

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: PRASHANT SARAN, WHOLE TIME MEMBER**

Order under Section 12A of the Securities Contracts (Regulation) Act, 1956

IN RESPECT OF UNITED STOCK EXCHANGE OF INDIA LIMITED

Date of hearing: April 09, 2012

Appearances:

For Noticee: Mr. K. Kumar, Dy. CEO, USE
Mr. P.K. Ramesh, CRO, USE
Mr. V. Soundararajan, Head - Operations, USE
Mr. J.J. Bhatt, Senior Advocate
Mr. Rohan Rajadhyaksha, Advocate
Mr. Ankur Kashyap, Advocate

For SEBI: Mr. SVMD Rao, Chief General Manager
Mr. Satyajit Jaware, Manager
Ms. Anitha Anoop, Deputy Legal Adviser
Mr. Pradeep Kumar, Assistant Legal Adviser
Ms. Anju Mahendra, Presenting Officer

1. Securities and Exchange Board of India (hereinafter referred to as 'SEBI') granted recognition to the United Stock Exchange of India Limited (hereinafter referred to as 'USE') vide notification dated March 26, 2010 under Section 4 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred as 'SCRA') to operationalise exchange traded currency derivative segment (hereinafter referred to as 'CD segment'), for a period of one year commencing on March 22, 2010. USE commenced its currency trading platform in September, 2010. On an application by USE, the recognition of USE was later renewed by SEBI for a period of one year commencing on March 22, 2012 and ending on March 21, 2013.

2. SEBI while reviewing the trading volumes across all the currency trading platforms noticed concentration of large trades and volumes mostly by two trading members at USE. It was observed that one of these two trading members had accounted for about 77-80% of the total turnover. SEBI vide

letter dated August 30, 2011 communicated its concern to USE. In response to this, USE submitted a reply dated September 21, 2011 to SEBI.

3. SEBI vide another letter dated September 30, 2011 advised USE that the trading volume needs to grow in an orderly manner over a period of time with wider participation from brokers/ clients. Thereafter, SEBI convened a meeting with the officials of the USE on October 03, 2011 wherein matters relating to governance and administration of the exchange was discussed. Subsequently, officials from SEBI visited the USE on October 10, 2011, in order to ascertain the functioning and evolving developments at the USE.
4. While so, SEBI received a letter from Mr. T.S. Narayanasami, the Managing Director and Chief Executive Officer (hereinafter referred to as 'CEO') of the USE on October 05, 2011, whereby he conveyed his resignation from the Governing Board (hereinafter referred to as 'board') of the USE. It was also written therein that the Board of USE desired that the Managing Director should continue his office till the end of November, 2011.
5. Subsequent to the visit to USE, SEBI issued a Show Cause Notice dated December 29, 2011 (hereinafter referred to as 'SCN') under Section 12A of the Securities Contract Regulation Act, 1956 (hereinafter referred to as 'SCRA') to the USE, wherein *inter alia* it was alleged that there was absence of robust surveillance system at USE, to monitor the trend of domination of trade/ artificial boosting of exchange volumes by one trading member, failure to build its own infrastructure, dilution of the independence of the Public Interest Directors (hereinafter referred to as 'PID'), absence of sustainable pricing policy and failure to ensure payment of turnover fees to SEBI by its members, inability of the USE Board to correct imbalances in favour of particular director including delayed payments and quorum rights, amendment of articles of association without approval from SEBI etc. The SCN also brings out that the then existing state of affairs at USE were not in the interest of securities market. USE was also advised to reply to the SCN, within a period of fifteen days from the date of receipt thereof. It was also informed that in

case of failure to reply, it would be presumed that USE had no explanation to offer and that SEBI would be free to take action as per law.

6. USE vide its letter dated January 23, 2012 replied to the SCN. Thereafter, an opportunity of personal hearing was granted to the USE on March 26, 2012. USE sought an adjournment, vide its letter dated March 21, 2012 as its advocate was not available on the scheduled date. Accordingly, the hearing was rescheduled to April 09, 2012. On this date, Mr. J.J. Bhatt, Senior Advocate appeared on behalf of USE along with Mr. K. Kumar, Deputy Chief Executive Officer, USE, Mr. P.K. Ramesh, CRO, USE, Mr. V. Soundararajan, Head, Operations, USE, Mr. Rohan Rajadhyaksha, Advocate and Mr. Ankur Kashyap, Advocate and made their submissions. During the personal hearing, USE was asked to submit certain details, the said details were communicated by USE to SEBI, vide its letter dated April 13, 2012.
7. The submissions of USE that were made during the oral hearing as well in its written replies dated January 23, 2012 and April 13, 2012, are summarized in brief below:
 - a. The SEBI Circular dated April 21, 2003 casts the responsibility on the Managing Director to monitor all surveillance related functions of USE.
 - b. Mr. T.S. Narayanasami, the Managing Director and CEO of USE was responsible for overall functioning and in charge of the affairs of USE. The issues which are also the subject matter of the SCN were not brought to the attention of the board of USE despite there being a meeting of the board on September 19, 2011. The entire correspondence which was exchanged with SEBI on the issues regarding the concentration of trades was notified to the surveillance committee and the board by Mr. T.S. Narayanasami, in its meeting held on October 01, 2011. In the board meeting held on October 01, 2011, Mr. T.S. Narayanasami submitted his resignation to the Chairman of the board by his letter dated September 26, 2011. Although the board decided to accept his resignation at first, it declined to accede to his demand of being relieved from the services of USE with immediate effect and asked him to continue for another two months to ensure continuity.

- c. Following the said meeting, the board of USE had taken charge of various matters and taken appropriate corrective/ preventive steps to rectify the issues. It was said that the board in its meeting has decided that communication shall be sent to those members whose concentration level crossed 30% on a monthly basis, asking for details of their value of business/ percentage and value of trades that had taken place between the terminals of the same member (self trades) and asking the members to take note of such patterns and exercise due care while undertaking transactions. The board confirmed that the trading concentration was brought down in October and then further in November and December.
- d. Once the board was notified about the concentration of trading volumes, immediate and effective steps were undertaken by USE, in relation to the concentration of trade issues. The board has acted diligently to ensure that SEBI's apprehensions are addressed and dealt with.
- e. SEBI has not prescribed any rules, regulations or parameters regarding the concentration of trades by the trading members. In the absence of the same, it cannot be said that USE has failed to detect and control such instances.
- f. Concentration of trades is a usual occurrence for any exchange in its initial stages. The surveillance systems at the USE did detect the concentration of trades and the same was reported to the erstwhile Managing Director and CEO. However, as there was no evidence of manipulative trading patterns, the same was not acted upon.
- g. After initiating a few steps by the board, the trading concentration, has substantially reduced and in fact, the top member concentration on a gross basis for the month of December 2011 was 21.24% and that of two trading members was 40.87%.
- h. USE has constituted a nomination committee in its meeting held on October 01, 2011, for reviewing the structure, size and composition of the board on regular basis. With this, steps have been taken to rectify the issues regarding the representation of the trading members on the board.
- i. The SCRA is silent on the manner of appointment of PID, therefore USE has followed the provisions as listed under Section 256 of the Companies Act,

1956 and accordingly the PIDs were subjected to retirement by rotation and re-election at the annual general meetings.

- j. USE has submitted that while a provision indeed exists for the selection of PIDs from the pool of persons empanelled with SEBI, the practice followed by USE is to seek prior approval from SEBI before appointing Directors under the category of PID. However, USE on January 19, 2012, asked SEBI for the list of persons empanelled by SEBI to be appointed as PIDs in the governing board of a stock exchange.
- k. USE has denied that the board structure is skewed in favour of Bombay Stock Exchange (hereinafter referred to as 'BSE') in any manner whatsoever. As per Clause 3.2(f) of SEBI Master Circular bearing number CIR/MRD/DSA/10/2010, it is said that "a person shall not act as 'Public Interest Director' on more than one Stock Exchange simultaneously". The two persons in question were first appointed as PIDs on the board of USE and thereafter appointed as shareholder director on the board of BSE and Chairman (Independent Director) on the board of Indian Clearing Corporation Limited (hereinafter referred to as 'ICCL') respectively. The said two persons are not discharging the roles of PIDs on the other respective boards of BSE and ICCL. It may be noted that SEBI guidelines do not prohibit a Director (PID or otherwise) on a stock exchange from being on the board of clearing corporation or any other company.
- l. BSE has never been a beneficiary of any preferential treatment by USE. On the contrary, payments made to BSE and ICCL towards Operation and Maintenance and Clearing and Settlement agreement are well below the market rates.
- m. BSE has suspended its Currency Derivative segment license and hence there is no conflict of interest between USE and BSE.
- n. Amendment to Article 37.1 of the Articles of Association (hereinafter referred to as 'AoA') was carried out in order to bring it in conformity with Section 256 of the Companies Act, 1956. As the amendment had no bearing on the constitution of the board as per Section 3(2) of the SCRA, no prior approval was sought from SEBI. It is also undertaken that USE shall seek the prior approval from SEBI for amending the AoA, henceforth.

- o. The USE by its letter has further confirmed to SEBI that the AoA of the company were amended to incorporate the Special Articles (Part II) in the Extra Ordinary General Meeting of the shareholders held on November 12, 2009 and in this regard, the requirements of the Companies Act, 1956 were complied with. USE has received a letter from SEBI asking it to keep the special AoA of USE in abeyance with immediate effect and not to act upon the same.
- p. SEBI permits late payment of the turnover fee with a penal interest of 15% per annum being applicable in case of delayed payments. USE is still following up with all the trading members, without exception, for the collection of penal interest towards late payment of the turnover fees to SEBI. On a few occasions, the delay in payment of turnover fee to SEBI was due to the non-availability of erstwhile Managing Director and CEO (the signatory for cheques) during the first week of certain months.
- q. When the organization structure was submitted to SEBI at the time of seeking recognition, no time line was specified by SEBI for terminating the deputation arrangement with BSE. On the contrary, SEBI sought two undertakings from BSE. Based on these undertakings, the inference drawn by USE was that SEBI was rightly concerned with ensuring continuity of infrastructure and personnel without any prejudice to the personnel being on deputation from BSE or on the rolls of USE.
- r. USE is a one year old exchange vis-à-vis its competitors who had been operating in the segment for three years before levying any transaction charges. Despite the competitive environment, USE has taken pro-active measures to build up a sustainable pricing policy and ensure sound financial health over a long term.
- s. Mr. Saurav Arora has been asked by USE to comply with the provisions of Section 314 of the Companies Act, 1956. In keeping with good corporate governance principles, USE by its letter dated December 28, 2010 had informed SEBI about the appointment of Mr. Saurav Arora in USE, in view of his past association as the Director of Jaypee Capital Services Limited and USE, in an absence of response from SEBI inferred that SEBI had “no objection” to the said appointment.

- t. The failure to convene the Board meeting was an inadvertent error and not in any way reflective of the Board's intent to review the performance or otherwise. The delay in convening the board meeting was a one off affair and may not be construed as an act of disinterest or failure of the Board in any way. The Board has conducted meetings on December 22, 2011 and January 12, 2012 since then.
- 8. I have carefully considered the SCN issued to the USE, the replies and the written submissions made by USE including those made during the personal hearing. Considering the above, the issues raised in the SCN are being discussed below *in seriatim*:

a. Absence of robust surveillance system:

It has been alleged in the SCN that the USE has failed to monitor concentration of the large size trades during the period of July, 2011 to August, 2011 at USE which had ranged from 6.25% to 45.84%. Nearly all trades of contract size more than 5,000 were done by the trading member, Todi Securities Pvt. Limited and the trades were executed from two separate terminals of the same trading member. It has been revealed that the trading member Jaypee Capital Services Limited and Todi Securities Pvt. Limited had accounted for more than 90% of the large sized trades on daily basis. These two trading members were the top trading members on USE accounting for more than 80% of the total turnover on USE in May, 2011, which increased to nearly 90% in July, 2011. It was further revealed that Jaypee Capital Services Limited had alone accounted for 77% to 80% of the total turnover during the period of July, 2011 to August, 2011 at USE, which in the absence of a robust surveillance system to monitor the trend of domination of trades by one trading member, resulted into a significant level of self trades through very large number of trading terminals from multiple locations. Since the beginning of the operations at USE, the top two brokers had accounted for 88% to 95 % of the total turnover on the exchange. This contribution to the turnover by the two trading members came down to 89% in October, 2011, pursuant to the intervention of SEBI. It has been alleged that

the exchange has failed to prevent such high concentration among a few trading members, even after one year of its operation and there was an attempt by a single trading member namely Jaypee Capital Services Limited of artificial boosting of exchange volumes.

USE in its reply has admitted that it had detected the concentration of the trades and that the same was reported to the erstwhile Managing Director and CEO. However, as there was no evidence of any manipulative trading patterns considering the fact that concentration of trades is a usual occurrence for any exchange in its initial stages, the same was not acted upon by the erstwhile Managing Director and CEO. USE has submitted that there are no rules and regulations prescribed by SEBI which lays down the parameters regarding concentration of trades by trading members. USE has also stated that the board of USE was not informed by the erstwhile Managing Director and CEO. However, in the meeting dated October 01, 2011, the concern of SEBI came to the knowledge of the board of USE and immediate steps were taken to bring down the concentration levels. As a result of the steps taken by the board of USE, the concentration and the volumes came down at USE i.e., the top member concentration on a gross basis for the month of December, 2011 was 21.24% and that of the top two trading members was 40.87%.

I have considered the submission of the noticee that Mr. Narayansami, erstwhile Managing Director and CEO, was responsible for overall functioning and in-charge of the affairs of USE, during his tenure. Further, all the correspondences sent by/ to SEBI were exchanged by its erstwhile Managing Director and CEO. This submission of USE finds no merit as the issues including concentration of trades by a single trading member/ volumes in Currency Derivative segment, once communicated to USE, it is for the USE to address to the issue. I note that the argument of USE that whether the Managing Director and CEO has not communicated these to the Board is an internal matter and rather raises question about its management. Additionally, the news about concentration of trades by a single trading member/ volumes

in the Currency Derivative segment was widely reported in the media. Therefore, in my opinion the board members should have been alerted, with these.

I note that the surveillance systems at the USE had detected the concentration of trades by a single member, which was not usual. The fact of continuous concentration by a single member, that too the one who is on the board of USE as a Trading Member Director for a long time, ought to have raised some suspicion to the board members of USE. Further, upon perusal of the contents of the minutes of the meeting of USE held on December 11, 2010, I note that Mr. Gaurav Arora, the Trading Member Director had assured that any point of time from January 01, 2011, the total volumes traded on the exchange will be 10% of the overall market volumes. This assurance indicated that the Board of USE knew regarding the concentration. I note that the issue of concentration of trades was also discussed in the inspection report dated July 04, 2011, which admittedly was considered by the board members in their meeting held on August 24, 2011. I have seen the observations made in the inspection report wherein it has been said that USE is a four dealer/ member exchange where these dealers/ members trade among each other with negligible client participation. I note the admission of USE that the bulk of the large size trades have mostly been executed by two trading members who operate with large number of trading terminals from multiple locations. However, it was denied that the said trades were 'wash trades' as no motives could be attributed to the nature of such trade, except affecting the volumes.

Quite true that after SEBI communicated its reservations about the concentration by two of the trading members, it was brought down. But the fact remains that USE turned a blind eye towards the volumes that were generated on its platform. The defense of USE that concentration of trades is a usual occurrence for any exchange in its initial stages is unacceptable as the concentration by trading members did continue until SEBI intervened. USE has submitted that it has started to communicate to members whose

concentration level cross 30% on a monthly basis. USE also states to be continuously monitoring the trades through its surveillance systems coupled with the follow up with the trading members. However, I observe that all the measures stated to be adopted by USE for reducing the concentration levels of the trades, were pursuant to the advice of SEBI.

b. Structure of the governing board of USE

It has been alleged in the SCN that the composition of the board of the USE was not in accordance with Section 4(B)(6)(c) of the SCRA and the SEBI Master Circular dated December 31, 2010. The representation of the Trading Member Directors exceeded the maximum prescribed limit by 25%. The SCN further states that PIDs were made to retire by rotation at the governing board of USE. It has been said by USE that PIDs are to be selected by the governing board of a stock exchange from amongst the persons empanelled by SEBI. As these directors are selected and not elected, they are not subjected to retire by rotation. Further, the SCN alleged that the additional role and responsibilities of existing PIDs due to their position as Shareholder Director at BSE/ Chairman of ICCL have the effect of dilution of independence of the PIDs in their functions at USE. SCN has said that the composition of the governing board of USE does not appear to be sufficiently broad based, which is not in compliance with the provisions of SCRA and the SEBI Master Circular dated December 31, 2010. Therefore, it was alleged that the governing structure of USE is skewed towards BSE which is a major shareholder of USE holding around 15 % of its equity.

In response to this allegation, the USE has submitted that it had discussed about the formation of a Nomination Committee, in its meeting dated August 24, 2011. Further, it constituted the Nomination Committee in the meeting held on October 01, 2011 for reviewing the structure, size and composition of the board on a regular basis, for identifying individuals suitably qualified to become members of the board or senior level position, for making recommendations to the board on relevant matters relating to the appointment or re-appointment of Directors, succession planning for the

whole time directors, etc. Thus, having constituted the Nomination Committee, according to USE, steps have already been taken by it to rectify the issue regarding the representation of the trading members on the Board and for ensuring the composition of the board in accordance with Section 4B(6)(c) of the SCRA and the SEBI Master Circular dated December 31, 2010. The Section 4(B)(6)(c) of the SCRA reads as under:

“(6) The Securities and Exchange Board of India may, while approving the scheme under sub-section (2), by an order in writing, restrict—

....

(c) the maximum number of representatives of the stock brokers of the recognized stock exchange to be appointed on the governing board of the recognized stock exchange, which shall not exceed one-fourth of the total strength of the governing board.”

USE has further submitted that Clause 3.2 (h) of the SEBI Master Circular bearing no. CIR/MRD/DSA/10/2010 with regard to the resignation of the PIDs states that “the manner of election, appointment, tenure, resignation, vacation, etc. of the Directors (except the Chief Executive) shall be governed by the Companies Act, 1956 save as otherwise specifically provided under or in accordance with the Securities Contract (Regulation) Act, 1956”. It has been stated that as the SCRA is silent on the manner of appointment of PIDs, USE followed the provisions as listed under Section 256 of the Companies Act, 1956 and accordingly, the PIDs were subjected to retirement by rotation and re-election at the annual general meetings.

USE has also said that its board structure is not skewed in favour of BSE in any manner whatsoever. USE has submitted that the two persons referred by SEBI had not discharged the role of PIDs on the other respective board of BSE and ICCL. USE has referred to the clause 3.2(f) of the SEBI Master Circular which states that ‘a person shall not act as ‘PID’ on more than one Stock Exchange simultaneously’. The two persons in question were appointed first as PID on the Board of USE and thereafter these were appointed as Shareholder Director on the Board of BSE and Chairman

(Independent Director) on the Board of ICCL, under the belief that there has been no breach of the Master Circular. USE further said that PIDs are reputable persons known for the good standing and integrity and they are unlikely to influence, on account of their directorships on the board of BSE/ ICCL. BSE has never been the beneficiary of any preferential treatment of USE. In addition, the payments made to BSE and ICCL towards the Operations and Maintenance Agreement and clearing and Settlement Agreement are well below the market rates. According to USE, the BSE has suspended its Currency Derivatives Segment license and hence there is no conflict of interest between USE and BSE.

I have considered the submissions of USE and note that inspite of discussion with the representatives of the USE, the issues have not been resolved. It is seen that the representative of the trading member director on the board was not found in accordance with Section 4B(6)(c) of the SCRA and the Master Circular dated December 31, 2010 and the same had exceeded the maximum prescribed limit of 25%. USE in its reply has submitted that it was under bonafide belief that the same will not constitute any violation of the SCRA. In my opinion, if things were not clear to USE it could have sought clarification regarding the same.

I note that the SEBI Master Circular dated December 31, 2010 states that:

"3.2 The other incidental and consequential matters relating to governance of stock exchanges shall be as under –

a) The Directors, except the Public Interest Directors and the Chief Executive such as CEO, ED, MD etc. shall be elected by the Shareholders.

....

....

e) 'Public Interest Directors' shall be selected by the Governing Board from amongst the persons in the SEBI constituted panel."

f) A person shall not act as 'Public Interest Director' on more than one Stock Exchange simultaneously.

It may be stated here that the procedure for the appointment/ empanelment of PIDs require to be in accordance with the existing laws in place. Further,

SEBI empanels the names of the candidates forwarded by the stock exchanges on the panel of PIDs. Having seen this, I am of the considered view that USE ought to have approached SEBI, if it was having any issue/doubt regarding the same.

I observe that PIDs were appointed on the board of USE subject to their approval by SEBI. I note that SEBI was never informed about their other directorship in BSE/ ICCL by USE. Subsequently, one of the directors have resigned as PID of USE and another PID resigned as Shareholder Director of BSE suggesting conflict of issues in holding such positions.

I note that there are four directors on the governing board of USE who are also holding vital positions at BSE/ ICCL. According to me, the issue of conflict of interest is definite, when the person who is acting as a Shareholder Director on one exchange acts as PID in another. It is seen that after the resignation of Mr. T.S. Narayanaswami from the post of MD and CEO of USE, Mr. Ashish Kumar Chauhan, Dy. CEO of BSE was appointed as Officer on Special Duty to USE. In my considered view, Mr. Chauhan is a Shareholder Director at BSE and his appointment as Officer on Special Duty at USE is in violation of SEBI Master Circular dated December 31, 2010, as 15% shareholding of USE is held by BSE.

I observe that USE has not appreciated the fact that it is just not any other company. It is a Stock Exchange and is vested with regulatory powers. It has to follow highest standards of propriety in the matters of corporate governance.

c. Inability to correct the imbalances in favour of particular directors

The SCN has alleged that the board of USE is unable to correct the imbalances in its governance, which favor interests of a particular director in the nature of delayed payments of statutory dues or quorum rights in the board where these rights to certain shareholders are in favour of certain shareholders and pre-judicial to the interest of other stakeholders. The SCN

has also alleged the inability of the board of USE to detect and remove conflicts of interest.

I note that the USE had made an application to SEBI for grant of recognition vide its letter dated September 22, 2008. Vide another letter dated October 16, 2008, USE forwarded a copy of its Articles of Association (hereinafter referred to as AoA). Later on, USE vide its letter dated November 13, 2009, submitted another application for grant of recognition enclosing therewith Memorandum of Association, AoA, etc. SEBI has noticed variations in the AoAs submitted by the USE along with its applications on different dates, and in the final application, Part II – Specified Articles has been inserted in the AoA. The said Part II gives special rights to the promoters i.e., Jaypee Capital, BSE and Federal Bank. The amended article 80.3 of the AoA, reads as under:

“The quorum for a meeting of the board, duly convened and held, shall be the minimum required by the provisions of the Act; provided, that no quorum shall be constituted unless at least one (1) Jaypee Capital Nominee Director; one (1) BSE Nominee Director; and one (1) Federal Bank Nominee Director or, in each case, their duly appointed alternate directors are present in the meeting of the Board.”

USE in its submission has said the AoA containing these provisions, were specifically approved by SEBI vide its letter dated March 26, 2010. It has further said that all the stakeholders have reviewed and confirmed the provisions of Part I and II before investing in USE.

I note that such kind of special arrangements as did by USE is not in the interests of independent functioning of the stock exchange. The Special Articles i.e., Part II of AoA has overriding effect over its General AoA and these rights to certain shareholders appear to be detrimental to the interest of other stakeholders. These are inconsistent, imprudent and contrary to the best corporate governance practices. In my opinion, such special arrangements surely constrain the independent functioning of the Stock Exchange. I also note that the USE has failed to bring ‘the amendment to its AoA’ to the notice of SEBI, while submitting its application on November 13,

2009. In the process, I note that these defaults on the part of USE not only reflect bias on the part of the Exchange towards certain shareholders, but also reveals that such provisions in AoA are against the spirit of demutualization of stock exchanges.

USE has further submitted that amendment to Article 37.1 of the AoA, was carried out in order to bring the same in conformity with Section 256 of the Companies Act. As the said amendment did not have a bearing on the constitution of the board as per Section 3(2) of the SCRA, no prior approval was sought from SEBI.

Vide its email to SEBI dated September 08, 2011, USE has also confirmed that henceforth it will seek prior approval from SEBI for amending its AoA. I note that SEBI, has advised USE not to act upon the Part-II of the Specified Articles of the AoA of USE and keep the same in abeyance till further order, vide its letter dated November 23, 2011.

9. Delayed payment of Turnover Fees

It has been alleged in the SCN that the board of USE has failed to ensure that the turnover fees to be paid to SEBI is paid by the trading member namely Jaypee Capital Services Limited represented by Mr. Gaurav Arora, a Director on the board of USE on time. USE in its reply has submitted that SEBI permits late payment of turnover fee with a penal interest of 15 % per annum. USE has also submitted that sometimes the delay in payment was due to non-availability of erstwhile MD and CEO, during the first week of the month, when it is payable and who was the signatory for cheques. It has been stated that USE is following up with all the trading members, without exception, for the collection of penal interest, towards late payment of turnover fees to SEBI. Further, full recovery has been made from Jaypee Capital Services Limited towards the turnover fees along with interest on late payment.

At this stage, I note that the provision regarding the late payment are applicable when the circumstances are beyond the control of the trading

member thereby disabling them to make the payment on time. In view of this, the submission of USE cannot be accepted and there appears to be lack of effective governance by its board. It also shows favour by USE to particular director by permitting delayed payments of statutory dues.

10. Deputation of staff from BSE on a continuous basis

I note that USE was initially permitted to take personnel on deputation from BSE to carry out the important functions of surveillance, inspection, trading platform and operations, compliance, membership etc. so that in the due course it can build its resources and start employing its own staff. It is seen that USE was also permitted to engage the services of BSE in respect of its requirements of hardware, software, technical/ process support, disaster recovery etc. The SCN has alleged that even after passage of twenty months since its recognition, USE has failed to build/ augment its own infrastructure including appointing its own staff, system etc.

USE in its reply has submitted that when the organizational chart was filed to SEBI at the time of its recognition as a stock exchange, no time line was specified by SEBI for terminating the deputation arrangement with BSE. Further, USE stated that, it was under the belief that SEBI was rather interested in the continuity of BSE's infrastructure and personnel, irrespective of whether they were on deputation from BSE or on the rolls of USE.

I note that a stock exchange should have its own human resources and a rather self sufficient infrastructure. Further, there should not be a need to depend on another Exchange. Important departments in an Exchange under the supervision of outsourced staff is unhealthy for the governance of stock exchange. During the personal hearing, USE has submitted that in the meeting of the Board of directors dated February 07, 2012, USE has decided to transfer the functions of surveillance, inspection, investigation, arbitration, investor grievance, investor services centre, etc. manned by staff on USE rolls and the process for the same will be completed by April, 2012.

11. Lack of Sustainable Pricing Policy

The SCN has also alleged that USE does not have a sustainable pricing policy to ensure sound financial health over a long term and it will have an impact on its net worth. Further, it is mentioned in the SCN that there is a decrease in networth of USE as compared to previous year. USE has submitted that it is a year old exchange. The board of USE has stated that prudent austerity measures are in place to reduce expenditure and efforts are also made for increasing the revenue. Further, it also said that the loss for the six monthly period ended September 30, 2011 has been brought down to ₹1.55 crore, in comparison to the loss of ₹7.35 crore incurred for the six monthly period that ended on September 30, 2010.

I note that SEBI vide circular dated October 14, 2009, regarding 'Revision of transaction charges by the stock exchanges', *inter alia* has specified that the stock exchanges while revising such transaction charges, are advised to ensure that 'it does not encourage generation of artificial demand'. It can very well be stated that failure/ delay in levying the transaction fee by USE at a time when NSE and MCX-SX had already started levying transaction charges, may amount to creation of artificial demand at USE. However, I note the undertaking of USE during the personal hearing that it has introduced the transaction charges effective from April 03, 2012 and is levying the same.

12. Appointment of Saurav Arora

It is seen that Mr. Saurav Arora, son of Mr. Gaurav Arora, the Trading Member- Director was appointed as the President of Business Development at USE. The SCN has alleged that such appointment was in violation of Section 314 of the Companies Act, 1956 and the resignation was tendered only when one of the shareholders of USE raised an objection. USE in its reply has submitted that it is in the process of taking appropriate steps to ensure compliance with Section 314 of the Companies Act, 1956 at the annual general meeting scheduled to be held on September 19, 2011 by passing a special resolution regarding the 'office of profit'. It has also been submitted

that for keeping with the good Corporate Governance principles, USE by its letter dated December 28, 2010 had informed SEBI about the appointment of Mr. Saurav Arora in USE, in view of his past association as the Director of Jaypee Capital Services Limited. USE said that in the absence of response from SEBI, it inferred that SEBI had 'no objection' to the said appointment. According to me, it is wrong for USE to have inferred that SEBI did not have objection to it. I note that exemption is to be specifically asked for and specifically given.

13. Failure to convene the board meetings within the statutory period

I note that there was a gap of more than five months between the two board meetings of USE (i.e. the twenty second meeting of the board of directors of USE was held on March 12, 2011 whereas the twenty third meeting held on August 24, 2011), which was in clear violation of the Companies Act, 1956 and the same goes on to show that the board of USE is not keen to review the performance of the exchange at regular intervals. USE in its reply has admitted its failure to convene the Board meeting claiming it to be an inadvertent error. It further submitted that following the resignation of the Managing Director and CEO, the board has taken active responsibility in the affairs of USE. During the personal hearing, USE was asked to provide the dates of the board meetings held from August 24, 2011. These details were submitted by USE, vide its letter dated April 13, 2012 and the dates of the meetings as per the information submitted by USE, are August 24, 2011, September 19, 2011, October 01, 2011, December 22, 2011, January 12, 2012, February 07, 2012, March 23, 2012 and April 10, 2012.

14. Having considered the facts and circumstances described in the above paragraphs, I note that the steps taken by USE are pursuant to the intervention of SEBI. In my opinion, USE should have noticed the trading concentration by two members on its platform. I have seen the current structure of the board of USE, i.e. as on April, 2012, which is as under:

- MD & CEO – (yet to be appointed)

- Trading Member Directors - 02
- Public Interest Directors - 02
- Shareholder Directors - 04

It is seen that USE has taken certain corrective steps and have brought new directors in order to bring its structure in line with the requirements of prevalent rules and regulations. USE has further, clarified the other issues like delayed payment of turnover fees, augmentation of its own staff personnel, putting in place the transaction charges, etc. However, these again appears to be an outcome of the intervention of SEBI. Having considered the above, I am convinced that USE was negligent to certain extent in the discharge of its functions and duties. I note that a Stock Exchange, who is in charge of the trading platform for all the market participants, has to function in an objective and just manner setting an example to the intermediaries related to its business and to promote healthy development of the securities market.

15. As regards the disputed AoA's of USE, I am of the considered view that the 'Part II- Specified Articles' needs to be amended suitably as observed in para 8(c) above.
16. Now, I have to decide on the appropriate penalty to be awarded to USE. While dealing with matters concerned with discharge of regulatory functions, there would be few occasions where monetary penalty would be appropriate. Suspending/ interrupting the working of the stock exchanges is also not an appropriate penalty as it involves negative externalities and could be considered only in extreme cases. Therefore, given the nature of the lapses and the efforts made, I am of the opinion that penalty of warning would be appropriate in this case.
17. I, therefore, in exercise of the powers conferred upon me in terms of Sections 11(2)(j) and 19 of the Securities and Exchange Board of India Act, 1992 read with Section 12A of the Securities Contracts (Regulation) Act, 1956, hereby

warn United Stock Exchange of India Limited to be more cautious and perceptive in the discharge of its functions and the regulatory duties.

18. USE shall amend its AoA as advised herein, within a period of two months, from the date of this order by following due procedure in this regard.

DATE : May 11, 2012

PLACE: MUMBAI

**PRASHANT SARAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**