BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved: 06.1.2022
Date of Decision: 18.2.2022

Appeal No.83 of 2021

HDFC Bank
HDFC Bank House,
Senapati Bapat Marg,
Lower Parel (West), Mumbai – 400 013. ...Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No.C-4A
G Block, Bandra Kurla Complex,
Bandra East, Mumbai- 400 051. ….Respondent

Mr. Janak Dwarkadas, Senior Advocate with Mr. Gaurav Joshi, Senior Advocate, Mr. Sameer Pandit and Ms. Krina Gandhi, Advocate i/b. Wadia Ghandy & Co. for the Appellant.

Mr. Rafique Dada, Senior Advocate with Mr. Manish Chhangani, Mr. Ravishekhar Pandey and Ms. Samreen Fatima, Advocates i/b. The Law Point for the Respondent.

Mr. Pradeep Sancheti, Senior Advocate with Mr. Rashid Boatwalla and Mr. Aditya Vyas, Advocates i/b. MKA & Co. for the Intervener-NSE.

CORAM: Justice Tarun Agarwala, Presiding Officer
Justice M.T. Joshi, Judicial Member

Per: Justice Tarun Agarwala, Presiding Officer

1. The present appeal has been filed against the order dated 21st January, 2021 passed by the Whole Time Member ('WTM' for short) wherein the appellant has been directed to pay a penalty of Rs.1 crore for defeating the directions contained in the interim order dated 7th October, 2019 and has further directed the appellant to deposit a sum of Rs.158.68 crores alongwith interest at the rate of 7% in an escrow account till the issue of settlement of clients' securities are reconciled.

2. The facts leading to the filing to the present appeal is, that the appellant is a banking company incorporated and registered under the Companies Act, 1956 and is carrying on the business of banking under the Banking Regulation Act, 1949. The appellant extended loan facility to M/s. BRH Wealth Kreators Ltd. (hereinafter referred to as 'BRH') who was a trading member/ broker on the National Stock Exchange of India Ltd. (hereinafter referred to as 'NSE'). These loan facilities was granted pursuant to a

loan agreement dated 7th October, 2005, 10th August, 2007 and 21st June, 2014 which was extended/renewed from time to time. Under this agreement the loan extended was secured by pledge of shares given by BRH.

3. At the time of availing the loan facilities, BRH made an express declaration in the overdraft request letters that securities pledged by BRH to the appellants were held by BRH in their own name as an absolute owner and not in any other fiduciary capacity. This statement was also expressly stated in clause 13(ii) of the loan agreement dated 21st June, 2014 wherein BRH expressly agreed and undertook to maintain segregation of securities held by it on behalf of its clients from the securities held by BRH in its own name as required under the Securities and Exchange Board of India Regulations. Under clause 13(iii) BRH confirmed that clients' securities would not be offered as security for the borrowings made by BRH. For

facility, clause 13 of the loan agreement dated 21st June, 2014 is extracted hereunder:

> *"13. Where the Borrower is an intermediary registered in terms of Section 12 of the Securities and Exchange Board of India Act, 1992, the Borrower hereby agrees and undertakes*
>
> > *(i) not to deal in penny stocks in any manner as stipulated in SEBI directives.*
> >
> > *(ii) to maintain segregation of securities held by him/her on behalf of clients from the securities held by the Borrower in his/her name, as required by the SEBI regulations.*
> >
> > *(iii) to confirm that the client securities will not be offered as security for borrowing from the Bank in any manner whatsoever.*
> >
> > *(iv) to provide details of securities held on behalf of the clients and securities held by Borrower in his/her own name to the Bank on demand."*

4. In addition to the aforesaid, the appellant also ensured that the pledge created in its favour by BRH as security for the loan facilities was in accordance with the Depositories Act, 1996 read with Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996. It was contended that the shares pledged by BRH stood in the name of BRH

and was recorded as the beneficial owner of the shares in the record of the Central Depository Services (India) Ltd (‘CDSL’ i.e. the concerned depository).

5. BRH defaulted on its obligations and, consequently, on 4th October, 2019 the appellant recalled its facilities from BRH which aggregated to Rs.191,16,49,098.19/-. The appellant informed BRH that if they failed to repay its dues the appellant would be constrained to enforce the securities to recover the dues. Since the default was not cleared the appellant invoked the pledge and sold the pledged securities between 15th October, 2019 and 20th December, 2019 worth Rs.148.04/- crores. As on 31st January, 2021, even after the sale of the pledged securities BRH continues to owe a sum of Rs.26.70/- crores.

6. In the meanwhile, on 30th September, 2019, NSE passed an order suspending BRH with effect from 1st October, 2019 for noncompliance of regulatory provisions of the exchange and, on 7th October, 2019 SEBI passed an ex-parte ad-interim order restraining

BRH and seven other related parties to BRH from accessing the securities market and further restraining them from dealing with their assets. The ex-parte ad-interim directions issued by the WTM against BRH and seven related entities are extracted hereunder:

> *"9. Under the above circumstances, I, in exercise of powers conferred upon me under Sections 11(1), 11(4), 11B and 11D read with Section 19 of the SEBI Act, 1992 and Regulation 35 of SEBI (Intermediaries) Regulations, 2008, by way of this ex parte ad interim order, hereby issue the following directions*:
>
> *(i) BRH Wealth Kreators Limited (formely BMA Wealth Creators Limited), Shiv Kumar Damani, Anubhav Bhatter, Murgesh Devashrayi, BRH Commodities Private Ltd. (formerly BMA Commodities Pvt. Ltd.), Prosperous Vyapaar Private Limited, Polo-Setco Tie Up Private Limited and Parton Commercial Private Limited are restrained from accessing the securities market and are further prohibited from buying, selling or otherwise dealing in securities, either directly or indirectly, or being associated with the securities market in any manner whatsoever, till further directions;*
>
> *(ii) The aforesaid Noticees shall cease and desist from undertaking any activity in the securities market, directly or indirectly, in any manner whatsoever till further directions;*
>
> *(iii) The aforesaid Noticees are directed not to dispose of or alienate any assets, whether movable or immovable, or to create or invoke or*

release any interest or charge in any of such assets except with the prior permission of NSE and BSE;

(iv) The aforesaid Noticees are directed to provide a full inventory of all their assets, whether movable or immovable, or any interest or investment or charge in any of such assets, including details of all their bank accounts, demat accounts and mutual fund investments immediately to NSE and BSE but not later than 5 working days from the date of receipt of this order;

(v) Till further directions in this regard, the assets of the Noticees shall be utilized only for the purpose of payment of money and/or delivery of securities, as the case may be, to the clients/investors under the supervision of the concerned exchanges/depositories;

(vi) The depositories are directed to ensure that no debits are made in the demat accounts, held jointly or severally, of the aforesaid Noticees and persons except for the purpose mentioned in sub-para (v) above, after confirmation from NSE/BSE;

(vii) The banks are directed to ensure that no debits are made in the bank accounts held jointly or severally by the Noticees except for the purpose of payment of money to the clients/investors under the written confirmation of NSE/BSE;

(viii) The exchanges, clearing corporations and depositories shall appoint forensic auditor to track misuse of client's funds/securities and to identify the net assets/liabilities of Noticee no.1

and Noticee no.5 and submit the report to SEBI within 90 days;

(ix) The exchanges shall deal with the complaints/claims of the clients against the member and may return the amount of client fund and securities to the clients and may also use assets of the Noticee no.1 to meet clients'/exchanges'/ clearing members'/clearing corporations', obligations; and

(x) The above directions are without prejudice to the right of SEBI to take any other action that may be initiated in respect of aforesaid entities/persons."

7. The aforesaid directions were issued against BRH and seven other entities as on a scrutiny it was found that there was a shortfall of clients' securities and that BRH had misappropriated the clients' securities and transferred it to the seven entities. The WTM prima facie observed that BRH failed to segregate clients' securities and violated SEBI circular dated 18th November, 1993, 26th September, 2016, the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 and the Securities Contracts (Regulation) Rules, 1957 and further failed to unpledge the securities as per the circular dated

20th June, 2019. Subsequently, the interim order was confirmed on 2nd January, 2020.

8. On 19th March, 2020, a show cause notice was issued to the appellant to show cause why appropriate directions should not be issued for not complying with ex-parte ad interim direction dated 7th October, 2019 and for illegally invoking the pledge of securities inspite of a direction that the assets of BRH shall not be utilised for purpose of payment. In the show cause notice it was alleged that HDFC granted a loan facility of Rs.191.68/- crores to BRH by pledging securities and that the appellant had invoked the securities to the extent of Rs.158.68/- crores from two demat accounts of BRH and that one of the demat account numbering 1204630000021137 was tagged as 'Corporate CM/TM Client Account' with the depository indicating that the account was maintained for safekeeping of securities from clients of BRH and that BRH had violated Clause 2.5 of circular dated 26th September, 2016 read with clause 2(c) of circular dated 22nd June, 2017 and that

BRH was only permitted to pledge the security of clients which has a debit balance or clients having indebtedness to BRH at the time of creation of the pledge. It was alleged that no due diligence was carried out by the appellant to verify the securities pledged and that one of the demat accounts had clients securities which could not have been pledged by BRH and, therefore, the appellant could not have invoked the pledge of the securities which infact did not belong to BRH clients. It was, thus, alleged that the appellant had wrongly invoked securities and, therefore, show cause notice was issued as to why suitable direction should not be passed against the appellant under section 11 and 11B of the SEBI Act.

9. The appellant replied that the securities pledged in the two demat accounts belong to BRH and before invoking the securities had taken a legal opinion and only thereafter had invoked the pledge which did not violate the ex-parte ad-interim order dated 7th October, 2019. It was contended that the show cause notice

issued by the WTM was without jurisdiction as the appellant was outside the purview of SEBI's jurisdiction. It was contended that due diligence was carried out by the appellant and the loan agreement expressly contained a provision wherein BRH agreed and confirmed to maintain and segregate the securities held by it and on behalf of the clients and expressly confirmed that clients' securities will not be offered as a security while availing the loan facilities. It was also alleged that BRH has already filed a suit before the Calcutta High Court against the invocation of securities and, therefore, the matter is sub judice. It was contended that the securities pledged by BRH were in its own name and were shown as beneficial owner in the records of the CDSL i.e. depository and, thus, on that basis, the appellant were fully entitled to accept a pledge of such shares which showed BRH as the beneficial owner under Section 10 and 12 of the Depositories Act. It was also contended that the pledge was created in accordance with the Depositories

Act and the Regulations framed therein. It was also urged that in any case the bank has a general lien under Section 171 of the Contract Act in all forms of securities presented to it.

10. The WTM after considering the material evidence on record held that the assets of BRH as per para 9(v) of the ex-parte ad-interim order dated 7th October, 2019 includes securities which are pledged to the bank and, therefore, once an order has been passed by the WTM it was not open to the appellant to invoke the pledged security. The WTM further held that even though the appellant was not a party to the ex-parte ad-interim order dated 7th October, 2019, nonetheless, the interim order partakes the character of an "*order in rem*" and binds all constituents including the appellant and, thus, the interim order was not confined to the noticees of the said interim order. The WTM further found that the act of invocation of the pledge without paying deference to the restrictions imposed on the assets was illegal and that the appellant was required to

approach an appropriate forum for recovery of its dues and could not invoke the securities unilaterally. It was, thus, urged that the directions given in the ad-interim ex-parte order especially paragraph 9(v) had to be read holistically. The WTM further found that the appellant failed to conduct due diligence for the purpose of verification of ownership of securities pledged at the time of creation of pledge and, therefore, the invocation of the pledge by the appellants was not in conformity with the directions contained in the interim order. The WTM accordingly directed the appellant to deposit a sum of Rs.158.68/- crores alongwith interest at the rate of 7% p.a. in an escrow account till the issue of settlement of clients securities was reconciled. The WTM also imposed a penalty under Section 15HB of the SEBI Act amounting to Rs.1 crore for defeating the directions contained in the impugned order.

11. We have heard Mr. Janak Dwarkadas, Senior Advocate assisted by Mr. Gaurav Joshi, Senior Advocate, Mr. Sameer Pandit and Ms. Krina Gandhi,

Advocate for the appellant; Mr. Rafique Dada, Senior Advocate assisted by Mr. Manish Chhangani, Mr. Ravishekhar Pandey and Ms. Samreen Fatima, Advocates for the respondent and Mr. Pradeep Sancheti, Senior Advocate assisted by Mr. Rashid Boatwalla and Mr. Aditya Vyas, Advocates for the Intervener-NSE.

12. The contention of the appellants is, that the assets of BRH, namely, the directions contained in paragraph 9(v) cannot include the securities which are pledged. Further, the order of attachment as per the interim order cannot create a right since third parties rights have already come into existence on the securities pledged by BRH. In support of his contention, the learned senior counsel has relied on the decision of the Supreme Court in ***(1998) 5 SCC 1 Harshad Shantilal Mehta vs. Custodian & Ors., (2001) 4 SCC 424 Standard Chartered Bank v. The Custodian, (2017) 14 SCC 722 Roger Shashoua & Ors. v. Mukesh Sharma & Ors***.

13. It was also urged that the ex-parte ad-interim order dated 7th October, 2019 is not an '*order in rem'* but an '*order in personam'*. It was urged that the direction in the interim order is against BRH and its related parties and in the absence of any direction being issued against the appellant the contention that a holistic approach should be taken or that the order should be read as '*order in rem'* was patently erroneous and is not based on any sound principles of law.

14. It was also urged that the allegation that the securities which were pledged by BRH belonged to the clients of BRH was erroneous and cannot be accepted in as much as the Pledge Master Report of the depository (CDSL) indicates that the securities were of BRH as it was shown as the beneficial owner. It was submitted that when the securities were pledged the appellants carried out due diligence and only accepted the securities when they saw the name of BRH as the beneficial owner in the records of the depository.

15. On the other hand, the stand of SEBI is the same as taken in the impugned order contending that the assets of BRH would also include the pledge created by BRH and that the impugned order is required to be read holistically as an *order in rem.*

16. Before we deal with the rival submissions of the parties it is necessary for us to deal with the intervention application filed by NSE. In this intervention application, it was urged that BRH was a registered broker with them and that the securities belong to the clients of BRH. These securities were wrongly pledged by BRH in favour of the appellant. After the impugned order was passed by SEBI and, upon their directions, NSE conducted a forensic audit through Ernst & Young ('E & Y' for short) and, in the report submitted by E&Y it was found that Rs.116.62/- crores of securities having nil balance was pledged by BRH which was illegally invoked by the appellant. It was urged that the purpose of the intervention application is to place on record the exercise

undertaken by the intervener to map the securities liquidated by the appellant which belong to the broker's clients.

17. This application was vehemently opposed by the appellant contending that the interveners are not necessary parties nor are interested parties and are unnecessarily poking their nose in the present appeal in which they have no stakes in the matter.

18. Considering the submissions made by the parties, we are of the opinion that NSE is not a necessary party nor is an interested party. Further, merely because the intervener has carried out a forensic audit based on which the intervener has gathered some evidence regarding securities pledged by BRH does not, in our opinion, entitle the intervener to intervene in the present proceedings nor is entitled to be impleaded as a necessary party. In ***Ramesh Hirachand Kundanmal vs. Municipal Corporation of Greater Bombay and Ors. (1992) 2 SCC 524*** the Supreme Court held that "*the mere fact that the intervener has some evidence*

which may have a bearing on the case s does not entitle the intervener to intervene or be made a necessary party". The said decision is squarely applicable in the instant case. Further, we find that the material gathered by NSE was forwarded to SEBI but the said material has not been relied in the impugned order. Further, the E&Y report/forensic report has not been filed before this Tribunal and, consequently, we are of the opinion that such evidence urged by the intervener cannot be taken into consideration for the purpose of deciding the present appeal. Even though we heard the intervener at length, we are of the opinion that the intervener has no locus to intervene nor is a necessary or an interested party. The intervention application is accordingly rejected.

19. The gist of the allegations levelled in the show cause notice is summarised as under:-

(a) Non-compliance of the directions contained in the interim order by wrongly invoking the pledged securities.

(b) Failure to exercise due diligence while extending credit facilities to BRH.

(c) Violation of Clause 2.5 of SEBI circular dated 26th September, 2016 read with Clause 2(c) of SEBI circular dated 22nd June, 2017 and

(d) Violation of Clauses 4.8 and 4.9 of SEBI circular dated 20th June, 2019 by invoking the pledge of securities without giving the requisite notice of five days to the clients of BRH thereby depriving them a fair opportunity of claiming back their securities.

20. We find that the directions contained in the ex-parte ad-interim order was against BRH and its related entities. Further, directions were issued to the stock exchange and depositories to ensure compliance. The directions contained in the interim order is an *order in personam* and does not take the character of an *order in rem* nor does this order binds all constituents dealing with the broker on his assets. We are clear that a specific direction was given by the WTM against the

broker and its related parties and, therefore, it is an *order in personam* and cannot be treated to be an *order in rem*. The said ad-interim order in our view is not applicable on the appellant nor is binding.

21. The finding that the appellant had violated Clause 2.5 of the circular dated 26th September, 2016, Clause 2(c) of the circular dated 22nd June, 2017 or Clauses 4.8 and 4.9 of SEBI's circular dated 20th June, 2019 is patently erroneous. Before we proceed further, it would be appropriate to have a look at these circulars. For facility, Clause 2.5 of the circular dated 26th September, 2016, Clause 2(c) of the circular dated 22nd June, 2017 and Clauses 4.8 and 4.9 of SEBI's circular dated 20th June, 2019 are extracted hereunder:

Clause 2.5 of the circular dated 26th September, 2016

"2.5 As per existing norms, a stock broker is entitled to have a lien on client's securities to the extent of the client's indebtedness to the stock broker and the stock broker may pledge those securities. This pledge can occur only with the explicit authorization of the client and the stock broker needs to maintain records of such authorisation. Pledge of such securities is

permitted, only if, the same is done through Depository system in compliance with Regulation 58 of the SEBI (Depositories and Participants) Regulations, 1996. To strengthen the existing mechanism, the stock brokers shall ensure the following:

2.5.1 Securities of only those clients can be pledged who have a debit balance in their ledger.

2.5.2 Funds raised against such pledged securities for a client shall not exceed the debit balance in the ledger of that particular client.

2.5.3 Funds raised against such pledged securities shall be credited only to the bank account named as "Name of the Stock Broker-Client Account".

2.5.4 The securities to be pledged shall be pledged from BO account tagged as "Name of the Stock Broker-Client Account".

2.5.5. Stock Brokers shall send a statement reflecting the pledge and funding to the clients as and when their securities are pledged/unpledged as given below:

**Ledger debit would be after adjusting for open bills of clients, uncleared cheques deposited by clients and uncleared cheques issued to clients."*

Clause 2(c) of the circular dated 22nd June, 2017

"2. SEBI has received further representations from the market participants regarding certain provisions of the aforesaid circular. Based on the discussions with different stakeholders, following clarifications are made:

(a)……….
(b) ………

(c) Clause 2.5 stand modified as follows: "As per existing norms, a stock broker is entitled to have a lien on client's securities to the extent of the client's indebtedness to the stock broker and the stock broker may pledge those securities. Pledge of such securities is permitted, only if, the same is done through Depository system in compliance with Regulation 58 of the SEBI (Depositories and Participants) Regulations, 1996. To strengthen the existing mechanism, the stock brokers shall ensure the following."

Clauses 4.8 and 4.9 of SEBI's circular dated 20th June, 2019

"4.8 Further, the client's securities already pledged in terms of clause 2.5 of SEBI Circular SEBI/HO/ MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and clause 2(c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 shall, by August 31, 2019, either be unpledged and returned to the clients upon fulfilment of pay-in obligation or disposed off after giving notice of 5 days to the client.

4.9 Accordingly, the Clause 2.5 of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and clause 2(c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 stands deleted with effect from June 30, 2019."

22. In the first instance these circulars were issued by SEBI to the Managing Directors of all recognised stock exchanges and depositories and have not been issued to any other entity, namely, the banks/appellants in the instant case. The subject of these circulars was a direction or guidelines to the recognised stock exchange and depositories for enhancing supervision of stock brokers/depository participants. Clause 2.5 of the circular of 2016 provides that a stock broker is entitled to have a lien of clients' securities to the extent of clients' indebtedness to the stock broker and to that extent the stock broker may pledge those securities. However, these pledges can only occur with the explicit authorisation of the client and the stock broker is required to maintain records of such authorisation. Further, pledge of such securities is permitted only if it is done through the depository system in compliance with Regulation 58 of Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996. Consequently, securities of only those clients

can be pledged by a stock broker who has debit balance in their ledger. Clause 2(c) of the circular dated 22nd June, 2017 removed the embargo on taking an explicit authorisation from the client before pledging meaning thereby that it was open to a stockbroker to pledge the security of its client if the client had a debit balance in its ledger.

23. Clause 2.5 and Clause 2(c) of the circulars of 2016 and 2017 are against the broker and, therefore the broker has to comply with these directions. The appellant has nothing to do with the compliances required to be done by the broker.

24. In the instant case, we find that there is no evidence of any sort which has come in the impugned order to indicate that the securities pledged by the broker of its clients did not have a debit balance nor anything has come on record to indicate that the funds raised by the broker on such pledged securities exceeded the debit balance in the ledger of that particular client. Further, nothing has come on record to indicate that the

securities pledged by the broker did not have the tacit/ explicit authorisation from its clients.

25. Further, Clause 2.5 of the circular dated 26th September, 2016 makes it apparently clear that the pledge was only permitted if the same was done through the depository system in compliance with Regulation 58 of the Depository Regulations, 1996. Nothing has come on record in the impugned order to show that the securities pledged by BRH were not in accordance with Regulation 58 of the Depository Regulations, 1996.

26. Allegation that the appellant has violated Clause 4.8 of the circular dated 20th June, 2019 is per se erroneous. The finding that five days previous notice was required to be given by the appellant to the clients of BRH before invoking the pledge is patently erroneous. Clause 4.8 of the circular dated 20th June, 2019 only directed the broker to unpledge the securities and return it to the clients upon fulfilment of pay in obligation or dispose off after giving five days'

notice to the client. The five days' notice is required to be given by the broker and not by the appellant. Further, Clause 4.9 of the circular of 2019 clearly indicated that Clause 2.5 of the circular of 2016 and Clause 2(c) of the circular dated 22nd June, 2017 stood deleted with effect from 30th June, 2019. Thus, the compliance, if any, of Clause 4.8 was required to be made by the broker and not by the appellant.

27. A finding has been given in the impugned order that there has been a failure to exercise due diligence by the appellants while extending credit facilities to BRH. It was urged that HDFC did not conduct adequate due diligence to verify the securities pledged in its favour which actually belonged to the clients of BRH having a debit balance at the time of creation of the pledge. This aspect in its entirety is totally erroneous and based on surmises and conjectures and is against the material evidence on record. In this regard, a categorical assertion was made that due diligence was carried out by the appellants before

extending the loan and taking securities as collateral securities. It was contended that the agreements entered by the appellants with the brokers contained a specific clause, namely, that BRH agreed and confirmed to maintain segregation of securities held by it on behalf of its clients from the securities held by it in its own name. Further, BRH expressly agreed and confirmed that the clients securities will not be offered as security to the loan taken by them. In addition to the aforesaid, a specific assertion was made that the securities pledged by the broker were in the name of the broker and was shown as a beneficial owner in the pledge master record which is maintained by the depository and which was sufficient proof to create a pledge of those securities. In our view, these assertions have not been dealt with nor denied in the impugned order and we are satisfied that adequate due diligence was carried out by the appellant while pledging the securities. It is not the job of the appellant to figure out as to whether the securities are

of the broker or of its clients and it is enough for the appellant to be informed by the depository that the securities are in the name of the beneficial owner which in the instant case was the broker BRH. Thus, the finding that the pledge created by the broker was invalid and, consequently, the subsequent invocation by the appellant was also illegal is totally misplaced.

28. It was alleged that para 9(v) of the ex-parte ad-interim order was violated by the appellants, namely, that the assets of BRH could be utilised only for the purpose of payment of money to the clients of BRH or the investors under the supervision of the depository/ exchange. It was alleged that the appellant has wrongly invoked the pledge and by invoking such pledge has violated Clause 9(v) of the interim order.

29. It was urged before us that the words 'assets of the noticees' includes the securities pledged by the broker and, therefore, such securities pledged could not be utilised by the Bank for its purposes.

30. In this regard, in ***Harshad Shantilal Mehta v. Custodian and Ors. (1998) 5 SCC 1*** the facts were that the property of the notified person was attached by the custodian under Section 3 of the Special Act. The Supreme Court held that where a mortgaged/pledged property of a notified person was already mortgaged/ pledged to the bank on the date of the attachment, then such mortgaged/pledged property could not be attached. Further, the proceeds from which distribution is to be made could only be from the proceeds in relation to the right title and interest of the notified person in that property. Where third party right is created, the interest of the third party in the attached property cannot be sold or distributed to discharge the liabilities of the notified person. The Supreme Court held that this would also be the position when the properties is already mortgaged or pledged on the date of the attachment to a Bank or to any third party. The right acquired by a third party in the attached property prior to the attachment does not

get extinguished nor does the property vests in the custodian. The Supreme Court held:

> *"17. The Custodian has raised certain further questions. We propose to consider one such question which has a bearing on the questions which have been framed by the Special Court. The question is whether in the case of mortgaged/pledged properties of the notified persons already mortgaged/pledged to the banks or financial institutions on the date of attachment, the words of Section 3 (3) "any property movable or immovable or both belonging to any person notified" would refer only to the right, title or interest of the notified person in the mortgaged/pledged property and not the entire property itself. If so, the liabilities mentioned in Section 11(2) which are to be paid from the proceeds of the sale of the attached property, would only refer to proceeds of the sale of the right, title and interest of the notified person in the attached property.*
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> *18. The last question can be answered first. As stated above, Section 3(3) clearly provides that the properties attached are properties which belong to the person notified. The words "belong to" have a reverence only to the right, title and interest of the notified person in that property. If in the property "belonging to" a notified person, another person has a share or interest, that share or interest is not extinguished. Of course, if the interest of the notified person in the property is not a severable interest, the entire property may be attached. But the proceeds from which distribution will be made under Section 11(2) can only be the proceeds in relation to the right, title and interest of the notified person in that property. The interest of a third party in the*

> *attached property cannot be sold or distributed to discharge the liabilities of the notified person. This would also be the position when the property is already mortgaged or pledged on the date of attachment to a bank or to any third party. This, however, is subject to the right of the Custodian under Section 4 to set aside the transaction of mortgage or pledge. Unless the Custodian exercises his power under Section 4, the right acquired by a third party in the attached property prior to attachment does not get extinguished nor does the property vest in the Custodian whether free from encumbrances or otherwise. The ownership of the property remains as it was."*

Similar view was again reiterated by the Supreme Court in ***Standard Chartered Bank v. Custodian and Ors. (2001) 4 SCC 424.***

31. In ***The Bank of Bihar vs. The State of Bihar & Ors. (1972) 3 SCC 196*** the underlying facts was that certain merchandise was pledged with the bank. The bank held the goods as security for the advances made. While the goods were in possession with the bank the district magistrate forcibly removed certain number of bags of sugar. No payment was made to the bank. The defence taken by the district magistrate was that the goods were seized pursuant to lawful orders which had been made and the sale proceeds were deposited in the

treasury which was later on attached under the recovery certificate towards arrears of sugar cess which was due from Bhita Sugar Factory with which the bank had entered into an arrangement while advancing the loan. The Supreme Court held that mere act of lawful seizure by the government would not deprive the bank of the amount which was secured by the pledge of the goods to it. The Supreme Court held:

> *"6. In our judgment the High Court is in error in considering that the rights of the Pawnee who had parted with money in favour of the pawnor on the security of the goods can be defeated by the goods being lawfully seized by the Government and the money being made available to other creditors of the pawnor without the claim of the Pawnee being fully satisfied. The Pawnee has special property and a lien which is not of ordinary nature on the goods and so long as his claim is not satisfied no other creditor of the pawnor has any right to take away the goods or its price. After the goods had been seized by the Government it was bound to pay the amount due to the plaintiff and the balance could have been made available to satisfy the claim of other creditors of the pawnor. But by a mere act of lawful seizure the Government could not deprive the plaintiff of the amount which was secured by the pledge of the goods to it. As the act of the Government resulted in deprivation of the amount to which the plaintiff was entitled it was bound to reimburse the plaintiff for such amount which the plaintiff in ordinary course would have realized*

> *by sale of the goods pledged with it on the pawnor making a default in payment of debt.”*

32. Thus, from the reading of the aforesaid judgments it is clear that where certain goods/property/shares are mortgaged or pledged, a third party right is created and, consequently, the interest of the third party in the pledged property cannot be sold to discharge the liabilities of the broker. Consequently, in our view the words “assets of the noticees” in para 9(v) of the interim order cannot include a pledge as any other interpretation on these words would put a clog on rights of a third party. We are, thus, of the opinion that the “assets of the noticees” used in para 9(v) of the interim order does not include the pledge made by the broker to the appellant.

33. In this regard, we need to look into certain provision of the Depositories Act, 1996. For facility Section 2(a), Section 7(1), Section 9, Section 9(1), Section 10, Section 11 and Section 12 are extracted hereunder.

<u>Section 2(a)</u>

*“**2. Definitions***
(1) In this Act, unless the context otherwise requires,—

(a) “beneficial owner” means a person whose name is recorded as such with a depository;”

Section 7(1)

***“7. Registration of transfer of securities with depository**.—*

(1) Every depository shall, on receipt of intimation from a participant, register the transfer of security in the name of the transferee.”

Section 9

*“**9. Securities in depositories to be in fungible form.***—

(1) All securities held by a depository shall be dematerialised and shall be in a fungible form.

[(2) Nothing contained in sections 153, 153A, 153B, 187B, 187C and 372 of the Companies Act, 1956 (1 of 1956) shall apply to a depository in respect of securities held by it on behalf of the beneficial owners.]”

Section 10

“10. Rights of depositories and beneficial owner.—

(1) Notwithstanding anything contained in any other law for the time being in force, a depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.

(2) Save as otherwise provided in sub-section (1), the depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it.

(3) The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

Section 11

"11. Register of beneficial owner*.—*

Every depository shall maintain a register and an index of beneficial owners in the manner provided in sections 150, 151 and 152 of the Companies Act, 1956 (1 of 1956).

Section 12

"12. Pledge or hypothecation of securities held in a depository*.—*

(1) Subject to such regulations and bye-laws, as may be made in this behalf, a beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository.

(2) Every beneficial owner shall give intimation of such pledge or hypothecation to the depository and such depository shall thereupon make entries in its records accordingly.

(3) Any entry in the records of a depository under sub-section (2) shall be evidence of a pledge or hypothecation."

34. From the aforesaid, a beneficial owner means a person whose name is recorded as such with the depository. Under Section 7(1) a depository is required to register the transfer of security in the name of the transferee. Under Section 9 all securities held by the depository shall be dematerialised and shall be kept in a fungible form. Under Section 10 a depository shall be deemed to be a registered owner for the purpose of effecting transfer of ownership of securities on behalf of a beneficial owner. The beneficial owner would be entitled to all rights and benefits and subjected to all the liabilities in respect of the securities held by the depository. Section 11 provides that every depository shall maintain a register and an index of beneficial owners in the manner specified in Sections 150, 151 and 152 of the Companies Act, 1956. Section 12 provides that subject to such regulations and bye laws as may be made in this behalf a beneficial owner may with the previous approval of the depository create a pledge in respect of a security owned by him

through a depository. Further, any entry in the records of a depository shall be evidence of a pledge.

35. In exercise of the powers conferred by Section 30 of the SEBI Act read with Section 25 of the Depositories Act, SEBI made the regulations known as Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018. One such provision provided under the regulation is clause (d) and (f) which are extracted hereunder:

> *(d) the manner of creating a pledge or hypothecation in respect of security owned by a beneficial owner under sub- section (1) of section 12;*
>
> *(f) the rights and obligations of the depositories, participants and the issuers under sub-section (1) of section 17;*

36. Regulation 79 provides the manner of creating a pledge or hypothecation. For Facility, Regulations 58 and 79 are extracted hereunder:

<u>Regulation 58</u>

"Agreement by participants

58. Every participant shall enter into an agreement with a beneficial owner before acting

as a participant on his behalf, in a manner specified by the depository in its bye-laws."

Regulation 79

"Manner of creating pledge or hypothecation

79. (1) If a beneficial owner intends to create a pledge on a security owned by him he shall make an application to the depository through the participant who has his account in respect of such securities.

(2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.

(3) Within fifteen days of receipt of the application, the depository shall after concurrence of the pledgee through its participant, create and record the pledge and send an intimation of the same to the participants of the pledger and the pledgee.

(4) On receipt of the intimation under sub-regulation (3) the participants of both the pledger and the pledgee shall inform the pledger and the pledgee respectively of the entry of creation of the pledge.

(5) If the depository does not create the pledge, it shall send a long with the reasons an intimation to the participants of the pledger and the pledgee.

(6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if pledger or the pledgee makes an application to the depository through its participant:

Provided that no entry of pledge shall be cancelled by the depository without prior concurrence of the pledgee.

(7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledger.

(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.

(9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledger and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledger and pledgee respectively.

(10) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).

(11) The provisions of sub-regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation:

Provided that the depository before registering the hypothecatee as a beneficial owner shall obtain the prior concurrence of the hypothecator.

(12) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a participant without

the concurrence of the pledgee or the hypothecatee, as the case may be."

37. A perusal of sub-clause (8) of Regulation 79 indicates that the pledgee may invoke the pledge and on such invocation the depository shall register the pledgee as beneficial owner of such securities in its record accordingly.

38. Before we proceed further we need to take a look at certain provisions of the Companies Act, 1956. For facility, Section 150, 151 and 152A of the Companies Act are extracted hereunder:

"***150. Register of members***

(1) Every company shall keep in one or more books a register of its members, and enter therein the following particulars:-

(a) the name and address, and the occupation, if any, of each member;

(b) in the case of a company having a share capital, the shares held by each member, [distinguishing each share by its number except where such shares are held with a depository], and the amount paid or agreed to be considered as paid on those shares;

(c) the date at which each person was entered in the register as a member; and

(d) the date at which any person ceased to be a member:

Provided that where the company has converted any of its shares into stock and given notice of the conversion to the Registrar, the register shall show the amount of stock held by each of the members concerned instead of the shares so converted which were previously held by him.

(2) If default is made in complying with sub-section (1), the company, and every officer of the company who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues."

*"**151. Index of Members***

(1) Every company having more than fifty members shall, unless the register of members is in such a form as in itself to constitute an index, keep an index (which may be in the form of a card index) of the names of the members of the company and shall, within fourteen days after the date on which any alteration is made in the register of members, make the necessary alteration in the index.

(2) The index shall, in respect of each member, contain a sufficient indication to enable the entries relating to that member in the register to be readily found.

(3) The index shall, at all times, be kept at the same place as the register of members.

(4) If default is made in complying with sub-section (1), (2) or (3), the company, and every officer of the company who is in default, shall be

punishable with fine which may extend to five hundred rupees."

"152A. Register and index of beneficial owners

The register and index of beneficial owners maintained by a depository under Section 11 of the Depositories Act, 1996 (22 of 1996), shall be deemed to be an index of members and register and index of debenture holders, as the case may be, for the purposes of this Act."

39. The aforesaid provision 150 and 151 provides that a company is required to maintain a register of its members containing particulars of the name/address/ occupation etc. of a member. Section 152A was enacted in the Companies Act with effect from 20th September, 1995 which indicates that the register and index of beneficial owners maintained by the depository under Section 11 of the Depositories Act would be deemed to be an index of members for the purpose of this Act, namely, the Companies Act.

40. In law the contents of the register of members under Section 150 of the Companies Act constitutes a prima facie evidence of the truth of the matter stated in that register, namely, that the name found in the register of

members under Section 150 indicates that such member is the owner of the shares of the Company. Section 152A provides that the register maintained under Section 11 of the Depositories Act shall be deemed to be an index of members under the Companies Act meaning thereby the name of a beneficial owner recorded in the register maintained under Section 11 of the Depositories Act would be sufficient proof of the ownership of the shares of that beneficial owner.

41. In ***JRY Investments P. Ltd. vs. Deccan Leafline Services Ltd. and Ors. (2003) SCC Online Bom 1134*** Justice Shri S.A. Bobde, as he then was, while considering the provisions of the Depositories Act and the principles of the Contract Act held:

> *"22. It must be remembered that the shares in question are demated shares, i.e., shares in the dematerialised form. In other words, the shares are not in the physical form of share certificates bearing a certificate number but are shares which are stored with or deposited as shares of the company in the dematerialised form without individual identity. They are in a fungible form. It is, therefore, clear that such shares cannot be pledged in accordance with the provisions of the Indian Contract Act, 1872, which requires*

delivery of the goods pledged. Section 172 of the Contract Act reads as follows:

> *"172. 'Pledge', 'pawnor' and 'pawnee' defined.--The bailment of goods as security for payment of a debt or performance of a promise is called 'pledge'. The bailor is in this case called the 'pawnor'. The bailee is called 'pawnee'."*

23. Section 148 defines bailment as follows :

> *"148. 'Bailment', 'bailor' and 'bailee' defined.--A 'bailment' is the delivery of goods by one person to another for some purpose, upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them. The person delivering the goods is called the 'bailor'. The person to whom they are delivered is called the 'bailee'."*

24. It is, therefore, obvious from the said provisions that for a valid pledge, there must be a delivery of goods, i.e., a physical possession of the goods. It might be possible to hold that such shares are goods as defined by Article 366(12) of the Constitution of India, i.e., "all materials, commodities and articles" and by Section 2(7) of the Sale of Goods Act which defines the word to include "stocks and shares". It would, however, be impossible to hold that such goods in a dematerialised form are capable of delivery that is by handing over de facto possession. Since such goods are invisible and intangible it would be impossible and in any case difficult to fix the fact of time and place of delivery. Even if it is possible according to some protocol, it does not seem to have been recognised by the law yet. Dematerialised shares cannot be delivered physically nor can physical possession of such dematerialised shares be handed over.

……………..

30. It is, therefore, clear that the Act and the regulations contain a whole and self-contained procedure for the creation of pledges. In any case, since it is not possible to physically deliver demated shares and therefore pledge them in accordance with the Indian Contract Act, 1872, it must be held that a pledge of such shares can only be validly created in accordance with the provisions of the Depositories Act, 1996,"

42. In ***Ankit Securities And Finance Co vs Birla Investment Services (2004) Bom CR 436*** Justice Shri D.Y. Chandrachud, as he then was, explained certain provisions of the Depositories Act especially Section 9 of the Depositories Act which required all shares to be dematerialised and would be in fungible form. For facility para 10 is extracted hereunder:

"10. In the context of the present case, it would be instructive to have regard to the relevant provisions of the Depositories Act, 1996. Section 9(1) of the Act provides that all securities held by a depository shall be dematerialised and shall be in a fungible form. The expression "fungible" is defined in Webster's Third New International Dictionary (1993 Edition page 922) as being "of such a kind or nature that one specimen or part may be used in place of another specimen or equal part in the satisfaction of an obligation". A related meaning is that 'which is capable of mutual substitution'. Under Sub-section (1) of Section 10 notwithstanding anything contained in any other law for the time being in force, a

> *depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of a security on behalf of a beneficial owner. However, under Sub-section (2) a depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it. Section 10(3) provides that the beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository. Under Section 11, every depository shall maintain a register and an index of beneficial owners in the manner provided in sections 150, 151 and 152 of the Companies Act, 1956. Fungible is the essence of the security held by a depository. Such securities are held in a dematerialised form. In the present case, the applicants have not been able to establish either with reference to the provisions of the Depositories Act, 1996 or on the basis of any cogent evidence that they are entitled to a beneficial ownership in respect of the shares or that they had acquired any interest therein on the basis of a valid transaction of sale or purchase."*

43. From the aforesaid provisions of the Depositories Act, the Companies Act and the decisions cited aforesaid it is clear that the Depositories Act is a complete Code by itself. Further, the Depositories Act and the regulations framed thereunder contains a whole and self-contained procedure for creation of pledges. Once the shares are dematerialised and are kept in fungible form as per Section 9(1) of the Depositories

Act such shares could only be pledged in accordance with the provisions of the Depositories Act read with the regulations and cannot be pledged in accordance with the provisions of the Indian Contract Act. Thus, shares which are dematerialised under Section 9 of the Depositories Act is to be governed under Section 10 of the said Act. A perusal of Section 10 would indicate that it begins with a non obstante clause and, therefore, excludes the provisions of the Contract Act or of the Transfer of Property Act. Thus, ownership and transfer of dematerialised shares would be squarely covered in accordance with the provisions of Section 12 of the Depositories Act which provides that a beneficial owner may with the previous approval of the Depository create a pledge in respect of a security owned by him.

44. In the light of the aforesaid, the decisions cited by the intervener is not required to be dealt with and are are not applicable as those cases are under the Contract Act wherein the principle that the pledgee cannot get a

better title than the pledgor was involved. The decisions cited are ***Solomon vs. Attenborough [(1912) 1 Ch. 451]; Ram Bharose Sharma vs. Mahant Ram Swaroop & Ors. [(2001) 9 SCC 471] and Shyam Sunder Kejriwal vs. Usha Kejriwal [2010 SCC Online Cal 2091]***.

45. In addition to the aforesaid certain other decisions have also been added in the written submissions are also on the issue of trust and trustee which again are not applicable and are also distinguishable.

46. In the light of the aforesaid, we find that a pledge was created by the broker BRH under the Depositories Act in favour of the appellant. Once a pledge is validly created by the broker in favour of the appellant and the appellants is recorded as the beneficial owner in the records maintained by the depository under Section 11 the beneficial owner becomes the registered owner under Section 10. Consequently, if a default is committed by the broker the appellant gets a right to invoke the pledge under the agreement. Nothing has

come on record to indicate that the invocation of the pledge by the appellant was wrongly done as there was no default committed by the broker. In the absence of such allegation we are of the opinion that the appellant had the right to invoke the pledge and that no violation was made by the appellant while invoking pledge in respect of the ex-parte ad-interim order which was subsequently confirmed issued by SEBI.

47. We are, thus, of the opinion that the appellant was justified in invoking the pledge made by the broker BRH. While invoking the pledge the appellants did not violate any direction contained in the ex-parte ad-interim order dated 7th October, 2019 passed by the WTM. The ex-parte ad-interim order is not an *order in rem*. The appellant could invoke the pledge under Depositories Act and is not required to approach any forum or Court of law for invocation of the pledge. The assets of the broker do not include pledge of the shares created by the sub broker.

48. In view of the aforesaid, the impugned order cannot be sustained and is quashed. The appeal is allowed. In the circumstances of the case, parties shall bear their own costs.

49. The present matter was heard through video conference due to Covid-19 pandemic. At this stage it is not possible to sign a copy of this order nor a certified copy of this order could be issued by the registry. In these circumstances, this order will be digitally signed by the Private Secretary on behalf of the bench and all concerned parties are directed to act on the digitally signed copy of this order. Parties will act on production of a digitally signed copy sent by fax and/or email.

Justice Tarun Agarwala
Presiding Officer

Justice M.T. Joshi
Judicial Member

18.2.2022
RHN