

SECURITIES FRAUD- DABBA TRADING- Applicability of Criminal Statute

A "Dabba Trading" also known as "Bucketing" is the process used by brokers to route their client's trades outside the Stock/Commodity exchange. In such trading, the broker either does not execute any trade or matches and execute trades on its own terminal. "Dabba" has its origin in the developed markets where a system called bucketing prevails. Bucketing is an illegal practice where a stockbroker executes a customer's trade without taking it to a stock exchange with the hope of making some gains at a future date.

Essentially, bucketing involves the confirmation of an order from a client without actually executing the order on the client's behalf. The anticipation is that the broker will be able to realize enough profit to offset the difference to the client at a future date, either due to executing the order at a later date or through profits generated on other transactions. Bucketing can take place in a couple of different ways. While all forms of bucketing involve the broker or brokers confirmation the execution of orders to the client that have not actually been completed, some forms of bucketing involve the broker executing the transaction on his or her own investment account. If the price rises, the broker realizes a profit and then belatedly executes the order for the client, but charging the higher rate. With this arrangement, there is a good chance that the investor will simply assume the price rose between the time of the decision to execute the transaction and the confirmation received from the broker that the transaction is complete.

The broking house that engages in this activity are called bucket shops. Dabba trading operates essentially like the American bucket shops of the 1920s that existed before the Securities and Exchange Commission (SEC) was set up.

The mechanics or Modus Operandi of [Dabba Trading](#)

The "Dabba" means box and in modern context, a computer. A Dabba operator in the securities market's parlance is the trader/operator who executes "Dabba Transactions". His office is the replica of any broker office having number of customers executing the trade on the terminals linked to the exchange showing market rates/trades. Earlier, the "Dabba Operator" does not execute the investor's trade on the exchange but in his books. But now, the NSE & BSE has provided the facility for the investors to verify their trades on the NSE/BSE websites. This facility has made the broker vulnerable to be exposed to the investor's and can made him liable for civil & criminal remedy.

Now as the investor is sitting in the trading room of the broker or verifying the trades on the website of NSE/BSE using order/ trade number, the operators have developed a new and sophisticated view of doing "Dabba Trade". In this process, they develop a program which is embedded with the existing trading software whereby, the operator executes a transaction on the trading terminal where the client is sitting but the embedded software immediately execute the reverse transaction. For Ex; if a trader buy one lot of ACC, the embedded software make it possible to execute the reverse transaction, i.e. sale of one ACC lot. This process can also be executed manually. In the evening when the trade files and STT files are downloaded from the exchange, then the client code of the reverse transaction is being changed to some dummy client code. Thus, the consequent effect of this transactions result into nil position of the client on the exchange. But the broker/operator raises the invoice of the trades instructed by the clients and not of the reverse transactions. Thus, when an investor verifies the

transaction on the exchange using order number only transaction pertaining to that order number is verified and investors did not know about the counter transactions.

Violation of Securities laws:

In the stock market when the broker executes the Dabba Trading in the client's account without executing the order on an exchange, it is [the violation of Section 13](#) of Securities Contract Regulation Act, 1956 which states that transaction has to be at recognized Stock Exchange between the two recognized stock brokers of the exchange unless it is exempted. Section 18 of SCRA exempts only spot transactions from the purview of section 13 of SCRA. The act of "Dabba Trading" by the broker is punishable offence [under Section 23 of SCRA](#).

Further the practice of "Dabba Trading" is covered under Regulation 3 and 4 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 & is punishable under Section 15 HA of SEBI Act, 1992.

A Dabba Trading also attracts Indian Penal Code and [Information Technology Act, 2000](#) apart from the provision of SEBI Act.

As is generally understood rather fallacy lies in thinking that anything related to the securities and any violation related to securities is the domain of Securities Exchange Board of India and its laws and regulations. The fallacy also lies on the general misconception on the part of law enforcement agencies too which brush aside the complaint related to securities related frauds on the premise that same is the domain of SEBI and they do not have jurisdiction to deal with the complaints disclosing fraud played by the brokers or market intermediaries on the gullible investors.

It may so happen, the broker who flouts the [SEBI Act, 2000](#) or its rules and regulations may also breach the provision of Indian Penal Code to cover up their misdeeds like they may try to give legitimate appearance to unauthorized fraudulent trades executed by them by making the fictitious entries in books of accounts, forgery and manipulation of books of accounts, forgery of contract notes & bills etc. with an intention to cheat the investor and thus commit the offence of criminal breach of trust in respect of funds & shares entrusted to the broker by the investor resulting in wrongful gain to broker & wrongful loss to the investor.

The malafide acts of the broker particularly Dabba Trading attracts the provision of Indian Penal Code and Information Technology Act as follows:-

(a) The broker by executing the transactions acts as an agent of the investor who is a principle. He is liable to account for all the transactions of the client on the exchange as a broker but when a broker executes a "Dabba Transactions" he acts as a principle with the investor. He becomes the counter party to the trade whereas he should be broker/agent who guarantees trade on the exchange on behalf of the investors. Thus, he can be held criminally liable within the meaning of Section 409 of India Penal Code.

(b) Now, with the levy of STT (Security Transaction Tax) this "Dabba Trading" also involves manipulation/forgery of STT which is a more serious offence, i.e. embezzlement of government revenue. Further, by changing the client code of the transactions, he commits forgery of the electronic records. The forgery of the electronic records and STT attracts [the section 467/471 of IPC](#). The other staff, operators and accountants who incorporate the bogus transactions and accounting entries to

manipulate the accounts in order to accommodate Dabba Transactions are also liable u/s 477-A of IPC and also for the conspiracy u/s 120-B IPC. Thus, the broker/operator and its staff who indulges in to the "Dabba Trading" can be prosecuted for the serious offences under the IPC which are punishable with imprisonment which may extend to 10 years.

(c) As the broker with a malafide intent to cause loss to the investors and corresponding gain to himself commits:-

(i) Manipulation of Electronic Records

(ii) Alteration of client codes in computer resource to fabricate transactions

The broker can be prosecuted for [the offence u/s 66 Information Technology Act, 2000](#).

SEBI vis-A -vis prosecution under criminal statute

Thus, if broker or market intermediary who commits the offence of Dabba Trading which is a violation of provisions under SEBI Act then the criminal proceedings under penal statutes i.e. IPC, IT Act, 2000 can also be initiated at the same time.

I. SEBI is a remedial statute: It may be pertinent to mention here that [the SEBI Act, 1992](#) is a remedial statute. The SEBI Act, 1992 came into force with effect from 30th January, 1992 and the preamble of the Act explains the objective which is "an act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate the security market and for matters connected therewith or incidental thereto". So the SEBI was established to protect the interest of the investors in securities and also for regulating the security market. The SEBI Act and the Regulations are intended to regulate the Security Market and related aspects and redress the grievances of the investors. The Hon'ble Supreme Court in the case of SEBI v. SHRIRAM MUTUAL FUND & ANOTHER has categorically held that "for breaches of provisions of SEBI Act and Regulations, according to us, which are civil in nature, mens rea is not essential."

II. Offences under the IPC virtually imports the idea of "Men-rea" : On the other hand every offence under the Indian Penal Code virtually imports the idea of criminal intent or mens rea in some form or the other for the offences because the definitions of various offences contain expressly propositions as to the state of mind of the accused. The definitions state whether the act must have been done "intentionally", "Voluntarily", "knowingly", "dishonestly" or "fraudulently" or the like. For example; Mens rea is one of the essential ingredients of the offence of cheating under Section 420 IPC because in order to attract [the provisions of Sections 420 IPC](#), the guilty intent, at the time of making the promise is a requirement and an essential ingredient thereto.

III. Indian Penal Code is a Penal Statute : The Indian Penal Code is a penal statute which is a complete statute which provides for prosecution of offender for any offence which is deemed to be committed against state. If there exists a right to prosecute under the Penal Code, such right cannot be impliedly taken away by the provision of another statute. Thus, the cognizable offences committed by the brokers under the Indian Penal Code or IT Act, 2000 may also entail certain acts which may also constitute violations of SEBI Act, 1992 or rules & regulations made thereunder, but that would not take investigation of the case out of realm of the provisions of Criminal Procedure Code.

IV. The purpose of SEBI Act and Penal statute is different: The purpose of the penal statute is to seek prosecution of the offenders for the offences committed under the Indian Penal Code which is entirely different from that under SEBI Act, 1992 r/w rules & regulations there under which provides for penalty for the violation of civil/statutory obligations mentioned therein which are neither criminal nor quasi criminal, although to some extent the both acts may be overlapping as the acts of the offenders may entail some violations of SEBI Act.

V. SEBI Act has no overriding effect as per the SEBI Act and Expert committee report: It would not be out of place to mention here that SEBI Act has no overriding effect and it no where bars the prosecution under the Indian Penal Code which is clear from the provisions of Section 21 of SEBI Act, 1992 itself which provides as follows:

"Nothing in this Act shall exempt any person from any suit or other proceedings which might, apart from this Act, be brought against him."

Thus, the reading of the Section 21 of SEBI Act, 1992 itself infers that a person is not immune from criminal proceedings which may be brought against him under Criminal Procedure Code r/w Indian Penal Code owing to the fact that investigation or proceedings under him are initiated against him under [the SEBI Act, 1992](#). Thus, the procedure and scheme of penalty & adjudication under the scheme of SEBI Act and Regulations & rules thereunder is specifically envisaged as supplemental to any other proceedings provided by any law for the time being in force. Moreover, the perusal of the Report of the Expert group headed by Mr. Justice M. H. Kania (former Chief Justice of India) for suggesting amendments to SEBI, Act 1992 reveals that SEBI Act has no overriding effect over other laws in the matter of securities. Infact the Expert committee recommended that SEBI Act may not be amended for giving an overriding effect to the SEBI Act over other laws. Further, the Hon'ble Supreme Court decision in Radheyshyam Khemka Vs. State of Bihar (1993) 77 Com. Case 356(SC) throws enough light on the role of dual agencies where enforcement of power is found overlapping. In Khemka's case the criminal proceeding pending against the appellants was challenged on the ground that since the provisions of the Companies Act take care of the interest of Investors and they put restrictions on the misbehaviour of the promoter and the directors of the company, for any lapse on their part in such matters they cannot be summoned to stand trial for offences under Indian penal Code. Demolishing this contention the Supreme Court held that:

"it is true that Companies Act contains Provisions regarding the issuance of prospectus, applications for shares and allotment thereof and provides different checks over the misuse of the funds collected from the public for issuance of shares or debentures. But can it be said that where persons issue prospectus and collect moneys from the public assuring them that they intend to do business with the public money for their benefit and the benefit of such public, but the real intention is to do no business other than collecting the money from the public for their personal gain, still such persons are immune from the provisions of the Indian Penal Code? In such a situation the quashing of the prosecution pending against the appellants only on the ground that it was open to the applicants for shares to have recourse to the provisions of the Companies Act, cannot be accepted"

Conclusion:

Thus, the aforesaid discussion clearly points out that the SEBI has no exclusive domain and the prosecution under the penal statute can be initiated in the securities related frauds if it attracts the cognizable offences punishable under [the Indian Penal Code or IT Act, 2000](#). If the prosecution under the

penal statute is not launched in such cases it may well mean that the accused in such cases would then be well ensconced and insulated from the legal consequences of a proper and effective investigation. Criminal justice would be the serious casualty then and in this type of situation the police has merely to look askance at such accused brokers helplessly on the mere fallacious misinterpretation of law that an offence or breach of provision under SEBI Act is also involved and hence the criminal proceedings cannot be initiated in these circumstances.

[Neeraj Aarora](#)
(Advocate)