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RUSODAY SECURITIES LTD.

v.

NATIONAL STOCK EXCHANGE OF INDIA LTD. & ORS.

(Civil Appeal No. 2690 of 2009 etc.)

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NOVEMBER 20, 2020

[A. M. KHANWILKAR AND DINESH MAHESHWARI, JJ.]

Securities Contracts (Regulations) Act, 1956:

- Sections 3(2) and 9 – Appellant admitted as trading member*
- C *of NSE (Stock Exchange) – Was authorized by the Stock Exchange to become a clearing member of National Securities Clearing Corporation Ltd. (NSCCL/ Clearing Corporation) – Appellant had executed undertaking in favour of the Stock Exchange as well as the Corporation to abide by and comply with the Rules, Byelaws, and Regulations of the Exchange and of the Corporation and also to abide by Circulars, Orders, Directions, Notices or Instructions issued/modified/amended from time to time – By Circular dated 19.05.1997 appellant was permitted to trade to the extent of 7 times its base capital – Trading facility of appellant was withdrawn by the Exchange on appellant's exceeding the permissible limit as per*
- D *the Circular dated 19.05.1997 – Further the Clearing Corporation closed out all the open positions in the securities trade of the appellant – The Exchange by letter dated 01.11.2004 informed the appellant about periodical appropriation of certain amounts made by the Exchange from the security deposits of the appellant in lieu of various membership charges – The Exchange also called upon the appellant to deposit additional sums to meet the shortfall created in the security deposit, to retain the membership of the Exchange – Appellant denied such obligation to pay, as its trading facilities had stood suspended throughout that period – Thereafter expulsion of membership of the appellant by the Exchange – The Securities*
- E *Appellate Tribunal upheld the closing out of all the outstanding positions of the appellant under clauses 17 and 18 of the Byelaws – Tribunal held the Circular dated 19.5.1997 as valid having binding value – Appeal to Supreme Court – Appellant's plea that the appellant was not bound by the Circular dated 19.5.1997 as the same was invalid for lack of prior approval of Central Government/SEBI and*
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the same being in conflict with Byelaws – Held: Subject matter of the Circular falls within ambit of operational parameters – Determination and announcement of operational parameters is within the competence of the Stock Exchange – The Exchange is empowered to announce such parameters by way of Circular – Clearing Corporation is also empowered to issue operational parameters relating to trading limits and consequent actions in case of non-compliance – No requirement of prior approval is provided for notifying such operational parameters – The power and mode of prescription of such circular falls within the residuary powers reserved for the Exchange – Since the Byelaws and Rules of the Stock Exchange are approved by the Central Government/SEBI, the action taken under the Byelaws/Rules/Regulations, by prescribing such operational parameters in the form of Circular would assume enforceable character – The Circular cannot be said to be ultra vires Clauses 17 and 18 of the Byelaws – The appellant is bound by the Circular – The appellant having submitted an undertaking to comply with such instructions, notice etc. cannot be allowed to take contrary plea – The Stock Exchange not only had the Authority to specify various deposit-related requirements, but also had the power to expel a member in case of default – The obligation of the appellant to keep up with the adequacy of deposits continued despite the withdrawal of its trading facility – In the present case, the appellant in having failed to maintain the requisite membership margins with the Exchange, acted in contravention of the Byelaws and Rules of the Exchange necessitating unto termination – National Stock Exchange Byelaws, 1994 – Clauses (10), (17) and (18); Chapter IX Clauses (5), (6) and (24) – Securities and Exchange Board of India Act, 1992 – National Securities Clearing Corporation Ltd. Byelaws – Chapter VI Clauses (11) and (16) – National Securities Clearing Corporation Ltd. Regulations – Chapters 9 and 10 – National Stock Exchange Rules – Chapter IV Rule 20(f).

National Stock Exchange Byelaws:

Chapter XII Clause (11); Chapter IX clause (24) – Realisation of security deposits – Stock Exchange is vested with the power to realize the assets of a defaulter member in due course – Security deposits can be realized by the Exchange per se without any additional condition as the Exchange enjoys a statutory lien over

- A such deposits by way of clause (24) of Chapter IX – However, such security deposits do not include forfeited/withheld assets/securities – Expulsion or declaration of defaulter is a pre-condition for realization of withheld securities – Vesting of withheld securities in favour of Exchange takes place only after expulsion or declaration of defaulter – Withheld securities can be categorized as ‘receiving securities’ and ‘introductory securities’ – In the present case ‘introductory securities’ since were in the names of third persons, could not have been realized by the Exchange – Actual recovery qua appellant/defaulting member could only be made from the ‘receiving securities’ as those securities were due/deliverable to the
- B appellant and were withheld as a collateral – National Securities Clearing Corporation Ltd. Regulations – Chapter 9.

National Stock Exchange Rules:

- C Chapter IV Rule 20(f) – Applicability of – Held: The relevant point of time for applicability of this Rule is “the date of expulsion” from the trading membership of National Stock Exchange.

- D Chapter XII Clause (ii) – Declaration of trading members as defaulter – Requirement – Nature of – Held: Though requirement of declaration as defaulter may be discretionary one under NSCCL Regulations, the same is mandatory requirement for vesting in clause (ii).

Lien:

- E Scope, extent and operation of lien – Held: Mere existence of lien may not entitle the lienee to sell off the property for satisfaction of debt without a court order – However, this principle is not absolute – When lien itself is a creation of byelaws, Rules or Regulations etc., the scope, extent and operation of such lien would be governed by the same scheme – No external conditions can be read into such scheme.

- F G Equity:

Equity is about balancing the competing interests – It never operates in an absolute manner – Principles’ of constructive trust and fiduciary relationships are equitable principles.

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Principles:

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Principle ‘Nemo dat quod non habet’ – Applicability.

Principles of ‘constructive trust’ and ‘fiduciary relationship’ – Nature and applicability of.

Words and Phrases:

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“Regulation” – Meaning of.

“Control” – Meaning of.

Disposing of the appeals, the Court

HELD: 1.1 The central scheme of Securities Contracts (Regulations) Act, 1956 reveals that the requirement of prior approval, in relation to matters specified in sub-section (2) of Section 3, of the Central Government, be it at the time of original framing of Rules of the Exchange or upon amendment thereof, is essential or pre-requisite. This mandate of Central Government was later entrusted to SEBI by issuing orders under Section 29A of the 1956 Act.[Para 25][251-H; 252 A-B]

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1.2 The legislature has omitted the usage of the word “Regulations” or “Circulars” in the parent Act; and as far as the governance of a stock exchange is concerned, the supervision or control of the Central Government/SEBI at the time of granting recognition to the stock exchange is limited to being satisfied that the Rules and Byelaws of the stock exchange applying for registration are in conformity with such conditions as may be prescribed for ensuring fair dealing and protecting investors. The domain of framing Regulations is kept separately in a standalone manner in the Byelaws of the Exchange and not in the Act. The framing of Regulations concerning governance of stock exchange is reserved for the Exchange. [Para 26][252-D-F]

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1.3 Clause (10) of National Stock Exchange Byelaws, 1994 (NSE Byelaws) defines “Regulations” to include business rules, code of conduct and such other Regulations prescribed by the relevant authority from time to time for the operations of the Exchange and they are declared to be subject to the provisions of the 1956 Act, Rules and Securities and Exchange Board of India Act, 1992. The definition is merely an inclusive definition

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- A and not exhaustive. The relevant authority here is the Board of the Exchange. Such Regulations can be prescribed on a wide range of matters as indicated in “Chapter III – Regulations”, including capital adequacy norms or “*any other matter as may be decided by the Board*”. Thus, the scope of “Regulations” that can be prescribed by the Exchange is expansive so as to cover all issues relating to governance of the Exchange. [Para 27][252-F-H; 253-A]

- 1.4 Clause (2) of the Byelaws specifies certain “Conditions” for the Trading Members. Sub-clause (a) of clause (2) signifies that apart from framing Regulations, the Byelaws also empower the Exchange to issue instructions regarding operational parameters, guidance etc. for the trading members. The term “*operational parameters*” is crucial. Chapter IX of the Byelaws, in clauses (5) and (6), titled “Transactions and Settlements” specifies certain operational parameters for trading. Clause (5) empowers the relevant authority of the Exchange to “determine and announce” from time to time certain operational parameters which may include “trading limits” and “capital adequacy norms” as per clause (6). Notably, clause (5) of Chapter IX of the Byelaws uses the phrase “*the relevant authority may determine and announce*” the operational parameters. Both “determination” and “announcement” of such parameters is therefore, within the competence of the Exchange. Such announcement can be made by the Exchange by circulating a communication amongst the members, as it rightfully did in the present case by way of the subject circular. A similar clause has been inserted in Chapter VI F of the Byelaws of the Clearing Corporation as well, thereby empowering the Clearing Corporation to issue operational parameters relating to trading limits and consequent actions in case of non-compliance. [Para 28][253-B-H; 254-A-B]

- 1.5 The subject matter of the circular in question pertains to trading/exposure limits coupled with sanctions in case of non-compliance. That falls squarely within the ambit of operational parameters which can be determined and notified by the Exchange from time to time. Nothing is brought to the notice of the Court from the text of this circular that it would militate against the norm of fair dealing and protection of investors. In any case, no H requirement of prior approval is provided for notifying such

operational parameters and as the name suggests, they are meant to tackle “operational” concerns as and when they emerge before the Exchange or the Clearing Corporation. The power and mode of prescription of such circular falls within the residuary powers reserved for the Exchange. [Para 29][254-B-D] A

1.6 Thus, the legislature has bestowed upon the Exchange sufficient freedom of action to effectively control and regulate the functioning of stock brokers who use the Exchange as a means to enter into financial relationships with the investors and common public. This freedom of action is guaranteed in the pre-approved Byelaws which enable the Exchange to frame Regulations, instructions, operational parameters, notice etc. and bring them into force without subjecting them to any added condition of prior approval of the Central Government/SEBI. The only limitation on this power of the Exchange is that such Regulations or operational parameters issued under the Byelaws are subject to 1956 Act, 1992 Act and Rules framed thereunder. Strictly speaking, this limitation does not *ipso facto* mean that such Regulations or operational parameters are subject to prior approval. [Para 31][255-E-H] B

1.7 The provision under s. 9 reinforces that the power to regulate and control the trading contracts enables the Exchange not only to make Byelaws and Regulations but to provide for everything therein which might be necessary (and permissible) for ensuring efficacy and vigour in the exercise of just power of control and regulation. It is in this light that the operational parameters or Regulations framed under the Byelaws are to be understood. For, without such power, the Exchange would be rendered toothless in controlling and regulating the contracts. [Para 30][255-D-E] C

1.8 Since the Byelaws and Rules of the Exchange are duly approved by the Central Government/SEBI, it can safely be stated that actions taken by the Exchange under the Byelaws or Regulations - by prescribing such operational parameters in the form of a circular and in consequence thereof, would assume enforceable character. The appellant having submitted an undertaking to comply with such instructions, notice etc., cannot be heard to argue to the contrary. The Court by interpretative D E F G H

- A process ought not to limit the efficacy of such a valid document by additional pre-conditions such as prior approval, not envisaged by the lawmakers or regulation framing authorities. To do so would entail in undermining the authority of the Exchange to regulate and control the stock market, directly or indirectly. [Para 32][256-C-E]
- B 1.9 The act of adoption of this circular by the Exchange and circulation of the same amongst the trading members was within the domain of the Exchange in terms of its Byelaws, and unless a case for such instructions to be *ultra vires* the Byelaws or the Act is made out, there is no reason to undermine its intended effect.
- C [Para 33][256-E-F]
 - D 1.10 The operational freedom of the Exchange cannot be stifled on mere assumptions and the burden lies on the claimant to demonstrate a real conflict between the exercise of power and source of power. Arguendo, had it been a deviation from the Byelaws, in the sense that the circular was defeating and not furthering the scope and objective of the Byelaws, it could have been examined as a constructive amendment or amendment by implication. Therefore, the principle of constructive amendment signifies that unless a clear case of repugnancy is made out, the later provisions could not be treated as modification or abrogation, more so when such provisions further the intent of the source provisions. [Para 35][256-H; 257-C-D]
 - E 2.1 For the same default, closing out action is contemplated both under the Byelaws of the Exchange and the subject circular.
 - F Clauses 17 and 18 of the Byelaws of the Exchange provide for closing out. Clause 17 envisages closing out for failure to complete the settlement operation. That, however, has no relation whatsoever to a situation of closing out due to failure to trade within defined limits, as specified by the Exchange, amounting to violation of the Byelaws of the Clearing Corporation, as in the present case. Whereas, clause 18 caters to another situation and is textually different. [Paras 37 and 39][257-E-F; 258-D-E]
 - G 2.2 Clause 18 is of a residuary nature and confers on the relevant authority of the Exchange the power to close out certain positions on grounds not specified in clause 17. The mischief
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creators in a stock market operate in a myriad set of ways and one cannot pre-set or comprehend all possible methods of undermining the health of the market. Thus, residuary situations of closing out may emerge and clause 18 enables the Exchange to promptly act against such attempt. The provision is premised on necessity. By reading in any requirement of due date in clause 18, on the lines of clause 17, the court would be doing violence to the clear intent of the clauses and the broad scheme of the Byelaws. Clause 18 would be rendered nugatory. Even logically, by importing a fictional requirement of "due date" in clause 18, the Exchange cannot be expected to gloss over a clear case of excessive reckless trading and allow the mischief to continue until the due date has arrived. Thus, there is no occasion to control the scope of clause 18 by establishing a fictional link with clause 17. [Para 44][260-B-F]

2.3 The circular provides for the effect of violation of the exposure limits and lays down that any such violation shall be treated as a violation of the Byelaws of the Clearing Corporation, without prejudice to the power of the Exchange to withdraw the trading facilities. This withdrawal is contemplated as an imminent action to protect the market from being exposed to unsecured financial exposure. Consequent thereto, closing out of open positions has been contemplated. Strictly speaking, the circular, triggers a closing out action upon fulfilment of two conditions: (i) exceeding the gross exposure limits while trading; (ii) failure to deposit additional capital within such time as may be granted by the Exchange/Clearing Corporation for continuance of trading. The nature of closing out prescribed in the circular does not envisage any failure in delivery or in payment to complete the settlement, unlike in clause 17. The conditions in the circular operate on a more basic level and are concerned essentially regarding the eligibility of a trading/clearing member venturing beyond the market exposure limits defined in the context of the advance security deposit. That is the condition and procedure prescribed from time to time by the relevant authority for dealing in securities by the member. For such non-compliance, the power ascribable in clause 18 may be attracted. [Paras 40, 41 and 42][258-E-G; 259-C-F]

2.4. In the present case, the appellant violated the condition and procedure prescribed by the Exchange/Clearing Corporation

- A vide subject circular. Thus, the manner of closing out contemplated in the circular is borne out by clause 18 and there is no conflict. Apart from the circular, clause 16 of the Byelaws of the Clearing Corporation also provides for closing out “*on failure of a clearing member to comply with any of the provisions relating to delivery, payment and settlement of deals or on any failure to fulfill the terms and conditions subject to which the deal has been made*”. The nature of action contemplated under clause 16 is in furtherance of the basic mandate laid down under Section 9 of the 1956 Act. For, section 9 of the Act clearly provides that all contracts/deals on the market are subject to the Byelaws
- B (including Regulations, operational parameters etc. issued under the Byelaws) and Rules of the Exchange. One of the consequences of not acting in accordance with the Byelaws is provided under clause 16, apart from other provisions. Understood thus, this clause is yet another self-contained provision envisaging forthwith closing out, which goes on to show that forthwith closing out is not a new phenomenon in the overall scheme of things. [Paras 45 and 46][260-F-H; 261-C-E]
- C 2.5 On a comprehensive view of the scheme of closing out under the Byelaws of the Exchange, Byelaws of the Clearing Corporation and the circular, an action of forthwith closing out is permissible under the said scheme, particularly clause 18, and thus, the circular is not *ultra vires* clauses 17 and 18 of the Byelaws. Rather, the circular furthers the spirit underlying clause 18. [Para 47][261-E-F]
- D F 3.1. The undertaking given by the appellant to the respondents fell within the broad scheme of the Byelaws/Rules, and was a quint-essential requirement for obtaining registration as a stock broker as both 1956 Act and Byelaws subjected the members to such conditions. Thus, the appellant is bound by the undertaking so given. [Para 51][262-G-H; 263-A]
- E G 3.2 Even otherwise, assuming the absence of undertaking, the very fact that a valid circular originated from the statutory scheme of the Byelaws is sufficient to bind the appellant with its provisions. Thus, the emergent legal position is that the appellant had subscribed to both statutory as well as contractual obligations
- H with the respondents for functioning as a stock broker. Any

deviation from the said circular could invite action under multiple provisions spreading across the Byelaws of the Exchange and Byelaws of the Clearing Corporation, in addition to the sanctions provided in the circular itself. Understood thus, the appellant is squarely bound by the circular and any breach of the same is to be viewed accordingly. [Para 51][263-A-C]

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3.3 The above view is reinforced by the “Master Circular for Stock Brokers” issued by SEBI on 01.06.2018, bearing headnote that “*This Master Circular is a compilation of relevant circulars issued by SEBI, which are operational as on date of this circular*”. Annexure-4 of the Master Circular titled “*Rights and Obligations of Stock Brokers, Sub-Brokers and Clients*” reiterates the correct legal position under clause 2 thereof which provides that the stock brokers are bound by all the Rules, Byelaws and Regulations of the Exchange and *circulars/notices issued in furtherance of such Byelaws and Rules*. [Para 52][263-C-E]

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3.4 The scheme of 1956 Act enables the Exchange to resort to suspension and expulsion of the members, in accordance with its approved Byelaws and Rules. Section 3(2) of the Act specifies certain matters that must be appropriately covered in the Byelaws or Rules. Clause (c) of the said sub-section expressly provides that matters of admission, qualification, exclusion, *suspension, expulsion* and re-admission of members must be covered in the Byelaws/Rules. [Para 54][263-G-H; 264-A]

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3.5 By SEBI letter No. SMD-I/11087/92 dated 04.11.1992 titled “Capital Adequacy Norms for Brokers”, the stock exchanges were directed to provide for norms relating to capital adequacy in their Byelaws. Apart from specifying certain requirements, the letter went on to state that “*the stock exchange shall continue to have the authority to impose suitable margins as per their judgment in the context of the market situation.*” Therefore, a stock exchange stood empowered not only to specify capital adequacy requirements for the trading members but also to take action against the defaulting members. [Para 55][264-D-F]

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3.6 Accordingly, for effectuating the mandate accorded upon the Exchange as per the Act, NSE Rules, 1994 and the abovesaid directive, it is obliged to deal with the subject of termination of membership on that basis. [Para 56][264-F-G]

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- A 3.7 The same regulatory intent is reflected in the Byelaws as well. Clause (1)(b) of Chapter-V of NSE Byelaws, 1997 (the operative Byelaws as regards the question of expulsion) empowers the relevant authority to “*specify prerequisites, conditions, formats and procedures for application for admission, termination, re-admission etc. of trading members*”. [Para 57][265-D-E]
- B 3.8 Consequence of failure to maintain the necessary deposits is addressed in Chapter XII of the Byelaws wherein clause (1) provides that such a member could be declared as a defaulter, which in itself is a ground for expulsion in the NSE Rules, 1994. [Para 57][265-G-H; 266-A]
- C 3.9 A holistic view of the scheme vividly reveals that the Exchange not only had the authority to specify various deposit related requirements but also had the power to expel a member in case of default. In the present case, it is not in dispute that the Interest Free Security Deposit to be maintained by the appellant actually fell short of the required margins during the relevant period. [Para 58][266-C-D]
- D 4.1 The obligation of the appellant to keep up with the adequacy of deposits continued despite the withdrawal of its trading facility. The relationship between a stock exchange and trading member runs across various levels. Action against members is to be taken only upon violation of conditions and procedures therefor. It is a serious matter and resorted to only upon the fulfilment of conditions specified in the Byelaws, Rules, Regulations or even in operational parameters. Notably, the conditions required for withdrawing the trading facility are distinguishable from the conditions required for suspension/expulsion of membership. Under the relevant provisions, withdrawal could take place upon a standalone violation of certain operational parameters on a given trading day (like exceeding the exposure limits as in the present case). Whereas, expulsion would take place upon a sustained violation of membership obligations (like failure to maintain the base capital and also for failure to replenish the prescribed amount) within the time frame specified therefor. The two actions vary not only in their texture, but also in their resultant effect. Withdrawal, for instance, does
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not extinguish the membership. It acts like a halt for indulging in further trading activity. [Paras 58 and 59][266-D-E; 266-E-H; 267-A]

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4.2 To say that mere withdrawal of trading facility would *ipso facto* absolve a trading member from keeping up with other obligations towards the Exchange for continuation of membership would result into an anomalous situation. It would amount to the diffusion of one stage of the relationship with the other, and would become a concocted way to extend benefit for its own wrong to a defaulting member. Such a consequence could not be intended to result from an action of withdrawal of trading facility. For, the withdrawal of trading facility is a temporary or interim action which is taken against an erring member to prevent him from continuing on a mischievous path during the trading hours and to take corrective steps forthwith. The nature of this action is preventive and the provisions governing this action provide for certain remedial acts, like depositing additional sums to increase the exposure limits, the performance of which can help a member in resuming his trading operations. The obligations for continued admission as a member are entirely different and merely because trading has been halted due to a member's own default, it does not result in a hiatus situation or extricate him from membership obligations. If that were to be the case, there was no need for the Byelaws to provide these actions separately. [Para 60][267-A-E]

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4.3 Pertinently, the capital adequacy norms, are meant both for admission as a member and for continuation as a member. Even the language of the governing provision i.e. Rule 32, signifies that requirements relating to capital adequacy are meant for "*continued admittance to trading membership*" and thus, the mandatory obligations would continue, as long as membership is formally continued. Despite the temporary action of withdrawal of trading facility, a member continues to be a member of the Exchange with all corresponding rights and obligations intact on both sides. [Para 61][267-E-G]

4.4 Having observed that the appellant failed to maintain the requisite membership margins with the Exchange for a long period and refused to make up for the shortfalls when called upon to do so by the Exchange, there is nothing to deviate from the view taken by the Tribunal that the appellant acted in

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A **contravention of the Byelaws and Rules of the Exchange necessitating unto termination. The actions taken by the Exchange, thus, were in accordance with the law. [Para 62][268-B-D]**

B **5.1 Apart from challenging the expulsion of membership, the appellant had also prayed for the release of withheld securities. No such plea was raised by the respondents in the stated proceedings in 2014. Rather, that appeal was allowed and claim regarding withheld securities was relegated to the Defaulter's Committee. That remand order was acted upon by all concerned and against which the present appeal arises before this Court. [Para 79][273-A-B; 273-E-F]**

C **5.2 It is not correct to say that cause of action accrued only after the Defaulter's Committee's order dated 04.12.2014, justifying the withholding of securities. The said order of the Defaulter's Committee did not result in the withholding of securities. It merely supplied reasons and justification for such withholding. The cause of action, if at all any, had arisen to the appellant from the moment their securities were withheld in 1997. Merely because a subsequent order is passed to justify a prior action, it cannot be a case of accrual of fresh cause of action to the aggrieved. [Para 80][273-F-G]**

D **5.3 In the factual scheme of the present case, there are two sets of assets in control of the respondents – *first*, security deposits and *second*, withheld securities. The security deposits came to be deposited on account of membership obligations and E the securities were withheld on account of failure to complete settlements. Though the challenge is limited to withheld securities, the provisions relating to such securities address both these categories of assets collectively. [Para 82][274-C-E]**

F **5.4 As per clause (11) of Chapter XII of the NSE Byelaws titled “Default”, the Exchange is vested with the power to realise G the assets of a defaulter member in due course. Clause (23) complements this action and provides for the order of priority for satisfying the claims. The clause (11) provides for realisation of three categories of assets: (i) security deposits, margin moneys and other deposits; (ii) securities which have been deposited by H the defaulter member; and (iii) moneys, securities and other assets**

due, payable or deliverable to the defaulter by any other Trading Member and recovered by the Exchange. Pertinently, different kinds of assets are subject to a different procedure of realisation. Out of the three categories covered under clause (11), security deposits can be called in and realised *per se* without any additional condition. There is no requirement of vesting with respect to such deposits neither in the language of clause (11) nor in the overall scheme. It is so because the Exchange enjoys a statutory lien over such deposits by way of clause (24) of Chapter IX - "Transactions and Settlements", NSE Byelaws which categorically provides that the Exchange has a first and paramount lien over the monies, bank deposits and other securities deposited by the trading member for any sum due to the Exchange. [Paras 83 and 84][274-E-F; 275-B-D; 275-E-G]

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5.5 But it covers only those assets which are voluntarily deposited by the member with the Exchange. Forfeited/withheld assets are not included herein. It is true that mere existence of lien may not entitle the licensee to sell off the property for satisfaction of debt without a court order. However, the same principle is not absolute and the cases in which the statutory/contractual scheme itself provides for such sale/realisation fall outside its purview. It is settled that when lien itself is a creation of Byelaws, Rules or Regulations etc., the scope, extent and operation of such lien would also be governed by the same scheme. [Para 84][276-B-D]

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5.6 Therefore, if provisions provide for realisation of such lien property, the same may be given effect to in accordance with the provisions. No external conditions can be read in such a scheme. Clause (11) expressly provides for realisation of security deposits as and when a member becomes subject to the provisions relating to defaulters. The phrase "*shall call in and realise*" signifies that realisation is warranted as an imminent action upon declaration of defaulter in case the security deposits are insufficient. The effect of this phrase is that once a trading member has been declared a defaulter, the Exchange is duty bound to realise the security deposits retained by it to satisfy its

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Unity Company Private Ltd. vs. Diamond Sugar Mills and Ors. AIR 1971 Cal 18 – referred to.

- A obligations and return the remaining deposits, if any. If the Exchange fails to do so, it may become liable to make good the loss of interest to the defaulter on any amount over and above the monetary obligation. [Para 84][276-G-H; 277-A-C]

- 5.7 In the present case, no fault can be found in the conduct B of the Exchange as it had actually realised the deposits at various points of time owing to the inability of the appellant to keep up with the statutory margin requirements. It holds no merit to state that the Exchange failed to perform its duty to realise the security deposits. The amount of Rs. 1.34 crores came to be added to the C total obligation again in 2017 when the Exchange returned the security deposit amount pursuant to an order of this court passed at the insistence of the appellant and thus, in law, that cannot be held against the Exchange in any manner. [Para 85][277-C-E]

- 5.8 Unlike the money deposits, no legal requirement of D forthwith realisation is envisaged in the case of withheld securities. The withheld securities can be categorised as – securities in which the appellant was a receiving member (*receiving securities*) and securities in which the appellant was an introducing member (*introductory securities*). [Para 86][277-F-G]

- 6.1 In the transactions during the trading period from E 24.09.1997 to 30.09.1997 and during the trading period from 01.10.1997 to 14.10.1997, the appellant was a “receiving member”. On account of failure of appellant to complete the settlements made during these periods, by making complete payment, the Exchange withheld the pay-outs of securities at F various points of time. The remaining securities were withheld wherein appellant was acting as an “introducing member” in the market. [Paras 87 and 88][278-C-E]

- 6.2 As regards the introductory securities, they simply G could not have been realised by the Exchange at any point of time as they were merely introduced by the appellant and did not belong to it. These introductory securities were registered in the names of third persons who are not parties to this proceeding. Concededly, there could have been no loss to the appellant relating to corporate benefits on these securities as it did not have any right therein, to receive any such benefit. Property in those H

securities neither vested in the appellant nor in the Exchange and they were held by the Exchange only as a lien on the physical copies of shares to the limited extent of obliging the appellant to fulfil its obligations. The benefits on those securities remained in third parties, as they must have, and no one has approached this court to raise the grievance that they have suffered any wrongful loss as regards those benefits. Even if any grievance exists between two clearing members as regards the receipt or non-receipt of those benefits, the best course of action would have been to proceed by way of a separate proceeding in that regard. Clause (11) of Chapter VI, NSCCL Byelaws categorically provides for a privity of contract between delivering and receiving clearing members. The interests of those third parties are not a part of the present *lis*. [Para 89][279-D-H] A

6.3 Indisputably, the introductory securities have been marked as objectionable by the companies; and securities with outstanding objections are of no use to the Exchange for the purpose of recovery so long as such objections are not removed. The introductory securities fall outside the purview of the vesting provision. Further, the responsibility of the Exchange was limited to providing the appellant an opportunity to remove the objections and continue withholding the securities in the interim. Any enquiry regarding the legality or illegality of objections could have taken place between the introducing member and the respective companies. The same also cannot form a part of the subject matter before this Court. [Para 90][280-A-C] D

6.4 The provisions relating to withholding and vesting of securities are provided in two separate documents. Whereas vesting is provided under Chapter-XII of NSE Byelaws titled “Default”, withholding is provided under Chapter 9 of NSCCL Regulations titled “Non-Delivery and Non-Payment”. [Para 93][280-E-F] E F

6.5 Declaration of defaulter upon non-payment is not an express pre-requisite for the recovery of dues here. Regulation 9.7 provides that all deliveries of securities which were due to the defaulter shall be handed over to the Clearing Corporation so as to enable it to realise their dues from those deliverable securities. Upon receipt of securities as per this Regulation, the action of withholding is contemplated in Regulation 9.9 G H

- A (Regulation 9.11 in NSE Regulations). In the present case, securities deliverable to the appellant as a receiving member were withheld by the respondents to clear their dues. [Para 94][281-C-D; 281-F-G]

- 6.6 On withholding, the stage of vesting comes in and this stage is important as vesting is a pre-requisite for dealing with the securities in any manner. There can be no action, be it of sale or registration, against a property unless the property vests in the entity. "*Nemo dat quod non habet*" is the fundamental principle of transfer of property which, if literally translated, means "*no one gives what they do not have*". Thus, unlike money deposits, withheld securities cannot be realised without legal vesting under clause (11). [Para 95][281-G-H; 282-A]

- 6.7 Though the requirement of declaration as defaulter may be a discretionary one under the NSCCL Regulations, the same is a mandatory requirement for vesting in clause (11). For, vesting takes place upon declaration of any trading member as a defaulter. The expression "*and such assets shall vest ipso facto, on declaration of any trading member as a defaulter*" reinforces the view. Even otherwise, the main vesting provision is included in the chapter on defaults and therefore, such declaration is necessary unless otherwise excluded. Therefore, the right of the Corporation to dispose of or realise these securities is circumscribed by the requirement of declaring such member as a defaulter. In the present case, no such declaration came to be made. However, despite the absence of any such declaration, vesting took place by way of Rule 20(f) in Chapter IV of NSE Rules, whereby the requirement of express declaration of defaulter upon expulsion is done away with. [Paras 96 and 97][282-A-D]

- 6.8 The emergent position of law, therefore, is that vesting does not take place in favour of the respondent Exchange unless a formal expulsion order is passed. The relevant point of time, therefore, is the date of expulsion. Without such legal vesting, the Exchange only sits upon the withheld assets as a custodian. There is no question of realisation. Such withholding is done to serve two purposes – *first*, to persuade the defaulting member to fulfil its obligations during the continuation of membership if it so wishes and *second*, to secure the liability at the earliest available opportunity as a preventive measure. If liabilities

continue to be unfulfilled, expulsion becomes an inevitable consequence and the withheld assets vest in the Exchange. [Para 97][282-G-H; 283-A-B] A

6.9 Thus realisation cannot be done unless vesting is complete and there is no obligation on the Exchange/Corporation to forthwith realise the securities upon withholding. Expulsion or declaration of defaulter, as the case may be, is a pre-condition for realisation, which, in the present case, took place only in 2006. Even on applying rule of prudence, such forthwith realisation would not be appropriate as such action would deprive the defaulting member from an opportunity to correct its mistake by settling liabilities within due course of time without giving up membership. [Para 98][283-B-C] B

6.10 The Rule 20(f) clearly signifies that it applies to expelled members and the moment a member is expelled from membership, this rule will automatically become operative. Literally understood, the relevant point of time for checking the applicability of this rule is the “date of expulsion”. In the instant case, expulsion of the appellant took place in 2006, whereas the said rule was inserted beforehand in 2001. Thus, the rule was very much in force when the appellant was in fact expelled. Consequently, the respondents were well within their powers to realise the withheld securities in accordance with clause (11) soon after expulsion in 2006. [Para 99][283-B-C] C D

6.11 Upon withholding followed by vesting, the manner of dealing is provided under Regulation 9.10, NSCCL Regulations (Regulation 9.12, NSE Regulations). This Regulation predicates that the Clearing Corporation is armoured with a set of measures as regards the withheld securities. The first part of the Regulation vests the Corporation with the power to deal with the securities at “such times” and in “such manner” as it may deem fit. The Regulation then specifies certain measures which may include: (a) closing out the withheld securities in the name of Exchange or any other entity; or (b) registering the withheld securities in the name of Exchange or any other entity. Thereafter, in the concluding sentence it is further specified that the funds received out of closing out of withheld or registered securities may also be dealt with in such manner and at such times as the Exchange may deem fit. It is therefore clear that the respondents had two F G H

- A courses of action open for dealing with the securities – *closing out* and *registration*. Chapter 10 of NSCCL Regulations titled “Closing out of Contracts” delineates the manner of closing out. [Paras 100 and 101][283-F-G; 284-B-F]
 - 6.12 Thus, the Corporation is duty bound to close out all outstanding deals against the defaulter and “determine” them for the purpose of its recovery. Regulation 10.9 specifies the manner of such determination. The Corporation is empowered with a set of methods to close out the outstanding deals against the appellant. Upon vesting, it could have sold out the withheld securities through an auction or by placing an order of sale in Exchange or in any other permissible manner. [Para 102][285-A-B; 285-D-E]
 - 7.1 The other action contemplated in Regulation 9.10 is of registration. The grievance is that the Exchange held on to the securities without registration and that it was abuse of discretionary powers and the respondents ought to have registered the securities in its name forthwith. Once an action of withholding is taken, multiple interests come into play and both the parties assume different roles as regards the withheld securities. – *role of Exchange and role of defaulting member*. [Paras 103 and 104][285-E-G]
 - 7.2 Regulation 10.9 requires the Exchange not to sit idle on the withheld securities and instead, obliges it “*to deal*” with them in an appropriate manner. This requirement is a manifestation of the basic “duty of care” implicit in regulatory relationships where one member is in a position to control the functionality of the other. The *raison d'être* underlying this duty is to protect the interests of a member and to prevent any undue damage to its interests as a crucial element of the market. [Para 105][286-B-D]
 - 7.3 In the present case, it is clear that the manner of dealing with the withheld securities is not circumscribed under strict parameters. The Exchange is bestowed with a discretion to choose amongst the available options and the appellant holds no control over such choice. To this limited extent, the role of the Exchange as regards the withheld assets is of a fiduciary character, obligating it to choose the just course of action out of the available

options. Traditionally speaking, the relationship of Member-Exchange may not be regarded as a fiduciary one. But the concern of the Court is limited to the dynamics of this relationship qua the withheld securities in light of the regulatory scheme. It is only for the purpose of performance of functions that a fiduciary character is recognised in this relationship. The scope of fiduciary duties is “*moulded according to the nature of the relationship and facts of the case*”. It is thus clear that constructive trust arises by operation of law in specific factual scenarios and not by any statute or contract. However, such trust, and rights and obligations under it would depend strictly upon the prevailing set of facts and governing provisions. [Para 106][287-B-F; 288-B-C]

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Robert L. Hodgkinson v. David L. Simms [1994] 3 SCR 377; *Frame v. Smith* [1987] 2 SCR 99 – relied on.

Hospital Products Ltd. v. United States Surgical Corporation Ltd. (1984) 156 C.L.R. 41; *Paragon Finance PLC v. DB Thackerar and Co.* [1991] 1 All ER 400 – referred to.

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“*Fiduciary Law: The Judicial Process and the Duty of Care*” by Professor Frankel, *Snell's Equity*, 32nd Edition – referred to.

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7.4 The principles of constructive trust and fiduciary relationships are equitable principles, and equity never operates in an absolute manner or in a vacuum. In fact, the very basis of the law of equity is its flexibility to take care of mutual concerns of the parties. Equity is about balancing the competing interests – by preventing the erosion of interests of one party while ensuring a free exercise of legally enshrined discretionary powers to the other. No doubt, specific fiduciary duties could definitely be recognised in the specific facts of the case but the manner of performance of such duties cannot be dictated in regulatory matters. Legal recognition of the role of a trustee and fixing actual obligations to be performed under such role are two separate matters. The latter is dependent on the nature of discretion and on the diligence of other party. [Para 108][288-D-F]

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Equity & Trusts, Alastair Hudson, 2nd Edition – referred to.

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- A **7.5** The duties of a trustee can be broadly classified into mandatory duties and discretionary duties. The court is always circumspect in enforcement of discretionary duties. A perusal of Regulation 9.12 succinctly reveals that the measure of registration is not provided as an exclusive one, rather, it is in addition to other residuary steps that an Exchange is entitled to take.
- B Therefore, there is no express statutory or contractual requirement of mandatory registration in the applicable law. A clear element of discretion is involved in the manner of dealing. It is true that such discretion cannot be exercised in a legally perverse manner, but it is equally true that a discretion cannot
- C be converted into a mandatory obligation, more so when such discretion is provided expressly by a statutory provision. [Para 109][288-G-H; 289-A-C]

Ashburner's Principles of Equity, Denis Brownie, 2nd Edition – referred to.

- D **7.6** It is the fundamental principle of an equitable examination that "*the one who seeks equity must do equity*". Registration of securities or any property for that matter is done in favour of an entity only upon fulfilment of certain allied conditions, including but not limited to the supply of consideration.
- E Without such consideration, contract itself becomes void, let aside entertaining a demand for registration. Upon withholding, it becomes the duty of the stock broker to raise a request for the registration of securities and to comply with the payment shortfall and other requirements. During the period commencing from 1997 to 2008, the appellant did not pursue the cause of dealing with the withheld securities in a proactive manner, seemingly because of two reasons- *first*, the appellant was pursuing multiple legal actions against the respondents at various forums and *second*, such a request would have to be preceded by fulfilment of conditions relating to settlement and payment. For, the
- F Exchange could not get the securities registered in the name of any entity until and unless such entity settles the transaction by making complete payment for the purchased securities. Clause (3) of Chapter-VI of NSCCL Byelaws titled "Clearing and Settlement of Deals" expresses the same view. [Para 110][289-E-H; 290-A-B]
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7.7 The appellant never offered to make such payment in lieu of registration. In fact, the Defaulter's Committee did propose to hand over physical possession of the securities to the appellant for getting them registered in its name. The appellant refused to comply with the direction of payment and instead, challenged this decision of the Defaulter's Committee before the Tribunal wherein a consent order was passed upon an undertaking given by the Exchange that it has no objection in performing its duty as "trustee" in respect of the unregistered withheld securities and taking appropriate steps by registering them in its name. Even this order was a conditional one as it specified that such registration shall not affect the legal rights and liabilities of parties in any manner. In pursuance of this order on 23.09.2015, the respondents got the securities transferred in their name and realised them after the impugned order in 2019. [Para 112][291-C-F]

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7.8 It is thus clear that the respondents were cognizant of their duty towards the withheld securities pending determination of final claim. However, no action of registration could have been taken without complying with other conditions. The role of the defaulting member was of an enabler and unless the Exchange was placed in a position to register, it could not have exercised its discretion to register. Permitting the Exchange to register forthwith as a matter of obligation would also be counterproductive to the interests of the defaulting member. For, such a blanket action would have the effect of converting a limited right of lien into that of absolute ownership over the withheld assets without giving the defaulter sufficient time to get his assets released much less before a declaration of being a defaulter or an order of expulsion. Such can never be the purpose of withholding. [Para 113][291-F-H; 292-A-B]

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7.9 To summarize, registration could only have been done on fulfilment of the following conditions:(i) request by the defaulting member; (ii) request to be preceded by fulfilment of conditions relating to payment; (iii) request to be accompanied with undertaking that any such registration in the name of the Exchange would be subject to final outcome of the case. [Para 114][292-A-C]

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- A **7.10** The appellant is not correct in saying that it has suffered loss of corporate benefits due to non-registration by the respondent. Firstly, the receiving securities legally vested in the Exchange as on the date of expulsion to the extent of liability. The appellant could not have claimed any right therein to further corporate benefits as regards these securities. Even before the date of expulsion, the respondents cannot be held liable for any loss on the withheld securities as the appellant always had the opportunity of making payment and protecting its interests. The appellant cannot fail to discharge its obligations for a period of 23 years and then turn around and claim loss of benefits in this manner. Acceding to such a claim would be akin to rewarding a wrong. Thus, the liability for the loss incurred by the appellant, if at all any, on account of corporate benefits (dividends, bonus etc.) accrued on withheld shares would not fall upon the Exchange, in the fact situation of the present case. [Para 115][292-C-F]
- D **7.11** The respondents' decision of not realising the securities or taking any adverse action during the pendency of multiple proceedings cannot be outrightly termed as an abuse of discretion. For, the decision of expulsion (and thus, of vesting) itself became sub-judice along with various other civil and criminal proceedings. Admittedly, the appellant had gone to the extent of initiating proceedings for criminal misappropriation against the Directors of respondents for using security deposits in regular course of business. This inevitably resulted in reluctance of the respondents to sell off the securities amidst pending proceedings. It is settled law that statutory appeal is a continuation of the original proceedings and once an appeal was filed, the question of expulsion remained sub-judice unto these appeals.[Para 116][292-F-H]
- G **7.12** The Tribunal misinformed itself by observing that this issue had already stood answered in the previous judgment of the Tribunal in Appeal No. 84 of 2008. The Tribunal simply entered into an examination of the provisions relating to withholding whereas the real question was regarding the manner of dealing with the withheld securities. [Para 117][292-H; 293-A-B]
- H **7.13** The amount of Rs. 1.34 crore was required to be returned by the respondents in SLP (Crl.) No. 9642-9643 of 2011,

which it had held as an interest free security deposit. It was meant to be utilised for the purpose of discharging the monetary obligation of the appellant during the period between withdrawal and expulsion. The appellants have advanced an erroneous proposition that the return of this amount by the respondents signified that there was no liability owed by the appellant towards them. The return of the security deposit was driven by a desire of the officials of the respondents to avoid the continuation of criminal proceeding against them resorted to by the appellant. It was neither a confession that they had misappropriated the said deposit nor an undertaking that they had no claim over the said amount for adjustment against the penalties. The effect of the said return was limited to the quashment of criminal proceedings involved therein. [Para 119][293-C-F] A

7.14 The loss caused to the Exchange due to return of interest free security deposit amount ought to be reckoned in determining the total liability of the appellant and the same ought to be adjusted by the respondents appropriately. The quantum of amount due from the appellant to the respondents, being a question of fact, has been decided by the Tribunal. [Paras 120 and 121][293-G-H; 294-A-B] D

8. Following directions are issued for full and final E settlement of all claims between the parties:

- (i) NSE to evaluate and get the remaining transferrable securities, if any, transferred in its favour and recover the remaining amount using the same evaluation criteria adopted in respect of other withheld securities of the appellant within 6 weeks. F
- (ii) After realisation, the surplus amount be returned forthwith to the appellant along with interest at the rate of 12% P.A. from the date of determination of claim/date of vesting until the date of payment. G
- (iii) Respondents to return the unrealised securities including those with outstanding objections to the appellant within 6 weeks.
- (iv) In case recovery is not possible from the remaining securities, for any reason whatsoever, the respondents H

- A may communicate the same to the appellant forthwith and the appellant shall then pay the amount so demanded (including interest, if any), to the respondents within 6 weeks from the date of receipt of such communication.
- B (v) NSE is directed to oversee the evaluation and realisation of remaining securities, and settlement of claims. [Para 122][294-C-G]

Case Law Reference

	[1994] 3 SCR 377	relied on	Para 106		
C	[1987] 2 SCR 99	relied on	Para 106		
CIVIL APPELLATE JURISDICTION: Civil Appeal No. 2690 of 2009					
From the Judgment and Order dated 13.01.2009 of the Securities Appellate Tribunal in Appeal no. 84 of 2008.					
D	With Civil Appeal No. 9571 of 2019.				
Siddhartha Mitra, Shyam Divan, Sr. Advs., Ashok Mathur, Raibal Banerji, Devashish Bharuka, Ajit Warrier, Angad Kochhar, Ms. Tanvi Dubey, Abhilosh Chaturvedi, Devansh Agarwal, S. S. Shroff, Rabin Majumder, Bhargava V. Desai, Ms. Aditi Diwan, Advs. for the appearing parties.					
The Judgment of the Court was delivered by					

A. M. KHANWILKAR, J.

1. These appeals under Section 22F of the Securities Contracts (Regulation) Act, 1956¹ take exception to the judgment and order passed by the Securities Appellate Tribunal at Mumbai² in Appeal No. 84 of 2009 dated 13.01.2009 and in Appeal No. 118 of 2015 dated 04.06.2019.

CIVIL APPEAL NO. 2690 OF 2009

2. In this appeal, the appellant challenges the judgment/order dated 13.01.2009 of the Tribunal wherein it had upheld the order of expulsion against the appellant, from the membership of the National Stock Exchange of India Limited³ - Respondent 1. The said order was passed in the aftermath of the withdrawal of trading facilities of the appellant on 13.10.1997 and consequent closing out of all outstanding positions on

¹ for short, "the 1956 Act"

² for short, "the Tribunal"

H ³ for short, "NSE" or "the Exchange", as the case may be.

14.10.1997 by the National Securities Clearing Corporation Limited⁴ - A Respondent 2.

3. The appellant herein, desirous of functioning as a stock broker in the stock market, registered itself as a Trading Member with NSE/ Exchange in November, 1994. As a pre-condition of such registration, the appellant was obliged to and did submit an undertaking in favour of the Exchange so as to strictly comply with the practice and stipulations in the applicable Byelaws, Rules, Regulations and other instructions of the Exchange issued from time to time. The said undertaking was given by the appellant on 19.06.1995. B

4. As per the conditions prescribed in the Bye Laws, Regulations and Rules of the Exchange, the appellant was obliged to maintain a set of deposits with the Exchange, namely - Interest Free Security Deposit (IFSD), security deposit (bank guarantee), margin money in cash and margin money in the form of bank guarantee. The sum total of these deposits of the appellant, collectively termed as the Base Capital of the trading member, amounted to Rs. 1.29 crores. C

5. In the year 1996, NSE transferred its clearing and settlement functions to its wholly owned subsidiary company NSCCL/Clearing Corporation. In furtherance of the original undertaking given by the appellant in favour of the Exchange, the Board of Directors of the appellant executed a subsequent undertaking dated 19.03.1996 in favour of the Clearing Corporation, whereby the appellant unconditionally resolved to abide by all Rules, Regulations, circulars etc., of the Corporation. Consequently, the appellant was admitted as a Clearing Member of the Clearing Corporation. D E

6. On 19.05.1997, the Exchange adopted and circulated the Circular No. NSCC/CM/C&S/030, originally issued by the Clearing Corporation, to all the trading/clearing members. The circular prescribed certain conditions to be complied with by the members during trading, including those relating to "Gross Exposure Limits" for daily functioning of the members. The circular further provided for "Effect of violation of gross exposure limit" and "Effect of failure to pay margins", whereby it specified various actions that the Corporation and Exchange could take against a member in case of contravention of the circular. Such actions included the withdrawal of trading facilities, closing out of all outstanding F G

⁴ for short, "NSCCL" or "Clearing Corporation", as the case may be H

- A positions and other actions as per the Byelaws. The introductory note specifying this position is relevant which reads thus:
- “Circular No. NSCC/CM/C&S/030 dated 19.5.1997 issued by National Securities Clearing Corporation Limited (NSCCL) to the Clearing Members of NSCCL is enclosed. All Trading Members
- B of the Exchange who are also the Clearing Members of the Clearing Corporation are required to comply with the said Circular and any modifications thereto as may be issued by the Clearing Corporation from time to time. Non-compliance with the said Circular will be treated as breach of the Rules, Byelaws and Regulations of the exchange. The Clearing Corporation will monitor the compliance and take suitable action for non-compliance.”
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- D 7. On 13.10.1997, the appellant was found to have exceeded the gross exposure limits while trading (as prescribed by the aforesaid circular) by more than 10% and consequently, the trading facility of the appellant was withdrawn forthwith by the respondents. Consequent thereto, communication ensued between the appellant and the Clearing Corporation on the same day whereby the appellant was asked to bring in an additional deposit of Rs.40.70 lakhs (calculated as per the circular) in order to enhance the trading limits. Additionally, the appellant was also asked to deposit a margin of Rs.29.10 lakhs towards unsettled trades
- E done on 10.10.1997, along with Rs.41,42,253.25 in lieu of short delivery under Settlement No. N1997039 and Rs.6,585.50 in lieu of bad delivery under Settlement No. N1997038. As per the communication, the said amounts were to be deposited before 10:30 AM on 14.10.1997 failing which all open positions of the appellant in various securities were to be closed out forthwith. The appellant failed to deposit the said amounts
- F and consequently, the Clearing Corporation closed out all the open positions of the appellant.
- G 8. Subsequent to the withdrawal of trading facilities and closing out of positions, the appellant pursued legal action, both civil and criminal, against the respondents at various forums, including the High Court of Calcutta and the Securities & Exchange Board of India⁵. The details of various legal proceedings instituted at the behest of the appellant, being unnecessary for deciding the subject matter brought before us, are not adverted to. After an unfruitful litigious relationship of 7 years, the Exchange addressed to the appellant a letter dated 01.11.2004 informing
- H ⁵ for short, “SEBI”

about the periodical appropriation of certain amounts made by the Exchange from the security deposits of the appellant in lieu of various membership charges due from time to time. The Exchange also called upon the appellant to deposit additional sums to meet the shortfall created in the Interest Free Security Deposit, in accordance with Rule 32 of Chapter III of Exchange Rules, to retain the membership of the Exchange.

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9. In the communication that followed the aforesaid letter, the appellant denied any such obligation to pay as its trading facilities had stood suspended throughout this period. The appellant was then granted a hearing and upon being dissatisfied with the response, NSE decided to suspend the membership of the appellant with effect from 16.02.2005. The reasons behind this decision were communicated to the appellant vide letter dated 30.03.2005 titled "Relevant Extract of Minutes of the Relevant Authority". The relevant extract reads thus:

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"..... In view of the above, the Committee after careful consideration of the various contentions of RSL was not satisfied of the merits of the contentions raised by RSL. The Committee concluded that RSL failed to substantiate the failure to meet the capital adequacy requirements for continued admittance of trading membership of the Exchange. Therefore, the Committee decided to suspend the membership of RSL with effect from February 16, 2005."

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10. Post suspension, another show-cause notice was served upon the appellant by NSE on 20.10.2005. This time for the expulsion of membership. Despite the second show cause, the appellant refused to fulfil additional requirements relating to the maintenance of deposits as indicated by the Exchange. Resultantly, the Committee on Declaration of Defaults, on 05.01.2006, decided to expel the appellant from the membership of the Exchange primarily citing two reasons – failure to comply with the requirement of maintaining IFSD and failure to meet continued admission norms despite suspension. The relevant extract of the communication dated 05.01.2006 reads thus:

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"..... You have neither replenished the shortfall in deposits nor appeared to show cause before the relevant authority on January 05, 2006. The relevant authority, at its meeting held on January 05, 2006, after duly considering the material on record ... has decided to expel you from the trading membership of the Exchange with immediate effect. ..." G

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- A 11. The order of expulsion was unsuccessfully challenged by the appellant before the Tribunal at Mumbai. The appellant's primary challenge rested in reference to respondents' decision of withdrawal of trading facility and subsequent action of closing out of open transactions. While upholding the decision of closing out of all the outstanding positions of the appellant under clauses 17 and 18, the Tribunal observed thus:
- “5. Byelaws 17 permits closing out of outstanding transactions only on failure to complete the same by the trading member by the due date. However, this Bye-laws is not exhaustive and does not preclude closing out the dealings in securities under other circumstances.”
- C Interpreting the combined effect of both the clauses, the Tribunal, in the same para, further observed thus:
- “5. It is a cardinal rule of interpretation that these provisions have to be read harmoniously and one cannot be read in isolation without appreciating the import of the other. Byelaws 18 clearly permits closing out of contracts or dealings in securities in such manner and within such time frame and subject to the conditions and procedures as may be prescribed from time to time by the relevant authority. Closing out the contracts and the conditions and procedures subject to which it could be done under Byelaws 18 is in addition to the closing out under Byelaws 17. As already observed, Byelaws 17 permits closing out only on the failure of a trading member to settle the transaction by the “due date” where as under Byelaws 18, closing out could be resorted to for any other reason subject to such conditions and procedures as may be prescribed by the relevant authority. If Byelaws 17 is read to mean, as was argued by the learned counsel for the appellant, that its provisions are exhaustive and that under no other circumstances can NSE close out the open positions of a trading member, then Byelaws 18 becomes otiose. Where was then the need to provide in Byelaws 18 that closing out of contracts “shall be in such manner within such time frame and subject to such conditions and procedures” when all these have been prescribed in Byelaws 17. Obviously, Byelaws 18 contemplates reasons and circumstances for a close out other than that mentioned in Byelaws 17. Relevant authority has been defined in the Byelaws to include NSE.”

As regards the validity of the circular, the Tribunal confirmed that A the circular holds binding value and observed thus:

“5. The word ‘prescribed’ as used in Byelaws 18 has not been defined and the conditions and procedures as contemplated by this Byelaws could be prescribed in any manner including through a circular. It is not in dispute that NSE adopted the circular dated May 19, 1997 which was issued by NSCCL (which is also a relevant authority) and circulated the same to its trading members for compliance making it clear that non-compliance would be treated as a breach of Rules, Byelaws and Regulations of the Exchange. This circular undoubtedly provides for a closing out of outstanding positions of the trading members even before the due date in the event of withdrawal of their trading facilities and that too, without any further notice to the trading member. In other words, withdrawal of trading facilities of a trading member as contemplated by the circular furnishes yet another ground to the NSE to close out the outstanding positions or dealings in securities. D
....”

The Tribunal also recorded certain observations regarding the necessity of a power of this nature with the Exchange and noted thus:

“5. We cannot lose sight of the fact that a stock exchange which is a primary level market regulator has also a duty to protect the interest of the investors and the integrity of the securities market. The conclusion that we have arrived at based on the interpretation of Byelaws 17 and 18 would advance that object. We are also of the view that it is essential that a stock exchange should have the power to close out the open transactions of a trading member when it finds that he (the trading member) is trading recklessly beyond his gross exposure limit as such limits, backed as they are by requisite margins, are prescribed with a laudable objective of investor protection. Such a power is essential to discipline the recalcitrant trading members. In the absence of such a power, the market and the investors would be exposed to a serious threat and the stock exchange would be reduced to the position of a mute spectator.” G

12. In the present appeal, the appellant has argued at length on various aspects of the entire transaction. As regards the decision of H

- A expulsion from membership, it is the case of the appellant that the said decision was founded on an illegality as its trading facility was wrongly withdrawn. The appellant has contended that since the trading facility itself was interdicted, it could not have been expected to keep up with various margins and deposits prescribed by the respondents as no trading was being permitted.
- B 13. The primary contention of the appellant relates to the vires of the circular under which the trading facility of the appellant was withdrawn. It has been submitted that the Tribunal failed to appreciate that the said circular was in contravention of the Byelaws, Rules and Regulations. It is urged that the adoption of the said circular by the Exchange amounted to a violation of 1956 Act and thus being void ab initio, the appellant was not bound by the said circular. To buttress this submission, it is argued that NSCCL is merely a clearing house of the Exchange and any circular issued by it cannot be accorded a legal sanctity at par with the Byelaws, Rules and Regulations of the Exchange. It is further argued that the disciplinary jurisdiction of the Exchange must be exercised only in accordance with the Byelaws and not any circular.
- C 14. As regards the prescription of the said circular by the Exchange to all trading members vide communication dated 19.05.1997, it has been submitted that by virtue of this communication, the Exchange effectively indulged in amending its own Byelaws by adopting the indirect route of issuing a circular and thus, the communication was violative of Section 9(1) and 9(4) of 1956 Act along with Section 21 of the General Clauses Act, 1897.
- D 15. The next submission relates to the closing out of the outstanding positions of the appellant. It is submitted that the closing out was not done in accordance with clauses 17 and 18 of the Byelaws as it was done before the *due date*. The argument stems from the contention that clause 17 enjoins the Exchange and Clearing Corporation not to close out any outstanding position of a trading member until and unless such member has failed to complete the delivery or payment by the due date.
- E The appellant has further submitted that clause 18 is nothing but a concomitant provision of clause 17 and comes into play only after closing out is done in accordance with clause 17 by complying with the requirement of due date. Impugning the observation of the Tribunal, it has been urged that clause 18 does not provide for additional conditions/
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reasons of closing out and does not operate independently of clause 17. A Instead, both clauses supplement each other.

16. Furthermore, the appellant has contended that on a proper interpretation of clauses 17 and 18, it can be concluded that once the relevant authority has closed out a transaction by exercising power under clause 17, such closing out would take place in *such manner*, within *such time frame* and subject to *such conditions and procedures* as may be prescribed from time to time. Closing out, as per the appellant's contention, begins in clause 17 and culminates in clause 18. B

17. To counter the submissions of the appellant, the respondents have submitted that both for admission and continuation of membership, the Byelaws of the Exchange provide for payment of fees, security deposit and other monies as may be specified by the Board or the relevant authority from time to time. Furthermore, they also provide for maintaining various margins with the Exchange and Clearing Corporation, and state that any contravention of the same is proceeded against as per the Rules. Similar provisions for admission and continued admission are provided in the Byelaws of the Clearing Corporation as well. C

18. Addressing the challenge to the Tribunal's interpretation of clauses 17 and 18, the respondents have submitted that the Tribunal has rightly concluded that clause 17 is not exhaustive as far as the action of closing out is concerned, and there could be other circumstances wherein the action of closing out ought to be taken in the investors' interest. Clause 17 does not preclude invoking other just circumstances. As per the respondents, such circumstances are covered by clause 18 which operates in addition to clause 17. It is further submitted that a stock exchange must have the power to close out transactions of a trading member when it discovers any reckless conduct in the market, including exceeding the specified gross exposure limits subject to which the trading platform is allowed to the trading members. D E F

19. In reference to the existence of authority of the Clearing Corporation to issue such circular, the respondents have submitted that the appellant had extended an unconditional undertaking in favour of the Clearing Corporation whereby it undertook to comply with and be bound by the Rules, Byelaws, Regulations, circulars etc. issued by the Corporation from time to time. Thus, the appellant is estopped from going back on its undertaking. It is further submitted that the circular G

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- A does not override or contravene any of the Byelaws, Rules or Regulations framed by the Exchange.

20. As regards the decision of expulsion, the respondents have submitted that the appellant was liable to maintain the Interest Free Security Deposit with the Exchange as he continued being a member of B the Exchange despite the suspension of trading facility. It has been further submitted that the appellant was granted multiple opportunities to make good the shortfall in deposits but failed to comply with its obligations even after the decision of suspension.

21. Addressing the challenge regarding the requirement of prior C approval for the subject circular from SEBI/Central Government as per 1956 Act, the respondents have submitted that the Byelaws of the Exchange were brought into operation only after the approval of the Central Government, as mandated under the Act, and the said circular was issued in furtherance of the powers of the Exchange in the Byelaws. D Therefore, since the Byelaws were brought into force after approval of the Central Government, no further approval was necessary for taking action under the said Byelaws. To reinforce, it is urged by the respondents that the designated authority of the Exchange, under clause 18, is vested with the power to prescribe the “due date”, “manner”, “time frame” and “conditions and procedures” as regards the action of closing out and E thus, any such action does not warrant any further approval from SEBI.

22. We have heard learned counsels for both the parties at length.

23. Having examined the submissions of the parties and documents on record, we are of the view that the following questions of law emerge for our consideration in the present appeal: -

- F (i) Whether prior approval of SEBI/Central Government was essential for enforcing the circular dated 19.05.1997 against trading/clearing members?
- G (ii) Whether the circular is invalid as being in conflict with the Byelaws of the Exchange, particularly regarding the manner of closing out prescribed therein?
- (iii) Whether the appellant is legally bound by the subject circular which allows the withdrawal of trading facility and forthwith closing out of open positions?

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(iv) Whether the appellant was obligated to maintain the prescribed Interest Free Security Deposit and other deposits, despite the withdrawal of its trading facilities, for continued membership of the Exchange? A

24. The intertwined nature of the provisions involved in the determination of the aforesaid questions requires us to analyse at length the scheme and scope of the Byelaws, Rules and Regulations of the Exchange and the Clearing Corporation vis-a-vis the 1956 Act and Securities and Exchange Board of India Act, 1992⁶. B

25. The 1956 Act was brought into force “*to prevent undesirable transactions in securities*” by regulating the securities market. In furtherance of this objective, the legislature provided for recognition of a stock exchange under Section 4 of the Act on the following terms: C

“4. (1) If the Central Government is satisfied, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require, — D

(a) that the Rules and Byelaws of a stock exchange applying for registration are in conformity with such conditions as may be prescribed with a view to ensure fair dealing and to protect investors;

...

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it may grant recognition to the stock exchange subject to the conditions imposed upon it as aforesaid and in such form as may be prescribed.” F

After specifying that the Byelaws and Rules of a stock exchange require prior approval of the Central Government, sub-section (5) of Section 4 imposes the same condition on any amendment of such Rules in the following terms:

“(5) No Rules of a recognised stock exchange relating to any of the matters specified in sub-section (2) of section 3 shall be amended except with the approval of the Central Government.” G

On a plain reading of the afore-quoted provisions, it is seen that the central scheme of 1956 Act reveals that the requirement of prior

⁶ for short, “the 1992 Act” H

- A approval, in relation to matters specified in sub-section (2) of Section 3, of the Central Government, be it at the time of original framing of Rules of the Exchange or upon amendment thereof, is essential or pre-requisite. This mandate of Central Government was later entrusted to SEBI vide S.O. 672 (E), dated 13-09-1994, published in the Gazette of India, Extra., Pt. II, Section 3 (ii), Dated 13-09-1994 (for prior approval at the time of framing); and vide S.O. 573 (E), dated 30-07-1992, published in the Gazette of India, Extra., Pt. II, Section 3 (ii), dated 30-07-1992 (for prior approval at the time of amendment) by issuing orders under Section 29A of the 1956 Act, which at the relevant point of time read thus:
- C “29A. Power to delegate.—The Central Government may, by order published in the Official Gazette, direct that the powers exercisable by it under any provision of this Act shall, in relation to such matters and subject to such conditions, if any, as may be specified in the order, be exercisable also by the Securities and Exchange Board of India.”
- D 26. Be it noted that the legislature has omitted the usage of the word “Regulations” or “circulars” in the parent Act; and as far as the governance of a stock exchange is concerned, the supervision or control of the Central Government/SEBI at the time of granting recognition to the stock exchange is limited to being satisfied that the Rules and Byelaws
- E of the stock exchange applying for registration are in conformity with such conditions as may be prescribed for ensuring fair dealing and protecting investors. The domain of framing Regulations is kept separately in a standalone manner in the Byelaws of the Exchange and not in the Act. The framing of Regulations concerning governance of stock exchange is reserved for the Exchange.
- F 27. For deciding the first question, we may now advert to NSE Byelaws, 1994, to understand the true import of the subject circular. In the chapter on “Definitions”, clause (10) defines “Regulations” to include business rules, code of conduct and such other Regulations prescribed by the relevant authority from time to time for the operations of the
- G Exchange and they are declared to be subject to the provisions of the 1956 Act, Rules and 1992 Act. The definition is merely an inclusive definition and not exhaustive. The relevant authority here is the Board of the Exchange. Such Regulations can be prescribed on a wide range of matters as indicated in “Chapter III – Regulations”, including capital adequacy norms or “*any other matter as may be decided by the*
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Board”. Thus, the scope of “Regulations” that can be prescribed by the Exchange is expansive so as to cover all issues relating to governance of the Exchange. A

28. Coming to “Chapter V- Trading Members” of the Byelaws, clause (2) specifies certain “Conditions” for the Trading Members. Sub-clause (a) of clause (2) is instructive which reads thus: B

“(a)Trading members shall adhere to the Byelaws, Rules and Regulations of the Exchange and shall comply with such ***operational parameters, rulings, notices, guidelines and instructions*** of the relevant authority as may be applicable.”

(emphasis supplied) C

The above clause signifies that apart from framing Regulations, the Byelaws also empower the Exchange to issue instructions regarding operational parameters, guidance etc. for the trading members. The term “***operational parameters***” is crucial. Chapter IX of the Byelaws, in clauses (5) and (6), titled “Transactions and Settlements” specifies certain operational parameters for trading. Clause (5) empowers the relevant authority of the Exchange to “determine and announce” from time to time certain operational parameters which may include “trading limits” and “capital adequacy norms” as per clause (6). Clauses (5) and (6) read thus: D

“Operational Parameters for Trading

(5) The relevant authority may determine and announce from time to time operational parameters regarding dealing of securities on the Exchange which trading members shall adhere to.

(6) The operational parameters may, inter alia, include:

(a) trading limits allowed which may include trading limits with reference to net worth and capital adequacy norms;

.....”

Notably, clause (5) of Chapter IX of the Byelaws uses the phrase “*the relevant authority may determine and announce*” the operational parameters. Both “determination” and “announcement” of such parameters is therefore, within the competence of the Exchange. Such announcement can be made by the Exchange by circulating a communication amongst the members, as it rightfully did in the present G

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- A case by way of the subject circular. A similar clause has been inserted in Chapter VI of the Byelaws of the Clearing Corporation as well, thereby empowering the Clearing Corporation to issue operational parameters relating to trading limits and consequent actions in case of non-compliance.
- B 29. The subject matter of the circular in question pertains to trading/exposure limits coupled with sanctions in case of non-compliance. That falls squarely within the ambit of operational parameters (as seen in clauses produced above), which can be determined and notified by the Exchange from time to time. In this case, the Exchange adopted the circular from the Clearing Corporation and notified it in the form of operational parameter. Nothing is brought to our notice from the text of this circular that it would militate against the norm of fair dealing and protection of investors. In any case, no requirement of prior approval is provided for notifying such operational parameters and as the name suggests, they are meant to tackle “operational” concerns as and when
- C they emerge before the Exchange or the Clearing Corporation. The power and mode of prescription of such circular falls within the residuary powers reserved for the Exchange.

30. At this stage, we consider it apposite to make a brief reference to Section 9 of the 1956 Act which provides for the power of a recognised stock exchange to make Byelaws for regulation and control of contracts. The terms “regulation” and “control” cannot be narrowed down and must receive a wide meaning. For, the contours of circumstances that may emerge between an exchange and a trading member in the process of regulation and control cannot be comprehended or cabined beforehand and thus, the Act permits the Byelaws to be armoured with a diverse set of measures so as to enable the Exchange to deal with unspecified situations that may emerge during such regulation and control of contracts. Sub-section (2) and (3) further signify that matters relating to clearing house, settlements, suspension and expulsion from membership etc. are best left to be dealt under the Byelaws. Relevant extract of sub-section (3) reads thus:

“9. Power of recognised stock exchanges to make Byelaws

- | | | | |
|-----|-----|-----|-----|
| (1) | xxx | xxx | xxx |
| (2) | xxx | xxx | xxx |

- (3) The Byelaws made under this section may— A
- (a) xxx xxx xxx
- (b) provide that the contravention of any of the Byelaws shall render the member concerned liable to one or more of the following punishments, namely:— B
- (i) fine;
- (ii) expulsion from membership;
- (iii) suspension from membership for a specified period; C
- (iv) any other penalty of a like nature not involving the payment of money.”

This provision reinforces that the power to regulate and control the trading contracts enables the Exchange not only to make Byelaws and Regulations but to provide for everything therein which might be necessary (and permissible) for ensuring efficacy and vigour in the exercise of just power of control and regulation. It is in this light that the operational parameters or Regulations framed under the Byelaws are to be understood. For, without such power, the Exchange would be rendered toothless in controlling and regulating the contracts. D E

31. A priori, it must follow that the legislature has bestowed upon the Exchange sufficient freedom of action to effectively control and regulate the functioning of stock brokers who use the Exchange as a means to enter into financial relationships with the investors and common public. This freedom of action is guaranteed in the pre-approved Byelaws which enable the Exchange to frame Regulations, instructions, operational parameters, notice etc. and bring them into force without subjecting them to any added condition of prior approval of the Central Government/ SEBI. The only limitation on this power of the Exchange is that such Regulations or operational parameters issued under the Byelaws are subject to 1956 Act, 1992 Act and Rules framed thereunder. Strictly speaking, this limitation does not *ipso facto* mean that such Regulations or operational parameters are subject to prior approval, as argued. To say that would result in rewriting of the provisions in question. The same is forbidden. The import of this subjection clause is merely to specify that any such Regulation/operational parameter must not run counter to F G H

- A the provisions of 1956 Act or 1992 Act, as the case may be, including the Rules framed thereunder.
 - 32. Indubitably, the Exchange provides a middle ground to the stock brokers and investors dealing with public funds/investments, and considering the nature of activities undertaken in a stock market, it is the bounden duty of the Exchange to fortify the public trust. In doing so, the Exchange is required to prevent and remedy all possible mischief "on a real time basis". To that end, it may prescribe a set of parameters for fulfilling its objective of "*regulating*" and "*controlling*" the stock market, as stated in the Preamble of the Act. Since the Byelaws and Rules of the Exchange are duly approved by the Central Government/SEBI, it can safely be stated that actions taken by the Exchange under the Byelaws or Regulations - by prescribing such operational parameters in the form of a circular and in consequence thereof as discussed above – would assume enforceable character. The appellant having submitted an undertaking to comply with such instructions, notice etc., cannot be heard to argue to the contrary. The Court by interpretative process ought not to limit the efficacy of such a valid document by additional pre-conditions such as prior approval, not envisaged by the lawmakers or regulation framing authorities. To do so would entail in undermining the authority of the Exchange to regulate and control the stock market, directly or indirectly.
 - 33. The act of adoption of this circular by the Exchange and circulation of the same amongst the trading members was within the domain of the Exchange in terms of its Byelaws, and unless a case for such instructions to be *ultra vires* the Byelaws or the Act is made out, there is no reason to undermine its intended effect.
- F 34. The contention of the appellant that the act of adoption of this circular by the Exchange amounts to an indirect amendment of the Byelaws is a tenuous argument. For, if every regulation or instruction concerning any procedural matter for effective regulation and control of the stock market prescribed by the Exchange, in furtherance of its powers coupled with duty under the Byelaws, is to be deemed as an amendment merely because it provides for something in addition to the Byelaws (but not repugnant thereto), it would make various other operational clauses of the Byelaws repugnant. That cannot be countenanced.
- H 35. The operational freedom of the Exchange cannot be stifled on mere assumptions and the burden lies on the claimant to demonstrate a

real conflict between the exercise of power and source of power. Arguedo, had it been a deviation from the Byelaws, in the sense that the circular was defeating and not furthering the scope and objective of the Byelaws, it could have been examined as a constructive amendment or amendment by implication. Black's Law Dictionary 11th Edition defines an "*amendment by implication*" as:

“Amendment by Implication (1868). A rule of construction that allows a repugnant provision in a statute to be interpreted as an implicit modification or abrogation of a provision that appears before it.”

Therefore, the principle of constructive amendment signifies that unless a clear case of repugnancy is made out, the later provisions could not be treated as modification or abrogation, more so when such provisions further the intent of the source provisions. The appellant, in our view, has failed to impress us on this count.

36. In order to assail the validity of the circular, the appellant has attempted to demonstrate a conflict between the circular and the Byelaws regarding the manner of closing out contemplated in the two. It is the case of the appellant that the circular contravenes clause 17 of the Byelaws and thus, invalid.

37. For the same default, closing out action is contemplated both under the Byelaws of the Exchange and the subject circular. Clauses 17 and 18 of the Byelaws of the Exchange provide for closing out. It is pertinent to note that since action is open under both, it is necessary to ascertain whether these corresponding closing out provisions entail any conflict amongst each other, as alleged.

38. In order to understand the scheme, it is important to reproduce the relevant provisions. Closing out under clauses 17 and 18 of the Byelaws of the Exchange is provided as under:

“Closing out”

(17) Subject to the Regulations prescribed by the relevant authority from time to time, any dealing in securities made on the Exchange maybe closed out by buying in or selling out on the Exchange against a trading member and/or Participant as follows: -

(a) in case of the selling trading member/Participant, on failure to complete delivery on the due date; and

- A (b) in case of the buying trading member/Participant, on failure to pay the amount due on the due date, and any loss, damage or shortfall sustained or suffered as a result of such closing out shall be payable by the trading member or participant who failed to give due delivery or to pay amount due.
- B (18) Closing out of contracts or dealings in securities and settlement of claims arising therefrom shall be in such manner within such time frame and subject to such conditions and procedures as may be prescribed from time to time by the relevant authority.”
- C 39. Under clause 17, closing out is permitted under specified and narrow circumstances i.e. only when a member of the Exchange has failed on delivery or on payment. The phrase “*on failure to complete delivery*” and “*on failure to pay the amount due*” signify the clear scope of operation of clause 17. Understood thus, clause 17 gets activated only when the default is in payment of amount due in case of buying
- D members or in delivery of shares in case of selling members and not otherwise. Succinctly put, clause 17 envisages closing out for failure to complete the settlement operation. That, however, has no relation whatsoever to a situation of closing out due to failure to trade within defined limits, as specified by the Exchange, amounting to violation of the Byelaws of the Clearing Corporation, as in the present case. Whereas,
- E clause 18 caters to another situation and is textually different.
- F 40. Let us now see how the action of closing out is envisaged in the circular. The circular provides for the effect of violation of the exposure limits and lays down that any such violation shall be treated as a violation of the Byelaws of the Clearing Corporation, without prejudice to the power of the Exchange to withdraw the trading facilities. This withdrawal is contemplated as an imminent action to protect the market from being exposed to unsecured financial exposure. Consequent thereto, closing out of open positions has been contemplated. The relevant extract of the circular dated 19.5.1997 reads thus:
- G “..... Effect of violation of Intra-Day Turn Over Limit and Gross Exposure Limit.
- H Any violation of exposure limits will be treated as violation of the Bye Laws of the Clearing Corporation and will entail appropriate action under the Bye Laws and Rules of the Clearing Corporation.
- I In addition, and without prejudice to the foregoing, the Clearing

Corporation may, within such time as it may deem fit, advise the Exchange to withdraw any or all of the membership rights of the TM clearing member including the withdrawal of trading facilities without any notice. **In the event of withdrawal of trading facilities, the outstanding positions of the TM clearing member may be closed out forthwith or any time thereafter by the Exchange, at the discretion of the Clearing Corporation, to the extent possible**, by putting counter orders in respect of the outstanding position of the TM clearing member without any notice to the TM clearing member. ...”

(emphasis supplied)

41. Strictly speaking, the circular, as discussed above, triggers a closing out action upon fulfilment of two conditions:

- (i) exceeding the gross exposure limits while trading;
- (ii) failure to deposit additional capital within such time as may be granted by the Exchange/Clearing Corporation for continuance of trading.

42. It must be carefully noted that the nature of closing out prescribed in the circular does not envisage any failure in delivery or in payment to complete the settlement, unlike in clause 17. The conditions in the circular operate on a more basic level and are concerned essentially regarding the eligibility of a trading/clearing member venturing beyond the market exposure limits defined in the context of the advance security deposit. That is the condition and procedure prescribed from time to time by the relevant authority for dealing in securities by the member. For such non-compliance, the power ascribable in clause 18 may be attracted.

43. After venturing beyond such limits, it may very well be possible that such member is still in a position to deliver the securities or to make the payment (depending on buying or selling). For, merely venturing beyond the exposure limits does not *ipso facto* render a trading member incapable of completing the settlement. But the circular does not go that far and attacks the mischief of exceeding the pre-defined limits in a “reckless fashion”. That is to preserve the interests of the unwary investors. The very fact that a member has over-exposed itself in the market while trading is enough to give rise to the cause of action under the circular. The action of forthwith closing out is of an inchoate nature

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- A as it seeks to curb continued reckless transaction, before it unfolds fully and damages the sanctity of the market in an irreparable manner. Therefore, what is being done under the circular is not the same as what is being done under clause 17.

44. Clause 18, on the other hand, is of a residuary nature and confers on the relevant authority of the Exchange the power to close out certain positions on grounds not specified in clause 17. The relevant authority, under clause 18, is empowered to determine and prescribe the “manner”, “time frame” and “conditions and procedures” in accordance with which such closing out can take place. The key words used here are wide in scope and are targeted to enable the Exchange to act effectively and promptly according to the prevalent dynamic state of the market by prescribing manner, conditions, procedures and time frame for a closing out action. The mischief creators in a stock market operate in a myriad set of ways and one cannot pre-set or comprehend all possible methods of undermining the health of the market. Thus, residuary situations of closing out may emerge and clause 18 enables the Exchange to promptly act against such attempt. The provision is premised on necessity. By reading in any requirement of due date in clause 18, on the lines of clause 17, the court would be doing violence to the clear intent of the clauses and the broad scheme of the Byelaws. Clause 18, as the Tribunal observed, would be rendered nugatory. Even logically, by importing a fictional requirement of “due date” in clause 18, the Exchange cannot be expected to gloss over a clear case of excessive reckless trading and allow the mischief to continue until the due date has arrived. Thus, there is no occasion to control the scope of clause 18 by establishing a fictional link with clause 17.
- F 45. Be it noted that clause 18 does not specify the “mode” of prescribing the manner, time frame, conditions and procedures necessitating closing out. In the present case, the appellant violated the condition and procedure prescribed by the Exchange/Clearing Corporation vide subject circular. Thus, the manner of closing out contemplated in the circular is borne out by clause 18 and we do not find any conflict, as suggested. Apart from the circular, clause 16 of the Byelaws of the Clearing Corporation also provides for closing out *“on failure of a clearing member to comply with any of the provisions relating to delivery, payment and settlement of deals or on any failure to fulfil the terms and conditions subject to which the deal has been made”*.
- H Clause 16 reads thus:

“16. CLOSING OUT

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(1) A deal admitted for clearing and settlement may be closed out on failure of a clearing member to comply with any of the provisions relating to delivery, payment and settlement of deals or on any failure to fulfil the terms and conditions subject to which the deal has been made, or such other circumstances as the relevant authority may specify from time to time. The deal may be closed out by the Clearing Corporation in such manner, within such time frame and subject to such conditions and procedures as the relevant authority may prescribe from time to time.

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.46. The nature of action contemplated under clause 16 is in furtherance of the basic mandate laid down under Section 9 of the 1956 Act. For, section 9 of the Act clearly provides that all contracts/deals on the market are subject to the Byelaws (including Regulations, operational parameters etc. issued under the Byelaws) and Rules of the Exchange. One of the consequences of not acting in accordance with the Byelaws is provided under clause 16, apart from other provisions. Understood thus, this clause is yet another self-contained provision envisaging forthwith closing out, which goes on to show that forthwith closing out is not a new phenomenon in the overall scheme of things. We do not delve any deeper into the scope of clause 16, for that is not the question before us.

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47. To summarize, on a comprehensive view of the scheme of closing out under the Byelaws of the Exchange, Byelaws of the Clearing Corporation and the circular, we are of the view that an action of forthwith closing out is permissible under the said scheme, particularly clause 18, and thus, the circular is not *ultra vires* clauses 17 and 18 of the Byelaws. Rather, the circular furthers the spirit underlying clause 18.

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48. Let us now examine the third question i.e., whether the appellant was bound by the circular dated 19.05.1997.

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49. As we move forward, we note that the SEBI (Stock Brokers & Sub-Brokers) Regulations, 1992 were framed under Section 30 of the 1992 Act, with an objective to regulate the functioning of stock-brokers by prescribing certain conditions. Regulation 9 specifies that any registration granted by SEBI shall be subject to the conditions prescribed therein and reads thus:

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- A “9. Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely—
- (a) xxx xxx xxx
- (b) he shall abide by the Rules, Regulations and Byelaws of the stock exchange which are applicable to him;
- B ...”
- The same intent is advanced in Rule 9 of the Securities Contracts (Regulations) Rules, 1957 which reads:
- C “Contracts between members of recognised stock exchange.**
9. All contracts between the members of a recognised stock exchange shall be confirmed in writing and shall be enforced in accordance with the Rules and Byelaws of the stock exchange of which they are members.”
- D 50. A stock exchange is primarily engaged in three activities – buying, selling and dealing in securities. In order to give effect to these activities, the Exchange performs an array of operations of which clearing and settlement form an integral part. As per the Byelaws of the Exchange, the functions of clearing and settlement were transferred to the Clearing Corporation by the Exchange. Accordingly, the Clearing Corporation framed its own Byelaws, similar to the Byelaws of the Exchange, for conducting its operations. The appellant tendered an unconditional undertaking in favour of both the entities – NSE and NSCCL – stating that it shall abide by all the Rules, Regulations, Byelaws, circulars etc. of both the entities. The undertaking dated 19.3.1996 reads thus:
- F “....
- G 1. That we shall abide by, comply with and be bound by the Rules, Byelaws and Regulations of the Corporation as in existence or as modified/amended by the relevant authority, from time to time and also with any circular, order, direction, notice, instruction issued and as modified or amended from time to time by the relevant authority.”
- H 51. Notably, the undertaking given by the appellant to the respondents fell within the broad scheme of the Byelaws/Rules, and was a quint-essential requirement for obtaining registration as a stock

broker as both 1956 Act and Byelaws subjected the members to such conditions. Thus, the appellant is bound by the undertaking so given. Even otherwise, assuming the absence of undertaking, the very fact that a valid circular originated from the statutory scheme of the Byelaws is sufficient to bind the appellant with its provisions. Thus, the emergent legal position is that the appellant had subscribed to both statutory as well as contractual obligations with the respondents for functioning as a stock broker. Any deviation from the said circular could invite action under multiple provisions spreading across the Byelaws of the Exchange and Byelaws of the Clearing Corporation, in addition to the sanctions provided in the circular itself. Understood thus, we are of the view that the appellant is squarely bound by the circular and any breach of the same is to be viewed accordingly.

52. We have no hesitation in observing that the view taken by us is reinforced by the “Master Circular for Stock Brokers” issued by SEBI on 01.06.2018 bearing headnote that “*This Master Circular is a compilation of relevant circulars issued by SEBI, which are operational as on date of this circular*”. Annexure-4 of the Master Circular titled “*Rights and Obligations of Stock Brokers, Sub-Brokers and Clients*” reiterates the correct legal position under clause 2 thereof which provides that the stock brokers are bound by all the Rules, Byelaws and Regulations of the Exchange and ***circulars/notices issued in furtherance of such Byelaws and Rules***. The clause reads thus:

“2. The stock broker, sub-broker and the client shall be bound by all the Rules, Byelaws and Regulations of the Exchange **and circulars/notices issued thereunder and Rules and Regulations of SEBI** and relevant notifications of Government authorities as may be in force from time to time.”

(emphasis supplied)

53. We now advert to the question of expulsion.

54. In light of the above discussion, it is clear that the scheme of 1956 Act enables the Exchange to resort to suspension and expulsion of the members, in accordance with its approved Byelaws and Rules. Section 3(2) of the Act specifies certain matters that must be appropriately covered in the Byelaws or Rules. Clause (c) of the said sub-section expressly provides that matters of admission, qualification, exclusion,

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- A *suspension, expulsion* and re-admission of members must be covered in the Byelaws/Rules. It reads thus:

“3. Application for recognition of stock exchanges.

(1) xxx xxx xxx

- B (2) Every application under sub-section (1) shall contain such particulars as may be prescribed, and shall be accompanied by a copy of the byelaws of the stock exchange for the regulation and control of contracts and also a copy of the rules relating in general to the constitution of the stock exchange, and in particular, to –

C (a) xxx xxx xxx

(b) xxx xxx xxx

(c) the admission into the stock exchange of various classes of members, the qualifications for membership, and the exclusion, suspension, expulsion and readmission of

- D members therefrom or thereinto;

...”

- E 55. In 1992, SEBI issued letter No. SMD-I/11087/92 dated 04.11.1992 titled “Capital Adequacy Norms for Brokers” whereby the stock exchanges were directed to provide for norms relating to capital adequacy in their Byelaws. Apart from specifying certain requirements, the letter went on to state that *“the stock exchange shall continue to have the authority to impose suitable margins as per their judgment in the context of the market situation.”* Therefore, a stock exchange stood empowered not only to specify capital adequacy requirements for the trading members but also to take action against the defaulting members.

- F 56. Accordingly, for effectuating the mandate accorded upon the Exchange as per the Act, NSE Rules, 1994 and the abovesaid directive, it is obliged to deal with the subject of termination of membership on that basis. Rule 28 thereof provides that a trading membership can be terminated, apart from other ways, by expulsion in accordance with the provisions contained in the Byelaws, Rules and Regulations. Rules 31 and 32 of Chapter III are relevant operative provisions for our consideration which lay down various obligations for continued admittance of membership and read thus:

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"Failure to pay Charges

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(31) Save as otherwise provided in the Byelaws, Rules and Regulations of the Exchange if a member fails to pay his annual subscription, fees, charges or other monies which may be due by him to the Exchange or to the Clearing House within such time as the relevant authority may prescribe from time to time after notice in writing has been served upon him by the Exchange, he may be suspended by the relevant authority until he makes payment and if within a further period of fifteen days he fails to make such payment, he may be expelled by the relevant authority.

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Continued Admittance

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(32) The relevant authority shall from time to time prescribe conditions and requirements for continued admittance to trading membership which may, inter alia, include maintenance of minimum net worth and capital adequacy. The trading membership of any person who fails to meet these requirements shall be liable to be terminated.”

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57. The same regulatory intent is reflected in the Byelaws as well. Clause (1)(b) of Chapter-V of NSE Byelaws, 1997 (the operative Byelaws as regards the question of expulsion) empowers the relevant authority to “*specify prerequisites, conditions, formats and procedures for application for admission, termination, re-admission etc. of trading members*”. Furthermore, clause (1)(c) of the same chapter provides that the members desirous of admission or of continued admission may be asked to deposit fees/security deposit in lieu of the same. The clause reads thus:

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"Appointment and Fees

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(1) (a) xxx xxx xxx

 (b) xxx xxx xxx

 (c) Such fees, security deposit and other monies as are specified by the Board or relevant authority would be payable on appointment as trading member and for continued appointment thereof.”

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Consequence of failure to maintain the necessary deposits is addressed in Chapter XII of the Byelaws wherein clause (1) provides

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- A that such a member could be declared as a defaulter, which in itself is a ground for expulsion in the NSE Rules, 1994. The clause reads thus:

“(1) Declaration of Default

A trading member may be declared a defaulter by direction/circular/notification of the relevant authority of the trading segment if:

- B (a) he is unable to fulfil his obligations; or
...”
- C 58. A holistic view of the scheme expository above vividly reveals that the Exchange not only had the authority to specify various deposit related requirements but also had the power to expel a member in case of default. In the present case, it is not in dispute that the Interest Free Security Deposit to be maintained by the appellant actually fell short of the required margins during the relevant period. Therefore, we are neither
- D on question of existence of power to expel nor on the factum of whether or not the deposits fell short of the prescribed margins. What falls for our examination, here, is the sole question as to whether the obligation of the appellant to keep up with the adequacy of deposits continued despite the withdrawal of its trading facility. An affirmative answer would justify the expulsion.

- E 59. Be it noted that the relationship between a stock exchange and trading member runs across various levels. Admission to membership, continuation of membership, denial of trading facilities, imposition of fines, calling for additional deposits, suspension of membership and expulsion of membership are various facets of this relationship. Action against members is to be taken only upon violation of conditions and procedures therefor. It is a serious matter and resorted to only upon the fulfilment of conditions specified in the Byelaws, Rules, Regulations or even in operational parameters, as seen above. Notably, the conditions required for withdrawing the trading facility are distinguishable from the conditions required for suspension/expulsion of membership. Under the relevant provisions, withdrawal could take place upon a standalone violation of certain operational parameters on a given trading day (like exceeding the exposure limits as in the present case). Whereas, expulsion would take place upon a sustained violation of membership obligations (like failure to maintain the base capital and also for failure to replenish the prescribed amount) within the time frame specified therefor. The two

actions vary not only in their texture, but also in their resultant effect. A
Withdrawal, for instance, does not extinguish the membership. It acts
like a halt for indulging in further trading activity.

60. To say that mere withdrawal of trading facility would *ipso facto* absolve a trading member from keeping up with other obligations towards the Exchange for continuation of membership would result into an anomalous situation. It would amount to the diffusion of one stage of the relationship with the other, and would become a concocted way to extend benefit for its own wrong to a defaulting member. Such a consequence could not be intended to result from an action of withdrawal of trading facility. For, the withdrawal of trading facility is a temporary or interim action which is taken against an erring member to prevent him from continuing on a mischievous path during the trading hours and to take corrective steps forthwith. The nature of this action is preventive and the provisions governing this action provide for certain remedial acts, like depositing additional sums to increase the exposure limits, the performance of which can help a member in resuming his trading operations. The obligations for continued admission as a member are entirely different and merely because trading has been halted due to a member's own default, it does not result in a hiatus situation or extricate him from membership obligations. If that were to be the case, there was no need for the Byelaws to provide these actions separately.

61. Pertinently, the capital adequacy norms, as discussed above, are meant both for admission as a member and for continuation as a member. Even the language of the governing provision i.e. Rule 32, signifies that requirements relating to capital adequacy are meant for "*continued admittance to trading membership*" and thus, the mandatory obligations would continue, as long as membership is formally continued. Despite the temporary action of withdrawal of trading facility, a member continues to be a member of the Exchange with all corresponding rights and obligations intact on both sides. A member can always resign from the membership of the Exchange and move out of all fiscal obligations after settling his dues, but as long as he opts to retain his membership of the Exchange, there is nothing in the governing provisions to support the view that withdrawal of trading would automatically extricate the defaulting member from his obligation regarding annual charges and margin requirements, as the case may be. The timely fulfilment of these requirements has been envisaged in the Byelaws as a

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- A pre-condition for admission or *continued admission* in the Exchange. Despite closer examination of the Byelaws, Rules and Regulations of the Exchange, we could not find anything to support a contrary view. The continuation of membership and fulfilment of capital adequacy norms run co-terminously with each other, and failure to comply with the latter would automatically put the former in jeopardy.
- B 62. Having observed that the appellant failed to maintain the requisite membership margins with the Exchange for a long period and refused to make up for the shortfalls when called upon to do so by the Exchange, there is nothing to deviate from the view taken by the Tribunal
- C that the appellant acted in contravention of the Byelaws and Rules of the Exchange necessitating unto termination. The actions taken by the Exchange, thus, were in accordance with the law.
- D 63. Schedule-II of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 prescribes a “Code of Conduct” for the stock brokers and clause 5 thereof specifies that compliance with statutory requirements is a mandatory aspect of code of conduct of a stock broker. The appellant consistently failed to comply with the requirements and acted in a manner which was prejudicial to the sanctity of a Member-Exchange relationship.
- E 64. To conclude, we hold that the Tribunal rightly confirmed the order of expulsion and we uphold the same.
- F **CIVIL APPEAL NO. 9571 OF 2019**
65. The seminal question involved in this appeal is about the mode of dealing with withheld securities of a defaulting member by NSE/NSCCL, consequent to his expulsion. The cause espoused in this appeal is in the backdrop of the decision of withdrawal of trading facilities of the appellant dated 13.10.1997, followed by withholding of various securities by the Exchange, purportedly belonging to the appellant. Concededly, there was no immediate challenge by the appellant against this decision of withholding of securities. It was only in Appeal No. 84 of 2008 filed before the Tribunal on 05.05.2008, the appellant had made
- G grievance about the non-return of stated withheld securities.
- H 66. Thereafter, further communication ensued between the parties as regards the withholding of securities. On 20.10.2008, representatives of the appellant were permitted by the respondent Exchange to inspect the physical records of securities at the premises of the Exchange and

as reflected in the records, such inspection did take place. However, no legal action was initiated by the appellant after this event for securing the release of the stated securities. The appellant, after a gap of almost six years, called upon the Exchange vide letter dated 21.02.2014 to return the withheld securities. It was done purportedly to prevent the flow of corporate benefits on those securities to third parties in whose name the securities stood registered in the books of the companies. Similar communications were sent on 04.04.2014 and 03.05.2014 to NSE and SEBI respectively.

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67. The appellant then approached the Securities Appellate Tribunal in Appeal No. 238 of 2014 praying for the release of withheld securities. On 09.09.2014, the counsel for the Exchange proposed to hear the appellant as regards the question of withheld securities and accordingly, the Tribunal relegated the parties before NSE for passing a reasoned order on the said question. The Defaulter's Committee of the Exchange heard the appellant and passed an elaborate order dated 04.12.2014 justifying the withholding of securities. This order was finally challenged by the appellant before the Tribunal on 17.01.2015 in Appeal No. 118 of 2015. The challenge was turned down by the Tribunal vide order dated 04.06.2019 (impugned order).

68. To understand the present challenge, it is apposite to note that the Tribunal decided the appeal on a narrow question which finds mention in para 5 of the impugned judgment as:

“5. The basic question raised in this appeal therefore is whether the respondent NSE is legally entitled to withhold the securities of the appellant who has been suspended/expelled with effect from 2005/2006.”

69. The Tribunal, after advertizing to the relevant provisions, in para 8, opined that the stated issue had been and stands answered in Appeal No. 84 of 2008, wherein the order of expulsion was upheld. The Tribunal then went on to answer the question on merits and observed thus:

“9. In any case dehors this ground of multiple litigations, on merit we find that the question of dues owed by the appellant to NSE and NSCCL has been communicated to the appellant multiple times giving calculations etc. The appellant has never questioned the calculations except stating that sufficient funds were available with the respondent in October 1997 which could have been

- A utilized towards settlement obligation. However, given the trajectory of the legal recourse resorted to by the appellant and thereby limiting the powers of the respondent in utilizing those deposits, this contention that the respondent could have utilized the money available does not stand any merit ...”
- B Subsequent to this observation, the Tribunal determined the total liability of the appellant towards the respondents (Exchange) and arrived at a final figure of Rs.2.41 crores. It further stated that the respondents were well within their rights to withhold the securities and realise the amount owed to them. The relevant extract of the impugned order in this regard reads thus:
- C “12. After carefully perusing the documents and the submissions made by the parties we have no doubt that the appellant owe an amount of Rs.2.41 crore to respondent NSE/NSCCL. Since the appellant is not ready to give this amount Respondent no. 1, is well within its rights to use the securities of the appellant withheld by them, to the tune of Rs.2.41 crore. Such calculations should also include corporate benefits such as bonus, dividends etc. if any accrued to NSE over the period as beneficial owner of the withheld securities. Needless to say that if any excess value is received or if the amount of Rs.2.41 crore is received by disposing of part of the securities withheld either the excess value or the remaining securities or both shall be returned to the appellant within one month from the date of this order.”
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- F 70. While assailing the order of the Tribunal before this Court, the appellant has primarily contended that the Tribunal misled itself by answering whether the respondents could have withheld the securities of a defaulting member, whereas, the real question was whether such securities could have been withheld despite the respondents being in possession of deposits equivalent to an amount exceeding the claim of the respondents and also whether such securities could have been withheld without getting them registered in the name of the respondents.
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- H 71. It is the case of the appellant that on the relevant date, the alleged amount due from the appellant stood at Rs.1.32 crore and the amount of deposits retained by the respondents was around Rs.1.34 crore and since the security deposit already exceeded the amount due, there was no occasion for the respondents to withhold the securities in order to realise any amount over and above the stated liability.

72. The thrust of the appellant's challenge is that as and when securities of the defaulting member are withheld by the Exchange, the Exchange being trustee thereof is under an obligation to get such securities registered in its name so as to prevent third parties from unduly deriving the corporate benefits (bonus, rights issues, dividends etc.) thereon, as and when they may accrue. It is the case of the appellant that in the present case, the Exchange merely sat over the withheld securities without further dealing with them in any manner whatsoever and for its inaction the appellant cannot be made to suffer.

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73. Though not addressed by the Tribunal in the impugned judgment, the appellant had also raised a question as regards the applicability of Rule 20(f) of Chapter IV of the NSE Rules as the said rule came into effect from July, 2001 onwards. According to the appellant, since the original decision of withdrawal of trading facilities was taken in 1997, the said rule could not be applied to the appellant. Be it noted that the said rule permits the application of Chapter XII- "Defaults" of NSE Byelaws enabling realisation of withheld assets of the expelled member.

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74. Per contra, the respondents would contend that it was not open to them to use the deposits worth Rs.1.34 crore to settle the dues owed by the appellant for the reason that the appellant had initiated a bunch of legal proceedings at various forums across the country from 1997 to 2006. Resultantly, the securities had to be withheld as per the rules in order to secure the liability and because the appellant had failed to meet its settlement obligations. It was not because of his expulsion as such. Further, such withholding was in tune with the Regulations of NSE and NSCCL and with the circular dated 19.05.1997.

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75. Responding to the appellant's contention regarding the appropriate manner of dealing with the withheld securities, the respondents have extensively relied upon Regulation 9.12 of NSE (Capital Market) Regulations whereby they are empowered to deal with the withheld securities at such times and in such manner as they may deem fit. Placing reliance upon the bare language of the Regulation, it has been submitted that "such manner" of dealing may include appropriating the withheld securities for the discharge of outstanding obligations, closing out the withheld securities or registering such securities in the name of the respondent or any other entity as the case may be. In other words, the manner of dealing by the respondents cannot be constricted.

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- A 76. The respondents would submit that upon expulsion of a member, the Exchange is well within its rights to realize the withheld securities in fulfilment of the obligations of defaulting member in accordance with Rule 20(f) of Chapter IV of NSE Rules which specifies the consequences of expulsion. It is further urged that Rule 20(f) became operative on 29.06.2000 whereas the appellant was expelled on 05.01.2006 and thus, the said rule was applicable to the case of appellant.

- B 77. An objection has also been raised by the respondents as regards the maintainability of the original appeal before the Tribunal. It has been urged that the appeal was barred by the principles underlying Order II Rule 2 of Code of Civil Procedure, 1908⁷ and/or *res judicata* as the same issue was raised and not pressed/rejected before the Tribunal in Appeal No. 84 of 2008.

- C 78. Before we proceed, we hasten to note that the real issue is not about the existence of power and authority of the respondents to withhold the securities or other assets of a trading/clearing member in cases of default. That is not disputed even by the appellant. Thus, our examination revolves essentially around the mode of dealing with the withheld securities. Having gone through the impugned judgment, submissions of the parties and documents on record, we are of the view that the following questions emerge for our consideration in this appeal:

- D E (i) Whether the respondents are obliged to forthwith realise the withheld securities and appropriate the sale proceeds towards the dues payable by the appellant in terms of Rule 20(f) of Chapter IV of NSE Rules read with Chapter XII on “Defaults”?
- F (ii) As a consequence of withholding of securities of a defaulting member, whether the respondents are under a legal obligation to deal therewith as a prudent person and more so as a “trustee”, and in discharge of fiduciary trust/responsibility are obliged to get the same registered with a view to protect the financial interests of the defaulting member and persons claiming through him?

- G 79. Before answering the questions of law on merits, it falls upon us to briefly examine the maintainability of the original appeal before the

H ⁷ for short, “the 1908 Code”

Tribunal for relief relating to withheld securities. Notably, in previous appeal registered as Appeal No. 84 of 2008, apart from challenging the expulsion of membership, the appellant had also prayed for the release of withheld securities. The prayer reads thus:

“(d) that the securities due to the Appellant and its constituents and now retained by the first and second Respondents may be paid out/return to the Appellant.”

It seems that the said relief was not pursued by the appellant before the Tribunal in right earnest or taken to its logical end. For, what is clear is that the afore-quoted relief prayed in the previous appeal whilst questioning the expulsion, was not answered/granted by the Tribunal. Either way, the legal consequence is that the second round of proceedings for the same relief would not be maintainable. If the relief was prayed for and given up during the course of the appeal without seeking leave for agitating it at a later stage, the principle underlying Order II Rule 2 of the 1908 Code may be attracted. Alternatively, if the prayer was duly pursued before the Tribunal in the previous appeal but not granted, in law, it would deem to be refused. In which case, the principle of constructive *res judicata* would act as a legal bar in the subsequent proceedings for that very relief. We do not wish to dilate on this aspect as no such plea was raised by the respondents in the stated proceedings in 2014. Rather, that appeal was allowed and claim regarding withheld securities was relegated to the Defaulter’s Committee. That remand order was acted upon by all concerned and against which the present appeal arises before us.

80. The appellant would then contend that cause of action accrued only after the Defaulter’s Committee’s order dated 04.12.2014, justifying the withholding of securities. This plea is *ex facie* untenable. The said order of the Defaulter’s Committee did not result in the withholding of securities. It merely supplied reasons and justification for such withholding. The cause of action, if at all any, had arisen to the appellant from the moment their securities were withheld in 1997. Merely because a subsequent order is passed to justify a prior action, it cannot be a case of accrual of fresh cause of action to the aggrieved.

81. Be that as it may, we forbear from non-suiting the appellant on this technical objection, but as aforesaid, in the peculiar facts of this case, we deem it appropriate to examine the subject matter on merits.

- A As per the general scheme of regulation of a trading/clearing member, it is settled position that a member whose membership has been terminated or who has been expelled is not absolved from fulfilling his contractual or other obligations in any manner. Rule 8(2) of Chapter IV and Rule 18(4) of Chapter V of NSCCL Rules textualize this position. Rule 8(2), for instance, reads thus:
- B “8. TERMINATION OF MEMBERSHIP
- (1) xxx xxx xxx
- (2) The termination of Clearing Membership shall not in any way absolve the Clearing Member from any obligations and liabilities incurred by the Clearing Member prior to such termination.”
- C 82. In the factual scheme of the present case, the foremost thing to be noted is that there are two sets of assets in control of the respondents – *first*, security deposits and *second*, withheld securities. The security deposits came to be deposited on account of membership obligations and the securities were withheld on account of failure to complete settlements. Though the challenge is limited to withheld securities, the provisions relating to such securities address both these categories of assets collectively and thus, they are being discussed accordingly for a comprehensive view of their scope and operation.
- D 83. As per clause (11) of Chapter XII of the NSE Byelaws titled “Default”, the Exchange is vested with the power to realise the assets of a defaulter member in due course. Clause (23) complements this action and provides for the order of priority for satisfying the claims.
- E Clause (11) reads thus:
- “Vesting of assets in the Exchange
- (11) The Defaulters’ Committee shall call in and realise the security deposits in any form, margin money, other amounts lying to the credit of and securities deposited by the defaulter and recover all moneys, securities and other assets due, payable or deliverable to the defaulter by any other Trading Member in respect of any transaction or dealing made subject to the Bye-laws, Rules and Regulations of the Exchange **and such assets shall vest ipso facto, on declaration of any trading member as a defaulter, in the Exchange for the benefit of and on account of any dues**
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of the Exchange, National Securities Clearing Corporation Limited, Securities and Exchange Board of India, other trading members, Constituents and registered sub-brokers of the defaulter, approved banks and any other persons as may be approved by the Defaulters' Committee and other recognised stock exchanges.”

(emphasis supplied) B

It is noted that clause (11) provides for realisation of three categories of assets:

- (i) security deposits, margin moneys and other deposits;
- (ii) securities which have been deposited by the defaulter member; and
- (iii) moneys, securities and other assets due, payable or deliverable to the defaulter by any other Trading Member and recovered by the Exchange.

Pertinently, different kinds of assets are subject to a different procedure of realisation. After examining what all can be realised under clause (11), we may now understand the modalities of realisation.

Realisation of security deposits

84. Out of the three categories covered under clause (11), security deposits can be called in and realised *per se* without any additional condition. There is no requirement of vesting with respect to such deposits neither in the language of clause (11) nor in the overall scheme. It is so because the Exchange enjoys a statutory lien over such deposits by way of clause (24) of Chapter IX - “Transactions and Settlements”, NSE Byelaws which categorically provides that the Exchange has a first and paramount lien over the monies, bank deposits and other securities deposited by the trading member for any sum due to the Exchange. It reads thus:

“Lien on Margins”

(24) The monies, Bank Deposit Receipts and other securities and assets deposited by a trading member by way of margin under the provisions of these Bye Laws and Regulations shall be subject to a first and paramount lien for any sum due to the Exchange. Subject to the above, the margin shall be available in preference to all other claims of the trading member for the due fulfilment of

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- A its engagements, obligations and liabilities arising out of or incidental to any bargains, dealings, transactions and contracts made subject to the Bye Laws, Rules and Regulations of the Exchange or anything done in pursuance thereof.”

- Be it noted that it covers only those assets which are voluntarily deposited by the member with the Exchange. Forfeited/withheld assets are not included herein. It is so because the property in the deposited assets may vest in the Exchange by operation of membership obligations, whereas such is not the case with withheld securities. It is true that mere existence of lien may not entitle the licensee to sell off the property for satisfaction of debt without a court order. However, the same principle is not absolute and the cases in which the statutory/contractual scheme itself provides for such sale/realisation fall outside its purview. It is settled that when lien itself is a creation of Byelaws, Rules or Regulations etc., the scope, extent and operation of such lien would also be governed by the same scheme. In *Unity Company Private Ltd. vs. Diamond Sugar Mills and Ors.*⁸, it was observed thus:

- “74. The lien in the instant case has been created by the agreement contained in the Articles of Association of the defendant company. The nature, extent, scope and effect of the lien will, therefore, have to be determined with reference to the Articles of the Company. While discussing Issue No. 2, I have earlier held that the lien created by the Articles in the instant case, cannot be equated to a mere equitable charge and the lien is wider in its extent, scope and effect. Express and specific power has been conferred on the company by Article 36 to sell the shares in enforcement of the lien and by Article 37, to apply the sale proceeds in satisfaction of the debt. The Articles, to my mind, clearly and unequivocally express the intention that the company, by itself, is competent to enforce the lien by sale of the shares which are subject to such lien and to apply the sale proceeds in satisfaction of the debt or loan without recourse to an action in a Court of Law for enforcement of the lien. ...”

Therefore, if provisions provide for realisation of such lien property, the same may be given effect to in accordance with the provisions. No external conditions can be read in such a scheme. Clause (11) expressly

H ⁸ AIR 1971 Cal 18

provides for realisation of security deposits as and when a member becomes subject to the provisions relating to defaulters. The phrase "*shall call in and realise*" signifies that realisation is warranted as an imminent action upon declaration of defaulter in case the security deposits are insufficient. The effect of this phrase is that once a trading member has been declared a defaulter, the Exchange is duty bound to realise the security deposits retained by it to satisfy its obligations and return the remaining deposits, if any. If the Exchange fails to do so, it may become liable to make good the loss of interest to the defaulter on any amount over and above the monetary obligation.

85. However, in the present case, no fault can be found in the conduct of the Exchange as it had actually realised the deposits at various points of time owing to the inability of the appellant to keep up with the statutory margin requirements. As reflected in the records, out of the total deposit of Rs.1.34 crores, amounts equivalent to Rs.91,72,163.49 and Rs.41,00,000 had already stood adjusted in favour of NSCCL and NSE respectively from 1997 to 2006. Thus, a total of Rs.1,32,72,163.49 was in fact realised by the Exchange and it holds no merit to state that the Exchange failed to perform its duty to realise the security deposits. The amount of Rs.1.34 crores came to be added to the total obligation again in 2017 when the Exchange returned the security deposit amount pursuant to an order of this court passed at the insistence of the appellant herein and thus, in law, that cannot be held against the Exchange in any manner.

Withheld securities

86. Unlike the money deposits, no legal requirement of forthwith realisation is envisaged in the case of withheld securities, as discussed hitherto. To understand the procedure of vesting and realisation of withheld securities, it is essential to segregate the two kinds of securities and analyse it appropriately. The withheld securities can be categorised as – securities in which the appellant was a receiving member (*receiving securities*) and securities in which the appellant was an introducing member (*introductory securities*). A member is termed as a receiving member when it is supposed to receive the securities for orders placed by it in a purchase transaction, subject to complete settlement and payment. NSCCL Byelaws define a receiving member as:

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A “13. RECEIVING MEMBER

“Receiving Member” means a clearing member who has to receive or has received documents in fulfilment of contracts to which these rules, byelaws and regulations apply unless the context indicates otherwise.””

- B Whereas, a member is termed as an introducing member when it introduces some securities to be transferred to the buyers in a sale transaction, subject to the securities being free from any objections.

87. During the trading period from 24.09.1997 to 30.09.1997, the appellant defaulted in Settlement No. N1997039 and delivered short of payment in lieu of securities for which purchase orders were placed. An amount of Rs.45,56,513 became due. Thereafter, during the trading period from 01.10.1997 to 14.10.1997, an amount of Rs.29.10 lakhs became due as margins for trading on 01.10.1997 in Settlement No. N1997040. In both these transactions the appellant was a “receiving member”. On account of failure of appellant to complete the aforesaid settlements by making complete payment, the Exchange withheld the pay-outs of securities at various points of time.

88. The remaining securities were withheld wherein appellant was acting as an “introducing member” in the market. The companies refused to complete the sale transactions initiated by the appellant and to register the said securities in the names of the purchasers citing some unresolved objections on the said securities. Resultantly, they were returned back to the Exchange and it became a case of bad delivery. As per the standard procedure in force at the relevant point of time, the Exchange participated in an auction in open market to procure the required securities free from objections so as to complete the purchase orders. Therefore, the objected securities were withheld by the Exchange as a lien on the money paid by it in the auction purchase. SEBI circular dated 16.07.1996 titled “*Uniform Norms for Good/Bad Deliveries*” specifies this procedure. The relevant extract thereof reads thus:

- G “iii) All stock exchanges shall adhere to the following time schedule for dealing with the cases of bad deliveries.
 a) **In case of deliveries coming under objection (objection cases), the first introducing broker of the same stock exchange shall be required to rectify the defects/replace**

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the shares alongwith accrued benefits within 21 calendar days from the date of receipt of the objection and share certificates from the last buying broker of that exchange. If the former fails to rectify the defects or replace the shares or transfer deeds, the exchange shall hold an auction for shares in the immediately following Auction Session according to the usual exchange procedure. The shares obtained from such an auction shall be given by the Exchange to the concerned buying broker. Further, the exchange shall debit the price of the shares to the account of the introducing broker of that Exchange. In case the shares are not available through auction, the exchange shall close out the transaction according to the procedure of the exchange and the close out amount shall be debited to the first introducing broker and credited to the last buying broker of the exchange.”

(emphasis supplied)

89. As regards the introductory securities, it must be noted at the very outset that these securities fall outside the purview of our examination on vesting. For, they simply could not have been realised by the Exchange at any point of time as they were merely introduced by the appellant and did not belong to it. These introductory securities were registered in the names of third persons who are not parties to this proceeding. Concededly, there could have been no loss to the appellant relating to corporate benefits on these securities as it did not have any right therein, to receive any such benefit. Property in those securities neither vested in the appellant nor in the Exchange and they were held by the Exchange only as a lien on the physical copies of shares to the limited extent of obliging the appellant to fulfil its obligations. The benefits on those securities remained in third parties, as they must have, and no one has approached this court to raise the grievance that they have suffered any wrongful loss as regards those benefits. Even if any grievance exists between two clearing members as regards the receipt or non-receipt of those benefits, the best course of action would have been to proceed by way of a separate proceeding in that regard. Clause (11) of Chapter VI, NSCCL Byelaws categorically provides for a privity of contract between delivering and receiving clearing members. The interests of those third parties are not a part of the present *lis*.

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- A 90. Indisputably, the introductory securities have been marked as objectionable by the companies; and securities with outstanding objections are of no use to the Exchange for the purpose of recovery so long as such objections are not removed. The introductory securities fall outside the purview of the vesting provision. Further, the responsibility of the Exchange was limited to providing the appellant an opportunity to remove the objections and continue withholding the securities in the interim. Any enquiry regarding the legality or illegality of objections could have taken place between the introducing member and the respective companies. The same also cannot form a part of the subject matter before us.
- C 91. Therefore, actual recovery qua the appellant/defaulting member could only be made from the “receiving securities” as those securities were due/deliverable to the appellant and were withheld as a collateral for the sole reason of non-payment. No third-party stake is involved therein.
- D 92. Be that as it may, unlike money deposits, the “receiving securities” withheld or recovered by the respondents require legal vesting before they could be realised for the satisfaction of dues. Here, it may be useful to advert to clause (11). The question is, what procedure ought to be followed for realisation of “receiving securities”. Is it forthwith realisation, or only upon its vesting in law?
- E 93. The provisions relating to withholding and vesting of securities are provided in two separate documents. Whereas vesting is provided under Chapter-XII of NSE Byelaws titled “Default”, withholding is provided under Chapter 9 of NSCCL Regulations titled “Non-Delivery and Non-Payment”. It falls upon us to harmonise the two sets of provisions in order to understand the procedure in a holistic manner.
- F 94. Regulation 9.5 provides that when a clearing member fails to pay for securities on pay-in day, the Clearing Corporation is entitled to withhold the securities thus: -
- “9.5 Securities On Hold Or Selling-Out On Failure To Pay**
- G If a CM clearing member fails to pay on pay-in day for the securities to be received by him, the Clearing Corporation shall be, without further notice or intimation to the member, entitled to withhold the securities due to the member or sell-out any/all of
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such securities in accordance with the Bye Laws and Regulations A relating to closing-out.”

The above provision also enables the Corporation to sell-out such withheld securities to recover their dues in accordance with the following provisions. Thereafter, Regulation 9.6 provides that failure to make payment empowers the Corporation to declare such member as defaulter. B It reads thus:

“9.6 Declaration Of Default

A CM clearing member failing to deliver the documents due from him or pay the amount due by him may be declared a defaulter as provided in these Byelaws and Regulations.” C

It is crucial to note that declaration of defaulter upon non-payment is not an express pre-requisite for the recovery of dues here. Regulation 9.7 provides that all deliveries of securities which were due to the defaulter shall be handed over to the Clearing Corporation so as to enable it to realise their dues from those deliverable securities. D It reads thus:

“9.7 Deliveries Due To The Defaulter

All deliveries, deliveries or otherwise, and payment due to the defaulter shall be handed over to the Clearing Corporation. The Clearing Corporation shall reserve the right to dispose of the securities to make good non-payment of funds or non-delivery of securities by the defaulting member in such manner it deems necessary.” E

Upon receipt of securities as per this Regulation, the action of withholding is contemplated in Regulation 9.9 (Regulation 9.11 in NSE Regulations). In the present case, it is seen that securities deliverable to the appellant as a receiving member were withheld by the respondents to clear their dues. F

95. On withholding, the stage of vesting comes in and this stage is important as vesting is a pre-requisite for dealing with the securities in any manner. There can be no action, be it of sale or registration, against a property unless the property vests in the entity. “*Nemo dat quod non habet*” is the fundamental principle of transfer of property which, if literally translated, means “*no one gives what they do not have*”. G

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- A Thus, unlike money deposits, withheld securities cannot be realised without legal vesting under clause (11).

96. We may now discuss the time/stage of vesting. Though the requirement of declaration as defaulter may be a discretionary one under the NSCCL Regulations, the same is a mandatory requirement for vesting in clause (11). For, vesting takes place upon declaration of any trading member as a defaulter. The expression "*and such assets shall vest ipso facto, on declaration of any trading member as a defaulter*" reinforces the view. Even otherwise, the main vesting provision is included in the chapter on defaults and therefore, such declaration is necessary unless otherwise excluded. Therefore, the right of the Corporation to dispose of or realise these securities is circumscribed by the requirement of declaring such member as a defaulter. In this case, no such declaration came to be made. However, despite the absence of any such declaration, vesting took place by way of Rule 20(f) in Chapter IV of NSE Rules.

97. Rule 20(f) does away with the requirement of express declaration of defaulter upon expulsion. It specifies that Chapter XII on defaults would automatically become applicable upon a member expelled from the Exchange. As per this Rule, declaration of defaulter runs synonymous with the expulsion of a member. It reads thus:

- E "Consequences of Expulsion"
- F 20. The expulsion of a trading member shall have the following consequence, namely:
- | | | | |
|-----------|-----|-----|-----|
| (a) – (e) | xxx | xxx | xxx |
|-----------|-----|-----|-----|
- (f) Consequences of declaration of defaulter to follow: The provisions of Chapter XII and Chapter XIII of the Byelaws pertaining to default and Protection Fund respectively, shall become applicable to the Trading Member expelled from the Exchange as if such Trading Member has been declared a defaulter."
- G The emergent position of law, therefore, is that vesting does not take place in favour of the respondent Exchange unless a formal expulsion order is passed. The relevant point of time, therefore, is the date of expulsion. Without such legal vesting, the Exchange only sits upon the withheld assets as a custodian. There is no question of realisation. Such withholding is done to serve two purposes – *first*, to persuade the
- H

defaulting member to fulfil its obligations during the continuation of membership if it so wishes and *second*, to secure the liability at the earliest available opportunity as a preventive measure. If liabilities continue to be unfulfilled, expulsion becomes an inevitable consequence and the withheld assets vest in the Exchange.

98. It is thus clear that realisation cannot be done unless vesting is complete and there is no obligation on the Exchange/Corporation to forthwith realise the securities upon withholding. Expulsion or declaration of defaulter, as the case may be, is a pre-condition for realisation, which, in this case, took place only in 2006. Even on applying rule of prudence, such forthwith realisation would not be appropriate as such action would deprive the defaulting member from an opportunity to correct its mistake by settling liabilities within due course of time without giving up membership.

99. Before proceeding further, we may note that a question has been raised by the appellant regarding the applicability of Rule 20(f) in this case. For, the Rule was not in existence when trading facility of the appellant was withdrawn. This plea, in our opinion, is misconceived. In that, the Rule clearly signifies that it applies to expelled members and the moment a member is expelled from membership, this rule will automatically become operative. Literally understood, the relevant point of time for checking the applicability of this rule is the “date of expulsion”. In the instant case, expulsion of the appellant took place in 2006, whereas the said rule was inserted beforehand in 2001. Thus, the rule was very much in force when the appellant was in fact expelled. Consequently, the respondents were well within their powers to realise the withheld securities in accordance with clause (11) soon after expulsion in 2006.

100. We now deal with the issue regarding the manner of dealing with withheld securities and requirement of registration. Upon withholding followed by vesting, the manner of dealing is provided under Regulation 9.10, NSCCL Regulations (Regulation 9.12, NSE Regulations), which reads as:

“9.10. Withheld Securities and Funds – How dealt with:

The securities and funds withheld pursuant to regulation 9.9 and regulation 9.9A above shall be dealt with the relevant authority at such times and in such manner as it may deem fit, which may include appropriating the withheld funds for the purpose of fulfilling

- A the obligations of the clearing member, **closing out of the withheld securities or registering the withheld securities in the name of the Clearing Corporation or any other entity** as decided by the Clearing Corporation. The funds received out of closing out of withheld or registered securities may be dealt with by the Clearing Corporation at such time and in such manner as it may deem fit.”
- B

(emphasis supplied)

- This Regulation predicates that the Clearing Corporation is armoured with a set of measures as regards the withheld securities. The
- C first part of the Regulation vests the Corporation with the power to deal with the securities at “*such times*” and in “*such manner*” as it may deem fit. The Regulation then specifies certain measures which may include:

- D
 - a. closing out the withheld securities in the name of Exchange or any other entity; or
 - b. registering the withheld securities in the name of Exchange or any other entity;

- Thereafter, in the concluding sentence it is further specified that the funds received out of closing out of withheld or registered securities
- E may also be dealt with in such manner and at such times as the Exchange may deem fit.

101. It is therefore clear that the respondents had two courses of action open for dealing with the securities – *closing out* and *registration*. Chapter 10 of NSCCL Regulations titled “Closing out of Contracts”
- F delineates the manner of closing out. Regulation 10.6 provides that once a member is declared defaulter, the Corporation “shall determine” all outstanding deals by closing-out against the defaulter member. It reads thus:

G “10.6 Closing-Out Contracts With Defaulter CM clearing member

If a CM clearing member be declared a defaulter, the Clearing Corporation shall determine all outstanding deals by closing-out against him in accordance with the Bye Laws and Regulations relating to default.”

- H

102. Thus, the Corporation is duty bound to close out all outstanding deals against the defaulter and “determine” them for the purpose of its recovery. Regulation 10.9 specifies the manner of such determination and reads thus: A

“10.9 Closing-Out How Effected

Closing out shall be effected against the CM clearing member by the Clearing Corporation in any of the following manners: B

- (a) by buying-in or selling-out against the CM clearing member through an auction initiated by the Clearing Corporation C
- (b) by declaring a closing-out at such prices as may be decided by the relevant authority
- (c) by buying-in or selling-out against the CM clearing member by placing order in the specified exchange
- (d) in any other manner as the relevant authority may decide D from time to time.”

The Corporation is empowered with a set of methods to close out the outstanding deals against the appellant. Upon vesting, it could have sold out the withheld securities through an auction or by placing an order of sale in Exchange or in any other permissible manner. E

103. The other action contemplated in Regulation 9.10 is of registration. The grievance is that the Exchange held on to the securities without registration. According to the appellant, it was abuse of discretionary powers and the respondents ought to have registered the securities in its name forthwith. F

104. To determine the requirement of registration, we need to resort to a true construction of Regulation 9.10. Once an action of withholding is taken, multiple interests come into play and both the parties assume different roles as regards the withheld securities. We proceed to examine these roles separately – *role of Exchange* and *role of defaulting member*. Any further action relating to such securities would depend upon the fulfilment of these roles, as we shall see. G

Role of Exchange

105. It is trite to note that the primary role of the Exchange is manifested in the phrase “*shall be dealt with by the relevant authority* H

- A *at such times and in such manner*". That takes within its ambit a power coupled with a duty. The power of the Exchange to deal with the withheld securities in the manner of its choice runs parallel with its duty to mandatorily "deal" with such securities as a prudent person would after coming in possession of securities. The usage of the word "shall" before the word "dealt" is conscious and instructive here, and its vigour cannot be toned down in a light manner. In other words, the Regulation requires the Exchange not to sit idle on the withheld securities and instead, obliges it "*to deal*" with them in an appropriate manner. This requirement is a manifestation of the basic "duty of care" implicit in regulatory relationships where one member is in a position to control the functionality of the other. The *raison d'être* underlying this duty is to protect the interests of a member and to prevent any undue damage to its interests as a crucial element of the market. No doubt, such dealing could be in any of the manners specified in the Regulation or even in any other unspecified manner, but to say that the respondents could sit idle on the withheld securities of an amount exceeding the amount owed by the defaulting member, without protecting them from being exploited by third parties in any manner, would be akin to permitting a free abuse of this provision.

106. The role of the Exchange is broadly premised on the principle analogous to fiduciary relationship. Propriety guides that when one party holds some property on behalf of the other, even for the fulfilment of any liability, it must treat the property in a manner in which a prudent person would. It is so because the property is not directly in dispute between the parties, rather, what is in dispute is an outstanding liability for the discharge of which the property is being held as a mere security. Ordinarily, the sanctity of such security needs to be preserved. An implied element of trust is involved in any action of withholding, which is the basic foundation of a fiduciary relationship. In **Robert L. Hodgkinson v. David L. Simms**⁹, the Supreme Court of Canada referred to **Frame v. Smith**¹⁰ wherein three basic characteristics of fiduciary relationship were laid down thus:

- G "In Frame v. Smith [1987] 2 SCR 99 at p. 136, Wilson J. defined the characteristics of a fiduciary relationship as follows:

"Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:

⁹ [1994] 3 SCR 377

H ¹⁰ [1987] 2 SCR 99

- (1) The fiduciary has scope for the exercise of some discretion or power. A
- (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests. B
- (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power."''' C

In the present case, it is clear that the manner of dealing with the withheld securities is not circumscribed under strict parameters. The Exchange is bestowed with a discretion to choose amongst the available options and the appellant holds no control over such choice. To this limited extent, the role of the Exchange as regards the withheld assets is of a fiduciary character, obligating it to choose the just course of action out of the available options. We are conscious of the fact that traditionally speaking, the relationship of Member-Exchange may not be regarded as a fiduciary one. But we are not examining the nature of this relationship as a generalised enquiry. Our concern is limited to the dynamics of this relationship qua the withheld securities in light of the regulatory scheme. Notably, Professor Frankel, in "***Fiduciary Law: The Judicial Process and the Duty of Care***"¹¹ highlights the existence of a limited fiduciary relationship thus:

“The law aims at deterring fiduciaries from misappropriating the powers vested in them solely for the purpose of enabling them to perform their functions.” E

Therefore, it is only for the purpose of performance of functions that a fiduciary character is recognised in this relationship. In ***Hospital Products Ltd. v. United States Surgical Corporation Ltd.***¹², it was rightly observed that the scope of fiduciary duties is “moulded according to the nature of the relationship and facts of the case.”¹³ The proposition gets strengthened by the equitable principle of constructive trust, which received a reasonably acceptable definition in ***Paragon Finance plc v. DB Thackerar & Co.***¹⁴thus:

¹¹ The 1993 Isaac Pitblado Lectures, Fiduciary Duties/Conflicts of Interest (1993)

¹² (1984) 156 C.L.R. 41

¹³ Snell's Equity, 32nd Edition

¹⁴ [1999] 1 All ER 400

- A “..... A constructive trust arises by operation of law whenever the circumstances are such that it would be unconscionable for the owner of property (usually but not necessarily the legal estate) to assert his own beneficial interest in the property and deny the beneficial interest of another.”
- B It is thus clear that constructive trust arises by operation of law in specific factual scenarios and not by any statute or contract. However, such trust, and rights and obligations under it would depend strictly upon the prevailing set of facts and governing provisions.
- C 107. Though the standalone question of law as regards the respondents’ duty to act as a prudent person in respect of the withheld securities stands answered, what remains to be examined is whether such duty of the respondent is an unqualified duty so as to make unilateral registration a mandatory obligation, as claimed. Additionally, could it be said that the respondent is obliged to deal with the securities in a particular way despite there being a clear discretion in the relevant provision?
- D 108. The principles of constructive trust and fiduciary relationships are equitable principles, and equity never operates in an absolute manner or in a vacuum. In fact, the very basis of the law of equity is its flexibility to take care of mutual concerns of the parties. Equity is about balancing the competing interests – by preventing the erosion of interests of one party while ensuring a free exercise of legally enshrined discretionary powers to the other. No doubt, specific fiduciary duties could definitely be recognised in the specific facts of the case but the manner of performance of such duties cannot be dictated in regulatory matters. Legal recognition of the role of a trustee and fixing actual obligations to be performed under such role are two separate matters. The latter is dependent on the nature of discretion and on the diligence of other party, as we shall see. In ***Equity & Trusts***¹⁵, Alastair Hudson, after noting the existence of constructive trust in certain matters, notes - “*what remains is the extent to which a constructive trustee would be liable*”, which signifies that the exact liability of a constructive trustee is determinable in the specific facts of the case.
- E 109. The duties of a trustee can be broadly classified into mandatory duties and discretionary duties. The court is always circumspect in enforcement of discretionary duties. A perusal of Regulation 9.12

H ¹⁵ *Equity & Trusts*, Alastair Hudson, 2nd Edition

succinctly reveals that the measure of registration is not provided as an exclusive one, rather, it is in addition to other residuary steps that an Exchange is entitled to take. Therefore, there is no express statutory or contractual requirement of mandatory registration in the applicable law. A clear element of discretion is involved in the manner of dealing. It is true that such discretion cannot be exercised in a legally perverse manner, but it is equally true that a discretion cannot be converted into a mandatory obligation, more so when such discretion is provided expressly by a statutory provision. In *Ashburner's Principles of Equity*¹⁶, the discretionary duties of a trustee are noted in a succinct manner. It is stated that such discretion must be exercised “freely”, “intelligently” and in a “*bona fide*” manner. More importantly, an exercise of such discretion in commercial relationships is guided by the nature of things, as they exist or vary from time to time. Illustratively, in the present case, it was out of this sound exercise of discretion that the Exchange did actually get some of the securities registered in its name. Equitable common law principles cannot be used to create mandatory legal obligations.

Role of defaulting member

110. Even if we consider the argument that the Exchange ought to have registered forthwith upon appellant’s demand, if not *suo motu*, such an enquiry cannot be undertaken in isolation. It is the fundamental principle of an equitable examination that “*the one who seeks equity must do equity*”. This brings us to the role of the defaulting member (appellant) qua the withheld securities. Registration of securities or any property for that matter is done in favour of an entity only upon fulfilment of certain allied conditions, including but not limited to the supply of consideration. Without such consideration, contract itself becomes void, let aside entertaining a demand for registration. Upon withholding, it becomes the duty of the stock broker to raise a request for the registration of securities and to comply with the payment shortfall and other requirements. During the period commencing from 1997 to 2008, the appellant did not pursue the cause of dealing with the withheld securities in a proactive manner, seemingly because of two reasons- *first*, the appellant was pursuing multiple legal actions against the respondents at various forums and *second*, such a request would have to be preceded by fulfilment of conditions relating to settlement and payment. For, the

¹⁶ Ashburner's Principles of Equity, Denis Brownie, 2nd Edition.

- A Exchange could not get the securities registered in the name of any entity until and unless such entity settles the transaction by making complete payment for the purchased securities. Clause (3) of Chapter-VI of NSCCL Byelaws titled “Clearing and Settlement of Deals” expresses the same view and notes thus:
- B “3.CONDITIONS AND REQUIREMENTS OF CLEARING AND SETTLEMENT
- The relevant authority may grant admission of deals dealt in the Exchange provided all the conditions and requirements specified in the Bye Laws and Regulations and such other conditions and requirements as the relevant authority may prescribe from time to time are complied with.”
- C Clause (10) further notes that:
- “10. CLEARING AND SETTLEMENT
- D Settlement shall be effected by clearing members giving and receiving delivery and paying and receiving funds as may be specified by the relevant authority from time to time in the Bye Laws and Regulations.”
- E 111. Be it noted that the appellant never offered to make such payment in lieu of registration. In fact, on one occasion when the Defaulter’s Committee passed the order justifying the withholding on 04.12.2014, the respondents offered to release the securities to the appellant for removal of objections subject to the submission of a bank deposit to secure the liability. The directions issued by the Defaulter’s Committee read thus:
- F “2. Without prejudice to the above, the Committee directs that the securities which have been withheld as per the list of securities given in Annexure-2 of this Order may be released to RSL, on as is where is basis, to (i) enable it to remove the Objections in respect of securities for which RSL is an introducing member and (ii) transfer the securities in its name in respect of securities for which RSL is a receiving member and return the securities to NSE in demat form, provided -
- G a. RSL furnishes an undertaking that it has no other claim against NSE or NSCC and that it will return the securities
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within a period of one year from the date of release A
after duly removing the objections and transferring in RSL's name as the case may be.

- b. RSL provides a deposit of or a bank guarantee for Rs.1,00,70,529.82 (i.e. the outstanding dues of RSL payable to NSCC of Rs.1,07,72,098.17 less Rs.7,01,568.35 being the value at closing price on NSE as on December 4, 2014 of securities already transferred in the name of NSCC – list enclosed as Annexure -3) to protect NSE against failure to return the securities.
- c. RSL provides the undertaking and the deposit or bank guarantee within a period of three months from the date of receipt of this Order.” C

112. Thus, the Committee did propose to hand over physical possession of the securities to the appellant for getting them registered in its name. The appellant refused to comply with the direction of payment and instead, challenged this decision of the Defaulter's Committee by filing M.A. No. 295 of 2015 before the Tribunal wherein a consent order was passed upon an undertaking given by the Exchange that it has no objection in performing its duty as “trustee” in respect of the unregistered withheld securities and taking appropriate steps by registering them in its name. Be it noted that even this order was a conditional one as it specified that such registration shall not affect the legal rights and liabilities of parties in any manner. In pursuance of this order on 23.09.2015, the respondents got the securities transferred in their name and realised them after the impugned order in 2019. D E F

113. It is thus clear from the state of affairs discussed above that the respondents were cognizant of their duty towards the withheld securities pending determination of final claim. However, no action of registration could have been taken without complying with other conditions. The role of the defaulting member was of an enabler and unless the Exchange was placed in a position to register, it could not have exercised its discretion to register. It is important to note that permitting the Exchange to register forthwith as a matter of obligation would also be counterproductive to the interests of the defaulting member. For, such a blanket action would have the effect of converting a limited right of lien into that of absolute ownership over the withheld assets G H

A without giving the defaulter sufficient time to get his assets released much less before a declaration of being a defaulter or an order of expulsion. Such can never be the purpose of withholding.

114. To summarize, registration could only have been done on fulfilment of the following conditions:

- B (i) request by the defaulting member;
- (ii) request to be preceded by fulfilment of conditions relating to payment;
- (iii) request to be accompanied with undertaking that any such registration in the name of the Exchange would be subject to final outcome of the case.

C 115. The appellant has contended that it has suffered loss of corporate benefits due to non-registration by the respondent. The same is unacceptable. Firstly, the receiving securities legally vested in the Exchange as on the date of expulsion to the extent of liability. The appellant could not have claimed any right therein to further corporate benefits as

D regards these securities. Even before the date of expulsion, the respondents cannot be held liable for any loss on the withheld securities as the appellant always had the opportunity of making payment and protecting its interests. The appellant cannot fail to discharge its obligations for a period of 23 years and then turn around and claim loss of benefits in this manner. Acceding to such a claim would be akin to rewarding a

E wrong. Understood thus, the liability for the loss incurred by the appellant, if at all any, on account of corporate benefits (dividends, bonus etc.) accrued on withheld shares would not fall upon the Exchange, in the fact situation of the present case.

F 116. Even otherwise, the respondents' decision of not realising the securities or taking any adverse action during the pendency of multiple proceedings cannot be outrightly termed as an abuse of discretion. For, the decision of expulsion (and thus, of vesting) itself became sub-judice along with various other civil and criminal proceedings. Admittedly, the appellant had gone to the extent of initiating proceedings for criminal misappropriation against the Directors of respondents for using security

G deposits in regular course of business. This inevitably resulted in reluctance of the respondents to sell off the securities amidst pending proceedings. It is settled law that statutory appeal is a continuation of the original proceedings and once an appeal was filed, the question of expulsion remained sub-judice unto these appeals.

H 117. We may revert to the manner in which the issue under consideration has been dealt with by the Tribunal. The Tribunal

misinformed itself by observing that this issue had already stood answered in the previous judgment of the Tribunal in Appeal No. 84 of 2008. The Tribunal simply entered into an examination of the provisions relating to withholding whereas the real question was regarding the manner of dealing with the withheld securities.

118. Having said thus, what remains for our consideration is the determination and recovery of liabilities for final culmination of the controversy. The Tribunal determined the final liability of the appellant to be Rs.2.41 crore in para 10, where it noted:

“10. ... It is abundantly clear that the appellant owed Rs.1.07 crore after adjusting for the deposits etc. in October 1997 and since the said deposit amount of Rs.1.34 crore has been subsequently returned the unadjusted amount of dues stands at Rs.2.41 crore.”

119. It is pertinent to note that the amount of Rs.1.34 crore was required to be returned by the respondents in SLP (Crl.) No. 9642-9643 of 2011, which it had held as an interest free security deposit. It was meant to be utilised for the purpose of discharging the monetary obligation of the appellant during the period between withdrawal and expulsion. The appellants have advanced an erroneous proposition that the return of this amount by the respondents signified that there was no liability owed by the appellant towards them. We must reiterate that the return of the security deposit was driven by a desire of the officials of the respondents to avoid the continuation of criminal proceeding against them resorted to by the appellant. It was neither a confession that they had misappropriated the said deposit nor an undertaking that they had no claim over the said amount for adjustment against the penalties. The effect of the said return was limited to the quashment of criminal proceedings involved therein. The order of this Court dated 02.11.2017 is self-eloquent, as it categorically notes that:

“.....

This order will not affect any other proceedings which may be dealt with independently in accordance with law. ...”

120. The matters in issue in the present set of appeals are distinct from those involved in the stated special leave petition (criminal). Therefore, the loss caused to the Exchange due to return of interest free security deposit amount ought to be reckoned in determining the total liability of the appellant and the same ought to be adjusted by the respondents appropriately.

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- A 121. The quantum of amount due from the appellant to the respondents, being a question of fact, has been decided by the Tribunal and we do not wish to interfere therewith. For, no serious error has been pointed out in any factual determination made by the Tribunal. Further, the scope of Section-22F is limited to entertaining an appeal on questions of law, and we have proceeded accordingly.
- B 122. The Tribunal gave one month's time for recovery of payment and return of remaining securities to the appellant. It is on record that an amount of Rs.1.74 crores has been recovered by the respondents from the transferred securities, fixed deposits and corporate benefits so far and an amount equivalent to Rs.66.81 lakhs (approximately) is remaining.
- C 123. We hereby issue the following directions for full and final settlement of all claims between the parties:
- (i) NSE to evaluate and get the remaining transferrable securities, if any, transferred in its favour and recover the remaining amount using the same evaluation criteria adopted in respect of other withheld securities of the appellant within 6 weeks.
 - (ii) After realisation, the surplus amount be returned forthwith to the appellant along with interest at the rate of 12% P.A. from the date of determination of claim/date of vesting until the date of payment.
 - (iii) Respondents to return the unrealised securities including those with outstanding objections to the appellant within 6 weeks from today.
 - (iv) In case recovery is not possible from the remaining securities, for any reason whatsoever, the respondents may communicate the same to the appellant forthwith and the appellant shall then pay the amount so demanded (including interest, if any), to the respondents within 6 weeks from the date of receipt of such communication.
 - (v) NSE is directed to oversee the evaluation and realisation of remaining securities, and settlement of claims.
- G 124. Accordingly, both appeals are disposed of in the aforesaid terms and directions with no further order as regards costs.
125. Pending applications, if any, also stand disposed of.