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VINAY BUBNA

v

STOCK EXCHANGE, MUMBAI AND ORS.

JULY 28, 1999

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[B.N. KIRPAL AND S. RAJENDRA BABU, JJ.]

Bombay stock Exchange Rules, Bye-laws and Regulations, 1957:

C *Rules 5,53 and 54—Stock Exchange—Membership of—Rights and privileges-Held: Membership is a personal permission from the Exchange to exercise the rights and privileges attached thereto—Once a member is declared a defaulter, right of membership vests in the Exchange under Rules 53 and 54—Membership card of a share broker is not his personal property, which, on default being committed by him, cannot be sold and proceeds distributed amongst his creditors—High Court rightly concluded that once a defaulting member ceases to be a member of the Exchange, no interest in his membership card remains and it cannot be regarded as his asset—Securities Contracts (Regulations) Act, 1957.*

E *Rule 16—Order of priority—Allocation—Validity—Held: R.16 is not illegal, arbitrary, void or unjust—On the contrary R.16 mitigates the hardship which may be caused by defaulting member—Constitution of India, 1950, Arts,14,19(1) and 300-A.*

F *Rule 16—Nature and scope of—Held, when the defaulting member is expelled from the Exchange no interest in his membership card remains in him and none can pass to his assignee—Hence, R. 16 not contrary to insolvency law.*

G *The appellant had dealings in sale and purchase of shares with respondent No. 3—a share broker—who was a member of the Stock Exchange until he was declared a defaulter by the Stock Exchange. The appellant claimed that respondent No.3 had not paid a sum of more than Rs.21 lakhs due to him.*

H *The appellant filed a writ petition before the High Court challenging Rules 16 and 43 of the Bombay Stock Exchange Rules, Bye-laws and Regulations, 1957 contending that payment to creditors like the appellant*

should first be made from the sale proceeds of the membership to replace respondent No. 3, the defaulter; and that the proceeds should not be distributed in the manner indicated by Rule 16. The High Court dismissed the petition. Hence this appeal. A

On behalf of the appellant it was contended that membership of the Stock Exchange was an asset which belonged to respondent No. 3; that a defaulting member has to be treated like an insolvent because he was unable to pay his debt; that distribution of the proceeds from the sale of the membership according to the order of priority indicated by Rule 16 was unfair, unjust, arbitrary and violative of Articles 14, 19(1) and 300-A of the Constitution; and that Rules 16 and 43 were inconsistent with the law of insolvency. B
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Dismissing the appeal, this Court

HELD : 1. Rules 5, 53 and 54 of the Bombay Stock Exchange Rules, Bye-laws and Regulations, 1957 provide that the membership of the Exchange constitutes a personal permission from the Exchange to exercise the rights and privileges attached thereto. Once a member is declared a defaulter his right of membership vests in the Exchange under Rules 53 and 54. The High Court, therefore, was right in coming to the conclusion that on a default being committed, the share broker ceases to become a member of the Exchange and all his rights, privileges etc. as a member come to an end. If he does not clear the dues within six months the Governing Body then has a right of nomination in respect of such membership. It will be incorrect to state that on the stock broker ceasing to be a member, he still retains any rights or interest in the permission which has been granted to him by the Exchange to carry on business as a member. The membership card of a share broker is not his personal property which, on default being committed by him and his ceasing to be a member, can be sold and the proceeds distributed amongst his creditor. Rules 53 and 54 leave no manner of doubt that member's right of membership vests in the Exchange after he is declared defaulter. D
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[1227-E; 1228-H]

Official Assignee of Bombay v. KRP Shroff, AIR (1932) PC 186, approved. G

2. There is nothing unfair or unjust in Rule 16 providing that the first priority from out of the sale proceeds would be towards the amounts due to the Exchange itself. The second priority is given to the debts, liabilities, obligations and claims arising out of the contracts made by the erstwhile H

A member. Even though at the time when the nomination is made by the Stock Exchange of the vacancy which has been created the erstwhile member has no interest, in law, therein, nevertheless Rule 16 makes a provision by providing for payment being made for clearing the debts etc. of the erstwhile members. But for Rule 16, in other words, creditors like the appellants would not have a ray of hope of receiving any money realised by the Stock Exchange on the vacancy being created by reason of default of the stock broker. In view of this it is not possible to accept that the said Rule is in any way bad in law. [1230-B-C]

Stock Exchange, Ahmedabad v. CIT, (1998) 18 SCL 135, held
C inapplicable

3. When the defaulting member is expelled from the Exchange no interest in his membership card remains in him and none can pass to his assignee. Once the membership card ceases to be an asset of the share broker the question of Rule 16 being contrary to the insolvency law does not D arise. [1229-G]

4. The High Court rightly came to the conclusion that once a defaulting member ceases to be a member of the Stock Exchange no interest in his card remains and the same cannot be regarded as his asset and furthermore Rules 16 and 43 are not illegal, arbitrary or void. [1230-G]

E CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4120 of 1999.

From the Judgment and Order dated 23.12.97 of the Bombay High Court in W.P. No. 1177 of 1997.

F V. B. Joshi and Umesh Bhagwat for the Appellant.

Ashok H. Desai, P. Venugopal, Nihar A. Modi, P.S. Sudheer, K.J. John, Bhargava V. Desai and Siddhartha Choudhary for the Respondents.

G The Judgment of the court was delivered by
KIRPAL, J. Special leave granted.

H The appellant in this appeal had dealings in sale and purchase of shares with one Yogesh Mehta - respondent No.3 [hereinafter referred to as 'the share broker'] who was a member of Bombay Stock Exchange until he was declared a defaulter by the said Exchange.

According to the appellant as on 10th May, 1995 a sum of Rs. A 21,81,635.50 P. was due and payable by the share broker but the payment was not made. Thereupon the appellant filed an arbitration petition against the said share broker before the Bombay High Court. In the said proceedings an application was filed for appointing a court receiver. The court did not grant to the appellant any relief in respect of the membership card of the share broker whereupon an appeal was filed and it was contended that a court receiver should be appointed in respect of the said membership card. This appeal was disposed of after a statement on behalf of the Stock Exchange was recorded to the effect that it "shall not apply any amount received by it as consideration on nomination of the membership to any person falling in the same category for the purpose of priority as the appellant under Rule 16 of the Stock Exchange Rules till the award of the arbitration was received". It may here be stated that in view of the default having been committed by the share broker he was, on 10th December 1996, declared defaulter by the Stock Exchange and thereafter he ceased to be it's member. B C

The appellant wanted Rules 16 and 43 of the Stock Exchange to be D amended. Letters were written by him to SEBI and other authorities including the Stock Exchange. When efforts in this behalf failed, a writ petition was filed in the Bombay High Court by the appellant with a prayer that Rules 16 and 43 of the Stock Exchange Rules, Bye-laws and Regulations 1957 should be declared as illegal, bad in law and *ultra vires* the Constitution of India. It was also prayed that the Stock Exchange be directed to amend/alter Rules 16 and 43 of the Stock Exchange. The main reason for impugning these rules was that, according to the appellant' the membership of the Stock Exchange was an asset of the share broker and on its sale from the proceeds thereof payment should first be made to creditors like the appellant of the share broker and the proceeds should not be distributed in the manner indicated E F by the said rules.

The Bombay High Court dismissed the writ petition, *inter alia*, holding that it regarded the said rules as being fair, just and reasonable. It was further held that on default being committed the share broker ceased to be a member of the stock exchange and there was no conflict between the provisions of G the said rules and the Insolvency Act.

On behalf of the appellant it was contended that the membership of the Stock Exchange was an asset which belonged to respondent No.3 and on the sale of the same to distribute the proceeds in the manner indicated by Rule 16 was unfair, unjust and arbitrary and was violative of Articles 14, 19 (1) and H

A 300A of the Constitution of India. It was submitted that a member who is declared as defaulter has to be treated in the similar position to that of an insolvent because he is unable to pay his debts and the Rules 16 and 43 framed by the Bombay Stock Exchange are inconsistent with the laws of insolvency as applicable in India which provide for manner of distribution of the asset of the insolvent which is at variance with the said rules.

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On behalf of the Stock Exchange it was submitted that after the respondent No.3 had been declared a defaulter, he ceased to be a member of the Stock Exchange whereupon his rights of membership vest in the Exchange free of all rights, claims and interest and the Exchange was at liberty to invite

C applications from other persons and to admit any one who offers to pay the highest amount. The proceeds so received do not belong to the ex-member and the order of priority contained in Rule 16 was just and fair and is not illegal, wrong or arbitrary.

The respondent - Stock Exchange is an incorporated association of **D** persons and is recognised under the Securities Contracts (Regulation) Act, 1957. According to its constitution, rules and bye-laws the Exchange, from time to time, admits members, popularly referred to as stock or share brokers. It is they who constitute the Exchange as per Rule 2 of the said rules. The Exchange is established, as per Rule 4, with the object, *inter alia*, to support and protect, in the public interest, the character and status of brokers and

E dealers and to further their interests and to maintain high standards of commercial honour and integrity. Rule 5 provides that the membership of the Exchange shall constitute a personal permission from the Exchange to exercise the rights and privileges attached thereto but this is subject to the Rules, Bye-laws and Regulations of the Exchange. Rule 6 provides, *inter alia*, that the

F right of membership is inalienable. As per Rule 7, subject to the provisions of the Rules, a member shall have a right of nomination which shall be personal and non-transferable. Rule 9 stipulates that "on the death or default of a member his right of nomination shall cease and vest in the Exchange." Rule 11 deals with nomination by members. With regard to nomination in case of defaulter sub-rule (c) provides as under:-

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Nomination in case of Defaulter

"The forfeited right of membership of a defaulter shall be restored to him if he be re-admitted as a member within six months from the date of default but if an application by a defaulter for re-admission be rejected by the Governing Board or if no such application be made

within six months of the declaration of default the Governing Board A may at any time exercise the right of nomination in respect of such membership."

Rules 53 and 54 deal with the effect of default and read as under:

DEFAULT

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"53. A member who is declared a defaulter shall at once cease to be a member of the Exchange and as such cease to enjoy any of the rights and privileges of membership but the rights of his creditor members against him shall remain unimpaired.

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LAPSE OF MEMBERSHIP RIGHT

54. A member's right of membership shall lapse to and vest in the Exchange immediately he is declared a defaulter."

A bare perusal of the aforesaid and other rules clearly shows that the said rules provide that the membership of the Exchange constitutes a personal permission from the Exchange to exercise the rights and privileges attached thereto subject to the Rule, Bye-laws and Regulations of the Exchange. According to Mr. Ashok H. Desai, learned senior counsel for the respondents, every contract notice issued to a constituent contains a specific provision that "the contract is made subject to the Rule, Bye-laws and Regulations and usages of the Stock Exchange, Bombay". The members of the Stock Exchange, namely, the stock brokers are permitted to buy and sell the shares for their clients like the appellant. To secure due performance of his obligations the Exchange takes security from each members upon which it has a lien as provided by Rule 43. A member is declared a defaulter if he fails to meet his obligation and the Rules further show that thereafter his right of membership and nomination ceases and vests in the Exchange and belongs to the Exchange. The vacancy thus created by the termination of the membership is filled by the admission of another person, who generally is a person who offers to pay the highest amount. The consideration which is received by the Exchange on making a fresh nomination after the termination of the membership is then allocated according to Rule 16 which reads as follows:

"16. ALLOCATION IN ORDER OF PRIORITY - When as provided in these Rules the Governing Board has exercised the right of nomination in respect of a membership vesting in the Exchange the consideration received therefore shall be applied to the following purposes and in

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A the following order of priority namely -

Dues of Exchange and Clearing House

B (i) first-the payment of such subscriptions, debts, fines, fees, charges and other monies as shall have been determined by the Governing Board to be due to the Exchange or to the Clearing House by the former member whose right of membership vests in the Exchange;

Liabilities relating to Contracts

C (ii) second-the payment of such debts, liabilities, obligations and claims arising out of any contracts made by such former member subject to the Rules, Bye-laws and Regulations of the Exchange as shall have been admitted by the Governing Board: provided that if the amount available be insufficient to pay and satisfy all such debts, liabilities, obligations and claims in full, they shall be paid and satisfied pro rata; and

Surplus

E (iii) third-the payment of the surplus if any to the funds of the Exchange: provided that the Exchange in general meeting may at its absolute discretion direct that such surplus be disposed of or applied in such other manner as it may deem fit.

F The order of priority laid down by the aforesaid Rule 16 ensures that dues to the Exchange or to the Clearing House have first to be met before the balance amount can be utilised for payment of debts, liabilities, obligations etc. arising out of any contract made by the former member. If the amount available is insufficient to pay all such debts, liabilities etc. then the payment is to be made pro rata. If, however, any surplus still remains the same is to be disposed of or applied in such manner as the Exchange in general meeting may decide.

G The High Court, in our opinion, was, therefore, right in coming to the conclusion that on a default being committed the share broker ceases to become a member of the Exchange and all his rights, privileges etc. as a member come to an end. If he does not clear the dues within six months the Governing Body then has a right of nomination in respect of such membership.

H It will be incorrect to state that on the stock broker ceasing to be a member,

he still retains any right or interest in the permission which has been granted to him by the Exchange to carry on business as a member. The membership card of a share broker is not his personal property which, on default being committed by him and his ceasing to be a member, can be sold and the proceeds distributed amongst his creditors. Rules 53 and 54 leave no manner of doubt that the member's right of membership vests in the Exchange after he is declared defaulter. This view, namely, that the defaulting member can claim no interest in the membership card and can pass none is in consonance with the decision of the Privy Council in *Official Assignee of Bombay v. K.R.P. Shroff and Ors.*, AIR (1932) Privy Council 186 In that case a member of the Bombay Stock Exchange had lost his membership for being a defaulter. The main question which arose for determination there was whether a card or right of membership of a share broker or the proceeds of sale thereof, when sold, would pass to the assignee in insolvency of the share broker's estate after he had lost his membership for being a defaulter. After referring to the Rules of the Stock Exchange in this connection it was observed at page 190 as follows:

"But although the rules are badly drawn and not in uniform phraseology their result in the case of a member who has lost his membership for being a defaulter clearly enough is that he loses all interest both in the property of the Association and in his card. In such a case no interest is reserved in the defaulter's card except to members of the Association who have suffered by his lapse - in the rules sometimes called his creditors - or to the Association itself. This seems to their Lordships to be the result of R. 18, 56, 57 and 62. The defaulting member himself has no interest in the result of the sale provided for under these rules nor can he require a sale to be made. The rules are there for the benefit of his "exchange creditors" and are doubtless enforceable at their instance."

In that case also a contention was sought to be raised that if the proceeds of the sale of the insolvent's card are not given to the official assignee, the same would be regarded as being contrary to the law of insolvency. It was rightly observed that when the defaulting member is expelled from the Exchange no interest in his membership card remains in himself and none can pass to his assignee. Once the membership card ceases to be an asset of the share broker the question of Rule 16 being contrary to the insolvency law does not arise.

As we see it not only Rule 16 is illegal, arbitrary or unjust but the same

- A is, on the other hand, framed in such a manner that the hardship which may be caused by the default committed by the erstwhile member is mitigated. There is nothing unfair or unjust in Rule 16 providing that the first priority from out of the sale proceeds would be towards the amounts due to the Exchange itself. The second priority is given to the debts, liabilities, obligations and claims arising out of the contracts made by the erstwhile member. Even
- B though at the time when the nomination is made by the Stock Exchange of the vacancy which has been created the erstwhile member had no interest, in law, therein, nevertheless Rule 16 makes a provision by providing for payments being made for clearing the debts etc. of the erstwhile members. But for Rule 16, in other words, creditors like the appellant would not have a ray
- C of hope of receiving any money realised by the Stock Exchange on the vacancy being created by reason of default of the stock broker. In view of this, it is not possible to accept that the said Rule is in any way bad in law.

Learned counsel for the appellant placed reliance on the decision of Gujarat High Court in *Stock Exchange, Ahmedabad v. Assistant Commissioner of Income-tax*, [1998] 18 SCL 135. In that case after the death of a stock broker he was declared a defaulter and the income tax department sought to attach the membership card. It was contended by the Stock Exchange that or. the stock-broker being declared a defaulter no right existed which could be attached. Reliance was placed on the Privy Council's decision in Shroff's case. The High Court rightly distinguished Shroff's case by observing that after the death of a stock broker he should not be declared as a defaulter. It appears to us, without going into the correctness of the said decision of the Gujarat High Court, that the same is of no relevancy in the present case because the validity of the action in declaring a member as defaulter has not been challenged in the present case whereas in the Gujarat case the Court had held that after the death of a stock broker he could not have been declared as a defaulter. This being so, the consequences which follow on a member being declared as a defaulter did not really come up for consideration in the Gujarat case.

G In our opinion, the High Court rightly came to the conclusion that once a defaulting member ceases to be a member of the Stock Exchange no interest in his card remains and the same cannot be regarded as his asset and furthermore Rules 16 and 43 are not illegal, arbitrary or void. For the aforesaid reason the appeal is dismissed but with no order as to costs.