

M/S. HARSHAD S MEHTA WAS GOVERNED BY RULES, REGULATIONS AND BYE-LAWS OF THE BOMBAY STOCK EXCHANGE (BSE) FRAMED BY IT IN 1957 UNDER SECURITIES CONTRACTS (REGULATION) ACT, 1956

HARSHAD COMMITTED NO CRIME IN TERMS OF THE BSE RULES, REGULATIONS AND BYE-LAWS OF BSE AND NON-DELIVERY OF SECURITIES AT THE HIGHEST ONLY AMOUNTED TO BREACH OF CONTRACT WHICH HAD CIVIL CONSEQUENCES AS DULY EXPLAINED BY AN ANALYSIS EXPLAINING THEIR APPLICABILITY TO THE FACTS OF HARSHAD MEHTA

DEALINGS IN SECURITIES

Government Securities

22. (a) Dealings are permitted in Government Securities which term for purposes of these Bye-laws and Regulations denotes securities issued by the Government of India, State Governments, Port Trusts, Municipalities and similar other bodies.

23. Dealings are permitted in securities (other than Government Securities) which are from time to time admitted to dealings on the Exchange by the Governing Body in accordance with the provisions in that behalf prescribed in these Bye-laws and Regulations.

Applicability

That as per Bye-laws 22(a) and 23 the Government securities and other securities like Units and PSU Bonds were listed on BSE and therefore dealings were permitted in them in terms of Bye-laws and Regulations.

[HSM entered into written contracts as member of BSE for every transactions in securities and all such contracts were legal and enforceable.]

PROCEDURE FOR SETTLEMENT OF BARGAINS

Settlement by Hand Delivery

80. All bargains in securities other than for the Clearing shall be settled outside the Clearing House by delivery and payment between the contracting parties in accordance with the provisions in that behalf contained in the relative Regulation* or such other provisions as the Governing Board may from time to time prescribe in addition thereto or in modification or substitution thereof.

Applicability

Bye-law 80 provides that delivery in case of transactions in securities are to be performed between contracting parties not through the clearing house of the Stock Exchange but directly between them in respect of delivery and payments.

[HSM could receive payments of securities sold by him in his name or direct his clients through delivery orders to make payments on his bankers or to his other chosen seller of securities. Such payments could legally be credited into his bank accounts and the banks had offered him routing facilities to enable M/s. Harshad S Mehta to complete his transactions and contractual obligations incurred by his firm.]

Cross Deliveries

81. The selling member who has sold securities under the provisions of these Bye-laws and Regulations is entitled at his discretion to deliver the same to the buyer who is his direct contracting party in respect of such securities or to any other buyer who is entitled under these Bye-laws and Regulations to receive from him delivery of securities of a like kind.

Applicability

In terms of Bye-law 81 the seller of securities had the discretion to deliver the securities to the buyer contracting party or to any other buyer who is entitled to receive securities of the like kind from him.

[HSM had complete discretion to decide how and from where he would tender the delivery of securities purchased from his brokerage firm and for the purpose could also net out several transactions in a manner to minimize actual deliveries. Unfortunately CBI alleged criminal offence on the basis that monies were deposited into Harshad's account as also on the basis that the buying bank in its records had unilaterally and without any intimation from HSM put a name of the counter party selling bank in whose account the monies were not credited. It has later been found that for transactions entered into by banks with HSM on a principal to principal basis had falsified their records by showing that M/s Harshad S Mehta was only a broker and usually the name of the counter party was filled up on the basis of the banks with whom the payments and deliveries were exchanged. The Hon'ble Special Court took judicial notice that the banks with full knowledge was undertaking transactions with HSM on a principal to principal basis but without paying any brokerage had yet put the name of M/s. Harshad S Mehta as broker. The Hon'ble Special Court has passed several adverse orders against banks falsifying their records atleast against NHB, SBI Caps, Citi Bank, Canfina, Syndicate Bank, Standard Chartered Bank, PNB Caps, PNB Mutual Fund, etc. and the above adverse orders are part of the list which is enclosed together with the orders.]

DELIVERY OF SECURITIES

Place of Delivery and Payment

142. The delivery of all documents and papers and the payment in respect of all contracts to which these Bye-laws and Regulations apply shall be

within the Fort Area of the City of Bombay and the parties shall be bound and deemed to give and take delivery in Bombay.

Performance of Contracts in Bombay

226. (b) The delivery of all documents and papers and the payment in relation to all contracts referred to in sub-clause (a) shall be within the city of Bombay and except when delivery is taken and given and payment made and received from and to the Clearing House through Clearing Member Banks as provided in these Bye-laws and Regulations the parties to all contracts shall be bound to take and give delivery and make and receive payment at the office of the member concerned within the Fort Area of the city of Bombay.

Applicability

As per Bye-laws 142 and 226(b) the delivery and payment in regard to transactions in securities had to be performed in the fort area of Bombay and all the clients had to make the payment at the office of the member.

[HSM could therefore receive or collect the payments in his office for sale of securities and perform deliveries in fort area of Bombay.]

Members When Not Liable for Defective Government and Bearer Securities

151. Members acting as brokers shall not be in any manner personally responsible for defective documents delivered in respect of contracts in Government Securities and bearer securities to which these Bye-laws and Regulations apply when the documents do not pass through their hands at the time delivery is effected but are delivered direct by the selling constituent or his agent to the buying constituent or his agent. But nothing herein contained shall affect the rights and obligations of the buying and selling constituents between themselves as principals in any action at law or in any other proceedings and the buying and selling members shall be bound to render every assistance to the buying constituent in any action at law or

other proceedings he may take against the selling constituent who receives payment against delivery of the defective documents.

Member When Liable for Defective Government and Bearer Securities

152. In respect of Government Securities and bearer securities delivered in fulfillment of contracts to which these Bye-laws and Regulations apply the selling member acting as broker who receives payment against delivery of the defective documents shall be personally responsible for them to the buyer to whom the same are delivered provided the documents pass through the hands of the selling member or his agent when delivery is effected and provided further the buyer gives intimation in writing to the selling member within twenty one days of the date on which the documents are delivered to him by the selling member or by the Clearing House on the selling member's behalf and establishes to the satisfaction of the Arbitration Committee (from whose decision an appeal shall lie to the Governing Board) that the documents are defective.

Applicability

As per Bye-law 151 member of BSE was not liable for defective delivery when the documents did not pass through his hands, whereas as per Bye-law 152 he would be liable for defective delivery if the documents passed through his hands.

[HSM performed the deliveries of securities either between the two clients or through the routing banks who offered him routing facility but in either case securities did not pass through his hands and therefore his brokerage firm strictly speaking was not liable for any defective delivery of securities.]

Refund of Moneys

159. If the selling member responsible for the defective documents fails to remove the defect or in the alternative to deliver to the buyer other regular,

genuine and valid documents in their place as provided in these Bye-laws and Regulations the buyer shall be entitled to claim from the selling member refund of their value at the then ruling market price.

Applicability

In terms of Bye-law 159 upon failure of member to make delivery of securities sold by him the buyer would be entitled to claim from the member refund of their value at the then ruling market price.

[HSM for non-delivery of securities at the highest only had an obligation to refund the amounts taking into account the ruling market price.

In case of SBI upon their seeking the refund HSM paid Rs.622.52 Crores in April 1992 for his failure to deliver securities and which monies were supposed to be used to purchase the securities from RBI to make up the shortfall. While Sucheta Dalal called it a scam it is ironic that SBI did not file any FIR against HSM for non-delivery of securities recognizing the above legal position. Scam is therefore the figment of imagination of Ms. Sucheta Dalal. The delivery of securities was affected because of massive IT raid on HSM. SBI has also admitted in its letter to CBI dated 26.12.1992 that even in other cases the delivery of securities was not received by SBI but the same was not treated as any criminal offence even by CBI. Harshad was therefore made a scape goat.]

CLOSING-OUT OF CONTRACTS

Closing-out

168. (a) A contract in securities made subject to the Rules, Bye-laws and Regulations of the Exchange may be closed-out by buying in or selling out against a member on his failure to comply with any of the provisions relating to delivery, payment and settlement of bargains or on any failure to fulfil the terms and conditions subject to which the bargain has been made.

Closing –out by Constituent on Failure to Perform a Contract

244. If a member fails to complete the performance of a contract by delivery or payment in accordance with the provisions of these Bye-laws and Regulations the constituent shall after giving notice in writing to the member close-out such contract through any other member of the Exchange within fifteen days from the date of default and any loss or damages sustained as a result of such closing-out shall be immediately payable by the defaulting member to the constituent. If closing-out be not effected as provided herein the damages between the parties shall be determined on the basis of the closing prices ruling on the fifteenth day following the date of default and the constituent and the member shall forfeit all further right of recourse against each other.

Applicability

In terms of Bye-laws 168(a) and 244 upon failure of delivery of securities by any member the client had an option to close out the transaction by giving notice in writing to the member within 15 days from the date of default and any loss or damages sustained by closing out would become payable by member to the client. If closing out was not effected the damages between the parties were liable to be determined on the basis of closing prices ruling on the 15th day following the date of default and the client and the member shall forfeit all further rights or recourse against each other.

[HSM's failure to deliver securities to SBI, NHB or SBI Caps gave them rights to close out the contracts in above manner but they never invoked these rights in view of the past track record.]

After receiving the monies under the full and final settlement with HSM, SBI in order to profit out of the situation has filed a claim of damages on HSM and succeeded in obtaining an *ex-parte* decree which has since been challenged by Smt Jyoti Mehta. The above Bye-laws also establish that non-delivery of securities does not amount to any criminal offence but invites only claim for damages as specified in the above Bye-laws.]

All Bargains Subject to Rules, Bye-laws and Regulations

192. All bargains in securities in which dealings are permitted shall in all cases be deemed made subject to the Rules, Bye-laws and Regulations of the Exchange which shall be a part of the terms and conditions of all such bargains and they shall be subject to the exercise by the Governing Board and the President of the powers with respect thereto vested in it or him by the Rules, Bye-laws and Regulations of the Exchange.

RIGHTS AND LIABILITIES OF MEMBERS AND CONSTITUENTS**All Contracts Subject to Rules, Bye-laws and Regulations**

226. (a) All contracts made by a member for or with a non-member for the purchase or sale of securities in which dealings are permitted on the Exchange shall in all cases be deemed made subject to the Rules, Bye-laws, Regulations and Usages of the Exchange which shall be a part of the terms and conditions of all such contracts and they shall be subject to the exercise by the Governing Board and the President of the powers with respect thereto vested in it or him by the Rules, Bye-laws and Regulations of the Exchange.

Operation of Contracts

274. All dealings, transactions and contracts which are subject to the Rules, Bye-laws and Regulations of the Exchange and every arbitration agreement to which the Rules, Bye-laws and Regulations of the Exchange apply shall be deemed in all respects to be subject to the Rules, Bye-laws and Regulations of the Exchange and shall be deemed to be and shall take effect as wholly made, entered into and to be performed in the city of Bombay and the parties to such dealings, transactions, contract and agreements shall be deemed to have submitted to the jurisdiction of the Courts in Bombay for the purpose of giving effect to the provisions of the Rules, Bye-laws and Regulations of the Exchange.

Applicability

In terms of Bye-laws 192, 226(a) and 274 all contracts entered into by a member with his clients are always subject to standard terms and conditions and the Regulations and Bye-laws of BSE and even if no written contracts are entered into it is deemed that all transactions will always be subject to Rules, Bye-laws and Regulations of BSE and they are subject to jurisdiction of the Courts in Bombay. The standard terms and conditions in respect of such contracts have been prescribed by BSE and are printed overleaf of the Contract Notes. Any claim or dispute are also subject to resolution through the machinery of arbitration as set out in the Bye-laws. In essence the transactions in securities and contracts entered into for the purpose were very well regulated by the BSE and therefore such contracts had very high sanctity for all market participants since they were always enforceable.

[M/s Harshad S Mehta had always reduced all the transactions entered into by the brokerage firm to writing and prior to February to May 1992 had an excellent track record of zero default and 100% performance. No criminal intent (*mens rea*) could ever be attributed to the contracts entered into by HSM. It is several banks who during May-June 1992 defaulted and committed breach in the contracts entered into by them with M/s Harshad S Mehta and even usurped the money market assets belonging to HSM as can be easily seen from several orders of Hon'ble Special Court and a judgment of Hon'ble Supreme Court adduced by me. The banks could have lodged their claims on HSM only in terms of such written contracts but instead obtained *ex-parte* decrees for much higher amounts without giving credit of counter claims and further claimed interest on such claims @ 15% to 18% p.a. wholly impermissible in law.]

Member as Principal

199. When executing an order a member may buy or sell securities for his own account as a principal provided he has obtained the consent or authority of his constituent thereto if such constituent be a person other than a member of a Stock Exchange recognized under the Securities

Contracts (Regulation) Act 1956 and provided that the price is fair and justified by the condition of the market:

Provided further that where the member has secured the consent or authority of such constituent otherwise than in writing he shall secure written confirmation by such constituent of such consent or authority within three days from the date of the contract.

Provided further that no such written consent or authority of such constituent shall be necessary for closing-out any outstanding contract entered into by such constituent in accordance with the provisions of these Bye-laws and Regulations.

Contracts by Members as Principals

221. (a) The contract notes rendered by members to non-members when buying for themselves as principals the securities of their constituents or selling as principals their own securities to their constituents in accordance with the provisions of these Bye-laws and Regulations may be in the form prescribed in the relative Regulation” or in such other form or forms as the Governing Board may from time to time prescribe in addition thereto or in modification or substitution thereof. Such contract notes shall disclose that the member is acting as a principal.

Applicability

In terms of Bye-laws 199 and 221(a) a member could undertake transactions acting as a principal i.e. on his own account subject to the consent of the client and for this purpose there was requirement that the Contract Note should specify that member is acting as a principal. The Regulations provided for 2 types of Contract Notes one in form “A” when member was acting as a broker for consideration of brokerage and form “B” when member was acting as a principal.

[M/s Harshad S Mehta acting as a market maker (jobber) to impart liquidity as the needs of the banks and FIs were instantaneously met by HSM by giving a two way quote. Thus all banks and FIs while dealing

with M/s Harshad S Mehta knew beforehand that he was acting as a principal but the Contract Notes were in form "A" and they were invariably accepted. Assuming that if these banks and FIs were unaware about the HSM acting as a principal they atleast got to know this fact before the exchange of payments and deliveries as HSM invariably performed his contracts through the routing banks like SBI, ANZ Grindlays bank, UCO Bank, etc. Each bank and FI knew which banks had extended routing facility to which brokers. The banks and FIs also knew that they were not paying any brokerage in respect of the transaction only because HSM was acting as a principal. Besides above, in Ready Forward transactions the banks and FIs always accepted performance of HSM from two different banks at the ready leg and for the forward leg. That what was clinching is that the banks have filed their claims earned by M/s Harshad S Mehta and obtained *ex-parte* decrees which claims could never have been made if M/s Harshad S. Mehta had acted as a broker as in that case he would only be an agent of the banks and FIs and therefore indemnified for his acts. The Hon'ble Special Court also took judicial notice of this fact atleast in following orders passed by it which are enclosed.

- i) Order dated 21.07.1994 in MA 269 of 1993 (Paras 15 to 17).
- ii) Order dated 24.08.1994 in MA 101 of 1994 (Para 9).
- iii) Order dated 03.02.1995 in MA 198 of 1993 (Paras 5, 6, 10 to 17, 21, 22).
- iv) Order dated 15.09.1995 in MA 255 of 1994 (Paras 2 to 18).
- v) Order dated 18.09.1995 in MA 221 of 1993 (Paras 5, 8, 9, 11 to 21, 30, 32, 36, 38, 40, 42 to 44, 49, 50 to 65, 80, 85, 87, 89 to 92, 113, 123, 129).
- vi) Order dated 24.10.1996 in MA 185 of 1993 (Paras 10, 13, 20, 26 to 35, 40).

BROKERAGE AND CONTRACT NOTES

Brokerage

205. Save as otherwise provided brokerage shall be charged and collected by members upon the execution of all orders for non-members in respect of purchase or sale or carry-over of securities. Members are entitled to charge brokerage at rates not exceeding the official scale prescribed in the relative Regulation* or such other scale as the Governing Board may from time to time prescribe in modification or substitution thereof.

Applicability

In terms of Bye-law 205 the members of the Stock Exchange shall charge and collect brokerage upon execution of all orders for purchase and sale of securities at the prescribed scale.

[M/s Harshad S Mehta had undertaken some transactions acting as a broker i.e. as an agent and has duly received / collected brokerage in such transactions. Where the brokerage was not charged / received the only reason was that in such transactions HSM had acted as a principal and therefore to find out whether M/s Harshad S Mehta had entered into any transactions in securities as a broker or acting as a principal was easily ascertainable from the fact whether the bank or the FI had made any payment of the brokerage in absence of which it was liable to be presumed that HSM had acted as principal in the subject transaction.]

Contract Notes

219. The contract notes rendered by members to non-members shall state that the contract is subject to the Rules, Bye-law, Regulations and usages of the Exchange and subject to arbitration as provided in the Rules Bye-laws and Regulations of the Exchange and subject to the jurisdiction of the Courts in Bombay. The contract notes shall not contain any provision inconsistent with the Rules, Bye-laws and Regulations of the Exchange. The names of the partners or the sole proprietor of a firm shall be printed on the contract

notes. The contract notes shall also be in such form as will provide that the words “Member(s) of The Stock Exchange, Bombay” shall immediately follow the signature.

Applicability

Members of BSE were required to invariably state in the Contract Notes that the same was subject to Rules, Regulations and Bye-laws of the Stock Exchange.

[M/s Harshad Mehta had always issued Contract Notes specifying the above.]

Contracts by Members as Agents

220. The contract notes rendered by members to non-members in respect of bargains made for and on behalf of such non-member's account may be in the form prescribed in the relative Regulation* or in such other form or forms as the Governing Board may from time to time prescribe in addition thereto or in modification or substitution thereof. Such contract notes shall state that brokerage at rates not exceeding the official scale of brokerage has been charged and allowed for in the price.

Applicability

In terms of Bye-law 220, members entering into contracts as a broker were required to issue Contract Notes in form “A” and also state the brokerage being charged.

[M/s Harshad S Mehta had complied with the above Bye-law.]

Constituent to Indemnify

228. Every member entering into any contract for the purchase or sale of any security or doing any act in relation thereto on the instructions of any constituent and on such constituent's account or request shall be entitled to be indemnified by such constituent as an agent acting on behalf of his principal.

Applicability

In terms of By-law 228 members acting as brokers i.e. as agents were entitled to be indemnified for all his acts by the clients.

[M/s Harshad S Mehta had no occasion to claim the above right.]

Members not bound to Accept Instructions and Orders

230. A member shall not be bound to accept all or any of the instructions or orders of constituents for purchase, sale, havala or carryout of securities. He may in his absolute and uncontrolled discretion decline to accept any such instructions or orders for execution wholly or in part and shall not be bound to assign any reason therefore:

Provided that when a member is not prepared to carry out such instructions or orders either wholly or in part he shall immediately inform his constituent to that effect.

Applicability

In terms of Bye-law 230 member had a discretion to accept or deny any instructions from the clients without assigning any reason.

[M/s Harshad S Mehta rarely exercised the above right and always accommodated any requests or instructions received from the client to enable smooth completion of contracts entered into by him.]

Delivery to Constituent

234 (a) In respect of a member buying securities on behalf of or selling his securities to a constituent whether residing in the city of Bombay or outside the date on which he delivers such documents to the buying constituent direct or to his bankers or agents in Bombay or draws a bill on the buying constituent through a Bank or sends an advice by post stating that the documents are ready for delivery shall be deemed to be the date of delivery to the buying constituent.

Constituents to make Payment

236. A constituent whether residing in the city of Bombay or outside shall pay to the member in the office of the member in the city of Bombay by the due date all sums which the constituent is bound to pay and when a member is liable to pay such sums on behalf of the constituent the payment must be made in the office of the member in the Fort Area of the city of Bombay atleast one business day previous to the date on which the member is required to make payment in compliance with the provisions in these Bye-laws and Regulations relating to such payment.

Applicability

In terms of Bye-laws 235 and 236 in respect of transaction of sale of securities the client had an obligation to deliver the same to the member or as per his instructions and in respect of transaction for purchase of securities the client had an obligation to make payment in the office of the member one business day previous to the date of execution.

[M/s Harshad S Mehta in terms of above Bye-laws was therefore within his right to receive the securities and payments from his clients and the presumption made by CBI that payments could not have been credited into the account of M/s Harshad S Mehta and that securities were instantaneously deliverable on the date of receipt of payment was grossly erroneous.]