

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: DR. K.M ABRAHAM, WHOLE TIME MEMBER

ORDER

UNDER REGULATION 28 (2) OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008 AGAINST M/S ASHOK KUMAR K. DAMANI

Date of Hearing: August 11, 2009

Appearance:

For M/s Ashok Kumar K. Damani : Mr. Joby Mathew, Advocate
Mr. Ashok Kumar Damani

For Securities and Exchange Board of India: Mr. Piyoosh Gupta, General Manager
Mr. Vijayakrishnan G, Deputy Legal Adviser

1. The Securities and Exchange Board of India (hereinafter referred to as SEBI), vide letter dated August 23, 2002 appointed M/s. V. Parekh & Associates, Chartered Accountants to conduct an inspection of the books of accounts, documents and other records of the stock broker, M/s Ashok Kumar K. Damani (Member, Bombay Stock Exchange Limited) for the period April 2000 to September, 2002. M/s Ashok Kumar K. Damani is hereinafter referred to as the Broker. Pursuant to the receipt of comments from the Broker in respect of the Inspection Report, SEBI vide order dated March 10, 2004 read with a subsequent order dated February 11, 2005 appointed an Enquiry Officer under the provisions of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (since repealed) to enquire into the alleged irregularities/deficiencies committed by the Broker. The Enquiry Officer, vide report dated September 25, 2006 recommended the suspension of the certificate of registration of the Broker for a

period of ten days. The Enquiry Officer observed that the Broker *inter alia* violated the following provisions of law/circular:

- (i) SEBI Circular No. SMD/MDP/CIR/043/96 dated August 05, 1996.
- (ii) Rules 8(1)(f) and 8(3)(f) of Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as SCRR).
- (iii) SEBI Circular No. SMD/SED/Cir/93/23321 dated November 18, 1993.

2. Subsequently, a notice dated November 02, 2006 was issued by SEBI to the Broker requiring it to show cause as to why action as recommended by the Enquiry Officer should not be imposed against it. A copy of the Enquiry Report was also sent with the said show cause notice. The Broker, vide letter dated November 21, 2006, *inter alia* stated that as per the practice in the market prevailing in 2001-02, contract notes did not have pre-printed numbers in the initial stage. The Broker contended that the deficiency, if any, was rectified from April 01, 2002. The Broker mentioned that on account of advanced computerization of the offices of the stock brokers, it was a widespread market practice not to use such physical pre-printed stationery but to do the same through secure software programmes for printing sequential serial numbers on contract notes which in effect amount to the same as pre-printed stationery. The Broker stated that the software which generates the serial numbers on daily basis cannot be tampered or interfered with manually. The Broker added that it ensured the generation of contract note within twenty four hours. Regarding acknowledgements not being obtained on duplicate copies of contract notes, the Broker stated that the settlement in respect of all the cases had been completed without any objection from clients. The Broker pleaded that obtaining of dates on contract notes by clients may be treated as technical lapse and be condoned. Regarding carrying out fund based activities, the Broker stated that all the funds were given from its own account and that the clients' money was not utilized for the same. The Broker added that no interest was charged on the amounts given and all the money that was given had been received back. With

respect to misutilization of clients' accounts, the Broker stated that whatever amount was withdrawn from clients' account was for meeting small expenses, electric bills, rent etc., which represented only brokerage income belonging to it. The Broker contended that many clients preferred to keep the funds in their account with it without transferring the same to their own account to avoid frequent transfer of funds. The Broker further contended that the clients also preferred to keep funds with it as margin money for future purchases. The Broker also claimed that there was no irregular payment or delay in payment to clients but the funds have been kept with it pursuant to the written instructions of the clients. The Broker also replied upon the earlier orders in similar matters passed by SEBI. The Broker further stated that, even in multiple cases of serious violations by stock brokers, penalties were reduced to warning. In this regard, the Broker also listed out certain cases wherein SEBI had passed warning orders against stock brokers.

3. Thereafter, an opportunity of hearing was given to the Broker on February 06, 2007. The said hearing was adjourned as requested by the Broker. Thereafter, another opportunity was granted to the Broker on September 26, 2008 which was further adjourned to December 17, 2008. In the meanwhile, on December 01, 2008, the Broker filed an application for consent order in terms of SEBI Circular dated April 20, 2007 and accordingly, the present proceeding was kept in abeyance. Pursuant to the rejection of the said application, the present proceeding was revived and an opportunity of hearing was granted to the Broker on August 11, 2009 wherein Mr. Joby Mathew, Advocate appeared and made submissions on behalf of the Broker. Mr. Ashok Kumar K. Damani, proprietor of the Broker was also present during the course of hearing. The submissions were made on the lines of the reply of the Broker dated November 21, 2006.

4. I have considered the Enquiry Report, the oral as well as written submissions made on behalf of the Broker and other material available on record. The Enquiry Officer observed that the Broker had generated the contract notes without pre-printed serial numbers and that the dates of acknowledgement on the contract notes were not mentioned. In terms of SEBI circular dated August 05, 1996, SEBI, *inter alia* advised that serious view would be taken, if certain deficiencies are found out during the course of inspections of the stock broker. One of such deficiencies specified in the circular was that the contract notes did not have pre-printed serial numbers. The plea of the Broker that it was a practice to start each serial number on a daily basis linked to the settlement or on a day-to-day basis cannot be accepted as the aforesaid mandate was in force since August 1996 and the period of inspection (of the Broker) was April 2000 to September, 2002. Besides, the submission of the Broker in its reply dated November 21, 2006 that *“as per the practice in the market prevailing at that time in 2001- 2002, contract notes were not having pre-printed numbers in the initial stage”* indicates that there was no pre-printed serial number on the contract notes. Needless to say, the Broker generated contract notes without the pre-printed serial numbers. In respect of the allegation that the dates of acknowledgment were absent on the contract notes, the Enquiry Officer observed that the Broker had not defended the said charge. The Broker contended that the said allegation be treated as a technical lapse and requested that same be condoned. In view of above, I have no hesitation to hold that the Broker violated the provisions of SEBI Circular dated August 05, 1996.

5. With respect to the charge that the Broker was involved in fund based activities; the Enquiry Officer observed that the payments were found to have been made to clients even though the clients' accounts reflected debit balances and that funds were received from the clients even though the clients' accounts reflected credit balances. I note that Rule 8(1)(f) of SCRR *inter alia* provides

that no person shall be eligible to be elected as a member, if he is engaged as a principal or employee in any business other than that of securities except as a broker or an agent, not involving any personal financial liability. I note that the Inspection Report (at Annexure 12 and 13) listed out various instances of funding. Annexure 12 mentioned the details of transactions where payments were made to clients when their accounts reflected debit balances. Similarly, Annexure 13 listed out the details of transaction where payments were received from the clients when their account showed credit balance. A perusal of Annexure 12 indicate that the Broker had made a payment of Rs. 25,00,000/- to one Bhagri Indra Kumar on December 18, 2001, even though the account of Mr. Bhagri Indra Kumar showed a debit balance. Though, the said amount was shown to have been repaid to the Broker on December 22, 2001, the Broker had failed to provide the purpose of funding, as observed by the Enquiry Officer. Besides, the Broker had not made any specific submissions in respect of the said transactions. Its contention was that the Enquiry Officer had failed to appreciate its submissions that it had funded its clients namely, Mr. Santosh Bihani and Mr. Rajesh Kalla, despite the fact that a stock broker may, in connection with or incidental to or consequential upon the securities business, borrow or lend funds. I am unable to accept the plea of the Broker. The Enquiry Officer had given detailed findings in respect of the said charge. Further, the Enquiry Officer had also observed *"43. From these 6 annexures i.e. J1-6, it is noted that AKKD owed Rs.2165.84 on July 5, 2001, Rs.80,26,810 on July 6, 2001, Rs.40,39,945/- on July 9, 2001, Rs.13,48,135/- on July 10, 2001, Rs.11,50,079/- on July 18, 2001 and Rs.5,11,254/- on July 19, 2001. All the said documents provided appear to be manipulated as the same were not furnished with the necessary contract notes. The contract notes would have actually highlighted whether such sale transactions were actually entered into, for which AKKD had paid an advance to these two clients. They also did not enclose the ledger extracts for the said clients as also the demat statement/transaction statement indicating such sale of shares, for which they had offered the funds in advance. In the absence of any such proof, the authenticity of the bills so enclosed is highly questionable. It appears to me that AKKD have fabricated such bills to suit their requirements.*

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45. *In view of the above, I am not inclined to accept the submissions made by AKKD with the support of the bills and hence hold that the charge of funding the clients i.e. Santosh Beheti and Rajesh Kalla stands established. This is a case in fact where serious cognizance is necessitated since the amount paid to the client; Santosh Biyani appears to be more than 1 crore rupees".*

6. Further, Annexure 12 to the Inspection Report also indicates that the Broker was continuously making payments to one Biyani Santhosh G., when the latter was having a debit balance in his account. When, Mr. Biyani Santhosh G. was having a debit balance of Rs.5,00,000/-, the Broker had made a payment of Rs.29,50,000/- on July 06, 2001. The said instance was not solitary as the Broker was found to have made continuous payments [Rs. 40,00,000/- on July 09, 2001 and Rs.10,00,000 (on July 10,2001)] to Mr. Biyani Santhosh G. Though, the learned counsel appearing for the Broker vehemently contended that the transactions were in connection with or incidental to or consequential upon the securities business, no sufficient evidence was produced before me in that regard. The contention of the Broker that all funds were given from its own account and 'clients moneys' were not utilized for funding cannot absolve its liability without a proper explanation in this regard. The Broker claimed that its funding was covered under the clarification given by SEBI, vide circular dated May 07, 1997 wherein it is stated "*It has been opined that borrowing and lending of funds, by a trading member, in connection with or incidental to or consequential upon the securities business would not be disqualified under Rule 8(1)(f) and 8(3)(f)*". However, it failed to establish with sufficient evidence that its transactions were covered under the aforesaid circular. In the absence of sufficient explanation, I am unable to disagree with the findings of the Enquiry Officer that the Broker violated the provisions of Rule 8(1)(f) and 8(3)(f) of the SCRR. Even, in respect of instances mentioned in Annexure 13 of the Inspection Report, the Broker could not establish the same.

I also note that the Enquiry Officer had observed that no documentary evidence was furnished by the Broker in respect of certain cases where it had received funds from its clients. The contention that no interest was charged on the amounts given and the same was reflected in all the half yearly networth certificate reports submitted to the Exchange has little merit. The issue is not whether he had received interest or not in respect of the amount given. On the other hand, it is to be proved by the Broker that the transactions were in connection with or incidental to or consequential upon the securities business. As mentioned earlier, the Broker could not establish that the said transactions were covered under the clarification given by SEBI, vide circular dated May 07, 1997. In the absence of such proof, the charge against the Broker in this regard stands established.

7. The Enquiry Officer observed that as the Broker was found to have misutilized clients' accounts in 8 months out of 24 months i.e. from April 2000 to March 2002. It was found that the Broker was transferring funds from the clients' accounts to own accounts and vice versa and thus it had violated the SEBI Circular dated November 18, 1993. In terms of the Inspection Report, the 8 instances indicating the value of the misused funds are as under:

Month	Amount of clients' funds misused (Rs.)
April 2000	3514981.24
June 2000	10715835.72
August 2000	11761887.43
October 2000	6519886.48
December 2000	13766639.88
February 2001	25708323.22
March 2001	9254331.41
May 2001	8348083.33

8. I note that out of the aforesaid 8 instances, the amount involved in 4 instances was more than Rs.1,00,00,000/-. The Enquiry Officer had given detailed finding in respect of those instances in the Enquiry Report. It was observed by the Enquiry Officer that *"No explanations were offered for column 6 of Annexure 14 to the inspection report which talked about the amount*

transferred from the clients' account to their account. There have been numerous such instances where the funds have been transferred from the clients account to self account". One of the main contentions of the Broker in its reply dated November 21, 2006 was that the amount withdrawn represented only his brokerage income from the client account which was used for meeting routine expenses like telephone charges, electric bills, rent etc,. In this regard, I note that no convincing explanation with supporting documents have been provided by the Broker. In the absence of sufficient explanation as to why funds were transferred from the clients' account to the Broker's account and also considering the huge sum of money which were misused by the Broker, I am unable to disagree with the findings of the Enquiry Officer that the Broker violated the SEBI Circular dated November 18, 1993.

9. It is the bounden duty of an intermediary operating in the securities market to comply with the statutory provisions including various circulars issued by SEBI from time to time. The requirements are conceived *inter alia* in the interests of investor protection and to ensure that the business and the conduct of the intermediaries are undertaken to reach the said objective.

10. I note that the present case has been initiated under the provisions of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002. Though, the said Regulations were repealed with the notification of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 anything done or any action (including enquiry) commenced under Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 before the publication of the 2008 Regulations (mentioned above) in the Official Gazette are deemed to have been done or taken or commenced under the corresponding provisions of the 2008 Regulations.

Therefore, this order is being issued under the corresponding provisions of the Securities and Exchange Board of India (Intermediaries Regulations), 2008.

11. I note that the Enquiry Officer had recommended the suspension of the certificate of registration of the Broker for a period of ten days. During the course of the hearing, the learned counsel for the Broker cited various orders (mentioned in the reply of the Broker) of SEBI and submitted that SEBI had taken a lenient view in respect of the violations/deficiencies observed during its inspections. It was also submitted that the Broker had stopped trading for clients but was doing only proprietary trades. On a careful consideration of the case in its entirety, the present proceeding is disposed of as ordered herein below.

12. In view of the foregoing, in exercise of the powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulation 28(2) of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, the stock broker namely, M/s Ashok Kumar K. Damani (Registration No. INB010001115) Member, Bombay Stock Exchange Limited, is hereby strictly warned for the deviations observed herein from the provisions of the circulars that regulate its function as a registered intermediary of Securities and Exchange Board of India and directed to strictly abide by laws, rules and regulations that govern dealings in the securities market.

DR. K. M. ABRAHAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai
Date: September 11, 2009