Sebi Vs. Doogar and Associate Securities

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Court : SEBI Securities and Exchange Board of India or Securities Appellate Tribunal SAT

Decided On : Oct-10-2003

Judge : A Batra

Appellant : Sebi

Respondent : Doogar and Associate Securities

Judgement :
1.1 M/S Doogar And Associate Securities Ltd, (hereinafter referred to as DASL) is a member of the National Stock Exchange (for brevity's sake referred to as the NSE) and registered with the Securities and Exchange Board of India, 1992 (hereinafter referred to as the SEBI) as a stock broker. The SEBI registration number of the said broker is INB 230876132. DASL is also a registered sub-broker of BSE since November 17, 2000.

1.2 A sudden spurt in the price of the scrip of M/s Munga Holdings Ltd. (hereinafter called 'Munga') which is listed only at the Delhi Stock Exchange (for brevity's sake referred to as the DSE), from Rs. 3.50 on January 1, 2001 to Rs. 43/- on August 31, 2001, was noted. As the rise amounted to 1130% in the price of the scrip in only 52 trading days, and it was found that in the above mentioned period, only 6 brokers viz. Securities Brokers of India Ltd., Mukesh Gupta & Co., SKG Stock and Share Brokers Ltd., SRG Global Capital Pvt. Ltd., D B (India) Securities Ltd and SMC Share Brokers Ltd. were trading in the scrip, an investigation was carried out by the DSE, which subsequently forwarded a report to SEBI.1.3 Based on the investigation report submitted by DSE, a preliminary investigation was carried out by SEBI where after the Chairman, SEBI vide his order dated August 08, 2002 ordered a detailed investigation into the possible violations of the SEBI (Stock Brokers and Sub-brokers) Rules and Regulations, 1992 (hereinafter referred to as the Broker Regulations) and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 1995 (hereinafter referred to as the FUTP Regulations) by various persons while trading in the scrip of Munga. The investigations found that DASL among others, dealt in the scrip of Munga, as a sub broker through a member of DSE, called SKG Stock and Share Broker Ltd. (hereinafter referred to as 'SKG') without obtaining registration as a sub broker from SEBI, resulting in the possible violation of clause A (5) of the code of conduct under Regulation 7 of the Broker Regulations and hence recommended that enquiry proceedings be initiated against DASL under the provisions of the SEBI (Procedure for holding Enquiry by the Enquiry Officer and Imposing Penalty), Regulations, 2002 (for brevity's sake referred to as the said Regulations).

1.4 Accordingly, an Enquiry Officer was appointed by the Chairman, SEBI vide an order dated January 28, 2003, under Section 4(3) of SEBI Act, 1992 (hereinafter referred to as the Act) read with Regulation 5(1) of the said Regulations to enquire into the possible violations of the Broker Regulations and the FUTP Regulations. Thereupon the enquiry officer issued a show cause notice dated February 4, 2003, under Regulation 6 of the said Regulations, upon DASL, in terms of which the broker was called upon to show cause as to why an appropriate order /orders under Regulation 13 of the Regulations, should not be passed against them for the said violations.

1.5 In reply to the same, DASL vide their letter dated February 27, 2003 while denying that they had indulged in any price manipulation or had acted without being registered with SEBI, inter-alia submitted that the total value of the shares transacted by them was a meagre Rs. 32, 785/- during the entire period of two months for a total number of 3600 shares and that they earned a small brokerage of Rs. 400/- from the client. Since DASL also requested for a copy of investigation report to enable them to reply to the show cause notice, a copy of the extract of the relevant portion of the investigation report was forwarded to them vide letter dated February 28, 2003. Thereupon, although DASL vide their letter dated March 07, 2003 inter-alia requested that their Director, Mr. M K Doogar, be permitted to appear before the enquiry officer on March 05, 2003, Mr. Doogar failed to appear on the said date. Thereafter the enquiry officer granted an opportunity to DASL to inspect certain documents on March 20, 2003. Shri Balveer Chowdhary, the authorized representative of DASL appeared before the enquiry officer on March 20, 2003 for the said purpose.

1.6 Thereafter, DASL sent a letter dated March 26, 2003, in which they inter-alia, denied committing any breach of any of the terms and conditions and / or provisions of SEBI Act and / or the Rules, Regulations or Guidelines framed by SEBI Act. They denied that they had violated Clause A (5) of Code of Conduct read with Regulation 7 of the Broker Regulations, Section 12 of SEBI Act and / or Rule 3 of SEBI (Stock Brokers and Sub Brokers) Rules, 1992. They further contended that they had traded on behalf of their client in the normal course of business without suspicion of any unwarranted movement in the price of the scrip and that the client for whom the transactions were undertaken had been dealing with them for several years and in view of the same, there was no reason to believe any wrong dealings on his part. It was submitted that they had not been engaged in any manipulative, fraudulent or other offensive activities ever since they started acting as a stock broker. They stated that they were already registered as a stock broker with SEBI and were a member of NSE (Regd. No. INB 230876132) prior to their dealings in the shares of Munga and therefore a separate registration as sub broker was not sought. It was further contended that SKG as the main member of DSE, was primarily responsible to get them registered as a sub broker under them, before introducing a third party to the physical shares in the market. They further denied that they had acted as an unregistered sub-broker.

2.1 Upon being referred to a statement made by Shri Balveer S Chaudary, on September 9, 2002, before the investigating authority to the effect that DASL had acted as a sub broker for the trades executed for their client M/s Poddar & Co., in the scrip of M/s Munga Holdings and that DASL was not registered as a sub-broker with SEBI, and that as they are the member of NSE and Shri Poddar was dealing with them for a long period, the said deal had been executed to render the service to Shri Poddar, DASL stated that Mr. Balveer Choudhary had misunderstood their position vis-is SKG's position. DASL insisted that they had complied with all the provisions relating to sub brokers regulations, such as maintenance of specified books of accounts, carrying out client verification / registration and had even executed the client agreement DASL assured that as they were registered as a broker and were a member of NSE, they would be more responsible in trading with clients / complying with rules / regulations. It was further submitted that in their course of carrying out business as a stock broker, they always entered into transactions on behalf of their clients on their instructions and that as long as the dealings of a client was fair i.e.

he was fulfilling his obligations in a timely manner, they had no reason to believe that a particular order out of a number of other orders of such a client, would result in any kind of price manipulation as alleged.

2.2 DASL submitted that not only during the period covered under the investigation, but for the period prior and subsequent to that period also, they had not entered into any transaction in the scrip of Munga, either on their own account or any of their directors' account. The transactions were carried on behalf of the client as per their instructions, for no personal gain or benefit except with a view to earn brokerage and that they were not aware that the said transactions were carried out for some ulterior purposes. It was stated that the said transactions were carried out bonafide, believing their client with whom they had long dealings in the past. In view of the same, they felt that they should not be held responsible for the alleged manipulations of the share price of Munga and hence requested for being granted a personal hearing.

2.3 Accordingly, DASL was asked to appear for a personal hearing before the enquiry officer on April 25, 2003, which was rescheduled to April 22, 2003. On the said date Shri M K Doogar, Chartered Accountant and Director, DASL, appeared before the enquiry officer and reiterated the submissions made earlier. He requested that the enquiry proceedings should be dropped against DASL.

3.1 Based on the submissions made on behalf of DASL, the enquiry officer submitted his report dated May 23, 2003, in which it was inter-alia noted that although there were certain lapses on the part of DASL, due to insufficient evidence to show that their actions had contributed to the market manipulation in the scrip of Munga Holdings Ltd, DASL would have to be given a benefit of doubt. As regards the charge on them having acted as a sub broker without registration, the enquiry officer concluded that DASL had dealt as a sub broker for 3600 shares of Munga during the relevant period, the value of which, at that point of time was Rs. 32, 795, thereby earning a brokerage of Rs. 400/-. The Enquiry Officer recommended that the registration of DASL, Member of NSE be suspended for a period of one month on the ground that DASL had violated Clause A(5) of Code of Conduct read with Regulation 7 of the SEBI Brokers Regulations and Section 12 of the Act as well as Rule 3 of the SEBI (Stock Brokers and Sub Brokers) Rules, 1992.

3.2 Thereafter, a notice dated June 16, 2003 was issued to DASL calling upon them to show cause in terms of Regulation 13 (2) of the said Regulations as to why penalty as recommended by the enquiry officer should not be imposed upon them and to reply to the said notice within 15 days of the receipt of the notice failing with SEBI would proceed ex parte. DASL was also asked to indicate whether they desired a personal hearing. In reply to the same, DASL vide their letter dated July 03, 2003 requested for a personal hearing and indicated that their reply if any, to the show cause notice would be given at the time of such hearing. Pursuant to the same, DASL was granted a hearing which though scheduled for August 27, 2003 was on their request, adjourned to September 08, 2003. Same was and later rescheduled to September 12, 2003.

3.3 On September 12, 2003, Shri Dinesh Agwani, Advocate, Shri M.K.Doogar and Shri Balveer Chowdhary appeared on behalf of DASL before me and reiterated the submissions made earlier and further submitted as follows : 1. A corrigendum dated May 20, 2003 was issued by the enquiry officer upon the conclusion of the hearing, whereupon, the original show cause notice was modified and instead of regulation 16 of the Regulations, Regulation 13 was relied upon. Hence DASL was called upon by the enquiry officer to file a further reply to the show cause notice, within 10 days from the date of receipt of the notice.

However, while the said corrigendum was received by DASL on or around May 23, 2003 and a reply as desired, was filed on June 3, 2003, no personal hearing was granted. Instead a notice dated June, 16, 2003 was received by them which called upon them to show cause in terms of Regulation 13(2) of SEBI Regulations 2002 as to why the penalty as considered appropriate should not be imposed. However, the enquiry officer enclosed along with the said show cause notice, his report dated May, 23, 2003 without even waiting for their reply.

In view of the same, the report of the Enquiry Officer was bad in law.

2. The show cause notice issued under Regulation 6 of the SEBI (Procedure for holding enquiry by enquiry officer and imposing penalty) Regulations, 2002 was itself bad in law in as much as the Board has travelled beyond the investigation report while issuing the show cause notice dated February 4, 2003. The investigating authority had held that DASL had violated clause A(5) under Regulation 7 of SEBI (Stock Broker & Sub-Broker) Regulation 1992, while in the show cause notice, besides alleging violation of the said regulations, the SEBI has increased the jurisdiction by alleging that DASL has violated Section 12 of the SEBI Act and Rule 3 of SEBI (Stock brokers and sub-brokers) Rules, also.

3. The enquiry report was liable to be quashed and no penalty as proposed was to be imposed due to the fact that while SKG was admittedly the main broker under whom DASL was allegedly acting as sub-broker, no action has been taken against the main broker.

Further, since DASL was a member of NSE, there was no need to get itself registered once again as a sub-broker. If at all, the registration of DASL as a sub broker was required, then the onus was upon the broker with whom the alleged sub broker was affiliated. (To support their stand, DASL referred to Regulation 11 and Form-C and Rule 5 of the SEBI (Stock brokers and sub brokers) Rules, 1992).

4. The circular dated January 16, 1998 relied upon by the enquiry officer was not mandatory and only advisory in nature. In view of Regulation 11, the said circular was contrary to the Broker Regulations.

5. As per the definition of 'sub-broker' under the Broker Regulations, any person not being a member of Stock Exchange and acts on behalf of stock broker as an agent or otherwise for assisting investors in buying, selling or dealing in securities through such stock brokers, was a sub-broker. Since DASL is a member of stock exchange, it does not fall within the definition of sub-broker as defined under Section 2(f) of the Broker Regulations.

Further, the obligations of the stock brokers are much more than that of the sub broker. Yet both in the investigation as well as in the enquiry report, the concerned authorities had failed to establish that DASL has failed to fulfill its obligation which it was required to do as stock broker.

6. Although a show cause notice was limited to the violation of clause A(5) of the Code of Conduct read with Regulation 7, the enquiry officer proceeded to consider and decide issues which were not even referred to it and had acted beyond his jurisdiction.

7. DASL had earned only Rs. 400 by way of brokerage and the total amount involved was approximately Rs. 32, 785/-. As such, the proposed punishment by the enquiry officer was not commensurate with the alleged offence and hence was liable to be set aside.

4.1 I have taken into consideration the facts and circumstances of the case and the material available on record which includes the findings of investigation, submissions made by DASL vide its letter dated July 03, 2003 and in the hearing held on September 12, 2003. On the basis of their contentions noted above, I granted DASL an opportunity to make written submissions as regards their case, before me, for the same to be taken into consideration by me at the time of passing of this order.

The representatives of DASL submitted written submissions dated September 12, 2003, which have been taken on record.

4.2 I have analysed all the submissions noted above. I have taken note of the fact that one of the representatives of DASL, during the recording of a statement made on September 9, 2002, before the investigating authorities, admitted that DASL had acted as a sub broker for the trades executed for their client M/s Poddar & Co., in the scrip of M/s Munga Holdings. The fact that DASL were not registered as a sub-broker with SEBI, and that as they are the member of NSE was also admitted. It was further stated that as Shri Poddar was dealing with DASL for a long period, the said deal had been executed to render the service to Shri Poddar. In response to the query as to the number of deals executed by DASL in their capacity as an unregistered sub broker, especially for their client Shri Poddar during the calendar year 2001, Shri Balveer submitted that the details of such deals would be submitted to SEBI by September 23, 2003. I have also taken note of the written reply made by DASL dated March 26, 2003, wherein Shri Doogar, a Director of DASL has stated that they did not act as an unregistered sub broker and that Shri Balveer Choudhary, clearly misunderstood the position. However, while Shri Doogar concedes that the statement of Shri Balveer Choudhary of September 19, 2002 was received by him on the next day i.e September 20, 2002, he did not make any attempt to point out this alleged misunderstanding of their authorized representative to SEBI, till the show cause notice was issued by the enquiry officer. If at all DASL disagreed with the statement made by Shri Choudhary, they should have retracted immediately on the first possible occasion, which arose on September 20, 2002. However, this was not done. Subsequently however, all through these proceedings and even during the hearing before me on September 12, 2003, DASL has admitted that they executed trades for their client - M/s Poddar & Co. in the scrip of M/s Munga for SKG without valid SEBI registration as a sub broker, but that the same was done on the premise that since they were already registered as a broker with SEBI and had NSE membership (Regd. INB 230876132), separate registration as sub broker would not be required and that their actions are bonafide. However, I have taken note of the fact that DASL had earlier sought for separate registration as a sub broker of BSE on November 17, 2000. Hence their argument elaborated above cannot stand. The fact remains that DASL has executed trades for their client - M/s Poddar & Co. in the scrip of M/s Munga for SKG, without valid SEBI registration as a sub broker. It is also apparent from the facts on record as regards the relationship between the parties that DASL wanted to accommodate their client and accordingly acted as a sub broker for their client.

4.3 In this regard, the definition of a sub-broker under Regulation 2(f) of the Broker Regulations may be referred to which inter alia provides that "sub-broker" means any person not being a member of a stock exchange, who acts on behalf of a stock-broker as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock-brokers. As DASL was not a member of DSE and since it had traded through a broker of DSE for its client, DASL had acted as a sub-broker. Hence in the instant case, if some of the clients of DASL wanted to deal on the stock exchange in which they were not a member, the proper course for DASL would have been to become a sub broker of that other exchange in which they desired to trade on behalf of their clients. To exemplify the case, it could be said that a member of DSE cannot deal in securities on the NSE. However, if such a member wanted to deal in stocks that are listed on the NSE, the proper course for him would be to become a sub broker of a member of the NSE, since he is not permitted to trade in the NSE without necessary registration.

5.1 On perusal of the SEBI Circular no SMD /Policy /CIR/ 3/98 dated January 16, 1998, which has been referred to by the enquiry officer while giving his recommendations I have noted that members of Stock Exchanges executing transactions of the clients through the members of the other exchanges are to be treated as Sub brokers. I have noted that there is a background for the rationale of a member of a stock exchange in becoming a sub broker with a separate registration. The fact is that the stock exchanges had to declare some of the members who were acting as sub brokers without the necessary registration as defaulters since they defaulted to the investors for the transactions done through member of other exchanges, although there was no default to the parent exchanges. Hence it was decided that the members of a stock exchange, executing transactions of their clients through the member of other exchanges, had to be treated as a sub broker. Hence it was necessary for any person, including a member of the stock exchange registered as a broker, who also acts as a sub broker, to hold a separate registration with SEBI as a sub broker, including the member of Stock exchanges who also act as sub broker. DASL has questioned the legality of the abovementioned circular. However, it is to be noted that all circulars are issued by SEBI by invoking its powers under Section 11 of the SEBI Act which confers upon it the power to adopt such measures as it thinks fit for the regulation of the securities market. Hence as these circulars derive their power from the Act itself, it cannot be stated that they are merely advisory and not mandatory. These are measures formulated by SEBI for the protection of the investors.

Assuming otherwise would mean that DASL does not think it proper to follow advice issued by the market regulator.

5.2 I have also noted from the documents furnished by DASL that the contract notes were issued as a broker and not as an agent / sub broker, although DASL traded for their client through a principal broker on DSE. This has all the elements of acting as a "sub broker".

The contract notes were issued subject to NSE jurisdiction whereas the trades were carried out on the floor of DSE. This is undoubtedly a violation of Clause B(2)(a) of the Code of Conduct specified for sub brokers under the Brokers Regulations. This kind of unauthorized activity puts the clients to grave danger. I am in total agreement with the views of the enquiry officer that in the event of a problem, and in case the client wished to invoke the arbitration mechanism of the Exchange, he would not have been able to invoke DSE's arbitration mechanism, since no contract notes was issued subject to DSE bye laws.

Even though DASL was a member of NSE, the client would have been unable to invoke NSE's bye laws effectively since the trades were not executed on the NSE. Hence non adherence to the circulars and bye laws of an Exchange can cause severe loss to the interests of the investor as well as compromise the integrity of the market.

5.3 In terms of Rule (3) of the SEBI(Brokers and Sub Brokers) Rules, 1992 read with section 12 of the SEBI Act, 1992, no stock broker or sub broker shall buy, sell or deal with securities unless he holds a certificate granted by the Board under the Regulations. In view of the same, as DASL is a member of NSE without being registered as a sub-broker of NSE, he is not entitled to act as a sub broker nor is he entitled to issue a contract note of DSE or any other contract note.

Therefore, DASL by failing to register as a sub-broker without obtaining a certificate of registration and functioning as such, has violated the provisions of the above mentioned circular and the provisions of section 12 of the SEBI Act, 1992 and Rule 3 of the Rules as well as the provisions of para C(4) of the code of conduct of sub-brokers specified under Regulation 15 of the Broker Regulations.

Accordingly, the invocation of the above mentioned provisions of law by the enquiry officer and by me are necessary in consideration of the facts and circumstances of the case at the time of the passing of this order.

5.4 I have taken note of the submission of DASL that since it was already a registered member there was no need to get themselves registered as sub-broker and that if at all it was required, the main broker namely SKG was to get DASL registered as a sub-broker. As regards the issue of penalizing the main broker, on the basis of my views stated above, I do not think it proper on the part of DASL, to shift the responsibility on the broker although the onus of abiding by the laws should lie on DASL itself. The fact is that although DASL is a member of NSE, and registered with SEBI as a broker, they failed to obtain registration as sub broker to act so. DASL is also registered with SEBI as a sub broker on BSE and therefore it is well aware that separate registration from SEBI is required for acting as a sub broker in DSE. By conducting business in the capacity of a sub-broker at DSE without having a separate registration in this behalf, DASL has KNOWINGLY committed misconduct. Such misconduct or offence cannot be viewed as trivial or technical.

5.5 It is relevant to note that a certificate of registration granted to a stock broker is granted by SEBI subject to the fulfillment of certain conditions laid down in Rule 4 of the Rules. Sub-rule (b) of rule 4 of the said Rules interalia provides that the

Board may grant a certificate to a stock broker subject to the following conditions, namely : (b) He shall abide by the rules, regulations and bye-laws of the stock exchange or stock exchanges of which he is a member." DASL has contravened the provisions as elaborated above, and has thus not complied with one of the conditions under which registration was granted.

As specified under clause (a) read with clause (e) of Regulation 25 of the Broker Regulations, failure of a stock broker to comply with any of the conditions subject to which registration has been granted, attracts penalty as specified in the SEBI (Procedure for holding enquiry by the enquiry officer and imposing penalty) Regulations, 2002.

5.6 It is stated that entering into the transactions mentioned above without being registered as a sub broker of these members is a violation of Section 12 of the SEBI Act read with Rule 3 of the Rules and SEBI circular no SMD/Policy/CIR -3/ 98 dated January 16, 1998.

5.7 It is to be noted that persons who operate in the market, are required to maintain high standards of integrity, fairness and compliance in the conduct of their business dealings. Those who fail to do so have of necessity to accept imposition of penal action.

6.1 Accordingly, in view of the facts and circumstances of the case wherein I have inter alia noted that DASL had earned only Rs. 400 by way of brokerage and the total amount involved was approximately Rs. 32, 785/-, I have thought it fit to reduce the penalty as proposed by the enquiry officer and accordingly I find that an order suspending his registration for a period of seven days would be adequate and meet the ends of justice. Passing of such an order would be necessary for the regulation of persons operating in the capital market as well as for the protection of investors.

6.2 In view of the above, in exercise of the powers conferred on me in terms of Section 19 of the Securities and Exchange Board of India Act, 1992 read with sub regulation (4) of Regulation 13 under the Securities and Exchange Board of India (Procedure for Holding Enquiry by the Enquiry Officer and Imposing Penalty)

Regulations, 2002, I hereby suspend the certificate of registration of M/s Doogar and Associate Securities Ltd. for a period of seven days.

6.3 This order shall come into effect from three weeks of the date of this order.