Mehta Equities Ltd. Vs. Securities and Exchange Board of India

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

Decided On : Aug-29-2007

Reported in : (2008)82SCL400SAT

Judge : N Sodhi, A Bhargava, U Bhattacharya

Appellant : Mehta Equities Ltd.

Respondent : Securities and Exchange Board of

Judgement :

1. The appellant before us is a stock broker registered with the Securities and Exchange Board of India (for short 'the Board'). It is also a participant of the Central Depository Services Ltd. and is registered as such with the Board. On receipt of some complaints from the investors in regard to the participant operations of the appellant, the Board carried out inspection of the books of account, documents, records, infrastructure, systems and procedures followed by the appellant during the period from April to September 2004. The Udaipur office of the appellant to which the complaints pertain was inspected along with the head office at Mumbai. During the course of the inspection, the inspecting team found that the appellant had committed various irregularities. It is not necessary to detail those irregularities here because admittedly, the appellant has been absolved of all the alleged irregularities except the one for which a penalty of Rs. 5 lacs has been imposed by the impugned order passed by the Adjudicating Officer. The only irregularity that now survives is that the appellant as a stock broker had failed to

deliver securities to a large number of investors on whose behalf it had traded in the market.

This, if true, is violation of regulation 26(vi) of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 (for short 'the Regulations'). On receipt of the inspection report, the Board initiated adjudication proceedings under Chapter VI-A of the Securities and Exchange Board of India Act, 1992 (for short 'the Act'). The appellant was served with a show-cause notice dated 18-5-2006 detailing all the irregularities found during the course of the inspection. It was stated in the show-cause notice that the appellant had failed to furnish 'Reasons for holding shares in various beneficiary accounts of Renaissance Securities'. We are not referring to the other irregularities mentioned in the show-cause notice as the appellant stands absolved of those in the impugned order. It is pertinent to mention that the appellant was formerly known as Renaissance Securities Pvt. Ltd. A detailed reply to the show-cause notice was filed. As regards the allegation that the securities had not been delivered to the clients within the time prescribed by regulation 26(vz) of the Regulations, this is what the appellant had to say in para 6 of its reply: As regards regulation 26(vi) of the Brokers Regulations, we would submit that we are fully compliant of that Regulation which permits settlement of trades after 48 hours to clients who has agreed in writing otherwise. In this connection, we reproduce hereunder clauses 30 and 32 of KYC and a declaration filed by the clients giving authority to us to withhold securities in certain circumstances (Specimen enclosed vide Annexure-II).

Annexure II that was annexed with the reply was the kit which the appellant as a stock broker was getting executed from its clients at the time of entering into an agreement to trade on their behalf. This kit also contained a letter addressed to the appellant by the clients requiring the former to hold back the shares on their behalf. The kit was produced as a sample pleading that such letters had been signed by the clients authorizing the appellant as a stock broker to hold back the shares on their behalf. It would be relevant to reproduce the sample letter which was placed before the clients at the time of their introduction. It reads as under: Shorter settlement cycle and the rolling settlement (NSE & BSE), I have made it

difficult to manage payment/delivery of all secondary market transactions. I/we hereby authorise Mehta Equities Limited to hold back credit balance/ shares on our behalf. If payment of the funds and or delivery of the securities is required, I/we shall inform Mehta Equities Limited after giving adequate notice in writing or I/we will be entitled to receive funds/Securities provided the securities are not withheld due to unclear funds.

The securities lying in withhold A/c should be considered as margin deposit.

Note: In case of the client being an individual then the above should be signed by him/her and in case of its being a partnership/company then the partners/ director should sign along with rubber stamp.

On a consideration of the material collected by the Adjudicating Officer during the course of the inquiry conducted by her and also the reply filed by the appellant including the aforesaid annexure thereto, she found that the appellant had failed to deliver the securities to its clients within hours of the settlement of the trades and, therefore, it violated the provisions of Section 15F(b) of the Act read with regulation 26(vi) of the Regulations. By her order dated 6-9-2006 she imposed a penalty of Rs. 5 lacs on the appellant. It is against this order that the present appeal has been filed under Section 15T of the Act.

2. We have heard the learned Counsel for the parties and are of the view that the impugned order cannot be upheld. The case set up in the show-cause notice with which we are now concerned is that the appellant had failed to comply with the provisions of Section 15F and regulation 26(vi) of the Regulations inasmuch as it failed to deliver the securities to its clients within 48 hours of the settlement of the trade. It would be relevant at this stage to refer to the provisions of Section 15F(b) of the Act and regulation 26(vi) of the Regulations which the appellant is said to have violated: 15F. Penalty for default in case of stock brokers. If any person, who is registered as a stock broker under this Act,- (b) fails to deliver any securities or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less; 26. Liability for monetary penalty. A stockbroker or a sub-broker

shall be liable for monetary penalty in respect of the following violations, namely- (vi) Failure to deliver any security or make payment of the amount due to the investor within 48 hours of the settlement of trade unless the client has agreed in writing otherwise.

3. A reading of the aforesaid statutory provisions would make it clear that if a stock broker fails to deliver any security to the investor within the period specified in the Regulations, he is liable to a penalty of rupees one lac for each day during which such failure continues or rupees one crore whichever is less. The time within which the security is required to be delivered to the investor is specified in regulation 26(vz) which makes it obligatory for the stock broker to deliver the same within 48 hours of the settlement of the trade unless the client has agreed in writing otherwise. In the case before us the appellant had specifically pleaded in para 6 of its reply that its clients had agreed in writing otherwise. The appellant also furnished along with the reply a specimen copy of the kit which it used to get signed from the clients at the time of their introduction. This kit included a letter authorizing the appellant to retain the shares with it. Of course, it was open to the clients not to sign this letter and take delivery of the shares within the time prescribed. The appellant had specifically pleaded that all its clients whose securities had been lying with it beyond 48 hours had given in writing that those could be retained by the appellant. The Adjudicating Officer did not dispute this position and referred to the plea of the appellant in para 19 of the impugned order but did not accept the same for the reasons which we are unable to understand. This is what the Adjudicating Officer observed in para 19 of the impugned order- ...I have also examined the letter of authority stated to have been issued by the clients that was forwarded by RSL. This is more like an undertaking given by the client to RSL entitling them to set off and adjust the moneys and/or securities owed by the said person to RSL against the money(s) and/or securities owed to the client by RSL.

4. One could have understood if the Adjudicating Officer had rejected the plea on the ground that what was produced before her was only a sample and the signed letters of authority were not forthcoming. We repeatedly asked the learned Counsel appearing for the Board as to whether the appellant was specifically

asked to produce these letters of authority at any stage of the inquiry proceedings before the Adjudicating Officer and her answer was in the negative. She, however, contended that as many as four opportunities were afforded to the appellant during the course of the proceedings to produce any other document which it wanted but it did not produce the signed letters of authority. We cannot accept this contention. May be, the appellant was afforded with the opportunities as argued on behalf of the Board but the appellant had not been specifically asked, as already observed, to produce these letters. Once the Adjudicating Officer accepted the plea of the appellant that such signed letters, the sample of which was produced before her, had been obtained from the clients in writing under their signatures, we do not think that it was necessary for the appellant to produce those letters thereafter. When we look at the finding recorded in para 19 we find that the Adjudicating Officer rejected the plea of the appellant on the ground that the letter of authority was "more like an undertaking given by the client to RSL entitling them to set off and adjust the moneys or securities...".

Having rejected the plea of the appellant on this ground the Adjudicating Officer in para 23 of the impugned order makes a passing reference when she states that the appellant had failed to provide even the consent letters of the clients seeking retention of the securities at its end. This observation is wholly unwarranted because the Adjudicating Officer has not rejected the claim of the appellant on the ground that it failed to produce the consent letters from the clients.

She had accepted the sample letter produced before her and also the plea that such letters had been obtained from the clients. The reason for rejecting the claim of the appellant is in para 19 as observed earlier. The sample letter which the appellant produced before the Adjudicating Officer has been reproduced hereinabove and we find that it clearly authorizes the appellant as a stock broker to retain the securities with it. We have, therefore, no hesitation in reversing the finding of the Adjudicating Officer and hold that the clients of the appellant had authorized it in writing permitting it to retain the securities. In this view of the matter, there was no violation whatsoever of Section 15F(b) of the Act or of regulation 26(vi) of the Regulations.

5. Before concluding, we may mention that apprehending that the respondent may contend that the signed letters of authority had not been produced, the appellant has produced before us at the time of hearing all such letters supported by an affidavit. The learned Counsel for the respondent has strongly objected to the production of these documents at this stage and contends that the same should not be taken on record. In view of our findings recorded above holding that the Adjudicating Officer at no stage of the proceedings required the appellant to produce the said letters and accepted its plea on the basis of the sample kit produced along with the reply, it is not necessary for us to examine these documents.

6. For the reasons recorded above, the appeal is allowed and the impugned order dated 6-9-2006 set aside leaving the parties to bear their own costs.