WTM/MSS/ID7/ 04/09

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA, MUMBAI
CORAM: M. S. SAHOO, WHOLE TIME MEMBER

In the matter of The United Western Bank Ltd.
erstwhile Banker to an Issue (SEBI Registration No. INBI00000059)
[since amalgamated with IDBI Bank Ltd. (SEBI Registration No. INBI00000076)]

Appearances:

For Noticee: 1) Shri Vinay Chauhan, Advocate, and
2) Shri M. V. Phadke, General Manager (Legal), IDBI Bank Ltd.

For SEBI: 1) Shri Suresh Gupta, General Manager
2) Shri Rajesh Gujjar, Astt. General Manager
3) Shri Amitesh Kumar, Legal Officer
4) Shri Jai Prakash, Legal Officer, and
5) Ms. Vasudha Goenka, Legal Officer

ORDER
Under Regulation 28(2) read with Regulation 38(2) of the Securities and Exchange Board of India (Intermediaries Regulations), 2008

1. Securities and Exchange Board of India (SEBI) had conducted investigations into the public issue and subsequent dealings in the shares of Anik Ship Breaking Industries Ltd. for the period June 25, 1997 to December 23, 1997. Based on the findings of the said investigations, vide order dated July 24, 2003, it appointed an Enquiry Officer (EO) to enquire into the alleged violation of the provisions of the SEBI (Bankers to an Issue) Regulations, 1994 by United Western Bank Ltd. (for brevity, 'UWB'/ 'transferor bank') [since amalgamated with IDBI Bank Ltd. (for brevity, 'IB'/'transferee bank') w.e.f. October 03, 2006], Lower Parel Branch, Mumbai.

2. The EO, after conducting the enquiry in accordance with the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (Enquiry Regulations), submitted the enquiry report dated October 29, 2004. In the said report, the EO found that UWB issued stock invests to 4 applicants against the fixed deposit account No. 95/30. However, on allotment, it debited the account of R. R. Investments, instead of the aforesaid fixed deposit account, towards application money. Since UWB failed to produce any documentary evidence based on which such debit was done, the

EO concluded that the UWB failed to exercise due care and diligence. Taking certain other factors into account, the EO took a lenient view of the irregularity and recommended that warning be issued to UWB.

3. A notice dated December 13, 2004 enclosing therewith a copy of the enquiry report was issued to UWB, calling upon it to show cause as to why appropriate action as recommended by the EO should not be taken against it. UWB, vide its letter dated December 30, 2004, replied to the show cause notice. While the proceedings were pending, UWB was amalgamated with IB.

4. A personal hearing was granted before me on May 06, 2009 when the Advocate and a representative of the transferee bank appeared and made oral and written submissions. The transferee bank concluded its arguments at the hearing. Since it neither sought nor was granted permission to file further submissions, the order was reserved at the conclusion of the hearing. However, the transferee bank, vide their letter dated May 13, 2009, submitted additional written submissions. In the interest of justice, I have considered the same also.

5. Vide its written submission dated December 30, 2004, the UWB, without disputing the facts, submitted that the *act (debiting another account) was bonafide without negligence though a few alphabets of authorization proof would have been of a greater assistance to the Bank*. It further argued that *there is no necessity of express authorization, when the transaction was done at the instance of and for the benefit of the family members inter se and authorization is required to be implied rather than negated in such cases.*

6. In addition to and continuation of submission dated December 30, 2004 of the UWB, the transferee bank, through written and verbal submissions, without disputing the facts of the matter, submitted as under:
   a) UWB was amalgamated with IB at the behest of the Reserve Bank of India in public interest. It was not an act of its own volition. Nor did it have any option or say in the said amalgamation. It produced a copy of the Gazette Notification dated September 30, 2006 in support of this.
   b) IB can't be held liable for the acts of the erstwhile UWB. In support of this, it cited a decision dated February 28, 2001 of the Hon'ble Securities Appellate Tribunal in the

matter of SKDC Consultants Ltd. Vs. P. Sri Sai Ram (Appeal No. 27 of 2000). In particular, it drew attention to the observation of the Hon'ble Tribunal: *"…In this context it is to be remembered that the Supreme Court in Hindustan Steel Ltd.'s case (supra) had observed that* ***"An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceeding."*** *It is not possible to assign the 'failure' in complying with a statutory requirement to someone else who was not responsible for the same and make him suffer the penalty attendant to such failure. If there is any liability to pay penalty by way of punishment, that cannot be transferred to a successor as it remains the liability of person who committed the offence. The liability is personal to the offender. ……"*

c) UWB debited the account of R. R. Investments for payment towards application money of four stock invest holders as per verbal instructions of the former. It was a banking practice to debit an account on verbal instructions of the account holder and hence there is no record in support of authorisation. Further, R. R. Investments has not denied that it had authorized UWB to debit its account in respect of the stock invest holders.

d) The EO, in his notice dated June 30, 2003, had alleged that UWB violated Clause 7 (as it stood at that time) of the Code of Conduct as specified in Schedule III to the SEBI (Bankers to an Issue) Regulations, 1994 read with Regulation 16 of the said Regulations. However, there is no finding in the enquiry report in respect of this allegation. The only finding in the report is that the bank had failed to exercise due care and diligence. Thus, the EO arrived at a finding which was not in the notice. The EO cannot allege violation of one clause in the notice and recommend penalty on the basis of alleged violation another clause.

e) The aforesaid Clause 7 reads: *"A banker to an issue shall not any time act in collusion with other agents in a manner that is detrimental to the small investor*". The EO has not found any collusion; nor is there any loss to any investor by the act of UWB in this matter.

f) The dealings in stock invest is purely a banking function and not a function of a bank in its capacity as a banker to an issue. SEBI Regulations are applicable to the activity of a banker to an issue and not to normal banking activity of a bank. Therefore, the alleged irregularity is not a matter within the purview of Bankers to Issue Regulations and hence the enquiry under reference is illegal and beyond authority.

g) The reach of Enquiry / Intermediaries Regulations is limited to intermediaries as provided for in Section 12 of the SEBI Act, 1992. It is no body's case that IB is as

on date registered with SEBI as a bankers to an issue. Hence the proposed order is without any legal basis.

h) There has been inordinate delay in conduct of the proceedings resulting in gross violation of principles of natural justice.

i) SEBI did not dispose of the matter by passing an order, despite the fact that the proceedings had concluded on December 30, 2004.

j) The enquiry proceedings have been conducted in a very lackadaisical and casual manner.

k) An order against IB for the violations committed by the erstwhile UWB would tarnish its reputation and would result in irreparable loss and damage.

7. I have carefully considered the enquiry report, show cause notices and the written and oral submissions made by the banks.

8. There is no dispute about the facts. The erstwhile UWB has debited account of R. R. Investments to honour the stock invest obligations of 4 other persons. There is no proof of authorization for such debit. Debit from the account of R. R. Investments, which was funded by the issuer, enabled the issue to obtain minimum subscription from public. These stock invest holders sold the shares received on allotment to a group company of the issuer.

9. Now I proceed to deal with the arguments of IB, as stated in Para 6 above, seriatim as under:

a) From the Gazette Notification produced before me, I note that page 13 and 15 *inter alia* read as follows:

"…… *And whereas the Reserve Bank of India, after* <u>*having sent the said scheme in draft to the banks concerned*</u> *in accordance with the provisions of sub-section (6) of the said section* <u>*and after having considered the suggestions and objections received*</u> *in regard to the said scheme, had forwarded it to the Central Government for sanction;*

Now, therefore, in exercise of the powers conferred by sub-section (7) of section 45 of the said Act, the Central Government hereby sanctions the following scheme on and subject to the terms and conditions hereafter mentioned. ……

(3) If on the prescribed date any suit, appeal or other legal proceedings of whatever nature by or against the transferor bank is pending, the same shall not abate, be discontinued or be in any way

prejudicially affected, but shall, subject to the other provisions of the Scheme, be prosecuted and enforced by or against the transferee bank;…….”

(Emphasis supplied)

From a reading of the clauses of the scheme and specifically those that have been reproduced above, I note that the scheme of amalgamation was forwarded by the Reserve Bank of India to the Central Government for sanction after considering the suggestions and objections from the IB. Hence, the submissions of the transferee bank that they had no option or say in the said amalgamation or it was thrust upon them in public interest is not correct.

b) The decision of the Hon'ble Securities Appellate Tribunal relied upon by IB cannot be applied in the present case. In the cited order, the Hon'ble Tribunal has referred to a judgment of the Supreme Court in Hindustan Steel Ltd. case where the Supreme Court had observed that *"An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceeding."* However, the present proceedings are civil proceedings and not quasi criminal. Further, the order observes that *"the agreement between the appellant and SKDC provides only for transferring the ongoing business with all the assets and liabilities of SKDC to the appellant"*. However, in the present case, I note that the scheme of amalgamation sanctioned by Central Government make it very clear that if any suit, appeal or other legal proceedings by or against the transferor bank is pending, the same shall not abate or be discontinued, but shall, be prosecuted and enforced against the transferee bank. Hence, the arguments of the transferee bank that it cannot be held liable for the acts of the erstwhile UWB cannot be accepted. Further, if the argument of the transferee bank is accepted, it would promote undesirable activities in the market where an entity would violate a law and later get merged with another clean entity and escape the penalty or consequences of its misdeeds.

c) The erstwhile UWB debited the current account of a third party, namely, R. R. Investments. There is no proof of authorization for such debit. While UWB is of the view that a few alphabets of authorization proof would have been of a greater assistance to the Bank, IB holds the view that it is a banking practice to debit accounts on verbal instructions. They have also argued that no body has objected to such debit, there is no need for express authorization, etc. Though IB argued that it was banking practice to debit accounts on verbal instructions, it failed to bring on record the relevant provision of law which supports this practice. In the absence of

any enabling legal provision, I find it difficult to believe that a bank, which holds the monies of its depositors in a fiduciary capacity, would debit their accounts based on verbal instructions. Allowing such practice to flourish can have disastrous consequences and lead to chaos in the financial markets.

d) What is material is the particular act of omission or commission. In the instant case, the particular act is debit from the account of a third party without authorization. If the said act is irregular, it is not of much significance as to whether the same is irregular under one provision of law or the other. Therefore, whether the erstwhile UWB violated Clause 7 or Clause 2 of Code of Conduct is not very much material so long as the irregularity committed by the delinquent is established. In the instant case, the irregularity is established. However, the EO concluded that the irregularity is failure to exercise due care and diligence. In this regard, I note that the delinquent has been given opportunities to defend itself against the findings of the EO.

e) The show cause notice dated December 13, 2004 states that the EO found UWB guilty of violation of Clause 7. However, I do not find this conclusive finding in the enquiry report, though it states that the act of UWB enabled the issuer to obtain minimum subscription and saved interest loss to stock invest holders. Therefore, the argument of the IB at Para 6 (e) above is not material.

f) I agree with the IB that stock invest activity is undertaken by any bank, not by a banker to an issue only. I, however, do not agree that it is a pure banking activity. It is a mechanism to facilitate investors to subscribe for public issues and irregularity in this activity has the potential to destabilize the securities markets. In the instant case, it enabled an issue to go through without having genuine minimum subscription. SEBI, who is responsible for protecting the market integrity, cannot remain a silent spectator if a bank misuses stock invest facility. Further, even assuming, but not admitting that stock invest was a banking activity, SEBI is obliged to take notice of the conduct of its registered intermediaries, even for the activities not strictly covered under the certificate of registration granted to it. Precisely for this reason, the then Bankers to an Issue Regulations provided: *" ……..[A banker to an issue shall abide by the provisions of such Acts and rules, regulations, guidelines, resolutions, notifications, directions, circulars and instructions as may be issued form time to time by the Central Government, the Reserve Bank of India, the Indian Banks Association or the Board and ……..*].

g) IB has rightly stated that the reach of Enquiry Regulations/SEBI (Intermediaries) Regulations, 2008 (Intermediaries Regulations) is limited to intermediaries, as

provided for in Section 12 of the SEBI Act, 1992, who are required to obtain registration form SEBI. In this regard, I find that IB is registered with SEBI in many capacities, including as a banker to an issue as on date and, therefore, is an intermediary in terms of Section 12 of the SEBI Act, 1992. It was also a registered banker to an issue on the day the erstwhile UWB amalgamated with it. Hence, the submissions of IB that it is not registered with SEBI as a banker to an issue and not covered by the Enquiry Regulations are not correct.

h) There has been some delay in disposal of the matter. Such delay, however, does not result in violation of principles of natural justice, as alleged by IB. I do not find that this proceeding has violated any principle of natural justice. IB has not elaborated how and which principle of natural justice has been violated.

i) UWB had filed its reply to the show cause notice on December 30, 2004. The proceedings are concluded only when SEBI passes the final order and not when the noticee files its reply. Therefore, the submission of IB that the proceedings were concluded on December 30, 2004 is not correct.

j) The procedure to be followed during the enquiry proceedings is provided under the Enquiry Regulations/Intermediaries Regulations. In the instant case, I find that the procedure laid down therein has been followed in letter and spirit and I do not find that the proceedings were conducted in lackadaisical and casual manner, as alleged by IB. IB has not elaborated how the proceedings were lackadaisical and how this has affected its rights.

k) Punishment has a purpose. If it harms reputation, let it be so. This cannot be a ground for exoneration of the guilty.

10. Based on the above analysis, I am inclined to agree with the lenient view of the EO and his recommendation. I, however, note that IB made attempts to mislead the proceedings, as evident from Para 9 above.

11. I am conscious of the fact that the said irregularity was, in fact, committed by the erstwhile UWB which has since been amalgamated with IB pursuant to the scheme of amalgamation notified by the Central Government. As UWB has ceased to exist, no penalty can be imposed upon it. In terms of the scheme of amalgamation, IB has been fastened with the responsibilities for all the acts of omissions and commissions of erstwhile UWB. I am also conscious of the fact that the alleged violations had taken

place in 1996 and 13 years have elapsed since then. I am also aware that stock invest activity has since been discontinued.

12. I note that pursuant to the notification of the Intermediaries Regulations, the Enquiry Regulations have been repealed and in terms of Regulation 38(2) of the Intermediaries Regulations, notwithstanding such repeal, any enquiry commenced under the Enquiry Regulations, shall be deemed to have been commenced under the corresponding provisions of Intermediaries Regulations.

13. Taking into account the facts and circumstances of the case, more specifically stated at Paras 9 and 11 above, I, in exercise of powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992, read with Regulation 28(2) of the SEBI (Intermediaries) Regulations, 2008, hereby advise the IDBI Bank Ltd. to be careful and cautious in the conduct of its business as a banker to an issue and adhere to and comply with all relevant statutory provisions while carrying on intermediation activities in the securities markets.

14. A copy of this Order shall be forwarded to the Reserve Bank of India to enable it to verify, if they so desire, the claim of the UWB and IB, as referred to in Para 5 and 6(c) above, that there is no necessity of express authorization for debiting an account and debiting an account on verbal instructions is a banking practice, and to take appropriate action, if so warranted.

Date: May 25, 2009
Place: Mumbai

M. S. SAHOO
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA