the notice within 15 days from the date of receipt of the notice and to appear for a personal hearing before me on October 03, 2006, along with supporting documents, if any.

7. In response to the above show cause notice, two elected directors submitted a reply vide letter dated March 03, 2006 and also requested for a personal hearing before SEBI. The two elected directors of the Exchange i.e. Shri Sanjay Saboo and Shri Shrimohan Somani in their reply sought to reason that the concerned issue pertained to the year 2001 and hence the present Governing Board should not be penalized. Further in the case of DASL, the previous directors including the Public Representative Directors of the Exchange had a personal interest in the issue which could be proven during the hearing. In another letter dated March 14, 2006 the Exchange informed that the reply for show cause notice was to be prepared by Shri Ashok Mehta, Public Representative Director. It was further mentioned in the above letter that no reply was received from Shri Mehta till the date of the letter and no letter had been sent to SEBI in reply to the notice.
8. As requested by the Exchange, a personal hearing was granted for which Shri Ashok Mehta, Shri J. C. Baheti and Justice P. D. Mulye, the Public Representative Directors of MPSE appeared before me on October 03, 2006 and made submissions.
9. An activity so fundamentally involving the role of the stock exchange cannot be looked at lightly. Blatant flouting of standards to be followed in the listing process has resulted in direct loss to investors holding shares of DASL and has dented their confidence in the capital market. The Governing Board should have taken initiatives in investigating and bringing to book those involved in flouting basic norms.

10. While the above matter was being considered, it was found that MPSE had not complied with The Madhya Pradesh Stock Exchange (Corporatisation and Demutualization) Scheme, 2005 (hereinafter referred to as 'C&D scheme' or 'scheme'). Therefore, another show cause notice was issued on November 14, 2006. C&D scheme was published by SEBI in the Gazette of India on August 29, 2005. As per the notified scheme, the MPSE was required to comply with four conditions mentioned in the C&D scheme, on or before the due date i.e. the date, as may be determined by the Governing Board of MPSE, which shall not be later than 3 months from the date of publication of the Order i.e. by November 29, 2005. The four conditions were as under:

Clause 4.2 The Governing Board, on and from Due Date, shall be constituted in accordance with the provisions of the Articles of Association of Madhya Pradesh Stock Exchange Limited (MPSEL) in force from time to time.

Clause 5.2 MPSEL shall allot the equity shares to the entitled Members or their nominees, as the case may be, as referred to in clause 5.1, by the Due Date.

Clause 11 On and from the Due Date, MPSE shall stand dissolved and MPSEL shall be entitled to, and shall, commence business and operations as the successor of MPSE.

Clause 12.2 MPSEL shall incorporate the provisions of this Scheme appropriately in its Memorandum and Articles of Association, Rules, Bye-Laws and Regulations on or before the Due Date.

11. MPSE had vide its letter dated November 22, 2005 sought extension of time of one month i.e. upto December 31, 2005 for complying with the requirements of the scheme notified by SEBI. However, it was observed that the Exchange failed to comply with the requirements of the C&D scheme even after a considerable lapse of time. Accordingly, SEBI vide letter dated May 05, 2006 directed the Exchange to complete all the conditions mentioned in the C&D scheme that were to be completed before the due date, without any further delay and in any case, not later than one month from the date of receipt of the letter. The Exchange was also cautioned that if it fails to abide by the above direction, SEBI would initiate suitable action against it and its Governing Board including levy of monetary penalty under section 23G of SC(R)A or supersession of the Governing Board under section 11 of SC(R)A.
12. MPSE vide letter dated May 15, 2006 informed that the application for change/renewal of the name of the Exchange, in terms of the C&D scheme, has been filed with the ROC, MP & Chattisgarh on May 15, 2006. Since the details regarding the status of compliance of the other conditions of the C&D scheme were not mentioned, SEBI vide letter dated June 05, 2006 advised the Exchange to furnish the status immediately. In reply MPSE vide letter dated June 15, 2006 informed that name availability has been received from ROC, Memorandum and Articles of Association had been finalised and two trading member directors had been elected, which is 1/4th of the total strength of the Governing Board.
13. As the above four conditions were not fulfilled for implementation of the C&D scheme, SEBI issued a notice dated November 14, 2006 under Section

11 of SC(R)A calling upon the Exchange to show cause as to why actions under Section 11 of SC(R)A for supersession of the Governing Board of the Exchange; withdrawal of recognition of the Exchange under Section 5(1) of SC(R)A or/and proceedings under Section 23G of SC(R)A may not be taken. Further, MPSE was advised to reply to the notice within 15 days from the date of receipt of the notice, along with supporting documents, if any.

14. In response to the above show cause notice, the Exchange submitted its reply vide letter dated November 30, 2006. The reply given by the Exchange with regard to non-compliance of the four conditions mentioned in the scheme are as under :

- i. Clause 4.2: The Governing Board, on and from Due Date, shall be constituted in accordance with the provisions of the Articles of Association of MPSEL in force from time to time.*

The Exchange had submitted that the Governing Board of the newly incorporated company MPSEL has been constituted as per the notified C&D scheme and the same has been incorporated in the Memorandum and Articles of Association of the company. The structure of the Board of MPSE comprises of 2 Elected Members, 4 Public Representative Directors and 2 SEBI Nominee Directors.

- ii. Clause 5.2 : MPSEL shall allot the equity shares to the entitled Members or their nominees, as the case may be, as referred to in clause 5.1, by the Due Date.*

The Exchange stated that the company was incorporated with an authorised share capital of Rs. 5.00 lakh and the company requires to increase its authorised share capital to allot the shares to members other than subscribers. For increasing authorised share capital, the approval of the members was required for which an EGM was to be convened on December 02, 2006.

- iii. Clause 11: On and from the Due Date, MPSE shall stand dissolved and MPSEL shall be entitled to, and shall, commence business and operations as the successor of MPSE.*

It was submitted that the Governing Board of the Exchange in its meeting held on September 16, 2006 decided the cut off date as September 30, 2006 for taking over the business of the Exchange by the company. Accordingly in the Extra Ordinary General Meeting held on October 05, 2006 the MPSE was dissolved and MPSEL took over all assets, properties, undertakings, business, books, records, registers, funds, reserves, rights, including intangible rights, powers, authorities, interest, privileges, exemptions, permissions, licenses, registrations and recognitions (including, in particular, the recognition of MPSE as a recognised stock exchange under SC(R)A) and other matters incidental there to as per clause 7 and its sub clauses from 7.1 to 7.7 of the C&D scheme.

- iv. Clause 12.2: MPSEL shall incorporate the provisions of this scheme appropriately in its Memorandum and Articles of Association, Rules, Bye-Laws and Regulations on or before the Due Date.*

The Exchange stated that they would incorporate the provisions of the scheme appropriately in its Memorandum and Articles of Association, Rules, Bye Laws and Regulations on or before the due date.

15. In the above reply, the Exchange had requested for withdrawal of the show cause notice and non-commencement of any kind of proceedings against the Exchange or its Governing Board. However no request was sought for a personal hearing.
16. The above mentioned show cause notice thus arose from repeated delays that took place in complying with the provisions of the C&D scheme like conversion/ re-registration from a company limited by guarantee to a company limited by shares, allotment of shares, reconstitution of the Governing Board, etc. on or before the due date. The scheme in itself was meant to effect segregation of ownership, management and trading rights. This process was found to be necessary in achieving the goals of protecting investors interest, promoting the development of and regulating the capital market. In spite of granting an extension as per the request of the Exchange and subsequently permitting further time to incorporate the change as directed by the C&D scheme, the Exchange's efforts were slow and failed to show a sincerity of purpose. However since the process was eventually completed, a lenient view on the same may be taken.
17. The third show cause notice served on MPSEL arose on account of certain further violations that came to SEBI's notice in the course of inspections conducted by SEBI on January 12-13, 2004 and November 22-23, 2006. The

notice highlighted that in light of the violations identified at present as well as taking into consideration the reasons highlighted in the earlier issued show cause notices dated February 16, 2006 and November 14, 2006, SEBI was of the prima facie opinion that it would be in the interest of the trade and also in public interest to withdraw the permanent recognition granted to MPSEL by the Central Government. MPSEL was advised to show cause as to why SEBI should not withdraw the permanent recognition granted to MPSEL under section 5 of SC(R)A. MPSEL was also advised to show cause as to why, pursuant to the said proposed withdrawal, necessary and consequential directions under section 12A of the SC(R)A should not be passed to secure proper management of the assets and other properties of the Exchange, in the interest of investors of the said region as well as the companies listed in MPSEL.

18. Some of the observations of inspection conducted during January 12-13, 2004 not implemented till the inspection conducted on November 22-23, 2006, the responses to the same submitted vide letter dated June 01, 2007, and replies if any on their implementation status are as under:

- a. **The Exchange does not have any of the standing committees like Investor Services, Ethics, Membership Selection and Audit Committee in violation of SEBI circular no. 52/2001 dated December 20, 2001.**

The Exchange submitted that as there was no trading activity taking place and the Exchange was almost non-functional, it was not in a

position to appoint the committees previously and that almost all the committees are now in position and functional.

- b. The Exchange does not have a standing Committee to investigate the problem of computerized trading system, such as hanging/slowdown/breakdown in violation of SEBI circular SMD/POLICY/CIR- 2/98 dated January 14, 1998.**

It was submitted that since January 2002 there was no trading activity on the Exchange and therefore there was no functional role for a committee to investigate the problems of computerized trading systems and in a fund starved Exchange any expenditure on such a “no use” standing committee would only be a burden on the Exchange rather than of any use. It was also submitted that this activity was being carried out by the Governing Board itself and before commencing trading on the Exchange the standing committee would be constituted.

- c. The Exchange has not gazetted the bye-laws even after them being approved by Governing Board of the Exchange on March 31, 2004.**

The Exchange submitted that the cost of publication of the bye-laws and rules of the Exchange in the Official Gazette of India as intimated by Govt. of India, Printing Press is approx. Rs. 20 lakh, which under the prevailing circumstances was too high for the Exchange. MPSEL submitted that when the English version was ready for publication, the Hindi version was not ready and for publication in the Gazette both the versions were required. Therefore, the bye-laws and rules had to be translated in Hindi,

which took the gazette office a long time to complete. The Exchange stated that they had received the Hindi translation and the same would be published without any delay.

- d. **The Exchange's sub-committee for monitoring compliance with SEBI's inspection report did not meet for more than two years till November 13, 2006 inspite of several observations pending for compliance.**

The Exchange has submitted that since it was trying its best to comply with all the requirements as pointed out in the inspection report and the Governing Board was also involved therein, the specific committee did not meet. During the period the limited manpower available with the Exchange was deployed to attend various matters relating to implementation of C&D scheme. It was further stated that post SEBI inspections the sub-committee has met twice on November 13, 2006 & January 22, 2007/January 23, 2007 and is taking care of the remaining matters pending for compliance.

- e. **MPSEL has no mechanism to ensure that due action is taken and records thereof maintained by the Electronic Data Processing (EDP) section, once listing permission is granted and the securities have been admitted for trading.**

The Exchange submitted that all the records pertaining to the existing listed companies have been maintained by the EDP and since for the past 5 years there has been no fresh listing there are no new records that are required to be maintained.

- f. **The Exchange does not have an escrow account to keep the 1% security deposit given by the companies at the time of entering the capital market separately.**

It was submitted that the Governing Board has approved the opening of the Escrow account at its meeting held on April 26, 2007 and the same has been opened.

- g. **The infrastructure relating to various support functions, such as accounting, valuation and monitoring of BMC etc., at MPSEL is poor and outdated.**

The Exchange submitted that since there was no trading activity taking place the need for new systems was not necessitated and therefore the same was not installed. However, improvement in the infrastructure was being implemented from time to time and new personal computers had been procured recently.

- h. **MPSEL has not set up a separate cell with separate identified staff for monitoring compliance with the listing agreement by all the listed companies, in violation of SEBI Circular No. SMDRP/POLICY/CIRCULAR - 6/99 dated April 08, 1999.**

It was submitted that the persons working in the listing department monitor the compliance of the listing agreement manually and the initiation of online monitoring is in progress. It was further submitted that efforts are being made to set up and implement appropriate mechanisms and procedures for monitoring non-compliance of listing requirements and other notices sent to companies.

- i. **MPSEL does not have a separate monitoring cell with identified personnel to monitor the compliance with the provisions of corporate governance violating SEBI circulars SMDRP/POLICY/CIR-03/01 dated January 22, 2001 and SEBI/MRD/SE/31/2003/26/08 dated August 26, 2003.**

The Exchange submitted that they had formed a separate cell for monitoring the compliance of the provisions of corporate governance with separate identified personnel and that the cell had been in operation since October 2006.

- j. **Some of the employees of the Exchange are working concurrently on subsidiary of the Exchange as well in violation of the SEBI Circular SMD/POLICY/CIR-04/2003 dated February 11, 2003.**

MPSEL submitted that at no point of time there have been employees concurrently working at the Exchange and at the subsidiary.

- k. **MPSEL has not published any publication in regional language for the benefit of the investors titled "Investor Grievances Rights & Remedies" violating SEBI circular SMD/POLICY/IECG/1-97 dated February 11, 1997**

The Exchange submitted that Hindi is the regional language of the state and that since publication of SEBI had already been uploaded on the SEBI website in Hindi, the Exchange felt that there was no need for publishing the same Hindi text separately and incurring additional expenditure as the purpose had been served.

Further in the inspection conducted on November 22-23, 2006 several violations/ deficiencies were observed. Observations of the inspection in brief, the Exchange's response to the same and comments if any on their status of implementation is as under:

- a. **Governance Vacuum:** It was observed that there has been no Executive Director on the Exchange since December 2004 and yet no effort has been made by the Exchange to appoint an Executive Director. The Exchange also did not have a designated head. Officially, the cheque signing powers at the Exchange were exercised by three employees of the subsidiary of the Exchange including the officiating CEO (CEO) of the subsidiary. However, the discussions with Exchange officials revealed that the financial powers were exercised almost entirely by the CEO. It was found that all day-to-day expenses are approved by the CEO. The Governing Board of the Exchange, while assigning financial powers to the CEO of the subsidiary, did not define limits upto which powers can be exercised. The matters relating to the Governing Board of the Exchange were handled by the Compliance Officer of the subsidiary who is employed on a contractual basis. The agenda to be placed before the Board being decided by him in consultation with the members of the Governing Board. This implies that there was no involvement of any employee of the Exchange in the matters relating to the Board of the Exchange. The result of the governance vacuum is that many issues relating to compliance with SEBI inspection report remain pending, large numbers of delisting applications remain pending, several important committees remain

dysfunctional or non-existent, financial mis-management is rampant and violation of a large number of SEBI requirements continues to take place. It was observed during the inspection that a number of meetings of the Governing Board were convened at very short notice and also the brokers attended in majority, in 27 out of 39 meetings.

The Exchange submitted that during the last 5 years it was under financial stress due to lack of revenue generation on account of no trading activity taking place at the Exchange. The lack of trading activity, also led to attrition and shortage in manpower which further resulted in the work remaining pending. The Governing Board made all efforts to bring in requisite staff so as to ensure the functioning of the Exchange smoothly. As on date sufficient staff exists to maintain continuity in the operations of the Exchange and the shortage of manpower has reduced substantially and there is optimal staff strength to meet the present requirements of the Exchange. The Exchange has submitted that advertisements for appointment of suitable candidate to the post of Executive Director of the Exchange have already been given. The post of Executive Director of MPSEL is only a nominal post and due to lack of career opportunities and for want of job satisfaction it is difficult to procure the services of a qualified person. The Exchange further submitted that the CEO of the subsidiary was only performing a ministerial act of simply counter signing the cheques with respect to meeting the routine administrative expenditure of the Exchange. He was not given power to take or influence decisions in the financial matters. According to the Exchange, the observation that matters relating to

Governing Board were being handled by the compliance officer, is also not correct. It was submitted that the compliance officer's work was limited to the drafting of notice etc. and not deciding the agenda. The observation that there was no involvement of any employee of the Exchange in the matters relating to the Board of the Exchange was also not correct.

- b. Corporatisation & Demutualisation:** The implementation of C&D scheme, approved and notified by SEBI under Section 4B of SC(R)A, has been delayed by more than one year and is yet to be completed. A show cause notice dated November 14, 2006 for non implementation of the scheme had already been issued to the Exchange. Also, the Governing Board was wrongly informed that the Exchange was getting an extension of one year for completing the Corporatisation & Demutualisation process.

The Exchange denied that they had at any time submitted any false information to the Governing Board. It was averred that the Governing Board had been correctly informed that the Exchange had got extension of time from SEBI vide its letter No. MRD/DSA/C&D/75204/2006 dated August 25, 2006 for demutualization of the Exchange. The Exchange submitted that the said letter was issued on the request of the Exchange vide its letter dated August 24, 2006. SEBI had acceded to their request of extension of time by twelve months, for dilution of 51% of shareholding of the trading members and the same was communicated to the Governing Board. Therefore the allegation that

false information was given to the Governing Board was, according to the Exchange, unfounded.

- c. **Financial Mismanagement:** The Exchange's financial situation is in precarious condition due to huge investments made by it in its subsidiary i.e. MPSE Securities Ltd. The Exchange, as on March 31, 2006, had cash and bank balance of Rs 2.24 crore which includes cash as well as the Fixed Deposits. Against this, the Exchange has borrowed Rs. 1.95 crore out of which Rs. 1.76 crore has been invested in the equity capital of its subsidiary since April 2005. As a result of this investment, the Exchange is left with usable liquid assets of Rs. 29 lakh only. Against these assets, the Exchange has liabilities as under:

1% security deposit to companies	Rs. 98.00 Lakh
IPF for which provision is made in the balance sheet	Rs. 17.47 Lakh
Excess BMC	>Rs. 30.00 Lakh
Total	Rs. 145.47 lakh

The Exchange has also provided a loan of Rs. 1.55 crore to its subsidiary without any loan agreement and without any agreed repayment schedule and the loan amount has not reduced from the time it was given. The subsidiary has not been paying interest on loan and rent to the Exchange since April 2006. Further, the subsidiary has allotted shares of Rs.10/- each to the Exchange at a premium of Rs. 10/- per share in lieu of the amount of Rs. 1.76 crore

lent to it by the Exchange, in a highly irregular manner without carrying out any valuation exercise to ascertain the amount of premium. The Board of the subsidiary also approved the allotment without ascertaining any price justification. The subsidiary has also not taken the approval of the Board of the Exchange for the conversion of the above amount into shares and no share certificates were issued to the Exchange.

The Exchange has stated that the investment made in the subsidiary is based on a prudent and commercial decision, in an attempt to generate some income for the Exchange and to benefit the localised investors and its members, as it involves receiving of interest at a rate which is higher than Bank Deposit rates at the time the Investment was made. The loan taken by the Exchange from the Bank for the purpose has been repaid. The Exchange has also stated that they are in the process of allotment of shares to the members of the Exchange as per the C&D scheme, which shall generate upto Rs.13.50 lakh. Provisions have been made in the balance sheet towards Investor Protection Fund (IPF)/ Customer Protection Fund(CPF) under the head "Reserves and Surplus" and the balance as on March 31, 2006 was Rs.17.47 lakh. The account has been opened for the IPF/CPF fund at Bank of India, Siyaganj Branch into which an initial deposit of Rs.3,00,000/- has been deposited. The loan agreement with the subsidiary has been executed on April 09, 2007 and with the repayment schedule being finalized and executable and as a result of the same the liquidity position would be strengthened and the Exchange would be in a position to meet

their liabilities more appropriately. The subsidiary has been converted from a company limited by guarantee to a company limited by shares on 6th July 2004 by a resolution passed in an AGM on July 22, 2003. At the time of the conversion, the subsidiary issued 5, 50,000 equity shares of Rs. 10/- each at a premium of Rs. 10/- per share against initial capital contribution made by the Exchange as the corpus fund of Rs. 1.10 crore.

- d. **Base Minimum Capital (BMC):** It was observed during the inspection that there are a number of cases in which BMC had fallen below the prescribed level of Rs. 1 lakh. The Exchange also had been valuing securities on weekly basis instead of daily basis, as provided in the circular dated February 23, 2005 dealing with comprehensive risk management. The Exchange has also given wrong certifications to SEBI regarding pending investor complaints in relation to requests for release of excess BMC. It was found that one complaint each was pending in the names of Shri Virendra Singh Bhandari and Shri Mohan Malpani.

The Exchange has submitted that final reminders have been issued to remaining members on April 05, 2007 to clear their dues and make good the shortfall in BMC by May 30, 2007. Also most of the cases of shortfall in BMC as observed in the notice are related to members who have already been suspended by the Exchange.

- e. **Non compliance with SEBI Guidelines on Investor Protection Fund:** MPSEL has not formed a trust for its IPF in violation of SEBI

circular dated October 28, 2004. Neither has it been crediting 100% of the interest on 1% Security Deposit kept with it by the companies in violation of the aforesaid circular. The Exchange also has not been contributing 1% of the listing fees received to the IPF/CPF on quarterly basis in violation of aforesaid circular. It was observed that the funds in IPF/CPF are not segregated and also are not immune from the liability of the stock Exchange in violation of the aforesaid circular.

The Exchange has submitted that since there was no trading taking place, a separate IPF had not been created. It has been further stated that since the liquidity position of the Exchange is improving the Governing Board of the Exchange has taken steps to get the draft Deed of Trust prepared for the trust with the name “Madhya Pradesh Stock Exchange Investor Protection Fund” as per the SEBI Circular and the trust deed would be placed at the next meeting of the Board for approval.

- f. **Monitoring of subsidiary:** It was observed that the Exchange has neither been conducting inspection of its subsidiary company nor its sub-brokers. It has not been verifying compliance of margin payments and other risk management measures applicable to the subsidiary company as a broker member of another Exchange.

The Exchange has submitted that their subsidiary company is a member of NSE and BSE and therefore the inspection of the subsidiary was done by these exchanges. In addition to the same

SEBI was also inspecting the subsidiary since it is a registered intermediary with SEBI and no adverse comments have been issued to the subsidiary either by SEBI or BSE with respect to margin payments and other risk management. The Exchange further stated that it has appointed auditors for the inspection of the subsidiary as decided at its meeting held on April 26, 2007 and the report of the Auditors is awaited.

- g. Listing/Delisting:** It was observed during the last inspection in January 2004 that listing of companies was being granted with the approval of the President till August 26, 2002, (the date of resignation of office bearers) and thereafter with the approval of the Executive Committee. Pursuant to the SEBI directions, the executive committee was dismantled and the listing applications were placed before the Governing Board for approval, without forming a Listing Committee. In the current inspection, it was observed that the Listing Committee had not been constituted so far. It has also been observed that delisting applications are not being routed through the Delisting Committee in violation of delisting guidelines specified vide SEBI circular dated February 17, 2003 and 62 applications are pending with the Exchange for delisting.

The Exchange has submitted that the delisting Committee has already been formed and three meetings of the committee have already taken place.

- h. Investor Service Fund:** SEBI, vide circular SE/10118 dated October 12, 1992 had directed the stock exchanges to set aside at least 20% of listing fees collected by them every year for providing services to the Investing Public. In violation of the said circular, the Exchange is yet to set up the Investor Services Fund (ISF). As per SEBI circular SMD/Policy/Cir-32/97 dated December 03, 1997, the stock exchanges are required to open at least one Investor Service Centre and these centres are required to provide certain basic minimum facilities to the investors. The Exchange does not have an Investor Service Centre, which is in violation of above SEBI circular. The Exchange has not submitted any reply , in this regard.
- i. Inadequate Manpower and Infrastructure:** The basic platform for trading and settlement such as Clearing House, a separate bank a/c for pay-in/pay-out, separate demat account for clearing & settlement, licensed and tested trading software, etc are not available. In other words, the Exchange has not adopted T+2 Rolling Settlement System. Further, the Exchange has only nine employees, out of which 2 are at executive level. Out of these nine employees, four have joined in October/November 2006 only. There is a huge gap between the resources currently available and the requirements, in terms of manpower, infrastructure etc, for MPSEL to function as a stock exchange.

The Exchange has submitted that there has been no trading activity on the Exchange since January 2002 and therefore the income of the Exchange from trading was almost nil. Setting up the basic

infrastructure for trading and settlement including a Clearing House, licensed and tested trading software etc. requires large funds and locking funds without utilising them, on account of the absence of trading activity, would be imprudent. Expenditure to the tune of Rs. 3.2 crore was incurred on the infrastructure required for implementing the T+2 rolling settlement system. However, the vendor who was programming the required database committed patent errors in the software due to which disputes arose between the Exchange and the programming vendor. This dispute is now pending in the Indore District Court. With regard to the number of employees and executives of the Exchange referred to in the notice, it has been submitted that there is no scope for appointing more employees and incurring additional expenditure at this juncture as there is not enough work for them in the absence of any trading. Increasing expenditure on employees, without commencement of trading activities would further result in erosion of capital and residual resources available with the Exchange. The employees at present available are sufficient and they are also qualified to manage the current day-to-day affairs of the Exchange.

MPSEL submitted their reply to the show cause notice vide letter dated June 01, 2007 and also requested for a personal hearing which was granted on July 24, 2007. Shri Ashok Mehta - PR Director of MPSEL, Shri Shrimohan Somani - Member Director of MPSEL and Shri Vinay Chauhan, Advocate appeared for the personal hearing before me and Shri Vinay Chauhan, Advocate made the submissions on behalf of MPSEL.

19. At the outset, I note that the inspection of MPSEL was carried out with an objective to ascertain whether the Exchange has complied with the terms and conditions of recognition / guidelines, directions etc. issued by SEBI/ Government of India from time to time and whether the Exchange provides fair, equitable and a growing market to the investors. However I observe that MPSEL did not make serious attempt to comply with the suggestions made through earlier communications, inspection reports as well as the previous show cause notices issued. The present order is necessitated in particular by the gross inefficiencies noted at the last inspection recorded on November 22-23, 2006.
20. The third show cause notice as already noted above emanated from the observations made vide the inspections conducted during November 22-23, 2006. The inspection conducted on these dates revealed that the earlier observations made after the inspections conducted on January 12-13, 2004 had also not been complied with, yet. Investor Services, Ethics, Membership selection and Audit Committees had yet not been set up, in violation of SEBI circular dated December 20, 2001. Trading infrastructure including the computerised systems were not effectively in place and the infrastructure relating to various support functions such as accounting, valuation and monitoring of BMC continue to remain outdated and ineffective. Moreover a standing committee to investigate the problem of computerised trading system as required by circular dated January 14, 1998 has also not been set up. The Exchange justifies these omissions on the grounds that in the absence of any trading activity it would be difficult to implement such directions. However it must be understood that a stock exchange cannot hope to ensure active trading without

having its basic facilities in place and securing the confidence of investors. The Exchange did not have an escrow account to keep the 1% security deposit given by the companies at the time of entering the capital market separately. Nor did it even bother to gazette the bye-laws as required by Section 9(4) of the SC(R)A inspite of them having been approved by the Governing Board of the Exchange on March 31, 2004. It is also noted that while in response to the allegation that employees were working concurrently in the Exchange as well as in the subsidiary in violation of circular dated February 11, 2003, a denial was first issued, the Exchange later observed that the deficiency had been rectified. This shows clearly that MPSEL had gone to the extent of giving false replies. In terms of investor awareness responsibilities also, the Exchange has defaulted by violating the circular dated February 11, 1997 by not ensuring publications in the regional language for the benefit of investors.

21. The second inspection conducted in November, 2006 depicted a continued dismal picture of affairs. In violation of SEBI circular dated April 20, 1993, I note that MPSEL did not have a full time Executive Director (ED) since December, 2004. It is the duty of the Executive Director to give effect to the directives, guidelines and orders issued by the Board in order to implement the applicable provisions of law, rules, regulations as also the Rules or the Articles of Association, Regulations and Bye-laws of the stock exchange. The Exchange's response that the ED's post is only a nominal one and that it is difficult to procure the services of a qualified person for the position is thoroughly inadequate and irresponsible. It is also incongruous on the part of MPSEL to argue

that while limits on powers of the CEO of the subsidiary have not been defined by the Governing Board, his role is continued to be dismissed as being limited to a ministerial function of countersigning the cheques. The decision by SEBI to necessarily appoint the above mentioned designated individuals was to ensure efficient running of these institutions.

22. As regards the issue of the fall in minimum prescribed BMC, the Exchange has not been able to answer satisfactorily as to why the securities have not been valued on a daily basis as provided in the SEBI circular dated February 23, 2005. The justification provided by the Exchange with regard to the delay in compliance in an issue as fundamental as the base minimum capital to be maintained is unacceptable. Therefore submissions that steps are in process to ensure compliance is far too naive and far too delayed. Financial mismanagement continues to take place particularly with regard to the Exchange's relationship with its subsidiary. The Exchange has not been able to convince satisfactorily why a repayment schedule had not been determined as regards the loan provided to the subsidiary broking firm and why interest on loan and rent has not been paid to the Exchange since April 2006. However short the time or small the amount, it is absolutely essential that dues are met appropriately. Moreover the valuation of the shares of the subsidiary has not been conducted in a satisfactory manner for which convincing reasons have not been provided.
23. The listing/ delisting procedures continue to be lax. The show cause notice dated May 7, 2007 had highlighted the fact that a separate cell to

monitor compliance of listing agreement by the listed companies had not been set up in violation of the circular dated April 8, 1999. In addition to this, the last mentioned inspection report observes that a listing committee continues to remain unappointed. This development is particularly worrying considering that the first show cause notice was as regards the irregularities that occurred in a listing process. Inadequate manpower and infrastructure is another serious area of concern. The Exchange has chosen to justify these inadequacies by stating that the lack of trading and the consequent reduction in revenue made it prohibitively expensive to incur expenditure on manpower or infrastructure. Another serious violation has been non-compliance with the SEBI circular dated October 28, 2004 that mandated the creation of a trust for forming the Investor Protection Fund. This is an issue that directly affects investor confidence and security of the market. It is unfortunate that the Exchange has failed to set up Investor Services Fund and the Investor Service Centre as mandated vide our circulars dated October 12, 1992 and December 3, 1997 which is a progressive move for investor awareness and education.

24. To function as an effective stock exchange, it is imperative to have adequate and qualified manpower. If the Exchange is serious about performing as a properly functioning institution, it first needs to ensure that it has the human resources to meet the challenges involved. Ironically while the Exchange had argued in response to the previous inspection report that they could not bring into effect a sub-committee for monitoring compliance with SEBI's inspection report on account also of the limited manpower, it has been observed that infact the Exchange was

consciously deputing its workforce to its subsidiary. Claiming that there wasn't enough manpower while actually sending its own personnel to its subsidiary is clearly contradictory and shows how insincere the management of MPSEL has been towards implementing SEBI directions.

25. Failure of the Exchange to ensure proper governance and implementation of the provisions of the SC(R)A, Bye-laws of the Exchange and the SEBI directives, circulars etc. could erode the confidence of the investors. Stock Exchange being a "Self Regulatory Organization" is a first level regulator and has a responsibility to oversee the management, administration, trading and settlement to regulate its own members, and monitor the functioning of its subsidiary. Besides, as has been observed by the Hon'ble Supreme Court of India in K. C. Sharma Vs. Delhi Stock Exchange and others [(2005) 4 SCC 4], the stock exchange is a "State" within the meaning of Article 12 of the Constitution of India. MPSEL is a public institution that regulates the dealings in shares and securities and is recognised under the SC(R)A and is guided not only by its own Rules, Bye-laws and Regulations but is also governed by the directives issued by SEBI/Govt. of India from time to time and is mandatorily required to follow them.
26. In the instant case the Exchange has had a number of reminders regarding its dismal functioning and yet it's claims of steady progress are in my opinion a mere eyewash. It would be only reasonable to expect that the Exchange would be more responsive to statutory compliances especially after the first two show cause notices. But the continuing nature of the violations is evidence of the callous attitude of the

Exchange. Also Basic systems continue to remain out of place. Issues as basic as the SEBI guidelines on Base Minimum Capital and the Investor Protection Fund etc have not been complied with. In spite of the fact that there is no trading on MPSEL since 2002, it is incumbent upon a stock exchange to supervise its trading members comply with the Rules, Bye-laws and Regulations of the exchange at all times during their period of holding of membership of an exchange irrespective of whether they trade or not. However, I find that certain observations like submission of audit reports, maintenance of BMC, collection / recovery of outstanding dues from the brokers etc. have not been complied with by the members of the Exchange.

27. I have noted that the Exchange has been demutualised and the appointed date notified in the Official Gazette of India is August 28, 2007. After Demutualisation, 51% of the equity of the Exchange is held by non-trading members. Further the management has changed since Shareholder Directors and Public Interest Directors have been inducted on the Governing Board of the Exchange. After going through the chronology of events, facts and circumstances of the case, I am of the considered view that the demutualised stock exchange should be given an opportunity to rectify the deficiencies made in the last inspection report of SEBI and put in place the basic systems required to perform as a recognized stock exchange.
28. In view of the above and in exercise of the powers conferred upon me under Sections 19, read with Sections 11 of the SEBI Act, 1992, I hereby direct MPSE to rectify the deficiencies made in the last inspection report

of SEBI and put in place the basic systems required to perform as a recognized stock exchange within a period of 3 months from the date of this order, failing which SEBI would withdraw the permanent recognition granted to the stock exchange. With regard to the irregularities in the listing process of preferential allotment of shares of DASL, appropriate action shall be initiated in accordance with law against the persons who were responsible for irregular listing of the shares.

29. This Order shall come into force with immediate effect.

Date: February 18, 2008

T.C. NAIR

Place: Mumbai

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA