
(2003) 10 AP CK 0030

In the Andhra Pradesh High Court

Case No : Writ Petition No's. 23584, 25746, 25758, 25762, 25776, 25805 and 25806 of 2000 and 6741 of 2001

P. Ravinder

APPELLANT

Vs

National Stock Exchange of India Ltd.

RESPONDENT

Date of Decision : 21-10-2003

Acts Referred:

Constitution of India, 1950 — Article 226
Securities Contracts (Regulation) Act, 1956 — Section 13, 15, 9

Citation : (2004) 121 CompCas 275 : (2004) 4 CompLJ 201 : (2004) 49 SCL 43

Hon'ble Judges : T. Ch. Surya Rao, J;J. Chelameshwar, J;Bilal Nazki, J

Bench : Full Bench

Advocate : M. Ramgopal Rao, S. Ravi, Y. Rama Rao, S. Satyam Reddy and M. Ram Mohan Rao, for the Appellant; P. Murali Krishna, P.V.S.S.S. Rama Rao, K. Suresh Reddy and Y. Ratnakar, for the Respondent

Judgement

Bilal Nazki, J.—This is a reference made by a Division Bench of this Court. When the matter was argued before the Division Bench it was contended that by-law 5(a) of National Stock Exchange Ltd., was ultra vires. It was also specifically pleaded in Writ petition No. 25806/2000 that by-law 5(a) was ultra vires. There was an earlier judgment with respect to vires of bylaw 5(a) of National Stock Exchange Ltd., therefore it was thought necessary to refer the matter to Full Bench.

2. At the outset, the learned counsel appearing for the petitioners in one of the Writ petitions stated that he is giving up challenge to by-law 5(a), therefore, we are not going into the question of legality or vires of by-law 5(a) of National Stock Exchange Ltd.

3. The reference was also made because it was thought by the Division Bench that annulment of transactions has been ordered by the respondents for the first time in the country and no precedents are available. In this background the reference was heard. Facts have been narrated in detail in the order of reference

but for the purpose of this judgment they will have to reiterated.

4. In all the Writ petitions, circular dated 21-11-2000 annulling all trades executed during settlement No. 27 in respect of shares of Maruti Organics Limited has been challenged. The facts which were mentioned by the Division Bench were taken from one of the Writ Petitions being W.P. No. 23584/2000. The facts may be summarised thus.

5. The petitioners deal in securities like shares, debentures and other instruments. They purchased shares of Maruti Organics Ltd. (hereinafter referred as MOL) during the period of various settlements by 1st respondent. They purchased and sold MOL shares. It is stated that, in all Stock Exchanges, sales and purchases of securities are being settled by the Stock Exchange. They are settled in block periods. The period is called "settlement period" and is usually a week. The 1st respondent at the beginning of the year 1996 had notified 52 settlements and the period from 3-7-1996 to 9-7-1996 had been notified as settlement No. 27. As per the settlement calendar for settlement No. 27 the date for pay-in was 16-7-1-996 and the date for pay-out was 17-7-1996, That would mean that the investors and trading members who purchase the shares through a trading member of respondent No. 1 had to pay-in for the shares as per the confirmatory note by 16-7-1996 and those investors who had sold through trading members would be able to get the amount by 17-7-1996. The respondents 4 and 5 in the present Writ Petition were the members of the 1st respondent and they had obtained registration u/s 12 of the Securities and Exchange Board of India Act (hereinafter referred as "SEBI Act") from 3rd respondent. During the settlement period 26-6-1996 to 2-7-1996 the petitioners purchased a large number of shares and also sold large number of shares of MOL for a negligible margin of Re. 1.00 on each share. There were no complaints by anybody. It is further submitted that the 1st respondent had evolved a method of trading called "NEAT" (National Exchange for Automated Trading) which was a software in the computer technology. The system generates an "order confirming slip" when an order is placed and such transaction can mature only when the quotation for buy transaction and the quotation for the sale transaction are matched by the computer at Mumbai. In this method the seller or buyer who go to a trading member will not be knowing who are the purchasers or sellers of the shares. Nobody can have even any complaint because of the fool-proof computer aided trades in securities. About 14 trading members complained to the 1st respondent that some of their clients who had placed purchase orders for the shares of MOL, during the trading period of settlement No. 27 were absconding and hence the trades should be annulled. The same trading members as per their complaints to the National Stock Exchange (hereinafter referred as "NSE") themselves admitted that these absconding clients had not been introduced properly with known sources of taking deposits and margins. Although the same trading members had made profits in MOL in 25th and 26th settlements, they suffered loss in 27th settlement on account of prohibition introduced by the Andhra Pradesh Government. The same persons lobbied with NSE and got

cancelled the MOL transactions to cover their losses. It is submitted that such complaints are common phenomenon in all the Stock Exchanges. With regard to MOL, complaints made by NSE trading members to the NSE, the NSE cleared the pay-in and pay-outs in such a manner that NSE had shielded its own buying brokers by not collecting the full pay-in and had suppressed the fact and are now trying to help them by cancelling the transactions at the cost of investors. All the complaints made by the buying members are similar in content and even styled alike and that all the complaining members have unitedly lobbied with the NSE. They bought their shares in anticipation of rise in price but when they could not achieve their objective they came up with complaints. On 11-7-1996 the respondent No. 1 issued a broadcast to its members which reads as follows:

"All trading members are hereby informed that the settlement obligations for normal settlement for 1996027 will not include the trades executed in Maruti Organics Limited between 3-7-1996 and 9-7-1996. Special settlement No. 196011 is being conducted for trades executed in Maruti Organics Limited between 3-7-1996 and 9-7-1996. The pay-in of securities will be held on Monday 15-7-1996 and pay-out of funds on Tuesday 16-7-1996. The pay-out securities and funds will be withheld by the Exchange until the investigation is completed."

The broadcast message was challenged before this Court in W.P. No. 13973 of 1996 and W.P. No. 14035 of 1996 on the ground that the action was without jurisdiction and that the same was unreasonable, arbitrary and irrational. The learned Single Judge disposed of the Writ petitions directing the 1st respondent to take a final decision with regard to settlement No. 27 with respect to trades relating to scrip of MOL within a period of two months. A Writ Appeal was filed which was also dismissed by the Division Bench. Thereafter, the 1st respondent got an enquiry done into the complaints made by 12 trading members who could not meet their settlement obligations. It is submitted that the enquiry did not indicate any trading member or broker. In fact, except in NSE in all other Stock Exchanges in India the trades of shares of MOL were settled. It is submitted that the trading members who gave complaints to NSE brought pressure on respondents 1 and 2 to annul the shares of MOL which were traded with them during settlement No. 27 and as a result the impugned circular dated 11-1-1997 was passed. In the said circular the 1st respondent informed that as per the request of the complaining trading members the NSE has decided to annul the trades in respect of which complaints had been received. The second respondent consequently issued letter on 21-1-1997 to respondents 4 and 5 and all other trading members enclosing a list of the trade done by respective trading members which were annulled and further enclosed a revised settlement obligation statement. In this letter the petitioners had been asked to take back delivery of the shares they sold to respondents 4 and 5 and also pay-in in respect of the shares which they had purchased. Aggrieved by these orders of respondents 1 and 2 the petitioners and other investors approached the Hon'ble High Court of A.P. by way of W.P. No. 1800 of 1997 and batch. The respondent No. 1 filed its counter and also filed a report on the basis of which the decision

was allegedly taken to annul only some of the trades. It is submitted that the report did not give any categorical finding either on the question of fraud or on the question of the person who was responsible for such fraud. After hearing both sides the High Court on 27-4-2000 quashed the annulment of the trades and directed the 1st respondent to make proper enquiry after serving a copy of the material which would be used by them in the enquiry on the petitioner and all other persons who were affected by the annulment. The High Court gave two months time to complete the enquiry. The 1st respondent thereafter sent a set of papers including their earlier report and a fresh report said to have been prepared in August, 2000. It is submitted that the fresh report was essentially an analysis of earlier material and analysis of the trades. On the basis of this analysis the 1st respondent sought to arrive at the conclusion that there was some sort of manipulation of the market. The petitioners had filed their objection to the material as well as the reports relied upon by the 1st respondent. Subsequently, the 1st respondent organized a public hearing where members of a committee of the 1st respondent interacted with both the complaining members as well as the other participating members and the investors. On 23-11-2000 the petitioners came to know that the 1st respondent issued a circular dated 21-11-2000. In this circular the 1st respondent had informed its members that all trades relating to the shares of MOL, in settlement No. 27 of 1996 have been annulled. It is submitted that the decision is arbitrary, illegal and unjustified, it is not based on any cogent evidence or material and it is also violative of fundamental rights guaranteed under Articles 14, 19(1)(g) and Article 300(A) of the Constitution of India. This circular has now been challenged in these Writ petitions.

6. In support of the plea that the circular issued by the 1st respondent on 21-11-2000 was illegal and unjustified various contentions have been raised. The first contention was that there was no evidence and it was a case of no evidence. The second contention was that the respondent No. 1 had no authority to annul the settlement under any Act or any law. The third contention was that, having accepted some of the trades in the earlier circular the 1st respondent could not seek annulment of all the trades in the impugned circular. Initially the sale of 50,800 shares by the petitioners in settlement No. 27 was accepted and the sale of 19,02,000 shares were annulled and by virtue of the impugned circular the sale of 50,800 shares which were earlier accepted have also been annulled.

7. Coming to the first argument and first point whether there was any evidence or not, the learned Senior Counsel Mr. Rafiq a Dada appearing for the respondents submitted that there is evidence which was made available to the petitioners, they were heard and thereafter the decision was taken. The whole thing started with complaints to the National Stock Exchange Ltd., (hereinafter referred as NSEL), We are not referring to all the complaints but some sample complaints will have to be referred to. On July 6, 1996 one letter was written on behalf of Param Finance & Securities Ltd., to one Shri R.H. Patil, Managing Director, NSEL. This letter is reproduced.

"PARAM FINANCE & SECURITIES LTD. STOCK & SHARE BROKERS MEMBER :
NATIONAL STOCK EXCHANGE OF INDIA LTD. SEBI Regd. No. INB 230752136

July 6, 1996

Personal Attn : Shri R.H. Patil Managing Director

The National Stock Exchange Ltd., Mahindra Towers, "A" wing, 1st floor, RBC
Worli, Mumbai-400018

Dear Sir,

Sub: Fraud in Maruti Organic Scrip on NSE - Request to declare all transactions
from Settlement No. 27 null & void.

Ref: Trading Member ID No. 07521

As a member of NSE, we are one of the victims of the fraud/scam committed by
a well-orchestrated price rigging operation along with certain people in the guise
of clients, who helped the rigging operators.

One Mr. V- Prabakar, who is one of the culprits associated with the operators,
purchased Maruti Organic shares as under:

On 3/7/96 80,000 shares On 4/7/96 35,000 shares Total 1,15,000 shares

(i.e. equivalent to 10% of the outstanding). Our office staff executed his
purchase orders in goodfaith. He is absconding and his whereabouts is not
known. Similarly the group has operated in different names in different centres
and promptly deposited the convincing margin moneys required by the NSE
brokers and built-up confidence in very short term and absconding by giving
fictitious address for communication and fictitious addresses in each of the
payment of the bankers cheques bought at various branches within the
respective cities.

On going through the facts of the operation of Mr. Prabhakar with us and in
different names with other brokers in Hyderabad and Madras, we are of the
opinion that this is a calculated scheme of Crime from the operators or someone
with the intent to cheat.

We strongly feel that if you take up the matter personally for investigating the
purpose and people behind this kind of fraudulent operation to make unlawful
gain by examining the books of the delivering brokers and impounding the
credits accruing in Settlements S/Nos. 25, 26 & 27 so that the actual culprit can
be traced. We intend to make a personal visit to meet you, to explain to you the
modus operandi of the calculated fraud they way in which this scrip was operated
and seek your help to sort out this problem.

We are enclosing herewith a sheet showing the calculated scheme of crime.

Thanking you, Yours faithfully, For Param Finance & Securities Ltd. Sd/- M.C.

Paramashivaiah Managing Director."

"PARAM FINANCE & SECURITIES LTD. STOCK & SHARE BROKERS MEMBER : NATIONAL STOCK EXCHANGE OF INDIA LTD. SEBI: Regd. No. INB 230752136
Our understanding of the schemers in this scrip of the intention of calculated fraud to wealth by unlawful operation.

Maruti Organics scrip on NSE terminal:

Schemer creating buying demand as under

Schemers selling against created artificial demand

Send x, y, z, in the guise of clients to innocent NSE members at centers like

Through NSE brokers (may be one or more centre all over India)

1. Hyderabad

2. Madras

3. Bangalore

4. Other centres

Pay convincing margin moneys (around 10%) at all the centres and built confidence with all the brokers to execute the big purchase quantities and abscond with the intention of not ?"fting the deliveries.

Now the schemed sellers will walkout of the operation in the scrip by unloading the targeted quantity by collecting the full money.

Note : For your ready information, the actual trading on

3/7/96 7,77,300 shares (Av. Mkt. Rs. 56) 4/7/96 5,17,000 shares (Av. Mkt. Rs. 57) 5/7/96 50,600 shares (no buyers) The volumes/price traded will speak of the way in which the schemed operators have walked out from the scrip in the market, after making unlawful profit."

Similar letters were written by some other parties also. One of the grievances of the petitioners is that the complaints are almost identical and have been written almost on the same date, some complaints from Mumbai, some from Chennai, some from Hyderabad and some from Bangalore. It is submitted that these complaints are manipulated because the complaints are not only identical but even the language is identical. The learned Senior Counsel submits that much cannot be read into the similarity of the complaints because of the fact that when various parties have dealt it in the name of the same company it is not unusual that they consult each other before making the complaints and it is not difficult in these days to contact each other within minutes from one city to the other city. After these complaints were made, the Stock Exchange started inquiring into the matter to which a reference has been given while narrating the facts.

8. Now, the case of the petitioners is that it was a case of no evidence as regards manipulation or fraud. We are conscious that this is not a Court of Appeal therefore our enquiry would be limited to seeing whether there was any evidence and if there was evidence then the Court will have to agree with the respondents, but if it is found that it was a case of no evidence then, of course, the matter would be different.

9. The report of investigation in the matter of trading of MOL is contained in Annexure-R5 from page-157. It starts with these words :

"It has been brought to the notice of the Exchange by various trading members that a group of persons were putting through substantial transactions in Maruti Organics, a Hyderabad based company, through a number of trading members to manipulate the market. The modus operandi alleged has been for a person approach a trading member to transact in the security, pay up the relevant margin amounts, built up confidence through small transactions and then take large positions....."

In page-160 it notes; "The net position in this scrip in settlement No. 27 was 8,79,200 shares (as far as buying was concerned). As far as sale was concerned, for the same settlement it states that, "only 3 trading members contributed to 84% and 10 trading members contributed to 96% of the net sell position." The names of the top 3 trading members, the cities from which they deal and their net sale position has been mentioned as under:

Member name	City	Net sell position
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Merfin India Ltd.	Hyderabad	3,35,700
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Nagarjuna Securities	Hyderabad	2,35,300
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Classic Share & Stock Broking Services	Bombay	1,22,800
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Total		6,93,800
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It is stated that, while Merfin India Ltd. had 55 clients dealing in Maruti Organics, Nagarjuna Securities had 14 clients. Classic Share & Stock Broking Services had 2 clients. It is also stated that, while selling trading members were few and concentrated, there were a large number of selling clients. On the buying side the document disclosed that, in settlement No. 27, only 7 trading members contributed to 64% of the net buy position. The names of the trading members, the cities from which they deal and their net buy position was also mentioned as under:

Member name	City	Client name	Qty.
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Param Finance	Bangalore	V Prabhakar	1,15,000
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Arcadia Share & Stock		V Prabhakar	75,000
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Artistic finance	Delhi	Raj Kumar	1,10,000
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Maheshwari Tech Arun Kumar 84,600

Somayajulu & Co.Ltd. Mumbai/ Chennai Sadashiv Madhav Madhuri 80,500

Springfields Securities Hyderabad P. Raju 54,800

Arvind Securities Madhav Narla 45,000

Total 5,64,900

Then, a relative position of settlement Nos. 26 and 27 is given which is also reproduced :

Name of the Member City Settlement No. 1996026

Settlement No. 1996027

Gross Net Gross Net

Merfin India Ltd Hyderabad 17.12,300 51,700 5,37,700 (-) 3,35,700

Nagarjuna Securities Hyderabad 5,48,900 23,700 2,98,500 (-) 2,35,300

Artistic Finance Delhi 2,33,600 0 1,90,400 (+) 1,10,000

Classic Share & Stock Bkg. services Mumbai 82,900 - 23,900 1,27,800 (-) 1,22,800

Brilliam Securities Hyderabad 2,06,800 10,000 53,000 (-) 40,000

Param Finance Bangalore 1,25,800 - 3,200 1,38,500 (+) 1,28,300

Client analysis has also been given as under:

"Client analysis

i. The top three trading members namely Merfin India, Nagarjuna Securities and Classic Share & Stock Broking Services have a common client, M.K. & Co., M.K. Securities (both these share a common address). The net sell position of this client (2,39,600 shares) of these clients constituted 35 per cent of the total net sell position of these three trading members (6,93,800 shares) and 27 per cent of the net market position.

ii. The list of clients of Merfiri India Ltd. included certain names with almost similar addresses, giving room to suspicion as to their veracity. The total net sell position of these clients as referred above, amounted to 98,600 shares which was 29 per cent of net sell position of Merfin India Ltd, and 11 % of the net market position.

iii While Classic Share and Stock Broking Services does not have any office in Hyderabad, both the clients of this trading member are from Hyderabad. The two clients of Classic Share and Stock Broking Services were M.K. Securities and Pennar Patterson Securities (WDM trading member).

iv. In respect of two trading members with net buy position, namely Param Finance and Arcadia Share and Stock Brokers, the client was one and the same, namely V. Prabhakar (net buy position of 1,90,000 shares). Mr. V. Prabhakar appears to have dealt only with Maruti Organics and he appears to be the major client of these trading members for this script. Mr. V. Prabhakar is absconding.

v. In respect of Somayajulu, while the trading member is operating from Madras and Bombay, all the three clients are from Hyderabad.

Then an investigation was made into phone calls. It is stated that, Arvind Securities, one of the trading members on the buy side, had reported that their client in respect of Maruti Organics Limited who has since absconded, made various phone calls from a local public booth on July 3, 1996 and July 4, 1996. The calls were identified as under:

Hyderabad:

Sl. No.	Telephone Nos.	No. of calls	No. belongs to
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1	3322450	22	Value Line Securities
2	243944	6	Brilliant Securities
3	243267	5	Brilliant Securities
4	311412	2	Rarnakrishna Equity Fund
5	7616307	11	Springfields
6	203188	2	CIL Securities

Madras:

Sl. No.	Telephone Nos.	No. belongs to
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1	4995769/4900374/8274589/52227571	Arvind Securities
2	8258388/8259176/ 8231552/8230577	Zen Securities

At page-171 the details of trading members from whom complaints have been received in respect of Maruti Organics Ltd., has been given. Our attention has also been drawn to another report which was prepared after the investigation conducted pursuant to the orders of the Hon"ble High Court in the earlier Writ petition. Under the caption "Sellers" while referring to "Nagarjuna Securities Limited", the report stated :

"A scrutiny of the ledger account of M.K. Securities Ltd,, also revealed a net debit of Rs. 15,85,800 (credit of Rs. 30,29,250 and debit of Rs. 46,15,050 for transactions of two different dates namely Jan 1, 1997 and March 1, 1997 but under the same bill No. 4610 dated March 11, 1997) for 15,000 shares of Reliance Industries Ltd. Initially the member had stated orally that the transaction represented certain carry forward deals in respect of the client at

Pune Stock Exchange. However, subsequently contract notes of Hyderabad Stock Exchange were forwarded to the Exchange vide their letter dated July 7, 2000, the nature of the transaction and the details thereof could not be provided by the member to the investigation team."

Summary of investigation of the Sell side was also given as under :

SUMMARY OF FINDINGS ON INVESTIGATION OF THE SELL SIDE

(a) Nexus between major seller clients and the selling members is indicated by (1) common holdings between M.K. Securities Ltd., M.K. & Co. and B.R. Securities, Mr. Y. Ravi Prasad, a common director of Valueline Securities Ltd., M.K. Securities Ltd. (selling clients) and Merfin (I) Limited, (major selling member). For further details please refer to the old report submitted in 1996. (2) The agreements entered into by Merfin (I) Ltd., were neither in the format nor reportedly executed in front of director (Mr. Nagabhushan Rao of Merfin (I) Limited) though it is stated so in the document. (3) Large acquisition of MOL shares by Nagarjuna Securities Limited apparently subsequent to the suspension of the scrip, indicating the presence of certain extraneous financing transactions.

(b) Nagarjuna Securities Limited vide their letter dated June 13, 2000 has stated that their shareholding of 2,54,100 shares in Maruti Organics Limited arose of company purchases of 1.33 lakhs shares of MOL from M.K. Securities vide contract note of Hyderabad Stock Exchange dated March 20, 1997 and 1.21 lakhs shares taken as collateral security. Though the security was not suspended in HSE the member had done an off market deal and also could not provide any evidence of reporting the same to the concerned exchange. The member had stated that the shares were purchased at the rate of Rs. 2,05p. However, the reasons for such purchase at this stage and the method of arriving at the price of Rs. 2.05p, documentary evidence for delivery etc., could not be explained/provided.

(c) The contradictory replies provided by the other selling clients of Merfin (I) Ltd. during the investigation and the lack of any evidence for the purchase of the shares of Maruti Organics Ltd., earlier, which they have currently sold, lack of awareness about the formalities like transfer deeds or signing of transfer deeds etc., the member entering only 10 selling client codes as evidenced by the order log, though he had stated that there were around 55 clients, contradictory reply of the introducer leaves an impression that both the clients and the introducer were only a facade and not genuine.

(d) Nagarjuna Securities Ltd. had made advances to the M.K. group which were outstanding for a long period of time. 1, 21, 100 shares of MOL along with certain other shares belong to Mr. Ch. Mohan Rao were taken by the member as security and risk containment measure due to the deferment of the (sic) 1996027. In such circumstances it is not clear (sic) aforementioned 1,33,000 shares of MOL were (sic) as collateral.

(e) To (i) may not be necessary.

10. With regard to "Buyers" the report dealt with region-wise. One Mr. V. Prabhakar appears to be a client who had purchased a majority of shares, he is not traceable. In the report, while referring to "Arcadia Share & Stock Brokers Pvt. Ltd.", it is stated :

"Enquiry with the trading member had revealed that the trades were executed on the account of a client Mr. V. Prabhakar at their trading terminal located at Bangalore. The address of the client was at Creative Constructions, 25, Vinayaka Layout, Whitefield, Bangalore 560066, The client had a pager No. 9624-226175.

The trading Member stated that the client approached their Bangalore Office for executing trades in the capital market segment. The client directly approached their office without any reference. The Bangalore office of the Trading Member sent one of their representatives to check out the address of the client. Mr. Prabhakar took the representative till 25, Vijayaka Layout, Whitefield, Bangalore and showed him the bungalow but did not take the representative inside stating that he was very busy and had to rush elsewhere.

While the Trading Member did not enter into any agreement with the client, an account opening form was taken from the missing client on June 26, 1996.

A scrutiny of the ledger accounts of the member revealed that a margin of Rs. 2,15,000 was taken by way of pay orders drawn on various banks at Bangalore on June 26, 1996 and Rs. 35,000 by way of pay order on June 27, 1996 and Rs. 1,35,000 on July 3, 1996. The margins collected thus totalled to around 3,85,000.

The missing client commenced trading operations with the members since June 26, 1996 of settlement No. 1996026. The entire dealings were in the shares of MOL. The client made a profit of Rs. 92,092 which was also added to the margin account. The total margins available at the beginning of settlement No. 199027 thus totalled to Rs. 4,77,092.

The trading member provided a trading limit of 10 times the margins provided by the client and the profits on account of trading in settlement 1996026. The client exceeded the exposure limit of 10 times in settlement 1996027 and efforts were made to contact the client by leaving messages in the client's pager No. 9624226175. Copies of the pager messages made available to the investigating team evidenced this statement of the member.

The member had stated that thereafter a visit was made to the address of the client. It was found that the address provided by the client was false. Subsequently an FIR was lodged with the Bangalore Police station on July 8, 1996. In settlement No. 1996026, the trading volumes of the missing client was around 16 per cent to the total volume of the Trading Member, on July 3 and 4 the trading volumes of the missing client was around 10 per cent and 4 per cent respectively of the Trading Member, the same was substantial which had led to the follow up by the member with the client for additional margins.

The total open position of the client was to the extent of Rs. 42.70 lakhs as on July 9, 1996.

With regard to another trading member "Param Finance & Securities Ltd.," it is stated:

"The member had stated that the missing client informed that he would be doing only square off transactions with the member. Hence the member had not entered into any agreement with the client, but obtained a client registration form (dated June 24, 1996) from the client before commencement of the trading. The client registration form inter alia requires a prospective client to mention bank account details. This was apparently required for verification purposes. The missing client had provided details of the bank account (Union Bank of India, Krishnarayapuram Branch, CA 11720). The address of the missing client and the bank account did not appear to have been verified by the Trading member before commencement of trading by the client."

** ** * * * * * "The missing client commenced trading operations with the member since June 24, 1996 of settlement No. 1996025. The entire dealings were in the shares of MOL in the settlements 1996025, 26 and 27. The client made a profit of Rs. 3,250 in settlement No. 1996025 and Rs. 1,53,940 in settlement No. 1996026 totalling to Rs. 1,57,190. This profit was also added to the margin account. The total margins available at the beginning of settlement No. 1996027 totalled to around Rs. 6.74 lakhs (after debiting service taxes etc.)"

With respect to Delhi region, while referring to Trading Members "Maheswari Technical & Financial Services Ltd.," among other things it is stated:

"On July 3, 1996, the total exposure of the client was around Rs. 27 lakhs, which was marginally above the 10 time limits. Further trading was permitted on July 4, 1996, on the promise of additional margins. On July 4, 1996 when the exposures shot up significantly, a margin call was apparently made, after which the client had vanished. In settlement No. 1996025, the trading volume of the missing client constituted only 0.65 per cent of the total volumes, which increased to 7.01 per cent in settlement No. 1996026. Small percentages to the total ensured that no suspicion arose in the operations of the missing clients during these settlements.

The Trading Member lodged police complaint with the Mandir Marg Police station. New Delhi on July 6, 1996 and an FIR was lodged on July 7, 1996.

The total open position of the client was to the extent of Rs. 46.18 lakhs."

While referring to "Artistic Finance Private Limited.," it is stated:

"Mr. Raj Kumar, the missing client, had approached the Trading Member for executing trades in the capital market segment without any reference. An agreement, as per the regular practice of the Trading Member, was executed between the Trading Member and the client Mr. Raj Kumar on June 22, 1996. The

address of the client was at MB-19/6, Antriksh Bhawan, Kasturba Gandhi Marg, New Delhi. The Trading Member also took the precaution of visiting the address as provided by the client. It is pertinent to note that the address of the missing client matches with that of the missing client of Maheswari Technical and Financial Services Limited, the other member from whose trading terminal at Delhi, similar operations in MOL had been carried out."

Similarly, with respect to missing clients of Bombay region and Chennai region details have been given in the report. While referring to "Yoha Securities Ltd.," of Chennai region it is also stated :

"However, to verify the address of the clients the Trading Member had sent the contract notes to the address of the client by post. In the case of the contract notes sent by the Trading Member to the above missing client, the post was returned undelivered only after the client had already vanished."

** ** * * * "The member also stated that subsequently when they observed that the client has not contacted them, they went to the client's address and found that the address was not correct. Then they got a call from a telephone booth operator that a person who called the member from his booth had not paid the booth operator. The member visited the booth and found that the missing client had called many NSE members in a similar manner."

Similarly with respect to the missing clients in Hyderabad region it is stated that:

"In Hyderabad two cases of missing client were reported to the Exchange during July 1996. The missing client of one of the members was the introducer of the missing client of the other. While in both the cases no registration forms/agreements were taken from the client, caution in the form of enquiry with the introducer, collection of margin money etc. was taken. The missing clients connections with the M.K. group, the major group of sellers in settlement No. 1996027, shows the nexus between the buying and selling clients. The operations of the missing client commenced from settlement No. 1996025 and spanned till 1996027. Like in other cases, profits were made in the first two settlements."

While referring to "CIL Securities Ltd." it is stated:

"The client had neither entered into any agreements nor given any registration forms. The member had stated that the concept of client agreement had not picked up during that time and hence the agreements were not entered into. The member had also stated that proper reference was taken before entertaining clients and in the said case, the client had reportedly given references of Mr. Mohan Rao of M.K. & Co. and Mr. B.D. Bansal, member HSE. The member in his reply to the questionnaire had stated that both the references were contacted before permitting dealings on behalf of the missing client. The member had also stated that Mr. Mohan Rao of M.K. & Co., member of HSE had informed that Mr. Papa Rao was his client and was dealing with him till about six months back and

during the tenure he had no problem with Mr. Papa Rao and his account was satisfactory. The member had also stated that Mr. Papa Rao worked as a sub-broker for two years with Mr. B.D. Bansal, the second reference."

In the summary of findings on investigation of the Buy side, among other things it is stated :

"Most of the members as a matter of financial precaution, had imposed limits on trading activity of the missing clients based on the amount of margins paid by them. However these margins were exceeded in the last days of the pertinent period and when the additional margin call was made the clients had vanished. In this connection, it is pertinent to note that the exposure limits on Gross exposure on the Stock Exchanges was imposed by SEBI only from January 1998 onwards. However, since NSE had been imposing gross exposure limits on its members even before that, the members had imposed similar limits as a matter of precaution.

All the complaining members had lodged either a police complaint or FIR about the missing client."

The analysis of telephone calls was also given. According to the report, calls were made from Mumbai, Chennai, Ahmedabad.

11. The learned counsel for the respondents submitted that, it is settled law now that only a decision making process and not the merits of the decision itself is reviewable as Court does not sit as appellate Court while exercising power of judicial review. In this connection he referred to a judgment of Supreme Court reported in *Tata Cellular Vs. Union of India*, .

12. We have taken samples from the evidence to come to a conclusion that there was evidence on the basis of which an opinion could be framed that market was manipulated in order to commit a fraud. Therefore, this cannot be termed as a case of no evidence.

13. On the question of jurisdiction and competence of the Stock Exchange to pass an order canceling the settlement, the learned counsels for the petitioners have referred to number of regulations but the learned Senior Counsel appearing for respondents submits that, in order to appreciate the controversy it will have to be seen as to how the Stock Exchange works and how it is created. He refers to Securities Contracts (Regulation) Act, 1956. This Act was promulgated to prevent undesirable transactions in securities by regulating the business of dealing therein by providing for certain other matters connected therewith. Section 3 of the Act lays down that, any stock exchange, which is desirous of being recognized for the purposes of this Act may make an application in the prescribed manner to the Central Government. Section 4 lays down the power of Central Government to grant recognition to Stock Exchanges. Section 5 lays down the procedure for withdrawal or recognition and Section 6 authorizes the Central Government to call for periodical returns and to direct inquiries to be

made. Section 8 gives power to the Central Government to direct rules to be made or make (sic) Section 9 gives power of recognized Stock Exchanges to make bye-laws. This section gives power to make rules in different areas including, under Sub-section 3(a), to specify the bye-laws, the contravention of which shall make a contract entered into otherwise than in accordance with the bye-laws void under Sub-section (1) of Section 14.

14. The learned Senior Counsel submits that, it is a fact, as contended by the learned Counsel for the petitioners, that Stock Exchange is a company incorporated under the Companies Act, but it exercises statutory powers and Sub-section (3) of Section 9 will have to be recognized as power of the Stock Exchange to cancel the transactions which in its view are fraudulent or manipulated. He submits that Section 9 contemplates a purposive interpretation otherwise even if Stock Exchanges are defrauded by sham transactions there would not be any methodology to stop such manipulations and frauds. He submits that when a Stock Exchange is recognized by Central Government on application in terms of Section 3, it draws its powers of making bye-laws from a statute and not on the strength of being a company. He refers to various judgments of Supreme Court to substantiate the view that a purposive construction is needed to be given to Section 3 read with Section 9. He further contends that when a Stock Exchange is recognized, u/s 3 it becomes a regulatory body and a regulatory body without the power to cancel fraudulent and manipulated transactions will not be able to discharge its functions under the Securities Contracts (Regulation) Act, 1956. He refers to a judgment in Reserve Bank of India and others Vs. Peerless General Finance and Investment Company Ltd. and another, . This was a case in which Section 45-K(3) of Reserve Bank of India Act (2 of 1934) was sought to be interpreted. Peerless was a company under the provisions of Indian Companies Act with name Peerless General Insurance & Investment Company Ltd. It was carrying the business of life insurance. After the enactment of the Life Insurance Corporation Act, 1956 Peerless could not carry on life insurance business and it changed its name to Peerless General Finance & Investment Company Ltd., and started business of finance and investment. It offered small saving schemes to the public at large wherein the subscribers were requested to pay subscriptions for a fixed number of years and on expiry of said period, the subscriber is paid a sum of money called Endowment sum, which was the face value of the certificate and certain additional amounts by way of bonus. The said scheme offered by the Peerless was somewhat similar to the recurring deposit schemes offered by the commercial Banks, In this context, arguments were made as to whether the Reserve Bank of India could regulate and control the business of Peerless Company. The words which were used in Section 45-K(3) were "in respect of any matters relating to or connected with the receipt of deposits", In para 22 the Supreme Court held :

"While construing the ambit of the power conferred on the Bank u/s 45-K(3), we cannot lose sight of the object underlying the said provision. Section 45-K is part

of Chapter III-B which was inserted in the Act by Act No. 55 of 1963. In the Statement of Objects and Reasons appended to the Bill it was expressly mentioned that "it is desirable that the Reserve Bank should be enabled to regulate the conditions on which deposits may be accepted by these non-banking companies or institutions". In the Statement of Objects and Reasons, hope was expressed "that the Reserve Bank will be able to prevent malpractice, if any, to stop unhealthy competition for deposits, and to prescribe and enforce reasonable conditions including realistic rates of interest, disclosure of any information or particulars in which the depositors may be interested, provision for returning of money to them in certain contingencies and other relevant matters". It would thus appear that Section 45-K(3) is an enabling provision enacted to empower the Bank to regulate the conditions on which deposits may be accepted by non-banking companies or institutions and to prevent malpractice in the matter of acceptance of such deposits. Such an enabling provision must be so construed as to subserve the purpose for which it has been enacted. It is a well-accepted canon of statutory construction that "it is the duty of the Court to further Parliament's aim of providing a remedy for the mischief against which the enactment is directed and the Court should prefer a construction which advances this object rather than one which attempts to find some way of circumventing it." (p. 654)

Again in para 25 the Supreme Court held;

"It is thus evident that the words "in respect of any matters relating to or connected with the receipt of deposits" in Section 45-K(3) confer a wide power on the Bank to issue directions and the said power is not restricted or limited to receipt of deposits only. The amplitude of this power cannot be curtailed by the words "including the rates of interest payable on such deposits and the periods for which deposits may be received" in Section 45-K(3). It is no doubt true that the word "including" is generally used in extensive sense to bring within the ambit of the provision matters referred to in the inclusive clause which normally would not have been covered by the provision. But that is not always so. Many times the Legislature uses an inclusive phrase to specifically include a matter by way of abundant caution. Having regard to the object and purpose underlying the enactment of Section 45-K, we are unable to construe the words including the rate of interest payable on such deposits and the periods for which deposits may be received" as restricting the ambit of the words "in respect of any matters relating to or connected with the receipt of deposits", which in our opinion, must be given their natural meaning as construed by this Court in *Peerless II*. This means that the Bank has been given the power to issue directions in respect of any matter relating to or connected with the receipt of deposits." (p. 655)

15. In the light of these judgments, it is contended that respondent No. 1 being a recognized Stock Exchange is entitled to frame bye-laws u/s 9 of Securities Contracts (Regulation) Act, 1956 and Section 9(2)(k) empowers making of bye-laws as to the regulation of the entering into, making, performance, recession

and termination of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer and the responsibility of members who are not parties to such contracts. It is submitted that the respondent No. 1 has a statutory power to frame bye-laws. On the other hand, the learned Counsel for the petitioners submitted that, the bye-laws are made in terms of Companies Act and not under the power available under the Securities Contracts (Regulation) Act. We are not able to appreciate this contention for the reason that, if the respondent No. 1 has not the power to regulate the business of Stock Exchange then the whole purpose of enacting Securities Contracts (Regulation) Act would be defeated and dishonest buyers and sellers or purchasers cannot be brought to book. Needless to mention that a regulatory authority is to regulate which includes regulating all matters connected to the business. The regulatory bodies have very wide jurisdiction. The Supreme Court in Cellular Operators Association of India v. Union of India [2003] AIR SCW 366 in para-33 while discussing the powers of regulatory bodies came to the conclusion:

"The regulatory bodies exercise wide jurisdiction. They lay down the law. They may prosecute. They may punish. Intrinsically, they act like an internal audit. They may fix the price, they may fix the area of operation and so on and so forth. While doing so, they may, as in the present case, interfere with the existing rights of the licensees."

It is further submitted by the learned counsel for the petitioners that even if it is conceded that some fraud was played by some people but their might be some genuine buyers, small time investors who saw the rate of a particular share going up and invested their money, therefore, at their cost Stock Exchange cannot annul the trade. The learned Senior Counsel Mr. Rafiq a Dada made a statement before the Court that all those persons who are found to be genuine buyers and are not part of the fraud or manipulation will be compensated, they shall not be paid compensation at the cost price but shall be paid at selling price, therefore, we do not want to go into the question whether Stock Exchange can annul the trade as a result of manipulation of fraud committed by some body. In this case, a judgment from Gujarat High Court was cited by the learned Counsel for respondents being Securities and Exchange Board of India v. D.M. Investments (1999) 1 Comp. L.J. 396 but since the counsel for respondents has given assurance to this Court that innocent and genuine buyers will not suffer, we do not want to go into that judgment.

16. Mr. Kodandaram, Advocate, however, submitted that the bye-laws might bind sellers, buyers, traders, etc., but not the third parties. If third parties suffer, their transactions cannot be annulled on the strength of bye-laws. This argument cannot be accepted. We have already held that the Stock Exchange is a Regulatory authority as is the Reserve Bank for Banking institutions. Third

parties will have to abide by the decision of the Stock Exchange because when they transact business they must have been aware that there are bye-laws which have the force of law and will bind them.

17. The learned Counsel for the petitioners submitted that, in the first circular which was challenged in the earlier Writ petition only some of the transactions were annulled and latter circular all transactions relating to the shares of MOL in settlement No. 27 of 1996 have been annulled. They contended that, if there was no evidence against them in the first instance how could it be that their transactions were cancelled subsequently. The learned Counsel for the respondents submits that since there was a direction of the High Court in earlier Writ petition that the Stock Exchange should not discriminate between two sets of buyers, therefore that decision was taken. But, since he has given assurance that all genuine buyers will be compensated, therefore we do not think that this argument will not detain us any further.

18. For these reasons, the Writ petitions are dismissed. No costs.

Bilal Nazki and T.Ch. Surya Rao. JJ.

19. After the judgment drafted by Mr. Justice Bilal Nazki was circulated to Mr. Justice J. Chelameswar, the latter wrote a separate judgment. We have gone through the judgment where Justice Chelameswar agreed with the conclusions drawn in the judgment circulated but gave some directions also in the last para of his judgment. In this context we agree with Justice Chelameswar.

J. Chelameswar, J.

20. The advent of the concept of "Joint Stock Companies", which is the legal ancestor of the present concept of Companies with limited liability, (it is said, is the genius of the English Common Law) brought about a tremendous change in the human history. The whole concept of Joint Stock Company is that innumerable small investors pool up their investments to run business under the umbrella of a "Body Corporate" which has a distinct legal entity from each and all of such investors while the investors are entitled for a share in the profits earned and declared as available for distribution by the company, the investor's liability is limited only to their share capital in the event of the company making a loss. Yet another significant factor in the nature of Joint Stock Companies is that the share or shares of each of the investors are freely transferable though from time to time either by law or by contract limitations are imposed on the transferability of such shares.

21. Over a period of about two centuries, the concept of Joint Stock Company, became a worldwide phenomenon known to almost every legal system. At any rate to all the legal systems based on Anglo-Saxem Jurisprudence including India.

22. While as a concept, the shares of a company are freely transferable, there are many practical difficulties in ensuring enjoyment of such a right. For example, if a small investor in a small company in some remote corner of a

country desires to sell his shares he might find it difficult to locate a buyer known to him. But, there might be a willing purchaser elsewhere in some other part of the country on his own perception of the profitability of the company of whose shares are offered for sale. To facilitate such remote sellers and purchasers of the shares, the concept of Stock Market was evolved. The individual buyer or seller of shares of any given company is relieved of the trouble of locating the seller or the buyer as the case may be. He could go to the nearest stock market and offer either to sell or purchase the shares of any given company and if he finds a seller or purchaser of the shares in the market, the transaction is completed. But in a given case, it is possible that when a seller goes to the nearest stock market he may not find immediately a purchaser in the same market, but in the modern world with the increased sources of information there could always be a purchaser at some other place, who is searching for a seller of that particular company's shares who also approaches the nearest stock market available to him. For individual investors obtaining information regarding the prospective purchasers or sellers is very difficult and expensive and becomes uneconomic having regard to the small or limited stakes they have in the market. This limitation provided an occasion for the invention of a concept of Stock Brokers. Stock Brokers are those who purchase and sell the stocks (shares etc.) from various individual sellers or buyers of stocks not because the stock broker would intend to retain all those stocks purchased, but because of his activity is constantly in possession of the information as to what is the current demand for a particular share in the various quarters of the country, of late, even in the world. The magnitude of the operation of the stock brokers makes it economic for them to obtain all the relevant information in that regard speedily and economically.

23. Over a period of time the activity of the stock market assumed such proportions which required monitoring by Law of such large scale transactions touching vast numbers of the population. Without going further into the historical development of Law on this aspect for the purpose of the present case, it can safely be started with the examination of the current statutory provisions on this aspect.

24. The first of them is the Securities Contracts (Regulation) Act, 1956 and the second, the Securities and Exchange Board of India Act, 1992, both enactments made by the Parliament, hereafter referred to as the 1956 Act and 1992 Act respectively.

Under the 1956 Act, the expression "Securities" is defined u/s 2(h) as follows:

"2(h) 'securities' include--(i) shares, scripts, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;"

The expression "Contract" is defined u/s 2(a) as follows:

"2(a) 'contract'--means a contract for or relating to the purchase or sale of

securities;"

The expression "Stock Exchange" is defined u/s 2(f) as follows:

"2(j) "stock exchange",--means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities."

Under Section 19 of the Act, it is declared that no person shall organize or assist in organizing, entering into or performing any contract in Securities except as a Member of a recognized Stock Exchange. Section 3 of the Act stipulates that any "body" which desires to be recognized as a Stock Exchange is required to make an application for that purpose in the prescribed manner to the Central Government. Section 19 read with 23 makes it an offence to organize a stock exchange without the permission of the Central Government. Section 4 declares that the Central Government may after such enquiry as is indicated in the said section if satisfied may grant a recognition to such an applicant. The Central Government is also authorized u/s 4 to impose certain conditions for granting of the recognition, the contours of which are indicated in Section 4. The various powers and obligations of a recognized Stock exchange are contained in the other provisions of the Act apart from the various powers that can be exercised by the Central Government vis-a-vis the Stock Exchanges.

25. For the purpose of the present case, it is necessary to examine the scope of Sections 13 - 15 of the Act. Section 13 reads as follows:

"13. Contracts in notified areas illegal in certain circumstances.--If the Central Government is satisfied, having regard to the nature or the volume of transactions in securities in any State or area, that it is necessary so to do, it may, by notification in the Official Gazette, declare this section to apply to such State or area, and thereupon every contract in such State or area which is entered into after the date of the notification otherwise than between members of a recognized stock exchange in such State or area or through or with such member shall be illegal."

The substance of the sections that once a notification u/s 13 is issued in the Official Gazette, any contract relating to the purchase or sale of securities within the area covered by the notification would be illegal unless it is a contract between the members of a recognized Stock Exchange. In other words, though the original concept of free transfer-ability of stock in a company is maintained, a restriction on the right of transfer insofar as the manner of transfer is concerned is created.

26. Section 14 stipulates certain further restrictions on the free transfer-ability of the Securities and declares void certain transactions though otherwise valid and in accordance with Section 13. The details of which may not be necessary for us for the present purpose.

27. Rules are framed under the 1956 Act called the "Securities Contracts

(Regulation) Rules, 1957 which prescribe the procedure required to be followed by the Government of India for the recognition of a Stock Exchange, the method and manner of making an application in that regard and the scrutiny thereof. Rule 8 of the said rules prescribes various qualifications and disqualifications for any person to become a member of the recognized Stock Exchange. The other rules provided for the various regulatory mechanisms of the activities of the members of a recognized Stock Exchange and also the activity of the Stock Exchange. The relevant rules will be referred to at a later point in this judgment, if required.

28. The members of a recognized Stock Exchange are also called Stock Brokers by definition under the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Rules, 1992 framed under the 1992 Act. Rule 2(e) defines Stock Broker to mean a member of Stock Exchange and a Stock Exchange is in turn is defined under the said Rule 2(d) as a stock Exchange which is recognized u/s 4 of the 1956 Act.

29. In view of the language of Section 13, in all the areas to which Section 13 applied, members of a recognized Stock Exchange/Stock Brokers can enter into a contract for the purchase or sale of securities, that is, a member of the Stock Exchange can purchase for himself or sell the securities from another stock broker. If Section 13 is interpreted literally an individual owning "securities" cannot legally either sell or purchase unless he also becomes a "member" of the Stock Exchange. Such a situation would result in a great inconvenience to the owner of "securities" who is not a stock broker and would defeat his right to either freely transfer or acquire "securities". Therefore, the law-makers enabled such persons to carry on the activity of sale or purchase of the "securities" through the members of the Stock Exchange/Stock Brokers. This conclusion is a necessary implication of a combined reading of Sections 13 and 15 of the 1956 Act. In fact, Section 15 reads as follows:

"15. Members may not act as principals in certain circumstances.--No member of a recognized stock exchange shall in respect of any securities enter into any contract as a principal with any person other than a member of a recognized stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal;"

Section 15 also recognises a right of a stock broker to purchase "securities" from persons other than "stock brokers". Having regard to the dual capacity of the stock broker either to purchase or sell securities for himself, which he may retain or trade in future, the stock broker is also required to sell or purchase securities on behalf of persons who are not stock brokers (for convenience, hereinafter referred to as "clients"). Section 15 mandates that the stock broker shall not enter into any contract as a principal with any person other than a stock broker and if a stock broker desires to enter into such a contract as principal, he is required to obtain the consent or authority of the client which is required to be in

writing either in the form of a note, memorandum or agreement of sale. These expressions, "note" and "memorandum" are not defined anywhere, but they are the documents which are invented by the stock brokers and exchanges over a period of time for the smooth facilitation of their business. What exactly is the legal nature of these documents called stock brokers notes or stock brokers memoranda is not required to be examined for the purpose of the present case except to state that they are pieces of evidence whenever a question comes up whether a stock broker dealt in a particular "security" whether in his capacity as a stock broker (agent of the owner of the security) or for himself i.e., as a principal.

30. By about 1993 there were about 21 recognized Stock Exchanges in the country and large number of stock brokers attached to those Stock Exchanges. In the last one decade and with the change of the policies of the Government of India, great many changes occurred in the organization of the stock markets. The coming into existence of the National Stock Exchange and the concept of dematerialisation of securities on statutory basis under the provisions of the Depositories Act, 1996 brought some main changes both in fact and in law in the day to day functioning of the Stock Exchange.

31. The proliferation of Companies in the wake of the liberalized economic policies of the Government of India in the last two decades resulted in a great increase of the activity in the stock markets and participation of millions of people in the trade of securities. A major scandal that occurred in the early 1990's in the stock markets rocked the country and made the Government of India to come up with the 1992 Act which provided for a great deal of control and scrutiny of the activity in the trade of securities.

32. Under the provisions of the above-mentioned two enactments and the subordinate legislation made thereunder, the stock brokers are required to maintain innumerable documents detailing each and every transaction entered into by them and those documents which made subject to his scrutiny by the various authorities from time to time under the above-mentioned two enactments.

33. Apart from the complicated regulatory mechanism created to monitor the juggernaut of the Stock Market, the activity of trade in securities is still governed primarily by the Law of Contracts. Where an individual decides either to buy or sell securities he is required to approach a stock broker for that purpose and when the stock broker agrees to execute the order of his client there is a Contract of Agency created by the "client" as a principal and the stock broker as an "Agent". Thereafter, the stock broker in turn enters into a contract with another stock broker for discharging his obligations arising under the above-referred Contract of Agency by either acquiring or selling as the case may be "securities" on behalf of the client. That another stock broker referred to above might be entering the contract in his capacity as a principal or as an agent for another client depending upon the facts of a given case. In a case where the 2nd

stock broker referred to above is entering into contract in his capacity as principal with the 1st stock broker, there are two contracts in existence in the transaction. One is a contract of agency between the client and the 1st stock broker and the 2nd is a contract of either sale or purchase of securities between the two stock brokers. In a case where the 2nd of the above-mentioned stock brokers is acting in his capacity as agent for some other client, there are three contracts in the transaction. Two contracts of agency between the two stock brokers referred to above and their respective clients and a contract for sale-purchase of securities between the two stock brokers.

34. When a stock broker is purchasing or selling securities in his capacity as a principal, the terms of the contract between him and his client are purely governed by the Contracts Act. When a stock broker enters into a contract of agency with some client either to sell or purchase securities for that client from the stock market, the stock broker does it for some financial gain which is normally called "commission" in the stock market. A client entering into a contract with stock broker with a requisition to purchase "x" quantity of particular security is necessarily under an obligation in the Law of Agency to pay the eventual purchase price of the security and also the commission to his stock broker and the stock broker in turn is under an obligation to pass on the price of the security to the seller of the securities. In the above-mentioned illustration, if a client fails to discharge his obligation to purchase price to the stock broker, the remedy of the stock broker under normal Law of Contract is to sue the client for the breach of contract.

35. But in this case, some stock brokers instead of suing their clients for the breach of contract, complained to the concerned Stock Exchanges for the annulment of the contracts of purchase made by them of the securities i.e., the shares of Maruti Organics Limited on the ground that their respective client's disappeared without paying the purchase price and that they (complaining stock brokers) have no means of finding out the whereabouts of such clients. It is also their case that it is not a stray case of a client refusing to fulfil his obligations under the Contract of Agency to pay the purchase price, but a systematic defrauding at the instance of the stock brokers who are the vendors of the stocks in question at the relevant point of time.

36. The various writ petitioners are individuals who claim to have held the shares of a public limited company called "Maruti Organics Limited" (hereinafter referred to as "MOL") except the petitioner in W.P. No. 23584 of 2000 which is said to be a proprietary concern owned by one Ch. Mohan Rao. The relief sought in all these writ petitions is common that the petitioners seek a declaration that the Circular No. NSE/COMP/2000/3, dated 21-11-2000 issued by the National Stock Exchange of India Limited and consequential communication issued by the National Securities Clearing Corporation Limited, dated 28-11-2000 as illegal, arbitrary and void and consequently direct the National Stock Exchange to pay the various petitioners the amount of money due to them representing the sale

price of the shares of MOL as quoted in the Settlement Period 27/96 along with interest.

37. About 15 stock brokers complained to the National Stock Exchange to the effect that their respective purchase orders for the shares of MOL during the Settlement Period of 27/96 is required to be annulled. The substance of complaint of all these brokers is that that a certain client approached each of them in the settlement periods prior to the one in question with a request of buy relatively small shares of MOL which shares were actually purchased by the complaining stock brokers in accordance with the requests of the respective clients for which the purchase price was paid by the respective clients to the respective complaining stock broker. Thereafter, for the settlement period of 27/96 those very respective clients of the complaining stock brokers placed orders for purchase of huge quantities of shares of MOL and the orders were executed. The clients did not turn up to keep their commitment and pay the purchase price. The above-mentioned facts resulted in a situation that the complaining stock brokers were left with a huge liability to make the payment to the corresponding selling brokers towards the price of MOL which amounts cannot be recovered by the complaining brokers from their respective clients. Further, the substance of the complaints is that the whole transaction was a well planned scheme to artificially increase the selling price of the shares of MOL thereby the selling brokers made a big profit and the buying brokers (complainants) incurred a heavy loss as they did not purchase the shares of MOL as principals, but as the agents of the respective clients and the clients disappeared without making the payment of the purchase price. All the complaints were dated 6th July, 1996.

38. On the receipt of all these complaints, the National Stock Exchange of India issued a broadcast to its members, the substance of which is that the settlement obligations, for the settlement period of 27/96 will not include the obligations incurred with reference to the trade in MOL in view of a pending enquiry into the matter. The said broadcast message was challenged in this Court by way of some writ petitions viz., W.P. Nos. 23974 of 1996 and 14035 of 1996, The said writ petitions were disposed of by a learned single Judge of this Court directing the National Stock Exchange to take an appropriate decision in the enquiry that was said to be pending within a period of two months. The order was confirmed by a Division Bench on an appeal.

39. Thereafter, an enquiry into the matter took place and as a consequence the trade in the shares of MOL for the settlement period of 27/96 with respect to some selling brokers was annulled and the sellers of the shares were advised to take back their shares. Challenging the said decision another batch of writ petitions came to be filed at this Court in WP No. 1800 of 1997 and batch. This Court by an order dated 27-11-2000 quashed the decision of the National Stock Exchange and directed a fresh enquiry and also issued certain other directions regarding the procedure to be followed by National Stock Exchange. Accordingly,

an enquiry was held which resulted in the present impugned action which is the subject-matter of these writ petitions. In substance the impugned action is that all the transactions of the settlement period 27/96 on the National Stock Exchange with reference to MOL shares now stand annulled.

40. The report of the Investigating Team concludes with the finding "therefore, it is evident that there has been a planned selling activity by planting buying clients with unsuspecting trading members. There is a case of widespread fraud in the trading of Maruti Organics Limited during Settlement No. 1996027 as indicated by the points mentioned above and sudden disappearance of buyers with major net buy positions in different centres simultaneously." As a consequence, the impugned action was taken.

41. It can be seen from the report that there were 15 corporate shareholders of MOL as per the records of the Stock Exchange between 19-8-1996 and 5-8-1998. As on 19-8-1996, there were only four major corporate share- holders who held 27,77,000 shares between them and the minor holders with a negligible number of shareholding. Whereas as on 30th September, 1997, the number of corporate stock holders of MOL increased to 14 with a cumulative shareholding of 30,55,900. As on 5-8-1998, they were once again 14 corporate shareholders whose cumulative shareholding was 30,80,000. Two corporate shareholders viz., Abhay Investment Private Limited, Abhyudaya Investments Private Limited had 13.285 lakhs, 12.747 lakhs respectively on the earlier date and reduced their shareholding to around 9 lakhs each by 30-9-1997 and continued to hold more or less the same number of shares by 5-8-1998. Whereas Nagarjuna Securities Limited had 90,700 shares initially which was increased to 2,41,800 shares by 30-9-1997 and continued to hold 2.54 lakhs by 5-8-1998. The other major corporate shareholders was one M.K. Securities Limited initially holding 83,100 shares, 82,800 shares as on 30-9-1997 and 12,700 shares as on 5-8-1998. Only one public sector company purchased about 8.41 lakhs shares as on 30-9-1997 while it did not have a single share by 19-8-1996. It appears that the said public sector bank was holding those shares as a custodian on behalf of the National Securities Clearing Corporation Limited, one of the respondents herein, but not on its own account, in view of the uncertainty of the situation.

42. The summary of the findings of the investigation on the selling side is that there is a nexus between the selling clients and the selling members. On the buyers side, the buyers were distributed all over the country partly classified by the report as Delhi, Bombay, Chennai, Hyderabad, Ahmedabad and Bangalore regions. From the summary of the report on the buyers side, none of the buying members entered into any agreement with their clients and the clients were not properly introduced to those buying stock brokers, the buying stock brokers did not even properly verify the correct permanent addresses of their respective clients. The investigating team, however, made enquiries into the accounts of these various selling and buying stock brokers and their transactions with their

respective clients came to the conclusion that there was a case of widespread fraud in the trading of MOL by artificially inflating the price of the script. From the report, it appeared that some of the corporate shareholders and the selling stock brokers of MOL were responsible for the fraud.

43. The learned Counsel for the petitioners made three submissions. The 1st submission is that there was no evidence at all to enable the respondent - National Stock Exchange to come to the conclusion that there was a case of widespread fraud, (2) that the respondent - National Stock Exchange had no authority to annul the Settlement in question, (3) that in the earlier circular dated 11-1-1997 sought to annul only certain transactions of the settlement period 27/96 which itself came to be quashed by this Court in W.P. No. 1800 of 1997 and batch and the present impugned circular (sic) seeks to cancel all the transactions of settlement period 27/96 with regard to the shares of MOL, therefore illegal.

44. In response to the 1st submission of the petitioners, it was argued by the respondents on the basis of the Judgment of the Supreme Court in Tata Cellular's case (supra) that it is only the decision making process and not the merits of the decision that is amenable to the jurisdiction of this Court under Article 226, that this Court does not sit as an appellate Court re-appreciating an evidence which led to the conclusion.

45. I agree with the conclusion reached by my learned brothers on this aspect that there was some material before the respondent - Stock Exchange to come to the conclusion that there was a widespread fraud with regard to the trade of shares in MOL in the settlement period 27/96. Therefore, this Court does not sit as a Court of appeal reappreciating the evidence while exercising jurisdiction under Article 226 of the Constitution of India.

46. But the question is whether the respondent-National Stock Exchange of India Limited has the necessary authority in law to take a decision annulling the trade in any particular security, when such a decision is likely to affect the rights accrued under a contract to a person who is not a member of the Stock Exchange. In other words, the contracts entered into between the members of the Stock Exchange. In other words, the contracts entered into between the members of the Stock Exchange and their respective clients (who are not members of the Stock Exchange) either for the purchase or sale of securities.

47. The Bye-Laws of the National Stock Exchange of India Limited in Chapter VII deal with this aspect - more particularly Bye-Law No. 5 of the said Chapter, which reads as follows :

"Inviolability of Trade

5(a) All the dealings in securities on the Exchange made subject to the Bye-Laws, Rules and Regulations of the Exchange shall be inviolable and shall be cleared and settled in accordance with the Bye-Laws, Rules and Regulations of

the Exchange. However, the Exchange may by a notice annul the deal(s) on an application by a Trading Member in that behalf; if the relevant authority is satisfied after hearing the other party/parties to the deal(s) that the deal(s) is/are fit for annulment on account of fraud or willful misrepresentation or material mistake in the trade.

(b) Notwithstanding anything contained in Clause (a) above, the Exchange may, to protect the interest of investors in securities and for proper regulation of the securities market, suo motu annul deal(s) at any item if the relevant authority is satisfied for reasons to be recorded in writing that such deal(s) is/are vitiated by fraud, material mistake, misrepresentation or market or price manipulation and the like.

(c) Any annulment made pursuant to Clauses (a) and (b) above, shall be final and binding upon the parties to trade(s). In such an event, the trading member shall be entitled to cancel the relevant contracts with its constituents."

48. Though in some of the present writ petitions the vires of the said Bye-Laws was challenged at the time of arguments, that submission was not pressed - the said fact is already recorded in the judgment of my learned brother Justice Bilal Nazki. However, a submission was made on behalf of the respondents that in view of the language of Section 9(2)(k) of the Securities Contracts (Regulation) Act, 1956, which reads as follows :

"the regulation of the entering into, making, performance, recession and termination of contracts, including contracts between members or between a member and his constituent or between a member and a person who is not a member, and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer, and the responsibility of members who are not parties to such contracts."

the respondent-National Stock Exchange of India is authorized to make Bye-Laws for regulating the contracts not only between the members of the Stock Exchange, but also the contracts between a member of Stock Exchange on the one part and non-member of the Stock Exchange on the other part. This submission, found favour by our learned brother Justice Bilal Nazki, but, I would, with respect to my learned brother Justice Bilal Nazki, withhold expressing any opinion on the aptitude and scope of Section 9(2)(k) of the above-said Act, as in my view, in view of the fact that the petitioners categorically gave up an attack on vires of Bye-Law No. 5(a) of the Stock Exchange, which Bye-Law is purported to have been made in exercise of the power conferred u/s 9(2)(k) of the above-said Act. Only a half-hearted submission was made on behalf of the petitioners about the vires of Bye-Law No. 5(a) of the Stock Exchange. Assuming for the sake of argument that the language of Section 9(2)(k) is wide enough to confer such a power on the Stock Exchange, whether such conferment of power on a non-sovereign subordinate law making body the respondent stock exchange - a company, would be consistent with the constitutional scheme of the delegation of

powers (legislative in nature) is a question of which in my view requires a deeper examination. No arguments were advanced on these questions.

49. But, then the entire report of the Investigating Committee on the basis of which the present impugned decision is taken is based on an analysis of the relevant material connected to the corporate shareholders, their " selling brokers and the nexus between the alleged missing clients of the purchasing brokers. The report does not disclose any material which implicates the individual shareholders who are the petitioners in these various writ petitions in the fraud. In which case whether the respondent-Stock Exchange is justified in annulling the trade in MOL with regard to settlement period 27/96 insofar as it pertains to the individual shareholders who are the various petitioners herein in a question which should logically arise next.

50. In this context, in view of the statement made by the learned Senior Counsel Sri Rafeeq Dada appearing for the respondent-Stock Exchange that such of those genuine sellers who have no part in the manipulation of the market will be compensated, I deem it appropriate to direct the respondents to pay such of those individual sellers of the shares in Maruti Organics Limited, who are the petitioners in these various writ petitions other than those sellers who are already identified in the report to have manipulated the market on the basis of which the impugned action is taken, shall be compensated in full by paying the market value of the share on the relevant date of the sale. In my view, having regard to the fact that the shares of the MOL are quoted not only in the respondent-Stock Exchange but also in certain other Stock Exchanges, the average value of the said share on the relevant date as quoted in the various other Stock Exchanges of the country should be paid as compensation.

51. Before parting with the case, I must also place it on record that in view of the admitted position that the complaining stock brokers did not take adequate precautions in ensuring themselves about the genuineness of the orders of purchase placed on them and in view of the fact that the complaining members/ stock brokers could have purchased the stocks either as the agents for a client or as principals themselves, which fact could be established clinchingly if only they had followed the procedure prescribed under the regulations. In the Investigation Report on the basis of which the present impugned action is taken, investigating team made a summary of the findings on the investigation on the buying brokers i.e. the complainants before the respondent-Stock Exchange. The relevant portion reads as follows :

"of the Capital Market Regulation of the Exchange inter alia states that every Trading Member shall enter into an agreement with each of its constituents before accepting or placing orders on the constituents behalf. Though the members did not enter into member constituent agreements with their clients, it is however, noted that in majority of the cases, client registration/account opening forms were taken from these new clients. Copies of the member-constituent and client registration forms are collectively marked and annexed

hereto as "Annexure 8". In almost all the cases margins were collected from the clients.

The concept of know your client was introduced by SEBI subsequent to the meeting of the Executive Committee of the Inter Exchange Coordination Group held on February 4, 1997 and advised to all the Stock Exchanges vide Circular No. CIR.No.SMD/POLICY/IECG/I-97, dated February 11, 1997. SEBI had inter alia advised in the circular as under: The Stock Exchange would ask member brokers to maintain a database of their client. The exchanges would assess the present procedure followed by the member brokers and design a suitable client introduction form in consultation with SEBI. In view of this, the members did not have the practice of collecting photographs, verifying the antecedents, etc., of their clients before the commencement of dealings with them."

52. I am of the opinion that the respondents be directed to take appropriate disciplinary action in accordance with the Stock Exchange Bye-Laws against the complaining members. Otherwise, in such a situation, the members of the Stock Exchange might resort to such complaints with impunity whenever their speculations in the market fail. The history of stock markets does not lack instances of such scandalous manipulations by some of the unscrupulous brokers. The delinquent stock brokers whatever be the nature of their delinquency, in my view, should not be allowed to go scot-free even assuming that their delinquency is innocent. I say for this reason, by the very complicated nature of the stock market operations, non-compliance with any Rule or Regulation made by the stock market by the members should not be viewed lightly as such non-compliance is likely to result in financial irregularities both from the point of view of the investors as well as Nation. If the members of the Stock Exchange/brokers need the protection of the Stock Exchange to avoid loss in the hands of the unscrupulous manipulators, the members must strictly comply with every obligation imposed on them under the law. Any deviation in the compliance, however, trivial it may appear must not be permitted or condoned because such deviations might result in a situation like the present one where perhaps the unscrupulous members of the Stock Exchange seek the protection at the cost of the bona fide investors.

53. In the result, I dispose of these writ petitions as indicated above.