BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA

ADJUDICATION ORDER No. Order/AN/RG/2023-24/30201

UNDER SECTION 23-I OF SECURITIES CONTRACTS (REGULATION) ACT, 1956 READ WITH RULE 5 OF THE SECURITIES CONTRACTS (REGULATIONS) (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005

In respect of:
Eureka Stock & Share Broking Services Limited
(PAN: AAACE5410B / SEBI Registration Number: INZ000169839)

In the matter of Eureka Stock & Share Broking Services Limited

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A. BACKGROUND

1. Securities and Exchange Board of India (hereinafter also referred to as '**SEBI**') conducted an inspection of Eureka Stock & Share Broking Services Limited (hereinafter also referred to as '**Noticee/ Entity/ Eureka/ SSBCL'**), jointly with Exchanges during November 10-16, 2022 for the Inspection period April 2021 to September 2022. The focus of inspection was to interalia verify whether the books of accounts and other books were being maintained in the manner required under the Broker Regulations; and whether the provisions of the Securities laws such as Securities Contracts (Regulation) Act, 1956 (hereinafter also referred to as "**SCR Act, 1956**"); SEBI Act, 1992 and the rules or regulations, bye-laws, directions or circulars, made thereunder were being complied with.

2. Pursuant to the inspection, the findings of the inspection were communicated to the Noticee by SEBI vide letter dated January 27, 2023 and comments / explanations of the Noticee were sought on the same. Noticee vide its letter dated February 15, 2023, submitted its reply to the findings and observations of SEBI.

3. Pursuant to the said inspection, based on the analysis of replies received and examination in the matter by SEBI, it was observed by SEBI that Noticee had allegedly violated provisions of Section 23D of SCR Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 (hereinafter also referred to as "**SEBI Circular dated September 26, 2016**").

B. APPOINTMENT OF ADJUDICATING OFFICER

4. Whereas, the Competent Authority was prima facie of the view that there were sufficient grounds to adjudicate upon the alleged violations by the Noticee, as stated above and therefore, in exercise of the powers conferred under Section 23-I of the SCR Act, 1956 read with Rule 3 of the Securities Contracts (Regulation) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter also referred as the '**SCR Rules**'), the Competent Authority appointed the undersigned as Adjudicating Officer ("AO") vide order dated October 13, 2023 to inquire into and adjudicate under Section 23D of SCR Act, 1956, the aforesaid alleged violations of the Noticee. The said proceedings of appointment were communicated to the undersigned vide Communique dated October 20, 2023.

C. SHOW CAUSE NOTICE, REPLY AND HEARING

5. A Show Cause Notice no. SEBI/EAD-5/AN/RG/50278/1/2023 dated December 14, 2023 along with Annexures ("SCN"), was served upon the Noticee under Rule 4 of the SCR Rules to show cause as to why an inquiry should not be held and penalty not be imposed against the Noticee under Section 23D of SCR Act, 1956, for the violation alleged to have been committed by the Noticee.

6. The allegations in respect of the Noticee inter alia brought out in the SCN are as under:

4. Findings and Observations by SEBI and alleged violations thereto in respect of the Noticee:

4.1.Misutilisation of clients' funds:

4.1.1. With respect to calculation of J, it is observed that the clients' funds lying with the clearing corporation/clearing member (C-A) is more than the sum of credit clients' margin obligations (MC) and free collateral deposits available with the clearing corporation/clearing member (MF) for eleven trading days 07/01/22, 11/01/22 to 13/01/22, 17/01/22 to 20/01/22, 24/01/22 to 25/01/22 and 31/01/22 (positive J balance), which indicates possible misuse of clients' funds towards margin obligations of debit balance clients and proprietary margin obligations. Value of positive J balance for 11 trading dates is in range from approximately Rs 3.05 Crore to Rs 21.69 Crore.

4.1.2. In this regard, as per SEBI, Stock broker has accepted misuse of funds of credit balance clients for own purposes or for debit balance clients. The reply of the entity alleging the misuse had occurred due to misinterpretation of SEBI/NSE guidelines by the back office vender is not acceptable as it is the responsibility of the stock broker to comply with the SEBI/NSE circulars in this regard and convey the requirements to their back office vendors.

4.1.3. It is observed from the reply submitted by the Stock Broker, calculation of J is +ve in 11 out of 62 sample instances observed during inspection and the misutilization ranges from Rs. 3.05Cr to Rs. 21.69 Cr. Hence, the reply of the entity is not to be accepted.

4.1.4. In view thereof, the Noticee is alleged to have violated Section 23D of SCR Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016.

7. Vide letter dated December 28, 2023, the Noticee provided preliminary response to the SCN and also sought inspection of documents, which was provided to and availed by the Noticee through its Authorised Representatives ("ARs") viz. Ms. Mitravinda Chunduru (Advocate, RHP Partners) and Ms. Riya Gokalgandhi (Advocate, RHP Partners), on January 04, 2024.

8. Having regard to principles of natural justice, vide Hearing Notice dated January 08, 2024, the Noticee was provided an opportunity of hearing on January 16, 2024.

9. However, vide email dated January 10, 2024, the Noticee requested for rescheduling of hearing citing, "*inspection was granted to the Noticee on January 4, 2024 … we most humbly request that SEBI grants the Noticee reasonable time starting January 4, 2024 for filing a suitable reply to the Show Cause Notice. The Noticee is in the process of collating relevant data and records for submitting a suitable reply and we undertake to have the same filed at the earliest, by January 15, 2024. We further request that an opportunity of personal hearing be granted to the Noticee after a week therefrom*". The Noticee's request was acceded to and the hearing was rescheduled to January 19, 2024.

10. Vide letter dated January 15, 2024, the Noticee submitted the reply to the SCN as below:

"…

1. We refer to the Show Cause Notice and are hereby responding to it. At the outset, we deny the contents of the SCN unless specifically admitted herein. Nothing contained in the SCN may be deemed to be admitted by us for lack of specific traverse. We humbly reserve our right to provide further submissions and evidence if needed.

<u>Preliminary Objections</u>

2. At the very outset, it ought to be pointed out that for the same set of alleged violations of the Noticee, parallel show cause notices are issued, under the authorisation of the same officer of SEBI –

*a. Enquiry proceedings under Section 25(1) of the SEBI (Intermediaries) Regulations, 2008 ("**Intermediaries Regulations**") for issuing recommendations under Regulation 23 of Chapter V read with Regulation 26 of the Intermediaries Regulations read with Section 12(3) of the SEBI Act, 1992 ("**Enquiry Proceedings**"); and*

*b. Adjudication proceedings under Rule 4 of the Securities Contracts (Regulations) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 ("**SCR Rules**") for holding an inquiry against the Noticee in terms of Rule 4(1) of the SCR Rules read with Section 23-I of the SCR Act, 1956 and imposing penalty under Section 23D of the SCR Act, 1956 ("**Adjudication Proceedings**").*

3. *It is trite law that Enquiry and Adjudication Proceedings are independent proceedings, which ought to be carried out independently. For the same reason, the Noticee is in receipt of 2 separate show cause notices under each of the said proceedings. However, the very purpose of separation and independency of proceedings is lost when both the Adjudicating Officer and Designated Authority is one and the same person. There will be no scope for independent determination of the Noticees' submissions by independent authorities of the issues under the 2 separate proceedings, when each of the proceedings are before the same person.*

4. *The Hon'ble Securities Appellate Tribunal, in the case of <u>Dilip S. Pendse vs. Securities and Exchange Board of India, [Appeal no.90 of 2007 dated November 20, 2008]</u> has considered the separate and independent character of adjudication proceedings and held that the finding in adjudication proceedings cannot be mixed up with the result of an enquiry under section 11 of the Act –*

   "Every finding of the adjudicating officer must be passed on an independent appraisal of evidence on record and cannot be allowed to be influenced by extraneous factors. For the same reason, we do not appreciate the adjudicating officer's reference to the appellant being penalized for the same alleged mischief in an enquiry under section 11 of the Act…"

5. *Similarly, in the case of <u>Dushyant N. Dalal vs. Securities and Exchange Boad of India [Appeal No. 184 of 2011 dated October 4, 2012]</u>, the Hon'ble Tribunal has held as under –*

   "19. The Board has been authorized to conduct multiple proceedings in respect of a wrong doing in a parallel manner. But each proceeding is independent by itself and a competent authority has to come to a well reasoned out conclusion after proper application of mind to the facts and legal issues. It cannot be held that the consequences in one of the proceedings can be automatically followed in other proceedings without observing the statutory requirements laid down in respect of the separate proceedings."

6. *In view of the aforesaid principle of independency, the Hon'ble Tribunal in the case of <u>Karvy Stock Broking Ltd. vs. Securities and Exchange Board of India [Appeal No. 92 of 2006 dated January 8, 2007]</u> has ruled that "… in order to allay the fears in the mind of the appellant we direct the enquiry officer to record his findings without being influenced by any observation made in the impugned [WTM] order".*

7. *In fact, the Ld. WTM / Competent Authority even holds the power, under Section 23(I)(3) of the SCR Act, 1956 to on its own accord review the decision of an Adjudicating Officer.*

The very provision turns meaningless and futile when the recommendations to the Ld. WTM / Competent Authority are reported to by the Adjudicating Officer itself.

8. *In view of the lack of independency in the proceedings, it submitted that the both the show cause notices issued upon the Noticee under the parallel Enquiry and Adjudication Proceedings ought to be revoked.*

9. *All further submissions hereinunder are being made without prejudice to this preliminary objection of the Noticee.*

<u>Preliminary Submissions</u>

Incomplete Inspection offered to the Noticee

10. *Firstly, it is humbly submitted that the Noticee vide letter dated December 28, 2023, had requested SEBI to provide with all the documents and records that have been submitted to the learned Adjudicating Officer ("**Ld. AO**") by SEBI for its consideration of the issues in the present matter. However, during the inspection, SEBI replied stating that only the documents relied upon in formulating the SCN would be made available for inspection, as opposed to disclosing the entirety of the records associated with the subject matter. It is thus submitted that such a limitation constitutes a gross violation of the principles of natural justice and due process. The denial of access to the comprehensive information and documents pertinent to the case undermines the Noticee's ability to effectively reply to the same. In the absence of all the information and documents, the alleged allegation imposed by SEBI is not sustainable. Copies of the Noticees letter dated December 28, 2023 and the Minutes of the Inspection Proceedings dated January 4, 2024 are enclosed herewith as* ***<u>Annexures – "1"</u>*** *and* ***<u>"2"</u>*** *respectively.*

Disregard of the Administrative Warning already issued upon the Noticee

11. *At the further outset, it is emphasized that the SCN inadequately addresses, and notably omits any reference to, the essential element necessary to substantiate the prima facie contravention alleged against the Noticee. It is submitted that the SCN is premised upon identical grounds that have been previously addressed by the Noticee before the Inspection Team, thereby transforming an issue that has already been addressed and dealt with, into an actionable violation without requisite substantiation. The SCN conspicuously lacks particulars regarding, inter alia, whether the Ld. AO was apprised of the Administrative Warning Letter dated September 27, 2023, issued by the Market Intermediaries Regulation and Supervision Department ("**MIRSD**") of SEBI*

*(“**Administrative Warning**”), which was issued further to the same inspection forming subject matter of the captioned proceedings. There is also no mention of the consideration of all the submissions made by the Noticee to the Inspection Team. a copy of the Administrative Warning dated September 27, 2023, is enclosed herewith as **<u>Annexure – “3”</u>**.*

12. *When the above was pointed out to the Ld. AO vide the Noticees’ letter dated December 28, 2023, the concerned officer of SEBI responded by email dated January 1, 2024, merely stating that the subject matter of instant proceedings and that of the Administrative Warning are distinct. Notably, even the Administrative Warning refers to the inspection carried out by SEBI officials during November 10, 2022 to November 16, 2022 (“**Inspection**”) for the inspection period of April 2021 to September 2022 (“**Inspection Period**”), which also forms the subject matter of the present SCN.*

13. *Without prejudice to the foregoing objections, the Noticee is filing a preliminary response to the SCN, based on the limited information available with the Noticee.*

<u>Brief facts of the present case</u>

Background of the Noticee

14. *The Noticee was established in 1992, and it had obtained registration as a member with NSE in 1996. By 2000, it had also received clearing and trading membership for derivative segments, and by 2004, the Noticee also joined BSE, NCDEX and MCX exchanges as a member. In 2001 and 2008 respectively, the Noticee became a depository participant with NCDL and CDSL.*

15. *Since its inception in 1992, the Noticee has had a track record of effective and ethical transactions. The Noticee now boasts of over 130 employees and 90,000+ satisfied clients who have received the Noticees’ expert investment solutions. All these years, the Noticee has been a sincere adherent of the law and has never faced proceedings of the present nature by any regulator whatsoever.*

Update of the Exchange’s system in 2021

16. *The NSE, on October 19, 2021, issued a circular bearing reference no. NSE/INSP/50012 on a new mechanism to calculate the margin utilised towards credit balance clients (“**NSE Circular**”). Vide the said NSE Circular, a provision was introduced that required re-pledged stocks to be reduced from the margins of credit balance clients. A copy of the said NSE circular dated October 19, 2021, is enclosed herewith as **<u>Annexure – “4”</u>**.*

17. *As per the understanding and interpretation of the NSE Circular by the backend software vendor viz. Techexcel Software Solutions Pvt Ltd, it had incorporated certain changes in the software systems whereby it had considered the 'entire securities pledged by the client to the trading member' rather than the 'shares which were re-pledged to the Clearing Corporation'. The said change by the software vendor resulted in a huge fall in the margin utilised towards the margin obligation of the credit balance client for the period between January 7, 2022, to January 31, 2022.*

18. *Due to the software vendor's actions, the Noticee observed the following discrepancies –*

    a. *That the re-pledged securities in total if deducted from the margin requirement will near or result in no margin to be collected from credit balance clients, if the total of re-pledge stock is sufficiently high in comparison to margin requirement.*

    b. *That the software vendor had started capturing the total value of re-pledge stocks, despite the eligible value as allowed by the Exchange might be lower than total re-pledged securities.*

    c. *As a result, it was noticed that in a few instances in the securities pledge files provided by the Exchange, the utilised value of securities pledged were greater than / equal to the value of securities pledged. The same would contravene the Exchanges requirement to maintain a margin limit of 50% of the value of securities pledged by the trading member.*

    d. *Similarly, in the case of both the credit and debit balance clients, it was observed that though such clients had re-pledged securities, but the utilisation was showing 'nil' as the securities were utilised by the Clearing Corporation in the first in first out (FIFO) method.*

    e. *That considering the above, it is assumed that the entire margin was funded by the trading member / Noticee in respect of the debit balance clients and also the credit balance clients' margin is fulfilled by pledged securities, though the cash component being utilised by such credit balance clients has been completely ignored.*

19. *In view of the double adverse effect being caused by the above, the Noticee had forthwith pointed out the above discrepancies to its software vendor and they had refused to co-operate with the Noticee in view of the absence of an Exchange circular clarifying this position.*

20. *Accordingly, the Noticee addressed 2 urgent emails dated, January 17, 2022, and February 4, 2022, to NSE explaining the above discrepancies along with supporting data and examples of the issues being faced by the software vendors causing incorrect positions for the Noticees' clients. Copies of the emails dated January 17, 2022, and February 4, 2022, addressed by the Noticee to the NSE are enclosed herewith as **Annexures "5"** and **Annexure "6"** respectively. Apart from that, the Noticee had even reached out to the one of the officials through Whatsapp, seeking clarifications for the issues faced by the Noticee. A copy of the said communication over Whatsaap is enclosed herewith as **Annexure "7".***

21. *The representatives of the Noticee even engaged with certain senior officials of the Exchange on January 13, 2022, and February 2, 2022, over calls, and video conference for a quick resolution the said issue, and the said officials after having discovered the ambiguity caused by the NSE Circular, informed the Noticee that only the 'securities re-pledged to the Clearing Corporation' is required to be considered. The Exchange officials had even issued clarificatory instructions to the software vendor, which was immediately implemented by February 2022.*

Inspection proceedings by SEBI

22. *Vide letter dated September 23, 2022, SEBI issued a notice to the Noticee for inspection of books of accounts, records and other documents under Regulation 19 of the SEBI (Stock Brokers) Regulations, 1992 ("**Inspection Notice**"). Along with the said Inspection Notice, SEBI enclosed a 'Pre- Inspection Questionnaire' seeking requisite information from the Noticee. A copy of SEBI's Inspection Notice dated September 23, 2022, is enclosed herewith as **Annexure – "8"**.*

23. *In reply to the aforementioned letter, the Noticees addressed letters dated October 10, 2022, and November 11, 2022, duly providing all responses along with supporting data, to the 'Pre- Inspection Questionnaire' of SEBI. Copies of the said letters dated October 10, 2022, and November 4, 2022, are enclosed herewith as **Annexure – "9"** and **Annexure – "10"**, respectively.*

24. *Thereafter, the Inspection was carried out of the Noticees records by the SEBI Inspection Team between November 10, 2022, to November 16, 2022, for the Inspection Period between April 2021 and September 2022. It maybe pertinent to note that during Inspection, the Inspection Team had requested the Noticee to furnish the 'Enhanced Supervision data' for the entire month of January 2022 and had allowed the Noticee only a day's time, for providing the same. However, in such time the Noticee could only submit*

the system generated data and not the entire 'Enhanced Supervision data'. Therefore, the Inspection was conducted hastily without even obtaining complete records from the Noticee.

25. *Subsequent to the aforementioned Inspection, SEBI issued a letter dated January 27, 2023, to the Noticee providing its findings derived from the Inspection. Vide the said letter, SEBI called upon the Noticee to provide their comments/ explanations concerning the identified findings/ irregularities/ violations stated therein. The following categories of findings were provided in the said letter:*

    A. *Misuse of client's funds;*
    B. *Reconciliation of Mismatch alerts;*
    C. *Delay and non-issuance of retention statement for Quarterly/ Monthly Settlement of Client Funds & Securities;*
    D. *Control System over Branch/ AP;*
    E. *Analysis of Enhanced Supervision Data (Weekly/ Monthly)*

    A copy of the said SEBI letter dated January 27, 2023, is enclosed herewith as ***Annexure – "11"****.*

26. *The Noticee had, by its letter dated February 15, 2023 ("****Preliminary Response****"), responded to each of the findings of the Inspection Team, and had provided relevant information and documents to demonstrate that most of the findings were misplaced, and how there was no violation whatsoever on the Noticees' part. In fact, it was also demonstrated that it was the Noticee who had taken active steps to resolve the glitch caused in the system of the National Stock Exchange of India Limited ("****NSE****"). The Noticee's response to each of the findings of SEBI is summarised as below -*

    A. *With respect to allegation of misuse of clients' funds, the notice denied the said allegation and provided a comprehensive response explaining the reason for G -ve balance on September 22, 2021, January 6, 2022, January 7, 2022, January 27, 2022 and J alert from January 7, 2022 to January 31, 2022. Along with this, the Noticee had also provided the data which does not form part of the SCN.*

    B. *With respect to reconciliation of mismatch alerts the Noticee provided a detailed account of a technical error that occurred. This error resulted in the system capturing partial data, leading to short reporting of 1,555 shares. The Noticee clarified that this particular error was an isolated incident among the 30 alerts generated during inspection. Emphasizing that the said occurrence was a system* *lapse and not indicative of any intentional misutilization of clients' securities, the Noticee formally requested the SEBI Inspection Team to treat the same as system lapse and not to draw any adverse inference.*

C. *With respect to delay and non-issuance of retention statement for quarterly/ monthly settlement of client funds/ securities the Noticee clarified that there was 5 days delay in issuance of retention statement owing to a technical issue in the back-office system. The Noticee even clarified that they actively initiated efforts to send the same since April 12, 2022. The Noticee was continuously following up with the back-office vendor. Since there were two holidays i.e., on April 14, 2022, and April 15, 2022, the issue was solved only on the evening on April 18, 2022, (Monday). Consequently, the statement was promptly delivered on April 19, 2022, i.e., the very next day.*

D. *With respect to control system over branch/ AP the Noticee clarified that they had conducted inspection of the APs and uploaded the same as mandated by BSE circular Notice No. 20211021-38 dated October 21, 2021. Notably, for branch 601, being the Noticee's own branch, the inspection details were not separately reported. The Noticee further explained that during the second and third wave of COVID 19 pandemic, a substantial number of their employees were infected, resulting in a shortage of manpower. Consequently, the inspection for that financial year was delayed. Additionally, due to infections amount of the employees at APs office, inspections for those specific APs from the designated list were also postponed. In light of these challenging circumstances, the Noticee formally requested SEBI not to undertake any adverse action, considering the exceptional difficulties faced during the specified period.*

E. *With respect to analysis of enhanced supervision data (Weekly/ Monthly) the Noticee clarified that the Noticee had made early pay-in of funds of Rs. 11,00,00,000. However, the inspecting team had considered it as early pay-in of securities. To substantiate this clarification, the Noticee submitted relevant extract from the corresponding Bank Statement. Additionally, a reference was made to Circular No. NSE/INSP/50012 dated October 19, 2021, which explicitly affirms that the inclusion of early pay in funds is a prerogative accorded to the trading member. The said clarification was presented to fortify the veracity of the Noticee's claims and rectify the misinterpretation made by the inspecting team.*

27. *After providing the said response to SEBI, there was no further communication whatsoever received from SEBI by the Noticee. Therefore, the Noticee believed that all*

*responses provided were to the satisfaction of the Inspection Team of SEBI, and that no further clarifications were warranted. Copy of the Noticee's Preliminary Response dated February 15, 2023, is hereby marked and annexed as **<u>Annexures – "12"</u>**.*

Administrative Warning from SEBI

28. *However thereafter, surprisingly, the Noticee was in receipt of Administrative Warning dated September 27, 2023 whereby the Noticee was warned to be careful in the future and improve its compliance standards. The Noticee was further advised to – (a.) take appropriate corrective steps to rectify the discrepancies/ deficiencies discovered during the Inspection; and also (b.) examine other cases not forming part of the sample for SEBI's inspection and take appropriate corrective steps in such cases as well.*

29. *The Noticee however with an urge of good compliance and reporting, graciously accepted the recommendations of the Administrative Warning. After taking all corrective measures, on October 25, 2023, the Noticee submitted an action taken report with SEBI. A copy of the said letter dated October 25, 2023, is enclosed herewith as **<u>Annexure – "12"</u>**.*

Present SCN and Inspection

30. *After conclusion of the proceedings vide the Administrative Warning, the Noticee is surprised to now receive the captioned SCN that seeks to not only re-open the proceedings that are already concluded, but also, converts the same issues into chargeable violations. Interestingly, various pertinent records including the Administrative Warning, and the complete details and submissions provided by the Noticee to the SEBI Inspection Team were not forming part of the SCN. Therefore, the Noticee had addressed its letter dated December 28, 2023, seeking complete inspection in the matter, which was however not provided to the Noticee.*

<u>Submissions of the Noticee</u>

Non consideration of the Noticees' submissions

31. *SEBI's Inspection Team failed to consider the Preliminary Response letter of the Noticee in perspective. The Inspection Report shows complete disregard of the clarifications and submissions provided by the Noticee. Had the Noticees' submissions been assessed in the correct perspective, the present proceedings would have concluded at the inspection stage itself, as it would have become evident at that very stage that there was no violation whatsoever on the Noticees' part. Admittedly, after submission of its Preliminary*

Response, the Inspection Team did not even re-approach the Noticees to seek any further clarifications if it were not convinced with the responses provided.

32. *In this context, it is pertinent to note the decision of the Hon'ble SAT in the case of* *<u>Religare Securities Limited v. SEBI [Appeal No. 23 of 2011 decided on June 16, 2011]</u>:*

"2. We have heard the learned Counsel for the parties who have taken us through the record and, in the circumstances of this case, we are inclined to exonerate the Appellant by giving it the benefit of doubt. We are clearly of the view that the inspection carried out by the inspecting team was faulty which compels us to give the benefit of doubt to the Appellant.

… ***<u>Only if the inspecting team at the time of inspection had made a query in this regard from the management, the reply would have then come and that would have made it clear</u>*** *whether the letters were then in existence or not.* ***<u>We would not have had to face the situation we are in.</u>*** *Again, if the letters were to be manufactured for the purpose of the defence, they would not have been left undated. In these circumstances, we cannot but give the benefit of doubt to the Appellant …*

4. We have carefully perused the impugned order and find that all the deficiencies found by the adjudicating officer ***<u>could have been adequately responded to by the Appellant if queries had been made by the inspecting team at the time of inspection. If this procedure/practice had been followed, there would have been no scope for an allegation that the supporting documents were subsequently prepared</u>****. It is not necessary for us to deal with each and every allegation as, in most of the cases, the adjudicating officer has refused to accept the stand of the Appellant on the ground that the supporting documents were not produced before the inspecting team. As already observed, the inspecting team did not make any queries nor did it ask for the supporting documents at the time of inspection.*

*5****<u>. It must be remembered that the purpose of carrying out inspection is not punitive and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. We also cannot lose sight of the fact that every in or discrepancy/irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and making it compliant</u>****. This will, of course, depend on the nature of the irregularity noticed and we hasten to add a caveat that it is not being suggested that if any serious a lapse is* *found during the course of the inspection, the Board should not proceed against the delinquent."*

[Emphasis Supplied]

33. *It is apparent from the ratio above that the purpose of an inspection is not to penalise an intermediary but to enable them to rectify any technical inadequacy. It is humbly submitted that the ratios above are squarely applicable in the facts of the present case where various issues would have been resolved - and the issuance of the SCN would have been prevented - had the submissions of the Noticee been considered before issuance of the Inspection Report/SCN.*

Technical breach of external entities

34. *Admittedly, the present proceedings are emanating from a technical breach on the part of the software vendor, which was caused by an ambiguous circular of the NSE. The Noticee had no role or control over the actions of these entities. On the other hand, the Noticee had taken all reasonable steps towards the earliest and most effective resolution of the issue caused.*

35. *The Noticee submits that, this is not a case of misutilization of client funds, but an incorrect reporting caused due to disconnect at the software vendor's end in adopting the updated system of reporting of the Exchange. The issue was addressed after the Exchange agreed to the ambiguity and issued clarifications to software vendor. There was a mere glitch in the technological system and no investor was harmed whatsoever. Accordingly, there is no cause for taking any action against the Noticee, that too, on repeated occasions.*

36. *It is humbly submitted that the Noticee has at all times remained compliant with the all the guidelines, rules, regulations and other applicable law. Therefore, any action against the Noticee is not warranted, especially considering it was never the Noticee who was at fault.*

37. *In P.G. Electroplast Ltd. & Ors. vs. SEBI [Appeal No. 281 of 2017], SAT held that:*

"Even if a minimum penalty is prescribed, the authority, after considering the circumstances of the case and other factors enumerated in Section 15J would be justified in refusing to impose penalty when there is a technical or venial breach of the provisions of the Act."

38. *In a similar judgment of SAT in the matter of Ashok Dal & Oil Mills vs. SEBI [Appeal No. 254 of 2022], it was held that:*

“The violation committed by the appellants is technical as they have transferred the shares of the company in the name of the partners for which no loss was caused to the investors. Considering the aforesaid, that it was only a technical violation, we are of the opinion that in the given facts and circumstances, the imposition of penalty under Section 15HB of the SEBI Act appears to be excessive and on the higher side.”

Accordingly in the above matter the SAT reduced the penalty imposed on the Appellant considering that the violation was technical in nature.

39. *In another similar instance, in the matter of <u>State Bank of India vs. SEBI [Appeal No. 304 of 2020]</u>, SAT has once again established that:*

“We do not find any justifiable reason to impose any monetary penalty in the present matters, <u>as every technical violation need not be visited with monetary penalty. In these matters a warning is sufficient</u>.”

No misutilisation of client’s funds

40. *Below are the allegations in the SCN in this regard –*

a. *With respect to calculation of J, the SCN alleges that the client’s funds lying with the clearing corporation/ clearing member (C-A) is more than the sum of credit clients’ margin obligations (MC). It is also alleged that there were free collateral deposits available with the clearing corporation/ clearing member (MF) for 11 trading days i.e., “07.10.2022, 11.01.2022 to 13.01.2022, 17.01.2022 to 20.01.2022, 24.01.2022 to 25.01.2022 and 31.01.2022” which indicates possible misuse of clients’ funds towards margin obligation of debit balance clients and proprietary margin obligations.*

b. *It is also alleged that the Noticee had accepted misuse of funds of credit balance clients for own purposes or for debit balance clients. It was also alleged that it was the Noticee’s responsibility to comply with the SEBI/ NSE circulars and convey the requirements to their back office software vendors.*

c. *Further, that, the Preliminary Response submitted by the Noticee showcases that the calculation of J was +ve in 11 out of 62 sample instances and the misutilisation ranges from Rs. 3.05 Cr. To Rs. 21.69 Cr.*

41. *As regards these allegations, it is firstly submitted that the Noticee on no occasion accepted that there was any misutilisation of funds whatsoever. In fact, in its Preliminary Response, the Noticee clarified that the J alerts in the month of January 2022 had occurred on account of the above stated ambiguity caused by the NSE Circular in the mind of the software vendor, which was eventually proactively resolved by the Noticee. The Noticee had even submitted manual calculations for the same [Ref: Supporting 2 to the Preliminary Response of the Noticee].*

42. *In respect of the alert on March 7, 2022 where the J was alleged to be positive, the Noticee even submitted the recalculation, considered in the correct method, to in fact show a negative J of - Rs. 12,37,42,471.01/- [Ref: Supporting 3 to the Preliminary Response of the Noticee].*

No profit or benefit has accrued to the Noticee or loss to investors

43. *Without prejudice to the above, it however submitted as a matter of fact that the Noticee has neither retrieved no benefit from the alleged violations, nor has it made any profit therefrom. Even assuming that the Noticee, and not the software vendor, was in fact responsible for the 'mis-reporting' of the client balances, the same does not amount to 'misutilization' of the same. SEBI has grossly erred in concluding the same.*

44. *Additionally it ought to be appreciated that no investors were harmed due to the ambiguity caused to the software vendor, as the same was immediately rectified. Pertinently, no investor complaints are also received by the Noticee for the alleged actions.*

45. *In this regard, it is pertinent to note the ruling of the Hon'ble SAT in the matter of <u>Neha Nilesh Patil vs. SEBI, [Appeal No. 688 of 2021]</u>, where it was held that:*

> *"We find that the violation of the LODR Regulations gave **<u>no disproportionate gain to anyone nor created any unfair advantage to the appellant nor any specific loss was caused to any investors</u>** and, therefore, in our opinion the direction of debarment and penalty imposed for violation of the LODR Regulations appears to be harsh and excessive."*
>
> *[Emphasis Supplied]*

46. *It is submitted that, if deemed necessary, the Noticee is prepared to submit comprehensive manual calculations for review and consideration.*

47. *In view of the above submission, it is most humbly submitted that the SCN ought to be disposed off without any adverse remarks or observation against the Noticee.*

…"

11. On the rescheduled date of hearing i.e. on January 19, 2024, the Noticee availed the hearing opportunity through it's ARs viz. Mr. Ravichandra Hegde (Advocate, RHP Partners), Ms. Mitravinda Chunduru (Advocate, RHP Partners), Ms. Riya Gokalgandhi (Advocate, RHP Partners), Mr. Rakesh Somani (Director, Eureka) and Ms. Nikita Parasrampuria (Manager-Compliance, Eureka) wherein the ARs inter alia relied upon and reiterated the written submissions made vide letter dated January 15, 2024. Further, the ARs sought additional time till January 29, 2024 to make additional submissions as final and complete in the matter. Accordingly, time till January 29, 2024 was allowed.

12. Subsequently, vide letter dated January 29, 2024, the Noticee made following additional submissions as reply to the SCN:

3.1. As a preliminary objection, it is submitted that parallel show cause notices for the same set of alleged violations are issued under adjudication and enquiry proceedings, which are being decided by the same officer of SEBI. The very purpose of separation and independency of proceedings is lost when the Adjudicating Officer adjudicating the issues between the Noticee and SEBI as per the scheme of the law under Chapter VI A of the SEBI Act, 1992 is the same person appointed as the enquiry officer in another identical parallel proceedings who is an officer of SEBI. While the officer adjudicating as Enquiry Officer is required to submit his recommendation to the Board for a final decision under the Intermediaries Regulations, 2008, he is an officer of SEBI and SEBI is one of the parties to the adjudication. We respectfully submit that this is against the spirit and scheme of the law and therefore would be prejudicial to the interest of the Noticee. This would as such render the independence of the Adjudicating Officer a nugatory if the officer is also representing SEBI in the enquiry proceedings against the Noticee. Therefore, there would not be an independent adjudication when the adjudicating officer holding the enquiry officer hat is the same person of SEBI. The prejudice caused to the Noticee because of such conflict is explained below.

3.2. It is submitted that under the Adjudicating Proceedings Rules, the learned AO is first required to issue a notice under Rule 4(1) calling upon the Noticee to respond to the allegations and thereafter based on the response provided frame an opinion / decide to hold an inquiry for which a Notice for hearing under Rule 4(2) is required to be issued. In the present case before even there was any reply and inspection proceedings were pending under the other parallel proceedings, the *learned AO had already issued the notice for hearing. Such is the prejudice caused to the Noticee. The following dates and events make it clear that both the proceedings have been deemed to be considered as a single adjudication:*

Date	***Events***
10.11.2022 – 16.11.2022	*SEBI officials conducted comprehensive Inspection for the Inspection period of April 2021 – September 2022.*
14.12.2023	*The Noticee was in the receipt of the SCN*
28.12.2023	*The Noticee vide a letter requested for inspection of the documents and records that have been submitted to the Ld. AO by SEBI for its consideration of the issues in the present matter*
01.01.2024	*SEBI vide email allowed partial inspection of only the annexures to the SCN on 04.01.2024.*
08.01.2024	*SEBI vide email served upon the Noticee a Hearing Notice scheduling the hearing on January 16, 2024, even before the Noticee could file its Reply to the SCN.*

3.3. Further, that the Noticees' rights under natural justice have been breached by SEBI's denial of disclosure of the entirety of the records associated with the subject matter as explained in the Reply to the SCN. The same undermines the Noticee's ability to effectively participate in the present proceedings.

3.4. The SCN, premised upon identical grounds previously addressed by the Noticee before the Inspection Team, notably omits any reference to the submissions already made by the Noticee, thereby transforming an issue that has already been addressed and dealt with, into an actionable violation without requisite substantiation.

3.5. That the present proceedings emanate from a technical breach on the part of the software vendor of the Noticee viz., Techexcel Software Solutions Pvt. Ltd., caused by an ambiguous circular of the NSE. The Noticee, having no role or control over the actions of these entities, had complied with all the applicable law and had on its own accord taken all reasonable steps towards the earliest and most effective resolution of the issue caused [Ref: Paras 18-21 of the Reply].

3.6. That the present case is not one of misutilization of client funds, but an incorrect reporting caused due to disconnect at the software vendor's end in adopting the updated system of reporting of the Exchange and also on account of erroneous files received from the Exchanges/Clearing Corporation with regard to utilization of securities for meeting the margin obligation of the clients. The same was notified by the Noticee to both- the software vendor and the Exchange, which can *be verified with the supporting attached with the Reply [Ref: Annexure 5 and 6 of the Reply]. Therefore, if at all, the present matter is case of 'mis- reporting' of the client balances and by no stretch of imagination could the same be called 'mis-utilization' of funds.*

3.7. The Show Cause Notice is vague and the charging provision is invoked based on assumptions as is clear from para 4.1.1 of the SCN where the words used is "possible". While the charging provision cannot be attracted based on mere assumption, it is submitted that even the assumption is incorrect. There was no adjustment of excess funds towards the obligations of the clients having debit balance at any point of time. Even if such obligations were to be adjusted, the Noticee could have utilized the margin availability of the proprietary account of the Noticee as is demonstrated in the reply and elaborated below. None of these issues were even raised by the Inspection Team during inspection. It is the case of the Noticee that no clients having debit balance or obligations to pay margin were ever accommodated using the funds and margin of the clients having credit balances. This is the main disconnect between the facts and charging provision. As per the required provisions of law, there was a clear segregation of accounts and funds which can be verified yet again by the learned Officer.

3.8. Despite being informed about the deficiency in the software coding over which the Noticee had no control, and the fact that the software vendor was the one approved by NSE, no attempts were made by the inspection team to verify the same from NSE. The correspondence exchanged with NSE which was immediately upon becoming aware of the problems by the Noticee clearly demonstrates the compliance level and understanding of the rules by the Noticee. It is nobody's case that the Noticee reached out to NSE after being alerted or inspected by any authorities including NSE or SEBI. The observations of the Hon'ble Tribunal in the cases extracted in the Reply therefore squarely applies to the present case.

3.9. No profit or benefit has accrued to the Noticee and neither has loss been caused to any client in any manner.

4. In addition to the above, the following submissions of the Noticee, as also presented during the personal hearing before the Ld. AO be taken into consideration –

Distinct role played by the AO and DA

4.1. The preliminary submission of the Noticee pertains to the distinct role of the Designated Authority ("DA") appointed in enquiry proceedings under under Section 25(1) of the SEBI (Intermediaries) Regulations, 2008 ("Intermediaries Regulations") and the Ld. AO in the captioned proceedings. While the Ld. AO possesses the power to issue final orders, the Ld. DA's role consists of presenting recommendations to the Ld. WTM for final determination of the matter by *the Ld. WTM and therefore the DA is discharging the function of SEBI as part of SEBI and not an independent person to adjudicate under Chapter VI A. The concern arises when the same individual assumes both roles, overseeing the Enquiry and subsequently passing an order in the same matter. We humbly submit that such convergence raises valid apprehensions about inherent bias as the Ld. AO, having been involved in the adjudication phase, may inadvertently carry preconceived opinions into its recommendations to the Ld. WTM, thereby compromising the fundamental principles of independence and impartiality in the two proceedings. Therefore, it is submitted that the separation of these roles is essential to uphold the integrity of both the Enquiry and Adjudication Proceedings.*

4.2. In other words, the simultaneous appointment of an individual to serve in dual capacities as the AO and the DA runs counter to the foundational principles and objectives of Adjudication as well as the Enquiry proceedings. This dual role inherently undermines the requisite independence that is integral to ensuring fair and impartial proceedings against a noticee. The appointment of a single individual to occupy both positions raises concerns about the potential conflicts of interest and the preservation of a neutral stance in the decision-making process. It is also submitted that such a confluence of roles not only deviates from the intended scheme of adjudication but also jeopardizes the credibility and integrity of the adjudicatory framework. Therefore, it is submitted that careful consideration should be given to preserving the autonomy and impartiality of roles of the Ld. AO and the Ld. WTM in order to uphold the integrity of the simultaneous proceedings against the Noticee.

No 'misutilization' of client funds

4.3. It is pertinent to highlight that Section 23D of Securities Contracts Regulations Act, 1956 ("SCRA") specifically addresses failure to segregate or to mis- utilize securities or client funds. However, the allegation outlined in the SCN only alludes to a "possibility of mismanagement". Therefore, without prejudice to the submissions made herein, it may be noted that the Noticee cannot be charged under Section 23D of the SCRA, when the findings of the Inspection Team are only of a mere "possibility" of mis- utilization, while in reality there was no misutilization of clients' securities/ funds whatsoever. It may be reiterated that the said finding of a "possibility" is however erroneous in view that there was only "misreporting" caused due to the ambiguous interpretation of the NSE Circular by the software vendor of the Noticee, which was however, immediately rectified due to the Noticees prompt actions. The charging provisions are therefore not attracted nor even applicable to the present case.

4.4. The Inspection Team could have verified the facts from the exchange by just asking for the client wise position and the margin obligations which only SEBI has the capacity to do. The Noticee has discharged its obligations by showing how there was no misutilization at all and that the *reporting was merely a software glitch which was rectified later and over which the Noticee had no control to begin with. It is also relevant to note that the allegation which was earlier pointed out by Inspection Team on "G" being negative was also accepted by SEBI which only points out to good compliance and clear segregation of client funds and securities.*

Misinterpretation of NSE Circular by the software vendor

4.5. The complete events that transpired were already presented before the Inspection Team of SEBI, which facts are not forming part of the SCN. After the Noticee had explained that there was unintended misreporting caused due to ambiguous interpretation of the NSE Circular by the software vendor to the Inspection Team, no revert was received or clarifications were sought by SEBI either from the Noticee or NSE. Doing the same would have concluded the issues in the matter at the very outset. There would have remained no cause to issue any SCN to the Noticee.

4.6. The client balances were wrongly reported by the software vendor due to its misinterpretation of the NSE Circular, which was instantly detected by the Noticee and the Noticee immediately approached the software vendor as well as senior level representatives of the NSE for ensuring immediate correction of the reporting to the Exchange.

4.7. The present proceedings are initiated despite there being no violation of any provisions of the SCRA or any other application law on the Noticees' part, let alone of the nature that are alleged in the SCN. This clearly shows non application of mind on the part of the Inspection Team and incompletion of fact-finding exercise by SEBI.

4.8. It is therefore urged that the Ld. AO uses its powers bestowed under the SCRA and seeks clarifications directly from the Exchange as well as the software vendor on the submissions made by the Noticee herein and in its Reply as regards its Circular dated October 19, 2021. The Noticee had even submitted its manual calculations of J to show the actual utilization of the client funds to the Inspection Team. Further the Noticee is hereby re-producing the Table of J calculation as " Annex ure A " incorporating the manual calculations by the Noticee which clearly demonstrates a huge change in the figures so reported. Considering this calculation, it clearly evident that on major days the violation of J principle is reverted and for the remaining days if the data had been captured correctly in the back- office system, there would not have been any instances of violation of J principle on any dates.

4.9. It is requested that the said Ld. AO may consider conducting an independent inquiry or verifies the manual calculations of the Noticee with the Exchange. The same would put the matter to rest, and there would remain no requirement to impose any penalty upon the Noticee.

4.10. After receiving the captioned SCN, the Noticee addressed an email dated December 22, 2023 seeking clarifications from NSE in respect of the issued impugned in the present matter which was the duty of SEBI to begin with. In the said email –

i. The discrepancy in the margin requirement between the MG01 file and the cumulative EOD margin requirement in the MG13 file was highlighted.

ii. It was explained that the elevated margin value in the MG01 file was causing a decrease in the available collateral with Clearing Corporation at the member level.

A copy of the said email dated December 22, 2023, is enclosed herewith as " Annexure B ".

4.11. Subsequently, on December 28, 2023, the representatives of the Noticee received a call from NSE officials, who confirmed to the Noticee that the MG01_02 file is required to be referred to while determining the value of free collateral specifically the "balance available", instead of the MG01 file as could be interpreted from the Circular.

4.12. Considering the above exchange of communications with NSE reverifies the Noticees submissions being made before SEBI and also the Ld. AO, it is therefore essential that the Ld. AO enquires into and considers these facts and factors before arriving at a decision under the captioned SCN.

4.13. Having said this, it may also be noted that the proprietary surplus maintained by the Noticee always exceeded the mandated proprietary margin obligation. Out of the 11 days that are impugned in the SCN, on 8 days, the proprietary surplus far surpassed the debit margin clients, as can be seen from below –

Date	***Surplus amount in the proprietary account***	***Total margin of debit balance of clients***
07.01.2022	*25,86,92,244.63*	*14,79,17,094.64*
11.01.2022	*21,92,65,271.60*	*20,23,49,108.16*
12.01.2022	*28,41,07,263.21*	*37,63,65,705.41*
13.01.2022	*26,92,33,998.99*	*21,32,59,642.51*
17.01.2022	*32,33,97,285.43*	*22,97,41,202.24*
18.01.2022	*39,23,23,577.01*	*37,75,40,721.05*
19.01.2022	*37,89,43,368.14*	*35,97,76,042.92*

20.01.2022	*31,45,80,655.53*	*27,71,94,749.60*
24.01.2022	*30,18,47,063.01*	*55,29,27,119.03*
25.01.2022	*27,80,19,730.67*	*61,85,57,217.55*
31.01.2022	*24,43,94,204.87*	*24,24,33,928.35*

4.14. Therefore, the Noticees proprietary surplus was so high that even in an event where the debit balance clients were unable to meet their obligations, the same could have been fulfilled with the proprietary surplus available with the Noticee. Infact, this would have even generated revenue by way of interest which is permissible under the SEBI rules. It is unimaginable why the Noticee would then misappropriate the credit balances of its other clients. There was no margin funding nor any requirement to begin with and therefore the Show Cause Notice should be disposed of immediately forthwith.

4.15. Furthermore, the Proprietary account had enough surplus to meet any shortfall in the debit balance clients' margin requirement.

DATE	***DEBIT CLIENT MARGIN OBLIGATION***	***DEBIT CLIENT SECURITIES UTILIZATION***	***PROP SURPLUS***
07.01.2022	*14,79,17,094.64*	*12,42,36,507.16*	*25,86,92,244.63*
11.01.2022	*20,23,49,108.16*	*15,14,42,951.60*	*21,92,65,271.60*
12.01.2022	*37,63,65,705.41*	*28,73,45,188.14*	*28,41,07,263.21*
13.01.2022	*21,32,59,642.51*	*16,80,26,459.60*	*26,92,33,998.99*
17.01.2022	*22,97,41,202.24*	*20,23,04,953.53*	*32,33,97,285.43*
18.01.2022	*37,75,40,721.05*	*26,99,72,132.49*	*39,23,23,577.01*
19.01.2022	*35,97,76,042.92*	*25,92,49,241.93*	*37,89,43,368.14*
20.01.2022	*27,71,94,749.60*	*23,07,33,103.07*	*31,45,80,655.53*
24.01.2022	*55,29,27,119.03*	*42,95,67,667.23*	*30,18,47,063.01*
25.01.2022	*61,85,57,217.55*	*51,35,40,657.62*	*27,80,19,730.67*
31.01.2022	*24,24,33,928.35*	*20,82,48,864.82*	*24,43,94,204.87*

5. The Noticee has firm internal systems to ensure compliance with all applicable rules and regulations. It is reiterated that there was no misutilisation of client funds whatsoever by the Noticee, and the balances were only misreported briefly after introduction of a new methodology of reporting by the NSE Circular, until the software vendor received correct instructions / clarifications from NSE.

6. The Noticee was issued a warning by SEBI on the same Inspection Report which was graciously accepted by the Noticee and the Noticee held internal discussions to ensure that the Noticee adopts further methods of compliances if any required. Such is the conduct of the Noticee and therefore any adverse remarks or observations by SEBI would only jeopardise the interest of the Noticee in any proceedings when there is no clear allegation or any wrongdoing other than mere assumptions which are addressed by the Noticee.

7. In view of the above, it is most humbly prayed that the SCN be disposed-of without imposing any monetary penalty against the Noticee.

D. CONSIDERATION OF ISSUES AND FINDINGS

8. The issues that arise for consideration in the instant matter are:

Issue No. I:	Whether the Noticee has violated Section 23D of SCR Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016?
Issue No. II:	If yes, whether the Noticee is liable for imposition of monetary penalty under Section 23D of SCR Act, 1956?
Issue No. III:	If yes, what should be the monetary penalty that can be imposed upon the Noticee?

9. Before proceedings with the matter on merits, I would first deal with key technical contentions /submissions made by the Noticee.

9.1. Noticee in its submissions vide letter dated January 15, 2024 as reply to the SCN has inter alia contended that "*It is trite law that Enquiry and Adjudication Proceedings are independent proceedings, which ought to be carried out* *independently. For the same reason, the Noticee is in receipt of 2 separate show cause notices under each of the said proceedings. However, the very purpose of separation and independency of proceedings is lost when both the Adjudicating Officer and Designated Authority is one and the same person. There will be no scope for independent determination of the Noticees' submissions by independent authorities of the issues under the 2 separate proceedings, when each of the proceedings are before the same person".*

In support of the same, the Noticee has relied on the following judgments:

- *Dilip S. Pendse vs. Securities and Exchange Board of India, [Appeal no.90 of 2007 dated November 20, 2008]*
- *Dushyant N. Dalal vs. Securities and Exchange Boad of India [Appeal No. 184 of 2011 dated October 4, 2012]*
- *Karvy Stock Broking Ltd. vs. Securities and Exchange Board of India [Appeal No. 92 of 2006 dated January 8, 2007]*

Further, the Noticee vide letter dated January 29, 2024 has submitted in this regard that, "*We humbly submit that such convergence raises valid apprehensions about inherent bias as the Ld. AO, having been involved in the adjudication phase, may inadvertently carry preconceived opinions into its recommendations to the Ld. WTM, thereby compromising the fundamental principles of independence and impartiality in the two proceedings. Therefore, it is submitted that the separation of these roles is essential to uphold the integrity of both the Enquiry and Adjudication Proceedings".*

9.2. In this regard, I note that in the event of violation of the provisions of the SCR Act, 1956 and the regulations made thereunder, SEBI has the power to initiate multiple proceedings under SCR Act, 1956 and/or under SEBI (Intermediaries) Regulations in the interest of investors or the securities market. I note that in exercise of the powers conferred under Section 23-I of the SCR Act, 1956 read with Rule 3 of the SCR Rules, the Competent Authority appointed the undersigned as AO vide order dated October 13, 2023 to inquire into and adjudicate under Section 23D of SCR Act, 1956. Further, in exercise of the powers conferred under Regulation 24(2) of SEBI (Intermediaries) Regulations, 2008, the Competent Authority appointed the undersigned as Designated Authority ("DA") vide order dated October 16, 2023 to submit a report and make a recommendation in compliance with Regulation 23, 26 and 27 of the SEBI (Intermediaries) Regulations, 2008.

I further note that whether adjudication proceedings and/or enquiry proceedings are to be initiated in a case would depend on the facts and circumstances of each case. I also note that, initiation of Adjudication proceedings and/or enquiry proceedings under the appropriate provisions of SEBI Act is a prerogative of SEBI depending upon the outcome of such exercise viz., Inspection and findings thereof.

Further, both Adjudication and Enquiry proceedings are separate is evident from the fact that SCNs are also separate, as also acknowledged by and pointed out by the Noticee, in so far as the Noticee has mentioned, "*the Noticee is in receipt of 2 separate show cause notices under each of the said proceedings.*"

Therefore, it is stated that both the Adjudication proceedings and Enquiry proceedings are separate and independent of each other. It is stated that Adjudication Proceedings are disposed of by AO by passage of AO order whereas in respect of Enquiry proceedings, the Designated Authority is required to recommend measures by way of a report which is thereafter to be dealt/ disposed by competent authority by following process as defined interalia under Regulation 27 of of the SEBI (Intermediaries) Regulations, 2008. It cannot be held that the consequences in one of the proceedings can be automatically followed in other proceedings without observing the statutory requirements laid down in respect of the each separate proceeding.

Further, there is no prohibition in the law prohibiting such an arrangement where the same person is be Adjudicating Officer as well as Designated Authority.

In view of the above, the Noticee's contention is devoid of merit and hence not tenable.

9.3. The Noticee has further interalia submitted, "*it is humbly submitted that the Noticee vide letter dated December 28, 2023, had requested SEBI to provide with all the documents and records that have been submitted to the learned Adjudicating Officer ("Ld. AO") by SEBI for its consideration of the issues in the present matter. However, during the inspection, SEBI replied stating that only the documents relied upon in formulating the SCN would be made available for inspection, as opposed to disclosing the entirety of the records associated with the subject matter. It is thus submitted that such a limitation constitutes a gross violation of the principles of natural justice and due process. The denial of access to the comprehensive information and documents pertinent to the case undermines the Noticee's ability to effectively reply to the same. In the absence of all the information and documents, the alleged allegation imposed by SEBI is not sustainable.*"

9.4. In this regard, I would like to note that the documents relied upon in the current proceedings have been provided to the Noticee. Further, on perusal of minutes of inspection, I note that all the documents relied upon during the proceedings were provided to the ARs of the Noticee for the inspection. Further, I note that during the proceedings, the Noticee has not requested for any specific document and that the Noticee's contention, "*disclosing the entirety of the records associated with the subject matter",* vague/roving in nature as the relied upon documents relevant to the current proceedings have been provided to the ARs of the Noticee for the inspection. In this regard, attention is drawn to judgment of Hon'ble Supreme Court in the matter of Kavi Arora vs. Securities and Exchange Board of India (14.09.2022 -SC) : MANU/SC/1163/2022), wherein it was held that:

"*49. It is well settled that the documents which are not relied upon by the Authority need not be supplied*.."

In view thereof, contention of the Noticee is devoid of merit and hence not tenable.

9.5. The Noticee has interalia contended that, "*At the further outset, it is emphasized that the SCN inadequately addresses, and notably omits any reference to, the essential element necessary to substantiate the prima facie contravention alleged against the Noticee. It is submitted that the SCN is premised upon identical grounds that have been previously addressed by the Noticee before the Inspection Team, thereby transforming an issue that has already been addressed and dealt with, into an actionable violation without requisite substantiation. The SCN conspicuously lacks particulars regarding, inter alia, whether the Ld. AO was apprised of the Administrative Warning Letter dated September 27, 2023, issued by the Market Intermediaries Regulation and Supervision Department ("**MIRSD**") of SEBI ("**Administrative Warning**"), which was issued further to the same inspection forming subject matter of the captioned proceedings. There is also no mention of the consideration of all the submissions made by the Noticee to the Inspection Team*."

9.6. In this regard, I would like to note that the present proceedings have emanated from SEBI's inspection of the Noticee. The allegations forming part of the SCN have been arrived at after considering Noticee's response to the findings of inspection, wherein SEBI carried out post-inspection analysis after considering Noticee's response to the findings of inspection. Therefore, the Noticee's contention, "*There is also no mention of the consideration of all the submissions made by the Noticee to the Inspection Team"* is devoid of merit and hence not acceptable. Further, vide SEBI's email dated January 01, 2024, the Noticee was also informed that the subject matter of the instant proceedings and that of administrative warning were distinct.

Further, I note from the material available on record that after considering of Noticee's reply to the findings of inspection, the Noticee was issued administrative warning for the following discrepancies:

a) W.r.t. 8 clients, retention statement for quarterly / monthly settlement of client funds & securities was issued with a delay of 5 days.
b) Inspection of 3 branches (301, 311 & 326) having more than 500 active clients during the inspection period, was not carried out.

However, the subject matter of the allegation levied against the Noticee in the SCN is with respect to misutilisation of clients' funds. Therefore, the Noticee's contention, "*The SCN conspicuously lacks particulars regarding, inter alia, whether the Ld. AO was apprised of the Administrative Warning Letter dated September 27, 2023, issued by the Market Intermediaries Regulation and Supervision Department ("**MIRSD**") of SEBI ("**Administrative Warning**"), which was issued further to the same inspection forming subject matter of the captioned proceedings"* is evidently misplaced and /or out of context as the subject matter of the allegation levied against the Noticee in the SCN is distinct from the violations for which the Noticee was issued administrative warning.

In view thereof, the Noticee's contention is devoid of merit and do not require any further consideration.

9.7. The Noticee has interalia contented that, "*SCN is premised upon identical grounds that have been previously addressed by the Noticee before the Inspection Team, thereby transforming an issue that has already been addressed and dealt with, into an actionable violation without requisite substantiation".*

Further, the Noticee has submitted the following in response to the SCN:

"*The Noticee had, by its letter dated February 15, 2023 ("**Preliminary Response**"), responded to each of the findings of the Inspection Team, and had provided relevant information and documents to demonstrate that most of the findings were misplaced, and how there was no violation whatsoever on the Noticees' part. In fact, it was also demonstrated that it was the Noticee who had taken active steps to resolve the glitch caused in the system of the National Stock Exchange of India Limited ("**NSE**")".*

…

After providing the said response to SEBI, there was no further communication whatsoever received from SEBI by the Noticee. Therefore, the Noticee believed that all responses provided were to the satisfaction of the Inspection Team of SEBI, and that no further clarifications were warranted.

…

After conclusion of the proceedings vide the Administrative Warning, the Noticee is surprised to now receive the captioned SCN that seeks to not only re-open the proceedings that are already concluded, but also, converts the same issues into chargeable violations. Interestingly, various pertinent records including the Administrative Warning, and the complete details and submissions provided by the Noticee to the SEBI Inspection Team were not forming part of the SCN"

9.8. In this regard, I note that initiation of Adjudication proceedings under the appropriate provisions of SEBI Act is a prerogative of SEBI depending upon the outcome of such exercise viz., Inspection and findings thereof. It would also be relevant to state that the subject matter of instant proceedings are as per the Communique of appointment of AO, duly approved by the Competent Authority. Accordingly, the contention of the Noticee in this regard cannot be accepted.

9.9. The Noticee has also interalia contended that, "*It maybe pertinent to note that during Inspection, the Inspection Team had requested the Noticee to furnish the 'Enhanced Supervision data' for the entire month of January 2022 and had allowed the Noticee only a day's time, for providing the same. However, in such time the Noticee could only submit the system generated data and not the entire 'Enhanced Supervision data'. Therefore, the Inspection was conducted hastily without even obtaining complete records from the Noticee*".

9.10. I note from the material available on record that after the inspection, the findings of inspection were shared with the Noticee vide SEBI's letter dated January 27, 2023. Even if the Noticee's contention for time being is assumed to be true, in any case the Noticee was at liberty to provide additional information to SEBI at the time of providing its response to the findings of inspection. Therefore, I am of the opinion that the Noticee's above contention is devoid of merit and not acceptable.

9.11. Noticee in its submissions as reply to the SCN had inter alia cited the Hon'ble Securities Appellate Tribunal ('SAT') order dated 16.06.2011 in the matter of Religare Securities Limited Vs. SEBI (Appeal No. 23 of 2011) and placed reliance on the following text:

"*2. We have heard the learned Counsel for the parties who have taken us through the record and, in the circumstances of this case, we are inclined to exonerate the Appellant by giving it the benefit of doubt. We are clearly of the view that the inspection carried out by the inspecting team was faulty which compels us to give the benefit of doubt to the Appellant.*

… Only if the inspecting team at the time of inspection had made a query in this regard from the management, the reply would have then come and that would have made it clear whether the letters were then in existence or not. We would not have had to face the situation we are in. Again, if the letters were to be manufactured for the purpose of the defence, they would not have been left undated. In these circumstances, we cannot but give the benefit of doubt to the Appellant …

4. We have carefully perused the impugned order and find that all the deficiencies found by the adjudicating officer could have been adequately responded to by the Appellant if queries had been made by the inspecting team at the time of inspection. If this procedure/practice had been followed, there would have been no scope for an allegation that the supporting documents were subsequently prepared. It is not necessary for us to deal with each and every allegation as, in most of the cases, the adjudicating officer has refused to accept the stand of the Appellant on the ground that the supporting documents were not produced before the inspecting team. As already observed, the *inspecting team did not make any queries nor did it ask for the supporting documents at the time of inspection.*

9.12. I note from the material available on record that after the inspection, the findings of inspection were shared with the Noticee vide SEBI's letter dated January 27, 2023 and the Noticee had provided its reply to the findings of inspection vide letter dated February 15, 2023. After receiving the Noticee's reply to the findings of inspection, SEBI carried out post inspection analysis and it was observed/alleged clients' funds lying with the clearing corporation/clearing member (C-A) were more than the sum of credit clients' margin obligations (MC) and free collateral deposits available with the clearing corporation/clearing member (MF) for eleven trading days 07/01/22, 11/01/22 to 13/01/22, 17/01/22 to 20/01/22, 24/01/22 to 25/01/22 and 31/01/22 (positive J balance). Therefore, the Noticee's reliance on the above text is out of context as regards the current proceedings.

9.13. The Noticee has further relied upon the following text from the SAT order dated 16.06.2011 in the matter of Religare Securities Limited Vs. SEBI (Appeal No. 23 of 2011):

5. It must be remembered that the purpose of carrying out inspection is not punitive and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. We also cannot lose sight of the fact that every in or discrepancy/irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and making it compliant. This will, of course, depend on the nature of the irregularity noticed and we hasten to add a caveat that it is not being suggested that if any serious a lapse is found during the course of the inspection, the Board should not proceed against the delinquent."

In this regard, in my opinion each case is peculiar in its facts and circumstances based on which the violations are ascertained. Whether adjudication proceedings are to be initiated in a case would depend on the facts and circumstances of each case. I also note that, initiation of Adjudication proceedings under the appropriate provisions of SCR Act, 1956 is a prerogative of SEBI depending upon the outcome of such exercise viz., Inspection and findings thereof. It would also be relevant to state that the subject matter of instant proceedings are as per the Communique of appointment of AO, duly approved by the Competent Authority.

I also note from the text of Hon'ble SAT order dated 16.06.2011 that Hon'ble SAT had inter alia held that "… *This will, of course, depend on the nature of the irregularity noticed and we hasten to add a caveat that it is not being suggested that if any serious lapse is found during the course of the inspection, the Board should not proceed against the delinquent…".*

Further in this regard, I also note that the alleged violations in respect of the Noticee are of extant applicable provisions of law as are otherwise applicable to the entire category of intermediary viz., Stock broker in the instant case, and not just about minor procedural aspects specific to the Noticee. It is also noted that in the instant proceedings, the alleged violation does not pertain to certain procedural rquirements with respect to maintenance of records but alleged misutilisation of client's funds. Accordingly, the contention of the Noticee in this regard cannot be accepted.

9.14. The Noticee vide its letter dated January 29, 2024 as its reply to the SCN, has interalia contended that, "*It is submitted that under the Adjudicating Proceedings Rules, the learned AO is first required to issue a notice under Rule 4(1) calling upon the Noticee to respond to the allegations and thereafter based on the response provided frame an opinion / decide to hold an inquiry for which a Notice for hearing under Rule 4(2) is required to be issued. In the present case before even there was any reply and inspection proceedings were pending under the other parallel proceedings, the learned AO had already issued the notice for hearing. Such is the prejudice caused to the Noticee."*

9.15. In this regard, I note that in the instant matter the SCN was issued on December 14, 2023 and was delivered through digitally signed email on the same day. Subsequently, the Noticee vide email dated December 28, 2023 had submitted a preliminary response to the SCN and sought inspection of documents. The inspection of documents was provided and availed by the Noticee on January 04, 2024 for enquiry as well as the adjudication proceedings. Subsequently, after forming an opinion, the Hearing Notice was issued in the captioned matter on January 08, 2024 and the Noticee was provided an opportunity of being heard on January 16, 2024, which was rescheduled to January 19, 2024 at Noticee's request. Further, in this regard, I note that the Noticee had availed the inspection of documents on January 04, 2024 and the Hearing Notice was issued subsequent to the inspection proceedings. Therefore, the Noticee's contention, "*even there was any reply and inspection proceedings were pending under the other parallel proceedings, the learned AO had already issued the notice for hearing"* is conflicting / contradictory in nature as on one hand Noticee has raised objections with respect to mixing of enquiry and adjudication proceedings and on the other hand, the Noticee is stating, "*inspection proceedings were pending under the other parallel proceedings, the learned AO had already issued the notice for hearing"*. Further the Noticee's contention, "*Such is the prejudice caused to the Noticee"* cannot be accepted as the Noticee has not demonstrated as to what/ how any prejudice was caused to the Noticee in this regard.

9.16. The Noticee further submitted, "*if deemed necessary, the Noticee is prepared to submit comprehensive manual calculations for review and consideration".* In this regard, I note that it was for the Noticee to make submissions in full/ complete manner along with relevant documents in support. Further, I note that the Noticee vide its additional submissions dated January 29, 2024 had submitted the manual calculations of J value.

9.17. The Noticee has further contended, "*The Show Cause Notice is vague and the charging provision is invoked based on assumptions as is clear from para*

4.1.1 of the SCN where the words used is "possible". While the charging provision cannot be attracted based on mere assumption, it is submitted that even the assumption is incorrect."

Also, vide letter dated January 29, 2024 as reply to the SCN, the Noticee has also submitted that, "*It is pertinent to highlight that Section 23D of Securities Contracts Regulations Act, 1956 ("SCRA") specifically addresses failure to segregate or to mis-utilize securities or client funds. However, the allegation outlined in the SCN only alludes to a "possibility of mismanagement". Therefore, without prejudice to the submissions made herein, it may be noted that the Noticee cannot be charged under Section 23D of the SCRA, when the findings of the Inspection Team are only of a mere "possibility" of mis-utilization, while in reality there was no misutilization of clients' securities/ funds whatsoever".*

9.18. In this regard, I note that SEBI had prima facie alleged the violation with respect to positive value of J, on 11 instances against the Noticee. Based on observations of SEBI, the SCN was issued against the Noticee, wherein the Noticee is at liberty to defend itself before the undersigned. Hence, the submission of the Noticee is not acceptable.

9.19. The Noticee has contended, "*It is also relevant to note that the allegation which was earlier pointed out by Inspection Team on "G" being negative was also accepted by SEBI which only points out to good compliance and clear segregation of client funds and securities."*

9.20. In this regard, in my view the Noticee's contention is evidently misplaced and/or out of context as the allegation is not about "G" but is about "J" value being positive. Hence, the Noticee's contention is not acceptable.

10. I will now proceed to deal with the matter having regard to the submissions of the Noticee on merits:

Issue No. I: Whether the Noticee has violated Section 23D of SCR Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016?

11. In this regard, the following was inter alia observed and /or alleged in respect of the Noticee:

11.1. **Misutilisation of clients' funds:**

11.1.1. In this regard, it had inter alia been observed and alleged that clients' funds lying with the clearing corporation/clearing member (C-A) were more than the sum of credit clients' margin obligations (MC) and free collateral deposits available with the clearing corporation/clearing member (MF) for eleven trading days 07/01/22, 11/01/22 to 13/01/22, 17/01/22 to 20/01/22, 24/01/22 to 25/01/22 and 31/01/22 (positive J balance), which indicates possible misuse of clients' funds towards margin obligations of debit balance clients and proprietary margin obligations and the misutilization ranges from Rs. 3.05Cr to Rs. 21.69Cr. It was observed from the reply submitted by the Stock Broker, calculation of J is +ve in 11 out of 62 sample instances observed during inspection and the misutilization ranges from Rs. 3.05Cr to Rs. 21.69 Cr. Therefore, it was alleged that the Noticee had violated Section 23D of SCR Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016.

11.1.2. In this regard, I note that Section 23D of SCR Act, 1956 reads as under:

> *"…*
>
> ***Penalty for failure to segregate securities or moneys of client or clients.***
>
> ***23D.*** *If any person, who is registered under section 12 of the Securities and ExchangeBoard of India Act, 1992 (15 of 1992) as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be [121][liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.]*
>
> *…"*

11.1.3. Further, in this regard, I note that Clause 3 of Annexure of SEBI Circular

SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 reads as under:

"…

3. Monitoring of Clients' Funds lying with the Stock Broker by the Stock Exchanges

3.1.Stock Exchanges shall put in place a mechanism for monitoring clients' funds lying with the stock broker to generate alerts on any misuse of clients' funds by stock brokers, as per the guidelines stipulated in para 3.2 & 3.3 below.

3.2.Stock brokers shall submit the following data as on last trading day of every week to the Stock Exchanges on or before the next trading day:

A-Aggregate of fund balances available in all Client Bank Accounts, including the Settlement Account, maintained by the stock broker across stock exchanges
B-Aggregate value of collateral deposited with clearing corporations and/or clearing member (in cases where the trades are settled through clearing member) in form of Cash and Cash Equivalents (Fixed deposit (FD), Bank guarantee (BG), etc.)(across Stock Exchanges). Only funded portion of the BG, i. e. the amount deposited by stock broker with the bank to obtain the BG, shall be considered as part of B.
C-Aggregate value of Credit Balances of all clients as obtained from trial balance across Stock Exchanges (after adjusting for open bills of clients, uncleared cheques deposited by clients and uncleared cheques issued to clients and the margin obligations)
D-Aggregate value of Debit Balances of all clients as obtained from trial balance across Stock Exchanges (after adjusting for open bills of clients, uncleared cheques deposited by clients, uncleared cheques issued to clients and the margin obligations)
E-Aggregate value of proprietary non-cash collaterals i.e. securities which have been deposited with the clearing corporations and/or clearing member (across Stock Exchanges)
F-Aggregate value of Non-funded part of the BG across Stock Exchanges
P-Aggregate value of Proprietary Margin Obligation across Stock Exchanges
MC-Aggregate value of Margin utilized for positions of Credit Balance Clients across Stock Exchanges
MF-Aggregate value of Unutilized collateral lying with the clearing corporations and/or clearing member across Stock Exchanges

3.3.Based on the aforesaid information submitted by the stock broker, Stock Exchanges shall put in place a mechanism for monitoring of clients' funds lying with the stock brokers on the principles enumerated below:

…

3.3.3.Funds of credit balance clients used for Margin obligations of debit balance clients and proprietary trading:

Stock Exchanges shall thereafter, verify whether the clients funds lying with the clearing corporation/clearing member are utilised towards margin obligations of debit balance clients and proprietary margin obligations.

Principle:

The clients' funds lying with the clearing corporation/clearing member should be less than or equal to sum of credit clients' margin obligations (MC) and free collateral deposits available with the clearing corporation/clearing member (MF)

If value of G is negative (i.e. A+B < C), then fund lying with the clearing corporation/ clearing member (B) is entirely clients' fund. In such cases, Bis compared with Margin obligations of credit balance clients and the free deposits available with the clearing corporation/ clearing member. The value of J is calculated as under:

J = B -(MC + MF)

If value of G is positive (i.e. A+B > C), then fund lying with the clearing corporation/clearing member (B) may contain proprietary and clients' fund. Hence, the value of clients funds lying with the clearing corporation/ clearing member i.e. (C-A)shall be considered in the place of B.

In such cases, (C-A)is compared with Margin obligations of credit balance clients and the free deposits available with the clearing corporation/clearing member. The value of J, which is clients' funds utilised towards margin obligations of debit balance clients and proprietary margin obligations, is calculated as under:

J = (C -A) -(MC + MF)

The value of J, if positive, indicates the extent of clients' funds utilised towards margin obligations of debit balance clients and proprietary margin obligations. This value of J acts as an alert to the Stock Exchanges on the possible mis-utilisation of clients' funds towards margin obligations of debit balance clients and proprietary margin obligations.

3.4.Based on the alerts generated, Stock Exchange shall, inter-alia, seek clarifications, carry out inspections and initiate appropriate actions to protect the clients' funds from being misused. Stock Exchanges shall also maintain records of such clarifications sought and details of such inspections. The aforesaid calculations are illustrated in tabular format in Table 1, 2 & 3 given at the end of the annexure.

3.5.Stock Exchanges shall put in place the aforesaid monitoring mechanism within three months from the date of this circular and carry out the monitoring of clients' funds for all stock brokers, except for those who are carrying out only proprietary trading and/or only trading for institutional clients.

3.6.Stock Brokers shall ensure due compliance in submitting the information to the Exchanges within the stipulated time

…"

11.1.4. In this regard, I note that the Noticee's submissions are in nature of admission in so far as the Noticee has submitted, "*J alerts in the month of January 2022 had occurred on account of the above stated ambiguity caused by the NSE Circular in the mind of the software vendor"* vide letter dated January 15, 2024 and "*The client balances were wrongly reported by the software vendor due to its misinterpretation of the NSE Circular"* vide letter dated January 29, 2024.

11.1.5. In this regard, I note that as per the Noticee the violation had occurred due to misinterpretation of NSE circular by the backend software vendor. Further in this regard, I note that the NSE Circular NSE/INSP/50012 dated October 19, 2021 became applicable with effect from the submissions for the week ended January 07, 2022. Therefore, it was for the Noticee to ensure compliance and take all necessary steps accordingly, during the intermittent period, say for example, back testing and check it for correctness etc. Further, as per the aforesaid NSE Circular, the obligation to comply was of the Noticee as it was for the Noticee to ensure compliance. Accordingly, the contention of the Noticee with respect to the vendor is devoid of merit.

11.1.6. The Noticee has further interalia contended that, "*this is not a case of misutilization of client funds, but an incorrect reporting caused due to disconnect at the software vendor's end in adopting the updated system of reporting of the Exchange.*"

11.1.7. In this regard, I note from Annexure A of the Noticee's submission dated January 29, 2024 that as per the Noticee's own manual calculations of the J value, J value is positive in 5 out of 11 instances. I note that the SEBI Circular dated September 26, 2016 states that, "The value of J, if positive, indicates the extent of clients' funds utilised towards margin obligations of debit balance clients and proprietary margin obligations". Therefore, the Noticee's contention that "*this is not a case of misutilization of client funds, but an incorrect reporting…"* is devoid of merit and contradictory in nature. Hence, the Noticee's contention is not acceptable.

11.1.8. The Noticee, vide its submissions dated January 15, 2024, has interalia submitted that, "*it is firstly submitted that the Noticee on no occasion accepted that there was any misutilisation of funds whatsoever. In fact, in its Preliminary Response, the Noticee clarified that the J alerts in the month of January 2022 had occurred on account of the above stated ambiguity caused by the NSE Circular in the mind of the software vendor, which was eventually proactively resolved by the Noticee. The Noticee had even submitted manual calculations for the same [Ref: Supporting 2 to the Preliminary Response of the Noticee]"*

11.1.9. I note from the Noticee's reply to the findings of inspection dated February 15, 2023 that Noticee had submitted, "*If we consider the manual calculation done by us there is hardly a few instances of 'J' alert in the months of January, (Enclosed sheet of manual calculation Reference Supporting 2)*".

11.1.10. On perusal of the above submissions of the Noticee, I am of the opinion that the Noticee's submission was in the nature of admission. Therefore, in my opinion SEBI had rightly mentioned in the post-inspection analysis, also alleged in the SCN subsequently, that the Noticee has accepted misuse of funds of credit balance clients for own purposes or for debit balance clients.

11.1.11. The Noticee has submitted that, *"…on December 28, 2023, the representatives of the Noticee received a call from NSE officials, who confirmed to the Noticee that the MG01_02 file is required to be referred to while determining the value of free collateral specifically the "balance available", instead of the MG01 file as could be interpreted from the Circular…",* which was also confirmed by SEBI. Therefore, I am inclined to give benefit of the doubt to the Noticee in this regard. I note that as per Noticee's calculation J was positive in 5 out of the 11 instances viz., 07.01.2022, 11.01.2022, 12.01.2022, 24.01.2022 and 25.01.2022.

11.1.12. The Noticee, in its submissions dated January 15, 2024, has interalia submitted that, "*In respect of the alert on March 7, 2022 where the J was alleged to be positive, the Noticee even submitted the recalculation, considered in the correct method, to in fact show a negative J of - Rs. 12,37,42,471.01/-".*

11.1.13. I note that the SCN does not allege violation with respect to J value on March 07, 2022 and hence, the Noticee's submission is out of context as regards the current proceedings.

11.1.14. The Noticee vide its letter dated January 29, 2024 has submitted that, "*it may also be noted that the proprietary surplus maintained by the Noticee always exceeded the mandated proprietary margin obligation. Out of the 11 days that are impugned in the SCN, on 8 days, the proprietary surplus far surpassed the debit margin clients*

….

the Proprietary account had enough surplus to meet any shortfall in the debit balance clients' margin requirement."

11.1.15. In this regard, I note that the Noticee has not substantiated with complete details along with relevant supporting documents as to how out of the 11 days, on 8 days, the proprietary surplus surpassed the debit margin clients. Further, as regards proprietary account having enough surplus, I note that as per Noticee's calculation the value of J was positive on 5 out of 11 instances, which, as per SEBI Circular dated September 26, 2016 indicates clients' funds were utilised towards margin obligations of debit balance clients and proprietary margin obligations. Hence, the Noticee's submissions are devoid of merit and are not acceptable.

11.1.16. In view thereof, I note that the Noticee has admitted to "J" value being positive on 5 instances viz., 07.01.2022, 11.01.2022, 12.01.2022, 24.01.2022 and 25.01.2022, which as per SEBI Circular dated September 26, 2016 indicates the extent of clients' funds utilised towards margin obligations of debit balance clients and proprietary margin obligations.

Accordingly, I find that the allegation that the Noticee has misused of clients' funds towards margin obligations of debit balance clients and proprietary margin obligations, stands established. Therefore, I hold that the Noticee has violated Section 23D of Securities Contracts (Regulation) Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016.

Issue No. II: If yes, whether the Noticee is liable for imposition of monetary penalty under Section 23D of Securities Contracts (Regulation) Act, 1956?

12. It has been established in the foregoing paragraphs that Noticee had violated provisions of Section 23D of Securities Contracts (Regulation) Act, 1956 read with Clause 3 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016.

13. The Noticee has also raised contention that, "…*There was a mere glitch in the technological system and no investor was harmed whatsoever*

…

Noticee has at all times remained compliant with the all the guidelines, rules, regulations and other applicable law

…

Noticee has neither retrieved no benefit from the alleged violations, nor has it made any profit therefrom

...

no investor complaints are also received by the Noticee for the alleged actions…"

In this regard, in my view said contentions would not exempt the Noticee from complying with the extant applicable provisions of securities laws violated, which Noticee was required to comply with and can at best be considered as mitigating factors.

In this regard, the Noticee has cited the following orders of Hon'ble Securities Appellate Tribunal's ("SAT") viz., Neha Nilesh Patil vs. SEBI, [Appeal No. 688 of 2021], State Bank of India vs. SEBI [Appeal No. 304 of 2020], Ashok Dal & Oil Mills vs. SEBI [Appeal No. 254 of 2022], P.G. Electroplast Ltd. & Ors. vs. SEBI [Appeal No. 281 of 2017]

In this regard, I note that each matter is peculiar in its facts and circumstances based on which the violations are ascertained. Noticee has merely cited and mentioned about the Orders, however, the Noticee has neither demonstrated as to how the cited orders was applicable in the instant matter nor demonstrated as to what are the relied upon findings in the respective orders which have a bearing on the alleged violations against Noticee in instant matter. In this regard, I am of the opinion that facts and circumstances of each matter are unique in nature and are accordingly dealt with and decided. Hence, any generic parallel drawn would be devoid of merit. Further in this regard, I note that the alleged violations by the Noticee were of the extant applicable provisions of law that were otherwise applicable to that entire category of the intermediary viz., SEBI Registered Stock Brokers and not just about minor procedural aspects specific to the Noticee.

14. In this regard, it is noted that the Hon'ble Supreme Court of India in the matter of SEBI v/s Shri Ram Mutual Fund [2006] 68 SCL 216(SC) inter alia held that:

> *" ... In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established .... "*

15. Therefore, for the above violations, as brought out in the foregoing paragraphs, I find that the Noticee is liable for monetary penalty under Section 23D of the SCR Act, 1956, which reads as under:

> "…
>
> ***Penalty for failure to segregate securities or moneys of client or clients***

If any person, who is registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be [121][liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.]

…"

Issue No. III: If yes, what would be the monetary penalty that can be imposed upon the Noticee?

16. While determining the quantum of penalty under Section 23D of the SCR Act, 1956 it is important to consider the factors as stipulated in Section 23J of the SCR Act, 1956, which reads as under: -

"………..
Factors to be taken into account while adjudging quantum of penalty.
23J. While adjudging the quantum of penalty under [138][section 12A or section 23-I], the [139][the Securities and Exchange Board of India or the adjudicating officer] shall have due regard to the following factors, namely:—
(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
(b) the amount of loss caused to an investor or group of investors as a result of the default;
(c) the repetitive nature of the default

Explanation.—For the removal of doubts, it is clarified that the power of an adjudicating officer to adjudge the quantum of penalty under sections 23A to 23C shall be and shall always be deemed to have exercised under the provisions of this section
…………...
"

17. In the instant case, I note that the material available on record does not quantify any disproportionate gain or unfair advantage or consequent loss caused to investors as a result of the violations committed by the Noticee. Further, there is nothing on record to show that the violations committed by the Noticee are repetitive in nature. However, I cannot ignore the fact that Noticee being a SEBI registered Stock Broker was required to comply with the extant applicable provisions of laws, which it failed to and SEBI is duty bound to enforce. The Noticee failed to comply with the provisions of law, as brought out in the foregoing, and such failure and/or non-compliances accordingly needs to be dealt with suitable penalty.

E. ORDER

18. After taking into consideration the facts and circumstances of the case, material available on record, submissions made by the Noticee and also the factors mentioned in the preceding paragraphs, in exercise of the powers conferred upon me under section 23-I of the SCR Act, 1956 read with Rule 5 of the Securities Contracts (Regulations) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005, I hereby impose penalty of Rs. 1,00,000/- (Rupees One Lakh Only), on the Noticee, for the aforementioned violation, as discussed in this order. In my view, the said penalty will be commensurate with the violations committed by the Noticee in this case.

19. The Noticee shall remit /pay the said amount of penalty within 45 days of receipt of this order through online payment facility available on the website of SEBI, i.e. www.sebi.gov.in on the following path, by clicking on the payment link:

    ENFORCEMENT → ORDERS → ORDERS OF AO → PAY NOW

20. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, SEBI may initiate consequential actions including but not limited to recovery proceedings under Section 23JB of the SCR Act, 1956 for realization of the said amount of penalty along with interest thereon, inter alia, by attachment and sale of movable and immovable properties.

21. In terms of the provisions of Rule 6 of the SCR Rules, a copy of this order is being sent to the Noticee and also to the Securities and Exchange Board of India.

DATE: March 28, 2024
PLACE: MUMBAI

AMAR NAVLANI
ADJUDICATING OFFICER