BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved on : 22.02.2023

Date of Decision : 20.12.2023

Appeal No. 35 of 2020

Axis Bank Limited
"Trishul", 3rd Floor,
Opposite Samartheshwar Temple,
Near Law Garden, Ellisbridge,
Ahmedabad- 380 006 …Appellant

Versus

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

2. Karvy Stock Broking Ltd.
   Karvy Millennium, Plot No. 31-P,
   Nanakramguda Financial District,
   Gachibowli,
   Hyderabad – 500 032.

3. National Securities Depositaries Ltd.
   4th Floor, "A" Wing, Trade World,
   Kamala Mills Compound,
   Senapati Bapat Marg, Lower Parel,
   Mumbai- 400 013.

4. Central Depository Services (India) Limited
   Marathon Futurex, A-Wing, 25th Floor,
   NM Joshi Marg, Lower Parel,
   Mumbai- 400 013.

5. National Stock Exchange of India Ltd.
   Exchange Plaza, Plot No. C/1, G Block,
   Bandra Kurla Complex, Bandra (E),
   Mumbai- 400 051 …Respondents

Mr. Gaurav Joshi, Senior Advocate with Mr. Neville Lashkari, Mr. Chaitanya D. Mehta, Ms. Sonali Aggarwal and Ms. Pranvi Jain, Advocates i/b. M/s. Dhruve Liladhar & Co for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Manish Chhangani, Ms. Samreen Fatima and Mr. Sumit Yadav, Advocates i/b The Law Point for Respondent No. 1.

Mr. Somasekhar Sundaresan, Advocate with Ms. Kinjal Shah and Ms. Etika Srivastava, Advocates i/b. M/s. Rashmikant and Partners for the Respondent No. 3 (NSDL).

Mr. Darius J. Khambata, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Indranil Deshmukh, Mr. Animesh Bisht, Ms. Drishti Das, Ms. Vidhi Shah, Ms. Roma Bhojani, Mr. Karan Sangani and Mr. Rima Jain, Advocates i/b. Cyril Amarchand Mangaldas for the Respondent No. 5 (NSE).

WITH
Appeal No. 50 of 2020

ICICI Bank Limited
ICICI Bank Towers,
Bandra Kurla Complex,
Mumbai – 400 051, India. …Appellant

Versus

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

2. Karvy Stock Broking Ltd.
   Karvy House, 46, Avenue 4,
   Street No. 1, Banjara Hills,
   Hyderabad – 400 034.

3. National Stock Exchange of India Ltd.
   Exchange Plaza, Plot No. C/1, G Block,
   Bandra Kurla Complex, Bandra (E),
   Mumbai- 400 051.

4. National Securities Depositaries Ltd.
Trade World, A Wing,
4th Floor, Kamala Mills Compound,
Lower Parel,
Mumbai- 400 013.

…Respondents

Mr. Sandeep Parekh, Advocate with Ms. Sudarshana Basu and Ms. Lipika Vinjamuri, Advocates i/b. Finsec Law Advisors for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Manish Chhangani, Ms. Samreen Fatima and Mr. Sumit Yadav, Advocates i/b The Law Point for Respondent No. 1.

Mr. Darius J. Khambata, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Indranil Deshmukh, Mr. Animesh Bisht, Ms. Drishti Das, Ms. Vidhi Shah, Ms. Roma Bhojani, Mr. Karan Sangani and Mr. Rima Jain, Advocates i/b. Cyril Amarchand Mangaldas for the Respondent No. 3 (NSE).

Mr. Somasekhar Sundaresan, Advocate with Ms. Kinjal Shah and Ms. Etika Srivastava, Advocates i/b. M/s. Rashmikant and Partners for the Respondent No. 4 (NSDL).

WITH
Misc. Application No. 113 of 2020
And
Appeal No. 112 of 2020

Bajaj Finance Ltd.
3rd Floor, Panchshil, Tech Park,
Plot 43/1, 43/2 and 44/2, Viman Nagar,
Pune – 411 014 (Maharashtra).

…Appellant

Versus

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

2. National Securities Depositaries Ltd.
4th Floor, "A" Wing, Trade World,
Kamala Mills Compound,
Senapati Bapat Marg, Lower Parel,
Mumbai- 400 013. …Respondents

Ms. Atika Vaz, Advocate for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Manish Chhangani, Ms. Samreen Fatima and Mr. Sumit Yadav, Advocates i/b The Law Point for Respondent No. 1.

Mr. Somasekhar Sundaresan, Advocate with Ms. Kinjal Shah and Ms. Etika Srivastava, Advocates i/b. M/s. Rashmikant and Partners for the Respondent No. 2 (NSDL).

WITH
Appeal No. 70 of 2020

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

Versus

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

2. National Securities Depositaries Ltd.
4th Floor, "A" Wing, Trade World,
Kamala Mills Compound,
Senapati Bapat Marg, Lower Parel,
Mumbai- 400 013.

3. National Stock Exchange of India Ltd.
Exchange Plaza, Plot No. C/1, G Block,
Bandra Kurla Complex, Bandra (E),
Mumbai- 400 051 …Respondents

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

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Manish Chhangani, Ms. Samreen Fatima and Mr. Sumit Yadav, Advocates i/b The Law Point for Respondent No. 1.

Mr. Somasekhar Sundaresan, Advocate with Ms. Kinjal Shah and Ms. Etika Srivastava, Advocates i/b. M/s. Rashmikant and Partners for the Respondent No. 2 (NSDL).

Mr. Darius J. Khambata, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Indranil Deshmukh, Mr. Animesh Bisht, Ms. Drishti Das, Ms. Vidhi Shah, Ms. Roma Bhojani, Mr. Karan Sangani and Mr. Rima Jain, Advocates i/b. Cyril Amarchand Mangaldas for the Respondent No. 3 (NSE).

AND
Appeal No. 75 of 2020

IndusInd Bank Limited
8th Floor, Tower 1,
One Indiabulls Centre,
841, S.B. Marg, Elphinstone Road,
Mumbai – 400 013. …Appellant

Versus

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

2. National Securities Depositaries Ltd.
   Trade World, 4th Floor,
   Kamala Mills Compound,
   Senapati Bapat Marg, Lower Parel,
   Mumbai- 400 013.

3. National Stock Exchange of India Ltd.
   Exchange Plaza, Plot No. C/1, G Block,
   Bandra Kurla Complex, Bandra (E),
   Mumbai- 400 051.

4. Karvy Stock Broking Ltd.
   Karvy Millennium, Plot No. 31 & 32,
   Financial District, Nanakramguda,
   Gachibowli,
   Hyderabad – 500 032.

5. Central Depository Services (India) Limited
   Marathon Futurex, A-Wing, 25th Floor,
   NM Joshi Marg, Lower Parel,
   Mumbai- 400 013.

…Respondents

Mr. Pesi Modi, Senior Advocate with Mr. Tomu Francis, Mr. Kunal Katariya, Mr. Arka Saha, Ms. Zarnaab Aswad and Mr. Apoorva Upadhyay, Advocates i/b. Khaitan & Co. for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Manish Chhangani, Ms. Samreen Fatima and Mr. Sumit Yadav, Advocates i/b The Law Point for Respondent No. 1.

Mr. Somasekhar Sundaresan, Advocate with Ms. Kinjal Shah and Ms. Etika Srivastava, Advocates i/b. M/s. Rashmikant and Partners for the Respondent No. 2 (NSDL).

Mr. Darius J. Khambata, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Indranil Deshmukh, Mr. Animesh Bisht, Ms. Drishti Das, Ms. Vidhi Shah, Ms. Roma Bhojani, Mr. Karan Sangani and Mr. Rima Jain, Advocates i/b. Cyril Amarchand Mangaldas for the Respondent No. 3 (NSE).

Mr. Jehangir Jejeebhoy, Advocate with Ms. Silpa Nair i/b M/s. Veritas Legal for the Respondent no.5 (CDSL).

CORAM : Justice Tarun Agarwala, Presiding Officer
Ms. Meera Swarup, Technical Member

Per : Justice Tarun Agarwala, Presiding Officer

1. Five appeals have been filed against two orders passed by Securities and Exchange Board of India ('SEBI' for short) rejecting the representation from accessing the securities pledged with the appellants. For facility, the facts stated in the appeal of Axis Bank Limited (Appeal no. 35 of 2020) are taken into consideration.

2. The appellant Axis Bank is a commercial bank under the Banking Regulations Act, 1949 and, is in the business of issuing credit facilities against securities. Respondent no. 1 is SEBI who is the regulator of the securities market. Respondent no. 2 is Karvy Stock Broking Ltd. (hereinafter referred to as 'Karvy') who is the stock broker registered with SEBI, Respondent nos. 3 and 4 are depositories under the Depositories Act, 1996 ('Depositories Act' for short) and Respondent no. 5 is the National Stock Exchange of India Limited (hereinafter referred to as 'NSE') which is registered Stock Exchange under the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as 'SCRA').

3. In the course of its business Axis Bank has been extending over draft facilities against shares to Karvy from time to time.

This over draft facility was pursuant to an agreement under which a total sum of Rs. 100 crore had been disbursed. As on December 7, 2019 an aggregate amount of Rs. 80.64 crore along with interest was due from Karvy.

4. The over draft facility was secured by shares pledged by Karvy from its demat account having Client Id – 19502787 which was named as "Karvy Stock Broking Ltd. – Client Account – NSE-CM". The shares pledged under the over draft facility agreement was of such clients of Karvy who had debit balance with Karvy as their stock broker. According to the Axis Bank the said pledge was in compliance with the SEBI circulars issued from time to time, namely, the circular dated September 26, 2016.

5. By a circular dated June 20, 2019 SEBI issued directions to the participants in the securities market, Stock Exchanges, Clearing Corporations, Depositories, Trading Members, Clearing Members and Depository Participants requiring all clients securities which were pledged earlier under the earlier circulars to be either unpledged or returned to the clients upon fulfillment of pay in obligation or dispose of after giving five days notice to the clients. Such unpledging of the clients shares

was to be done by August 31, 2019 which was subsequently extended to September 30, 2019.

6. The appellant Axis Bank vide their letter dated August 20, 2019 intimated Karvy calling upon it to clear the outstanding amount under the over draft facility so that the pledged securities could be unpledged. Axis Bank vide their letter dated August 28, 2019 also informed SEBI about the aforesaid letter written to the broker. Axis Bank also informed SEBI that it would not be possible for the Bank to unpledge the shares where the broker was not able to clear the outstanding amount by August 31, 2019 and that the shares would be unpledged only when the broker had paid the complete outstanding amount.

7. By another letter dated September 18 2019 Axis Bank again reminded Karvy to pay the outstanding amount and unpledge the securities. By letter dated October 3, 2019 Axis Bank informed SEBI that the broker had requested for three months time to clear the outstanding amount.

8. While all this was going on, SEBI through its Whole Time Member (‘WTM’ for short) issued an *ex parte ad interim* order dated November 22, 2019 against Karvy alleging that Karvy had misused its clients securities. The *ex parte ad interim* order

found that Karvy did not report DP Account No. 11458979 named "Karvy Stock Broking Ltd." to the Stock Exchange in which clients securities were pledged. Further, Karvy credited the funds raised by pledging of clients securities to six of its own bank accounts instead of crediting it in the stock broker – client account and also did not report the six bank accounts to the Stock Exchange. The WTM further *prima facie* found that the securities lying in the DP Account No. 11458979 actually belonged to the clients who are legitimate owners of the pledged securities. Based on the above *prima facie* finding the WTM issued the following directions :-

(i) KSBL is prohibited from taking new clients in respect of its stock broking activities;

(ii) The Depositories i.e. NSDL and CDSL, in order to prevent further misuse of clients' securities by KSBL, are hereby directed not to act upon any instruction given by KSBL in pursuance of power of attorney given to KSBL by its clients, with immediate effect;

(iii) The Depositories shall monitor the movement of securities into and from the DP account of clients of

KSBL as DP to ensure that clients' operations are not affected;

(iv) The Depositories shall not allow transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD. (BSE) with immediate effect. The transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD. (BSE) shall be permitted only to the respective beneficial owner who has paid in full against these securities, under supervision of NSE; and

(v) The Depositories and Stock Exchange shall initiate appropriate disciplinary regulatory proceedings against the Notice for misuse of clients' funds and securities as per their respective bye laws, rules and regulations;

9. The WTM clearly directed that the depositories shall not transfer securities from DP Account No. 11458979 named Karvy Stock Broking Ltd. (BSE).

10. Pursuant to the *ex parte ad interim* order passed by the WTM, National Securities Depositaries Ltd. ('NSDL' for short) Respondent no. 3 issued a communication dated November 23, 2019 intimating the appellant Axis Bank that based on the *ex parte ad interim* order dated November 22, 2019 passed by the WTM, the clients securities that were pledged with the Bank would remain in a state of abeyance.

11. On November 29, 2019 the WTM rejected the request of Karvy on an application filed by them seeking flexibility in using the power of attorney issued by its clients. On December 3, 2019 Axis Bank invoked the pledge through NSDL and filed Appeal Lodging no. 597 of 2019 challenging the order of NSDL dated November 23, 2019 before this Tribunal which was disposed by an order dated December 17, 2019 directing the Axis Bank to make an appropriate representation to SEBI which would be decided. Accordingly, a representation was made praying that the ex *parte ad interim* order passed by the WTM dated November 22, 2019 was not applicable and that the Axis Bank should be allowed to invoke the pledge on account of the default made by Karvy.

12. The representation of Axis Bank was rejected by the impugned order dated January 14, 2020 passed by the WTM. The WTM held:-

(i) That the shares pledged by Karvy was invalid and therefore cannot be invoked by Axis Bank.

(ii) In terms of SEBI Circular dated September 26, 2016 Karvy as a stock broker was entitled to have a lien on client's securities only to the extent of indebtedness of the client and that Karvy could only pledge securities of indebted clients with the "explicit authorization" of the client.

(iii) "Explicit authorization" was needed to create a pledge which was not done.

(iv) If a stock broker pledges securities of its fully paid up client it amounts to misappropriation of clients securities by the stock broker.

(v) Disputed data of pledged shares supplied by NSE was relied upon to come to a conclusion that the securities pledged by Karvy in favour of Axis Bank belongs to fully paid and partly paid by clients.

13. The appeals filed by ICICI Bank, HDFC Bank, IndusInd Bank and Bajaj Finance Ltd. are against the order dated December 13, 2019 wherein under similar circumstances the representation of the said appellants were rejected. The facts are that they had advanced loan to Karvy against securities pledged by Karvy. Since Karvy defaulted they wanted to invoke the pledge but prior to that SEBI had passed an *ex parte ad interim* order dated September 22, 2019 directing the depositories not to allow the transfer of securities from DP Account No. 11458979. According to the appellants the securities pledged by Karvy was from this DP Account. These appellants filed appeals before this Tribunal seeking relief to invoke the pledge pursuant to the default committed by Karvy. Their appeals were disposed of directing them to make a representation. These appellants made representations which were rejected on similar grounds as given in the appeal of Axis Bank.

14. Insofar as Axis Bank is concerned this Tribunal while disposing of their appeal by an order dated December 17, 2019 had directed the parties to maintain *status quo* in respect of the securities in DP Account No. 19502787. Axis Bank had also filed a claim petition before the DRT Hyderabad wherein a stay

order was granted in respect of transfer of pledged shares. As a result of the interim order the pledged shares are still intact and has not been encashed. On the other hand, even though the shares were pledged in favour of the other appellants, namely, ICICI Bank, HDFC Bank, IndusInd Bank and Bajaj Finance Ltd., NSDL issued a press release dated December 2, 2019 stating therein:-

> *"SEBI has passed Orders WTM/AB/SEBI/MIRSD/HO/35/2019 and WTM/AB/SEBI/MIRSD/HO/36/2019 in the matter of Karvy Stock Broking Limited (KSBL). As per the directions of SEBI and under supervision of NSE, securities have been transferred from the demat account IN300394-11458979 named Karvy Stock Broking Limited (BSE) to the demat accounts of respective clients who have paid in full against these securities. The number of such clients who have received securities are 82,559."*

15. NSDL without revoking or cancelling the pledge in accordance with the Depositories Act and the DP Regulations 1996 transferred the pledged shares to the clients of the broker.

16. Pursuant to the rejection of their representation these appellants had filed their respective appeals praying not only for the quashing of the impugned order dated December 13, 2019 but further praying that a direction should be issued to the respondent to restore the pledge that was removed by the

depositories or in the alternative direct the respondent to compensate the appellants with the value of the underlined securities pledged in favour of the appellants or direct NSDL to indemnify the appellants with the said amounts under Section 16 of the Depositories Act.

17. We have heard Shri Gaurav Joshi, the learned senior counsel, Shri Pesi Modi, the learned senior counsel, Shri Sandeep Parekh and Ms. Atika Vaz, the learned counsel for the appellants in respective appeals and Shri Shiraz Rustomjee, the learned senior counsel, Shri Darius J. Khambata, the learned senior counsel, Shri Somasekhar Sundaresan and Shri Jehangir Jejeebhoy, the learned counsel for the respondents in respective appeals.

18. The learned senior counsel for Axis Bank contended that the respondent had no jurisdiction to pass the impugned order. It was contended that the NSDL had no jurisdiction under the SEBI Act or under the Depositories Act to hold that the clients securities that were pledged will remain in the state of abeyance. It was urged that so long as the shares are pledged neither SEBI nor the depository have any jurisdiction over the said shares until and unless it was unpledged. It was urged that Axis Bank

is not a member of NSDL and therefore NSDL had no authority to issue any direction against the appellants. The learned senior counsel further contended that the finding that the pledge created by Karvy was invalid since clients securities were pledged without explicit authorization is patently misconceived and cannot be accepted. It was contended that the requirement to seek the explicit authorization from the client pursuant to the circular dated September 26, 2016 was modified by SEBI circular dated June 22, 2017 and Clause 2.5 of the circular dated September 26, 2016 seeking the explicit authorization was done away meaning thereby that explicit authorization from the client was not required by the broker while pledging the shares of the clients. It was, thus, urged that the finding given by the WTM was patently erroneous and against SEBI's own circulars.

19. It was also contended that the pledge created by Karvy was valid. It was contended that if Karvy has not complied with the circulars issued by SEBI the pledging of the shares will not become invalid. SEBI circulars made it very clear that enhanced supervision was required to be conducted by the Stock Exchanges, Clearing Corporations and by the Depositories, and if, while pledging the securities, it was found that it was not in accordance with the circulars, then the responsibility has to be

fixed upon authorities under the circulars but no finding can be given that the shares which were pledged becomes illegal. It was contended that the controversy involved in the present appeal was squarely covered by a decision of this Tribunal in ***HDFC Bank Ltd. vs SEBI, Appeal No. 83 of 2021 decided on February 18, 2022*** wherein this Tribunal considered the matter of pledge of clients securities by a broker to a bank. It was contended that if the shares are pledged in accordance with the Depositories Act read with Regulation 58 of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 ('DP Regulations' for short) then the said pledge is a valid pledge until and unless it is revoked or cancelled by the competent court after due process which in the instant case has not been done. It was, thus, urged that once a pledge is validly created by the broker in favour of the appellant has a right to retain possession of the pledged shares till the outstanding liability was exhausted by the broker.

20. The learned senior counsel for the other appellants also made similar submissions contending that SEBI's *ex parte ad interim* order dated November 22, 2019 is an order '*in personam*' against Karvy and does not bind other parties dealing with the broker such as the appellants, namely, the

banks and financial institutions. It was contended that the appellants holds a valid pledge over the securities of Karvy and is entitled to all the statutory rights available to a pledgee under the provisions of the Depositories Act and the DP Regulations. It was contended that the pledge was created in accordance with the Depositories Act and Regulation 58 of the DP Regulations and therefore the pledge cannot be held to be invalid merely because the broker has violated the circulars issued by SEBI. The contention that the due diligence was not shown by the appellants while taking the shares as securities towards the loan granted is patently misconceived. It was urged that it was not the job of the appellants to figure out as to whether securities are of the broker or of its clients and it is enough for the appellants to be informed by the Depository that the securities are in the name of the beneficial owner which in the instant case was Karvy. Thus, it was urged that the pledge created by the broker was valid and was in accordance with provisions of the Depositories Act and the DP Regulations. It was urged that as per the Pledge Master Report the securities pledged in favour of the appellants were in the account named, Karvy Stock Broking Ltd. and therefore Karvy was authorized to pledge such securities, being the beneficial owner of such securities. It was, thus, urged that for the purpose of creation of a pledge, the

beneficial owner of the securities was Karvy in accordance with the applicable laws. It was also urged that it was the duty of the Stock Exchange to monitor the activities of the stock broker and if there was failure on the part of the stock broker in not complying with the circulars or if there was failure on the part of the Stock Exchange and Depositories in not ensuring the securities so furnished were not that of the broker, in that event, the said authorities were at fault and such default cannot be passed on to the appellants on the basis of holding that the pledge was invalid. Once a pledge has been created, third parties right comes into picture which cannot be defeated on the pretext of holding that the pledge so created was invalid. It was urged that violation of the circulars by the broker did not invalidate the pledge which was created prior to the said date. It was also urged that the action of SEBI and NSDL in unilaterally transferring the pledged shares to the clients of the broker without revoking the pledge was wholly arbitrary, illegal and in violation of the Depositories Act and amounted to a highway robbery which not expected from the regulator and the first level regulators. It was urged that the action of NSDL was contrary to the Depositories Act and other applicable laws such as the Contract Act.

21. On the other hand, the submissions of the respondents that the appellants are not the owners of the shares which were pledged. It was contended that Karvy violated the circulars issued by SEBI and wrongly pledged the securities of its clients which was not permissible and therefore the pledge created by Karvy was invalid in law. It was contended that the SEBI had the power to freeze the Karvy's DP Account No. 19502787 and that *ex parte ad interim* order was effected by NSDL to all other accounts of Karvy even though it was not specifically mentioned in the *ex parte ad interim* order. It was contended that NSDL had passed the order by taking a proactive measure and therefore directing the securities pledged with Axis Bank to remain in a state of abeyance was perfectly justified in the light of the fact that some shares pledged by Karvy of its clients could not have been pledged under the circulars. The respondent further contended that the Depositories Act does not override the common law namely the Contract Act and other general laws such as the Sales of Goods Act, Companies Act and relied upon the judgment of the Supreme Court in ***PTC India Financial Services Ltd. vs Venkateshwarlu Kari and Anr. 2022 SCC OnLine SC 608***. It was urged that in view of the said decision of the Supreme Court, the Depositories Act does not override the Contract Act and that the two Acts must be read

harmoniously to complement each other in view of Section 28 of the Depositories Act.

22. The learned senior counsel contended that the general law on transfer of title to property is that no person can give a better title that he has and this principle is based on a latin maxim "*nemo dat quod non habet*" which means that no person can give what he does not have. In support of his submissions the learned senior counsel placed reliance upon Section 27 of the Sales of Goods Act and relied on the decision in ***Nitin Gupta vs State of Meghalaya & Ors. (2005) 13 SCC 686, Jasvir Singh vs Manmohan Singh and Others ELR 2010 159 PNH 46, Hindustan Dorr Oliver Ltd. vs A K Menon and others (1994) 80 Company Cases 384 and Abn Ambro Bank vs Indian Railway Finance Corporation and others decided by the Special Court at Bombay dated March 31, 1998***. It was urged that since Karvy did not have title to the shares it could not have pledged it under the Depositories Act and therefore the pledge was invalid. It was contended that the order of the WTM does not suffer from any error of law and the appeals should be dismissed.

23. In addition to the aforesaid, the learned senior counsel for the NSE contended that the appellants have no *locus standi* to make a claim against NSE. It was urged that any loss which may have been incurred by the appellants due to fraudulent acts of Karvy cannot form the basis for making a claim against NSE. It was urged that any claim for compensation or loss that the appellants may have suffered can only be made against Karvy. Further, no damages can be claimed from the NSE Investor Protection Fund Trust since there is no relationship / privity of contract between the appellants and NSE. It was further contended that the relief sought against NSE is more or less in the nature of compensation and / or damages in tort which is not permissible.

24. The learned counsel for NSDL contended that a depository is simply a record-keeping agency and a neutral party that follows instructions issued by beneficial owners, and directions and orders issued by the regulator. Depositories do not take any decisions and only implement the decisions handed out to them in terms of the Depositories Act and the subordinate legislation made thereunder. Depositories have bye-laws making power (legislative) but no decision-making power (executive) or adjudicatory power (judicial). In the absence of any quasi-

judicial decision-making powers, the legislative design of the Depositories Act does not even entail an appellate framework for the Depository.

25. It was urged that the prayer made by the appellants is to restore the pledge or indemnify against the illegal sale. It was contended that under Section 16 of the Depositories Act only the beneficial owner can be indemnified by the Depository and that the beneficial owner in the instant case is Karvy and not the appellants. It was further contended that under the Depositories Act it was Karvy's statutory duty to satisfy itself that the securities were available for creation of the pledge and that the Depository had no role to play and therefore were not liable for the loss alleged by the appellants.

26. Having given our thoughtful consideration in the matter, we find that at the outset, *ex parte ad interim* order dated November 22, 2019 passed by the WTM against Karvy was confined to DP Account no. 11458979 and had nothing to do with the securities lying in DP Account no. 19502787. If the WTM wanted to freeze all the DP Accounts of Karvy it could have done so in the *ex parte ad interim* order, but it did not do so and only confined the restraint order to DP Account no.

11458979. Further, the Depositories were directed not to allow transfer of securities from DP Account no. 11458979 only.

27. Thus, the Depository was only bound to act within the four corners of the directions issued by the WTM in its order of November 22, 2019. NSDL had no authority to widen the scope of the directions to other Karvy accounts. Such freezing of other Karvy's account was totally without jurisdiction. NSDL, in our opinion, has acted beyond the directions issued by the WTM in its order of November 22, 2019. NSDL has admitted in their written submissions that they have no authority to make any decisions and only follow instructions issued by the beneficial owners and directions issued by the regulator.

28. The contention of SEBI that NSDL adopted a proactive measure to comply with the orders of WTM dated November 22, 2019 is patently erroneous. The directions given by the WTM in its order dated November 22, 2019 was clear and explicit and was confined only to one DP Account no. 11458979 and NSDL was required to ensure that securities from this DP account should not be transferred. The proactive measures adopted by NSDL are without jurisdiction.

29. Thus, the direction of NSDL intimating the appellant Axis Bank that the securities kept in Demat Account no. 19502787 would remain in the state of abeyance was without jurisdiction and beyond the powers conferred to NSDL under the Depositories Act.

30. The finding of the WTM that explicit authorization should have been given by the client of the broker and only then a valid pledge could be created by the broker under Clause 2.5 of the circular dated September 26, 2016 is wholly erroneous.

31. Before we proceed, it would be appropriate to consider SEBI circulars which have been relied in the impugned order, namely, Clause 2.5 of the circular dated September 26, 2016, Clause 2(c) of the circular dated June 22, 2017 and Clause 4.8 and 4.9 of circular dated June 20, 2019 which 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."

32. 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 authorization" 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 the DP Regulations. 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 authorization" 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 and there was no need to take an "explicit authorization" from the client.

33. 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 appellants have nothing to do with the compliances required to be done by the broker.

34. We find from the above that the "explicit authorization" that was required to be given by the client to the broker for creating a pledge was done away pursuant to Clause 2(c) of the circular dated June 22, 2017 and therefore the stock broker was not required to take the explicit authorization from its clients for the purpose of creating a pledge. This view of ours was also held by us in ***HDFC Bank vs Securities and Exchange Board of India, Appeal no. 83 of 2021 decided on February 18, 2022***, wherein this Tribunal held:-

> *"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."*

The said decision is squarely applicable in the instant case.

35. We may also state that the circulars as stated aforesaid are not applicable upon the appellants and these circulars applies to the stock broker, Stock Exchanges, Depositories and Clearing Corporations. If the circulars have been violated then SEBI has to take action against the stock broker, Stock Exchanges, Depositories and Clearing Corporations but has no jurisdiction to hold that the appellants are not entitled to invoke the pledge and encash the same.

36. Clause 2.5 of the circular dated September 26, 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 DP Regulations. Nothing has come on record in the impugned order to show that the securities pledged by Karvy were not in accordance with Regulation 58 of the DP Regulations.

37. The finding of the WTM that since the circulars were violated by the broker, Karvy had no authority to create a pledge in favour of the appellants is patently erroneous. In the first instance we find that the circular September 26, 2016 permitted a broker to pledge the shares of the clients to the extent of the debit balance of the clients. Thus, a broker was allowed to pledge the shares of its clients and the finding that

the broker did not have the jurisdiction to pledge the shares of the client is *per se* erroneous.

38. Assuming that the broker has pledged the securities of its clients which did not have a debit balance it would not make the pledge invalid. SEBI would be justified in taking action against the broker and direct the broker to unpledge the shares but had no jurisdiction to hold that an invalid pledge was created in as much as we find that when the pledge was created, the broker had the right to create a pledge that could include clients securities under the circular dated September 26, 2016.

39. If the circular dated September 26, 2016 was violated by the broker, it is the responsibility of the Depository to ensure that the shares of clients who did not have a debit balance could not be utilized for creating a pledge. Failure on the part of the Depository and failure on the part of the Stock Exchange in not monitoring the situation will make them liable for violating the circulars issued by SEBI but will not entitle SEBI to hold that an illegal or an invalid pledge was created. Thus, the contention of the respondent that the shares pledged by Karvy was invalid and cannot be invoked by the appellants is patently erroneous.

40. 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 :-

Section 2(a)

*"**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."*

41. 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.

42. 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, 1996. One such provision provided under the DP Regulation is the manner of creating a pledge or hypothecation in respect of security owned by a beneficial owner under sub- section (1) of section 12 and the rights and obligations of the depositories, participants and the issuers under sub-section (1) of section 17.

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

Regulation 58

"Manner of creating pledge or hypothecation

58. (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) The depository after confirmation from the pledgee that the securities are available for pledge with the pledger shall within fifteen days of the receipt of the application create and record the pledge and send an intimation of the same to the participants of the pledger and the pledge.

(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 along 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)(a) 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).

(b) 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.*

(11) 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."

44. A perusal of sub-clause (8) of Regulation 58 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. Sub-clause (6) of Regulation 58 provides that no pledge can be cancelled without the prior concurrence of the pledgee.

45. 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."

46. The aforesaid Section 150 and 151 of the Companies Act 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.

47. 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.

48. 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, paragraph 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."

49. From the aforesaid provisions of the Depositories Act, the Companies Act and the decision cited aforesaid it is clear that the Depositories Act is a complete Code by itself. Further, the Depositories Act and the DP 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 DP 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, ownership and transfer of dematerialised shares would be on behalf of a beneficial owner and 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.

50. Certain provisions of the Contract Act are also required to be considered. Section 172 of the Contract Act provides as under:-

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

51. As per Section 172, creating a valid pledge requires delivery of possession of goods by the pawnor to the pawnee by wayof security upon the promise of repayment of a debt or the performance of a promise, thereby, creating an estate that vests with the pawnee. Sections 176, 177 and 179 of the Contract Act read thus:-

> *"**176. Pawnee's right where pawnor makes default.** — If the pawnor makes default in payment of the debt, or performance; at the stipulated time or the promise, in respect of which the goods were pledged, the pawnee may bring a suit against the pawnor upon the debt or promise, and retain the goods pledged as a collateral security; or he may sell the thing pledged, on giving the pawnor reasonable notice of the sale.*
>
> *If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the surplus to the pawnor."*
>
> *xxxxxx*
>
> ***177. Defaulting pawnor's right to redeem.** – If a time is stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, and the pawnor makes default in payment of the debt or performance of the promise at the stipulated time, he may redeem the goods pledged at any subsequent time before the actual sale of them,but he must, in that case, pay, in addition, any expenses which have arisen from his default."*
>
> *xx xxxx*
>
> ***179. Pledge where pawnor has only limited interest.**– Where a person pledges goods in which he has only a limited interest, the pledge is valid to the extent of that interest."*

52. Section 176 provides that when a pawnor makes a default in payment of debt or performance of a promise, the pawnee may bring a suit against the pawnor upon such debt or promise and retain the goods pledged as collateral security, or he may sell the goods pledged upon giving the pawnor reasonable notice of the sale. If the pledged goods are sold, and the proceeds of such sale are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance amount to the pawnee. If the proceeds of such sale exceed the amount due, the pawnee will be liable to pay the surplus to the pawnor.

53. Section 177 gives statutory right to the pawnor, who is at default in payment of the debt or performance of the promise, to redeem the pledged goods at any time before 'actual sale' by the pawnee. However, in such cases, the pawnor must pay in addition the expenses that have arisen from his default. Section 179 states that the limited interest that a pawnor has in the goods can be validly pledged.

54. The Supreme Court in ***PTC India Financial Services Ltd. (supra)*** has dealt in detail with regard to the provisions of the

Depositories Act read with Regulation 58 of the DP Regulations and its effect with the provisions relating to pledge under the Indian Contract Act, 1872. The Supreme Court had held that the provisions of Depositories Act and the DP Regulations are not in derogation of the Contract Act but in addition to it in view of Section 28 of the Depositories Act. The Supreme Court held that the provisions of the Contract Act which is substantive and General Law relating to Contract Act and Depositories Act which is primarily a law relating to securities must be interpreted harmoniously. The Supreme Court held that the two statutes should be read together consistently and harmoniously to complement each other.

55. The Supreme Court held that Depositories Act was inacted to lay down the process and rules for dematerialization of securities by converting them into electronic data stored in the computers of the Depositories. The Depositories Act established the depository eco system and introduced the concept of a registered owner and beneficial owner. The Depository was the registered owner but did not have any voting right or any other right in respect of the securities held by it and that the beneficial owner was solely entitled to all rights, benefits and liabilities attached to the securities held by the Depositories.

56. The Supreme Court found that the power and right to transfer ownership of a dematerialized security vests with the beneficial owner which is the same as in the case of buying and selling physical securities. The Supreme Court noted that under Section 10 of the Depositories Act, the Depository would be deemed to be the registered owner and was entitled to effect the transfer of ownership of the securities on behalf of the beneficial owner and that no person including the pawnee could transfer the pawn held in dematerialized form without being registered as beneficial owner. The Supreme Court held:-

> *"72. In terms of sub-section (1) of Section 12, a "beneficial owner" can create a pledge or hypothecation regarding the security owned by him through "the depository", subject to prior approval of "the depository". Section 12 or for that matter the Depositories Act does not define pledge or hypothecation, and thereby accepts and adapts their meaning as known in the commercial sense to people in the trade. This means that the Depositories Act recognises the principles relating to pledge prescribed by the Contract Act and the common law. The Depositories Act states that such a pledge or hypothecation should be made in accordance with the regulations and bye-laws made under the Depositories Act. A "beneficial owner" as the pawnor is required to intimate such pledge or hypothecation to the depository, which thereupon makes entries in its records. This entry, made by "the depository", is evidence of pledge or hypothecation.*
>
> *74. Clearly, Section 12 of the Depositories Act is not ex facie inconsistent with pawnee and pawnor's contractual rights and obligations under the Contract*

Act and the common law. On the other hand, the Depositories Act expressly concedes that the securities held by the depository can be pledged and hypothecated by the "beneficial owner". It simplifies the process by bringing transparency and certainty. It checks and curtails possibilities of disputes as the pledge must be registered with the "depository".

75. Undoubtedly, the Depositories Act distinguishes between the "registered owner" and the "beneficial owner" i.e., the de facto owner, but this does not in any manner contradict or lay down a rule which is contrary to the provisions of Sections 176 and 177 of the Contract Act. These sections, given the objective and purpose behind them, would still apply to any pledge deed and do not get diluted or overridden by the provisions or requirements of the Depositories Act. Section 10, a non obstante provision, which prevails over existing enactments by law, treats the "depository" as the "registered owner" and the shareholder/holder as a "beneficial owner". It does not undermine or rewrite the provisions of the law of pledge and mutual obligations and rights of the pawnee and pawnor. This aspect has been elaborated in some detail subsequently in this judgment.

78. A reading of Regulation 58 would show that a "beneficial owner" is entitled to create a pledge on security owned by him. To do so, he must apply to the "depository" through the participant who has his account in respect of the securities. Sub-regulation (2) requires the participant to accord its satisfaction that the securities are available for pledge and make a note in this regard in its records. The note is to be forwarded to the "depository". In terms of sub-regulation (3), the "depository" is required to within fifteen days create and record a pledge and send an intimation to the participants of the pledgor/pawnor and the pledgee/pawnee. The participants of the pawnor and pawnee are required to inform the pawnor and the pawnee as to the entry of creation of the pledge. If the "depository" does not create the pledge, intimation of the reasons has to be given to the participants of the pawnor and the pawnee. The "depository" can cancel the pledge if the pawnee

applies to the depository through its participants. The pawnor can also apply through its participant to the "depository" for cancelling the pledge. In this case, the entry can be cancelled by the "depository" with the prior concurrence of the pawnee. On cancellation of the pledge entry, the "depository" is to inform the participant of the pawnor.

79. Sub-regulation (8) of Regulation 58 uses the expression "subject to the provisions of the pledge document" with a specific purpose and objective. In other words, sub-regulation (8) of Regulation 58 does not seek to curtail or restrict, but on the other hand respects party autonomy and freedom to decide the terms of the pledge, including the event of default that would entitle the pawnee to invoke the pledge and sell the pawn. The sub-regulation does not expressly nullify any provision of the Contract Act. However, the stipulation that the pawnee may invoke the pledge, and on such invocation, the pawnee is to be recorded as the "beneficial owner" of the pledged securities is mandatory. A pledge document cannot stipulate to the contrary, and any contravening contractual stipulation would not be binding. The records maintained by the "depository" are to be amended on the pawnee invoking the pledge and thereupon, the "depository" shall register the pawnee as the "beneficial owner" of the securities. Consequent to the change and in terms of sub-regulation (9) of Regulation 58, the "depository" is to inform the participants of the pawnor and pawnee, with a direction that they shall make necessary changes in their records and that the participants shall inform the pawnor and pawnee, respectively.

80. Thus, the non obstante part of sub-regulation (8) of Regulation 58 serves a limited objective and purpose : the pawnee must record itself as a "beneficial owner" before he proceeds to sell the pledged securities. Without the pawnee being accorded the status of a "beneficial owner", a pawnee cannot proceed to sell the pledged dematerialised securities. A contractual term cannot overwrite the requirement of Sections 7 and 10 of the Depositories Act, which is reflected in sub-regulation (8) of

Regulation 58 as per which the pawnee must be recorded as the "beneficial owner" before the pledged dematerialised securities are sold. Section 38(1)(e) of the Depositories Act requires the "depository" to maintain, inter alia, records of all approvals, notices, entries and cancellations of pledge and hypothecation, as the case may be. This mandate of sub-regulation (8) of Regulation 58 will apply whenever the pledged/pawned goods are dematerialised securities. To reiterate, this requirement of sub-regulation (8) of Regulation 58 does not circumscribe or limit the contractual rights and obligations agreed upon between the parties on the agreed terms, including the pawnee's right to sell the pawned goods. While the contractual terms are fundamental and determine the rights and obligations inter se the parties including when the pawnee would be entitled to get his name substituted as a "beneficial owner" under the 1996 Regulations, however, the contractual terms are not permitted to override the Contract Act as explained above insofar as it regulates the rights and obligations of the pawnee and pawnor, and the requirement of compliance with Regulation 58(8). It is absolutely necessary that the pawnee must be accorded status of "beneficial owner" to enable him to exercise his right to sell the pledged dematerialised securities. The object is to ensure compliance with the procedure prescribed for the sale of dematerialised securities and not to interfere with the freedom to contract as long as they comply with the Contract Act and other laws. Further, if the terms of the pledge document violate Regulation 58(8), the pledge is not rendered void or illegal, albeit enforcement of the pledge viz. the dematerialised securities will be rendered unattainable unless steps are taken to act in accordance with the procedure prescribed by the 1996 Regulations. The pawnee would be entitled to sue the pawnor for recovery of money, breach of contract and may even apply for injunction/restrain on sale of dematerialised securities. However, third-party rights on transfer of the dematerialised securities, unless injuncted by a prior court order, would not be affected as long as the transfers are in terms of the Depositories Act and the 1996 Regulations.

E. Effect of the Depositories Act, 1996 and the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 on the pledge under the Contract Act, 1872

81. As per the 1996 Regulations, the pledgor/pawnor is not entitled to sell the pledged/pawned securities. The special rights of the pledgee/pawnee in the pawn remain intact under the Depositories Act and the 1996 Regulations. However, the right to sell dematerialised securities is conferred and given to the "beneficial owner", who exercises this right through the participants. Consequently, if a pawnee wants to exercise his right to sell dematerialised security it is mandatory for the pawnee first to get himself recorded as a "beneficial owner" in "the depository's" records. Without the said exercise, the pawnee cannot exercise its rights to sell the pledge and retrieve the monies due by taking recourse to its rights under Section 176 of the Contract Act. Right to sell the pledge after reasonable notice is one of the options, albeit, both under the common law and under the Contract Act, the pawnee has the choice even after issue of notice for sale to sue for the debt due while retaining possession of the pledged goods. Similarly, the pawnor under the Contract Act and the common law has the right to redeem the pledged goods till "actual sale". Sale by the pawnee to self does not defeat the right of redemption of the pawnor. It may amount to conversion in law. Other provisions of the Contract Act enumerated in Chapter IX may well apply.

82. The Depositories Act [except for Section 10 which has been examined by us in some detail in re its application (supra)] and the 1996 Regulations do not expressly state that their provisions prevail over the Contract Act or any other law in force. On the other hand, Section 28 states that "[t]he provisions of this Act shall be in addition to, and not in derogation of, any other law for the time being in force relating to the holding and transfer of securities". Thus, the Depositories Act is in addition to other laws relating to the holding and transfer of securities. Our

reasoning does not mean that compliance with Section 12 and Regulation 58 is not compulsory or mandatory. Violations of the statute may lead to penalties and even criminal action when permitted and warranted. Nevertheless, given the nature and requirements under Section 12 or Regulation 58, do not by implication or due to conflict overwrite and undo the legislative mandate of Sections 176 and 177 of the Contract Act. We do not read any legislative intent in the Depositories Act and the 1996 Regulations to change the law of pledge requiring issue of reasonable notice; or as allowing sale to self, or abolishing the right of the pawnor to redeem the pledged goods till "actual sale". Sections 176 and 177 are not obliterated, insofar as they would equally apply to pawned dematerialised securities as they apply to other pawned goods.

83. The Depositories Act and the 1996 Regulations do not state or impliedly reflect that sale of the pledged securities by the pawnee to self, which amounts to conversion and does not affect the rights of the pawnor under Section 177, are no longer applicable. Doing so would tantamount to reading and adding words to Section 12 and Regulation 58 to defy Sections 176 and 177 of the Contract Act. Law of pledge is dynamic and as observed above must adapt itself in the context of the current commercial environment, albeit we would avoid palpable conflict that would arise in view of the enactment of the Depositories Act and the 1996 Regulations, or else the operation of law in practice would lead to compliance difficulties and complications. While interpretating the law relating to commercial matters and commerce the Court must consider the real-world impact and consequences. Therefore, the expression "actual sale" in Section 176 read in the context of the Depositories Act and the 1996 Regulations have to be given a meaning. The expression "actual sale" used in Section 177 in our opinion should be read as "the sale by the pawnee to a third person made in accordance with the Depositories Act and applicable bye-laws and rules". It also means and requires compliance with Section 176 of the Contract Act. Mere exercise of the right by the pawnee to record himself as the

"beneficial owner", which is a necessary precondition before the pawnee can exercise his right to sell, is not "actual sale" and would not affect the rights of the pawnor of redemption under Section 177 of the Contract Act. Every transfer or sale is not "actual sale" for the purpose of Section 177 of the Contract Act. To equate "sale" with "actual sale" would negate the legislative intent.

84. In Madholal Sindhu [Official Assignee of Bombay v. Madholal Sindhu, 1946 SCC OnLine Bom 47 : AIR 1947 Bom 217] and several other decisions, the expression "actual sale" in Section 177 of the Contract Act has been interpreted to mean lawful sale to a third person and not conversion or unlawful sale contrary to Section 176 of the Contract Act. According to us, exercise of right on the part of the pawnee and consequent action on the part of the "depository" recording the pawnee as the "beneficial owner" is not "actual sale". The pawnor's right to redemption under Section 177 of the Contract Act continues and can be exercised even after the pawnee has been registered and has acquired the status of "beneficial owner". The right of redemption would cease on the "actual sale", that is, when the "beneficial owner" sells the dematerialised securities to a third person. Once the "actual sale" has been effected by the pawnee, the pawnor forfeits his right under Section 177 of the Contract Act to ask for redemption of the pawned goods.

85. We, however, accept that the Depositories Act, bye-laws and rules relating to sale of dematerialised securities would be gravely undermined in case the pawnor is entitled to redeem the dematerialised shares from the third party on the ground that reasonable notice, as postulated under Section 176 of the Contract Act, was not given to the pawnor. To this extent, we would accept that there is a conflict between the Depositories Act and the interpretation given in Madholal Sindhu [Official Assignee of Bombay v. Madholal Sindhu, 1946 SCC OnLine Bom 47 : AIR 1947 Bom 217] , which has been followed in other cases, including the judgment of the Delhi High Court in Nabha Investment [Nabha Investment (P)

Ltd. v. Harmishan Dass Lukhmi Dass, 1995 SCC OnLine Del 239] . If this principle is applied to dematerialised securities that have been transferred to the third parties in accordance with the provisions of the Depositories Act, bye-laws and rules, it would materially impact certitude in the transaction in listed dematerialised securities which would become vulnerable to challenge even when the arm's length purchasers are innocent third-party buyers for valuable considerations. Open market operations would be affected. To this extent, therefore, we do hold that the dictum in Madholal Sindhu [Official Assignee of Bombay v. Madholal Sindhu, 1946 SCC OnLine Bom 47 : AIR 1947 Bom 217] and Nabha Investment [Nabha Investment (P) Ltd. v. Harmishan Dass Lukhmi Dass, 1995 SCC OnLine Del 239] , that the pawnor has a right to redemption against third parties when the pawnee does not give reasonable notice under Section 176 of the Contract Act, would not apply to listed dematerialised securities which are sold by the pawnee in accordance with the provisions of the Depositories Act, bye-laws and rules. In fact, the stipulations in Section 12 of the Depositories Act and Regulation 58 of the 1996 Regulations have in-built provisions in terms of which the pawnor and the pawnee are informed about the change of status with the pawnee making a request and being accorded a status of the "beneficial owner". The pawnee cannot make the sale of dematerialised securities without being registered as a "beneficial owner", which is a step that a pawnee must take before he proceeds to sell the pledged dematerialised securities.

89. Significantly, regarding the Depositories Act and the 1996 Regulations, this judgment in Pushpanjali Tie Up case [Pushpanjali Tie Up (P) Ltd. v. Renudevi Choudhary, 2014 SCC OnLine Bom 3661] rightly observes that dematerialised shares must comply with the said pledge requirements to enable the pawnee to exercise the right to sell. A third party would be entitled to and justified in presuming that there is no pledge unless the procedure prescribed under the Depositories Act is followed. To this extent, the Depositories Act has introduced a new regime. The legislative intent is to provide an inode of putting the

third parties concerned to express notice of the pledge. Subject to the pledgor's rights, only a party with express notice of the pledge created by the "beneficial owner", following the manner prescribed for the creation of a pledge, deals with the securities at his own risk. This safeguards innocent third parties who would otherwise have no means of being aware of the pledge in case of dematerialised shares. The provisions of the Depositories Act, and in particular Section 12 thereof, and the 1996 Regulations, and in particular Regulation 58, are salutary as they introduced transparency and certainty in the securities market. There is no other discernible reason for the legislature to have provided for a particular manner alone for creating a pledge of shares in a dematerialised form. More significant for our purpose are the observations in Pushpanjali Tie Up case [Pushpanjali Tie Up (P) Ltd. v. Renudevi Choudhary, 2014 SCC OnLine Bom 3661], with which we again agree, that the prescription in the Depositories Act and the 1996 Regulations are for the manner in which creation and transfer of the dematerialised shares can be achieved. It is to regulate the creation and transfer of dematerialised securities, including how the pledge can be transferred to a third party. The Contract Act does not stipulate that a pledge can be created only in a particular manner. The Depositories Act prescribes how the dematerialised securities can be pledged. The provisions of the Depositories Act and the 1996 Regulations are not in derogation of the Contract Act but in addition to it. In this regard, reference is made to Section 28 of the Depositories Act, which we have referred to earlier. Therefore, the object of the Depositories Act is not to rewrite the provisions of the Contract Act but to regulate the creation and transfer of dematerialised securities. Regulation 38(1)(e) requires a depository to maintain, inter alia, records of all approvals, notices and entries, and cancellation of pledge or hypothecation, as the case may be."

57. In the light of the aforesaid provisions and the decision in ***PTC India Financial Services Limited (supra)*** it is submitted

that the appellant held a valid pledge over the securities lying in Karvy Account and as a bona fide pledgee, the appellant was entitled to all statutory rights available to a pledgee under the provisions of the Depositories Act, 1996, the SEBI (Depositories and Participants) Regulations, 1996 and the relevant bye-laws of the depositories.

58. This Tribunal in ***HDFC Bank vs SEBI, Appeal no. 83 of 2021 decided on February 18, 2022*** held that:-

> *"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."*

59. Thus, once a pledge is validly created by a broker in favour of the appellants and the appellants are recorded as a 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.

60. We are further of the opinion that once a valid pledge is created in favour of a third party then a third-party right is created in the attached property and the same cannot be sold or distributed to discharge the liabilities of the broker.

61. 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."*

> *"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."*

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

63. 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."*

64. 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.

65. A finding has been given by the WTM that there was lack of due diligence on the part of the appellants during the creation of the pledge and therefore the appellants are not entitled to invoke an invalid pledge. This finding and contention of the respondent is patently erroneous. The contention that the appellants being a registered depository participant should have been alerted by the categorization of Karvy's account as a "non house" beneficiary account is completely erroneous. The contention that the appellant should have been alerted by the use of the word "BSE" in the name of Karvy's account and also the absence of the word "proprietary" and should have therefore made further enquiries before proceeding to create a pledge in our opinion it is the role of the Depository to ensure that a proper security is being utilized by the broker for the creation of the pledge. The appellants were not acting as a depositor participant but were participating in the capacity of an ordinary lender. The appellants had no notice or information either from NSDL or from Karvy regarding the categorization of the account as "non house" and therefore the appellants could not have been reasonable to make any enquiry about the same. The register and index of beneficial owners maintained by the Depository under the Depositories Act indicated that Karvy was

the beneficial owner. For the purpose of creation of the pledge the persons whose name is recorded in the depository system as beneficial owner is legally empowered under the Depositories Act to create a pledge. Based on the entries in the register due diligence was done by the appellants and a valid pledge was created since Karvy was shown as beneficial owner. The pledge was created in accordance with the provisions of the Depositories Act and Regulation 58 of the DP Regulations. Nothing has come on record to show that the securities pledged by Karvy were not in accordance with Regulation 58 of the DP Regulations. In this regard Section 88(3) of the Companies Act provides:-

> *"(3) 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 the corresponding register and index for the purposes of this Act."*

66. Further, Section 95 of the Companies Act states as under:-

> *"95. Registers, etc., to be Evidence*
>
> *The registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be prima facie evidence of any matter directed or authorized to be inserted therein by or under this Act."*

67. In view of the above, it can be concluded that the register and index of beneficial owners maintained by a depository is

prima facie evidence of who the beneficial owner is. For the purpose of creation of the pledge, the person whose name is recorded in the depository system as 'beneficial owner' is legally empowered under the Depositories Act to create the pledge. Any action taken by such person cannot be invalidated on the ground that the pledged securities were not actually owned by such person. Any other interpretation of the term 'beneficial owner' would defeat the very objective of the Depositories Act.

68. In this regard, reliance is also placed on the observations of this Tribunal in ***HDFC Bank (supra)*** which has been affirmed by the Supreme Court wherein it was held that:-

> *"27. [..]*
> *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.*
>
> *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.*
>
> (emphasis supplied)

69. Once a valid pledge has been created and an entry has been made in this regard in the records of the depository, the Depositories Act does not envisage a situation wherein persons whose names are not recorded in the depository could be regarded as the beneficial owner of the pledged securities and such pledges could be rendered invalid subsequently. As per the Pledge Master Report, the securities pledged in favour of the appellant were in the account named "Karvy Stock Broking Limited (BSE)" and the same implied that Karvy was authorized to pledge such securities as the "beneficial owner" of such securities.

70. In addition to the aforesaid, Section 15 of the Depositories Act recognizes that the Bankers Books Evidence Act, 1891 will apply to a depository. For facility, Section 15 is extracted here under:-

> *"15. Act 18 of 1891 to apply to depositories.*
>
> *The Banker's Books Evidence Act, 1891 shall apply in relation to a depository as if it were a bank as defined in section 2 of that Act."*

71. Thus, an entry in the register and index of beneficial owners is *prima facie* evidence of who the beneficial owner is. The name of Karvy was recorded in the register and index of

beneficial owner based on which a valid pledge was created. Thus, the finding that due diligence was not done by the appellant while creating a pledge is patently erroneous.

72. We also find that the action of SEBI and NSDL to unilaterally transfer pledge shares to the clients of Karvy was wholly illegal and without jurisdiction. Such unilateral transfer of the shares without revoking the pledge is *per se* illegal and against the provisions of the Depositories Act and Regulation 58 of the DP Regulations. We are of the opinion that no revocation of pledge is permitted unless consent is obtained from the pledgee under Section 58(6) of the DP Regulations which in the instant case were the appellants. No such consent was taken. Regulation 58(6) of the DP Regulations states that no transfer of securities which is pledged shall be effected by a participant without the concurrence of the pledgee.

73. Further, Clause 9.9.9 of the NSDL Bye Laws states that:-

> *"9.9.9. The Depository, after receiving prior confirmation from the Participant of the pledgee through an application made by the pledgee to the Participant in the form specified in Business Rules in this regard, shall cancel the entry of pledge made under Bye Law 9.9.4 and send an intimation of the same to the Participants of pledgor and pledgee."*

74. The relevant clauses of NSDL's Bye Laws and Business Rules further state that:-

> *"9.9.10 The pledge may invoke the pledge made under Bye Law 9.9.4, subject to the provisions of the pledge document, by making an application in the form specified in this regard in the Business Rules, to the Depository through its Participant.*
>
> *9.9.11. The Participant shall make a note in its records, of the request of invocation of the entry of pledge and forward the request to the Depository.*
>
> *9.9.12. The Depository, on receipt of a request under Bye Law 9.9.11, shall invoke the pledge and amend its record accordingly to register the pledge as a beneficial owner of the securities and shall thereafter, send intimation of the same to the Participants of the pledgor and the pledgee."*
>
> NSDL Business Rules
>
> *"12.9.5. For the pledge closure request received from the pledgor, the Participant of the pledgee shall request confirmation of closure of pledge on receipt of the pledge closure confirmation form as laid out in Form 28, from the pledgee.*
>
> *Provided however that for the pledge closure request received from the pledgee, no separate confirmation for closure of pledge is required.*
> *……*
>
> *12.9.7. In case when the pledge closure request is received from the Participant of the pledgee, the Depository may close the pledge."*

75. In view of the aforesaid provisions, neither NSDL nor SEBI could release or transfer a pledged share without the

approval of consent from the pledgee which in the instant case are the appellants.

76. The press release issued by NSDL on December 2, 2019 indicates that the pledge shares were transferred as per the directions of SEBI and under supervision of NSE. We are of the opinion that SEBI had no power to transfer a pledged shares in contravention of the Depositories Act, DP Regulations and Contract Act. The pledge, namely, the appellants are entitled to retain possession of the pledge till such time their liabilities are not cleared by the pledgor as held by the Supreme Court in ***PTC India Financial Services Ltd. (supra)***. It was, thus, arbitrary on the part of SEBI to direct NSDL to transfer the pledge securities to the clients of the brokers without considering that the shares were pledged in favour of the appellants and who had a right of possession. When a third-party right is created SEBI could not intervene and remove the shares arbitrarily. In our opinion SEBI has acted arbitrarily in directing NSDL to transfer the pledge shares without revoking the pledge. Unless and until the pledge was revoked the shares could not be transferred to the clients of Karvy. We are of the opinion that as quasi judicial body SEBI was itself bound by the provisions of the Depositories Act and the DP Regulations. The *ex parte ad interim* order did not

permit NSDL to violate the Depositories Act, the Contract Act and the DP Regulations in removing the shares without revoking the pledge. The action of NSDL under the directions of SEBI were wholly illegal and invalid and had unlawfully deprived the appellants of its statutory rights as a pledgee. We are of the view that so long as the pledge is created under the Depositories Act read with DP Regulations until and unless the pledge is revoked the shares cannot be transferred under the directions of SEBI through NSDL. Such action is patently illegal and without jurisdiction.

77. In this regard Section 59(4) of the Companies Act 2013 provides as under:-

> *"59. Rectification of register of members. –*
> *(4) Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), the Securities and Exchange Board of India Act, 1992 (15 of 1992) or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned."*

78. The aforesaid provision indicates that if a transfer of the securities was in contravention to the SCRA or SEBI Act then

the Depositories has a right to undo the contravention and rectify its register of records by moving an application before the NCLT. In our view if SEBI / NSE / NSDL were of the opinion that the pledge was wrongly created by Karvy as it included clients securities who had no debit balance then the appropriate remedy for SEBI or to the Depository was that the Depository should file an application before the NCLT for rectification of its register. This process was not done and like a highway robber NSDL through illegal directions from SEBI transferred the pledged shares (which were fungible) to the clients of Karvy which action was without any authority of law.

79. Thus, in our view the action of the respondents in not allowing the appellants to revoke the pledge under the Depositories Act and in removing the pledged shares without the appellant's consent was wholly illegal and without any authority of law. The shares so removed and transferred by NSDL under the directions of SEBI are liable to be restituted.

80. In ***Edelweiss Custodial Services Ltd. vs NSE Clearing Ltd. & Ors., Appeal no. 441 of 2020 decided on December 15, 2023***, it was found that the shares sold by the Clearing Corporation was illegal and therefore the Committee directed

the restitution of the shares. This Tribunal upheld the directions of the Committee to restitute the shares. The said decision squarely applies. In addition to the aforesaid, this Tribunal under Rule 21 of the Securities Appellate Tribunal (Procedure) Rules, 2000 has sufficient powers to direct restitution. For facility, Rule 21 of the Securities Appellate Tribunal (Procedure) Rules, 2000 states that :-

> *"The Appellate Tribunal may make, such orders or give such directions as may be necessary or expedient to give effect to its orders or to prevent abuse of its process or to secure the ends of justice."*

Thus, this Tribunal can direct restitution of the said shares which were pledged in favour of the appellants to secure the ends of justice.

81. In view of the aforesaid, the impugned orders dated January 14, 2020 and December 13, 2019 are quashed. The appeals are allowed. The appellant Axis Bank is permitted to invoke the shares pledged in its favour in Demat Account no. 19502787 in accordance with the provisions of the Depositories Act read with the DP Regulations. A direction is given to SEBI, NSE and NSDL to restore the pledge which was made in favour of the appellants within four weeks from today. In the alternative SEBI, NSE and NSDL are directed to compensate

the appellants with the value of the underlined securities pledged in their favour along with interest @ 10% p.a. within the same period. In the circumstances of the case, parties shall bear their own costs.

Justice Tarun Agarwala
Presiding Officer

Ms. Meera Swarup
Technical Member

20.12.2023
msb/PTM