

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER SECTION 12(3) AND SECTION 19 OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH REGULATION 27 OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008

In respect of –

MK Commodity Brokers Limited

[Registration No. INZ000032536]

In the matter of National Spot Exchange Limited

BACKGROUND

1. Securities and Exchange Board of India (hereinafter be referred to as “**SEBI**”) initiated enquiry proceedings against MK Commodity Brokers Limited (hereinafter referred to as “**Noticee**”), registered with SEBI as a commodity derivatives broker under the SEBI (Stock Brokers) Regulations, 1992 (hereinafter be referred to as “**Stock Broker Regulations**”), for the alleged violations of Regulations 5(e), 9(b) and 9(f) read with Clause A(1), A(2) and A(5) of Schedule II of the Stock Broker Regulations read with Schedule II of the SEBI (Intermediaries) Regulations, 2008 (hereinafter be referred to as “**Intermediaries Regulations**”).
2. The Noticee was a Trading and Clearing Member of the National Spot Exchange Limited (hereinafter be referred to as “**NSEL**”), which was incorporated in May, 2005 as a spot exchange for trading in commodities. NSEL organised trading in commodities after it was granted exemption from certain provisions of Forward Contracts (Regulation) Act, 1952 (hereinafter be referred to as, “**FCRA**”) by the Department of Consumer Affairs of the Ministry of Consumer Affairs, Food and Public Distribution, Government of India, vide Gazette Notification No. SO 906(E) dated June 05, 2007 (hereinafter referred to as “**2007 Exemption Notification**”), in exercise of powers conferred under Section 27 of FCRA subject to certain conditions which, *inter alia*, included “no short sale by members of the exchange shall be allowed; that

all outstanding positions of the trade at the end of the day shall result in delivery and that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency”.

3. In September 2009, NSEL allegedly introduced the concept of '*paired contracts*', i.e. buying and selling the same commodity through two different contracts at two different prices on its platform wherein investors could buy a short duration settlement contract and sell a long duration settlement contract and vice versa at the same time. It entailed occurrence of Buy Trades (T+2 / T+3) and Sell Trades (T+25 / T+36) on the same day at different prices on the platform of NSEL.
4. On February 06, 2012, the erstwhile Forward Markets Commission (hereinafter referred to as “**FMC**”) was appointed by the Department of Consumer Affairs, Government of India as the ‘designated agency’, authorizing it to collect the trade data from the NSEL and to examine the same for taking appropriate measure, if needed, to protect investors’ interest. The FMC had accordingly, *inter alia*, called for the trade data from NSEL in the prescribed reporting formats. After analysing the trade data received from the NSEL, the FMC passed Order No. 4/5/2013-MKT-1/B dated December 17, 2013 in the matter (hereinafter referred to as “**FMC Order**”) wherein it was, *inter alia*, observed that 55 contracts offered for trade on the NSEL platform were in violation of the relevant provisions of the FCRA and that the condition of ‘*no short sale by members of the exchange shall be allowed*’ was not being complied with by the NSEL and its members. FMC further observed that the ‘*paired contracts*’ offered for trading in the NSEL platform were in violation of the provisions of the FCRA and also in violation of the conditions specified by the Government of India in its 2007 Exemption Notification.
5. On perusal of the FMC Order in respect of the ‘*paired contracts*’, which were traded on the NSEL platform during the relevant period, I note that the FMC had, *inter alia*, observed that the following conditions stipulated in the 2007 Exemption Notification were violated:

- a. **Short Sale**

NSEL had not made it mandatory for the seller to deposit goods in its warehouse before taking a sell position. Hence, the condition of “*no short sale by members of the NSEL shall be allowed*” was not being met by

the NSEL and its trading/clearing members who traded in the '*paired contracts*' during the relevant period.

b. Contracts with Settlement Period going beyond 11 days

Some of the contracts offered for trade on NSEL had settlement periods exceeding 11 days and therefore, such contracts were "*non-transferable specific delivery*" contracts under the FCRA. As per the FCRA, the "*ready delivery contracts*" were required to be settled within 11 days of the trade and hence, the contracts traded on the NSEL which provided settlement schedule for a period exceeding 11 days were not allowed under the aforesaid Notification.

6. Hence, it was alleged that the NSEL organised trading in '*paired contracts*' in violation of the 2007 Exemption Notification. It was also alleged that the Trading Members and Clearing members of the NSEL facilitated and/or participated in trading in such '*paired contracts*' which were in alleged violation of the 2007 Exemption Notification. Thus, by participating in / facilitating trading in '*paired contracts*', such entities, allegedly, had acted in a manner detrimental to the interest of the securities market.
7. As per information available with SEBI, the Noticee, being a Trading Member and Clearing member of the NSEL, facilitated trading in '*paired contracts*' on the NSEL platform, in alleged violation of the provisions of Regulation 9(b) and 9(f) read with Clauses A(1), A(2) and A(5) of Schedule II of the Stock Broker Regulations. Based on this information, SEBI was *prima facie* satisfied that there were sufficient grounds to enquire into whether the Noticee, is a '*fit and proper person*' to continue to hold certificate of registration as Trading and Clearing Member in terms of Regulation 5(e) of the Stock Broker Regulations read with Regulation 27(iv) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations.

ENQUIRY BY DESIGNATED AUTHORITY

8. A Designated Authority (hereinafter referred to as "**DA**") was appointed by SEBI vide order dated September 24, 2018 to conduct an enquiry against the Noticee and submit a report and make recommendation/s in terms of Regulation 27 of the

Intermediaries Regulations (as applicable at the relevant time) in respect of the violations alleged to have been committed by the Noticee mentioned at para 7 above.

9. After conducting the enquiry as envisaged under regulation 25 of the Intermediaries Regulations, the DA submitted an Enquiry Report dated December 17, 2020 (hereinafter referred to as the “**Enquiry Report**”) to the Competent Authority, *inter alia*, observed and recommended as under:

“In view of the facts and circumstances of the case and material placed before the me, I am of the view that the Noticee is not a fit and proper person in terms of Regulation 5(e) read with Regulation 27(iv) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations. Therefore, in terms of Regulation 27 of the Intermediaries Regulations, I recommend that the registration of the Noticee i.e. MK Commodity Brokers Limited [Registration No. INZ000032536] as a commodities derivatives broker may be cancelled.”

POST ENQUIRY PROCEEDINGS

Show Cause Notice, Reply and Personal Hearing

10. After considering the Enquiry Report, a post-enquiry Show Cause Notice dated January 15, 2021 (hereinafter referred to as the “**SCN**”) was issued to the Noticee under regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) enclosing therewith (a) copy of the Enquiry Report, (b) copy of the letter dated December 30, 2014 of the Department of Economic Affairs (DEA) Ministry of Finance and (c) a copy of the order dated August 22, 2014 passed by the Hon’ble Bombay High Court in Criminal Bail Application No. 1263 of 2014 in the case of *Jignesh Prakash Shah Vs. The State of Maharashtra*. The SCN was issued to the Noticee calling upon it as to why action as recommended by the DA or any other action should not be taken against, as deemed fit, by the Competent Authority. The Noticee vide letter dated March 05, 2021 filed its reply and made the following submissions:

- (i) The enquiry report has been prepared based on wrong assumption that the Noticee has been provided with the documents relied upon by SEBI while the fact is that no such documents whatsoever were provided to the Noticee and consequently principles of natural justice had not been adhered to while conducting the enquiry proceedings. The documents which were available in

public domain were provided to this Noticee, however, case specific documents have till date not been provided to this Noticee;

- (ii) The appointment of the Designated Authority in the present matter is bad in law and violative of regulation 24(2) of Intermediaries Regulations in terms of which the Designated Authority is required to be appointed by the Executive Director and not the Ld. Whole Time Member (WTM). The delegation of powers under the SEBI Regulations will be rendered irrelevant if the SEBI (Delegation of Powers) Order, 2015 (hereinafter referred to as “**DOP Order**”) supersedes/overrides the SEBI Regulations;
- (iii) In terms of Section 29A(2)(e) of the FCRA, SEBI could initiate prosecution proceedings against the members of the NSEL for alleged violation of FCRA and could not initiate enquiry proceedings under the Intermediaries Regulations;
- (iv) The DA has not answered the contentions of the Noticee as regard the retrospective application of the SEBI Regulations and has wrongly relied upon the decision of the Hon’ble SAT in the matter of **Jermyn Capital LLC Vs. SEBI**¹;
- (v) The DA has not paid heed to the objection of the Noticee that SEBI has no jurisdiction over spot market, for which, reliance has been placed on the letter dated November 20, 2015 of the Ministry of Finance wherein it had been stated that SEBI is not expected to deal with matters not dealt by FMC and since spot market was not dealt with by FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets;
- (vi) The reliance on the decisions of **Jermyn Capital LLC Vs. SEBI** and **Mukesh Babu Securities Vs. SEBI**² to establish close connection with NSEL is misplaced as in the instant case there is no allegation of any of the directors/ key managerial persons of the Noticee having any close association with anyone against whom CBI or any other intelligence agencies have initiated prosecution proceedings. Further, the show cause notice also does not allege that the Chairman/ Whole Time Director/ managing Director of the Noticee are

¹ Appeal No. 26 of 2006, decided on September 06, 2006, Also available at - <https://indiankanoon.org/doc/1511076/>

² Appeal No. 53 of 2007, decided on December 10, 2007, Also available at- <https://indiankanoon.org/doc/129504/>

involved in any criminal case which affects their reputation and thereby makes the Noticee not a 'fit and proper' person;

- (vii) Although the DA has placed reliance on FMC Order dated December 17, 2013, decision of the Hon'ble Bombay High Court in the matter of 63 Moons' Technologies Vs Union of India, interim report of EoW etc., the same has not been provided to the Noticee and therefore cannot be relied upon. Further, the aforesaid FMC order found fault with the operations of NSEL for launching the paired contracts and the neither Noticee was a party to the said proceedings nor the court had considered the role/ activities of the Noticee as a member of NSEL. Similarly, the Noticee was also not a party to the aforesaid Hon'ble Bombay High Court Order;
- (viii) There are no specific charges against the Noticee in the interim EoW report and the Noticee had traded in/ facilitated the paired contracts as a member of NSEL in accordance with the business rules and regulations of NSEL. The amount of ₹18,97,37,876/- was due and receivable to the Noticee's clients for trades executed on NSEL;
- (ix) The DA has erroneously observed that Noticee allowed itself to become an instrument of NSEL in promoting trading in paired contracts. The said contracts were introduced by NSEL with the approval of its Board and Noticee, as a member, had no option but to trade in such contracts by observing business rules of the NSEL;
- (x) The DA has erred in holding that the Noticee ought to have conducted due diligence before entering into paired contracts as it was not within the power of a broker to question the legality of any trading and the same was the job of Central Government or FMC;
- (xi) The Noticee denies that the issue of legality of paired contract has achieved finality with the judgment of Hon'ble Supreme Court dated April 30, 2019 as the said judgment has no relevance so far as the role of members of NSEL or the Noticee is concerned and thus, it is incorrect to infer that only because the Noticee traded in the '*paired contracts*', the Noticee was closely associated with the NSEL;
- (xii) A broker operating on the stock exchange cannot be treated as a close associate of a stock exchange, unless there is a common ownership,

- management or control. Since '*paired contracts*' were a product of NSEL in which the investors could trade, the same cannot be viewed as a person or entity enjoying good or bad reputation. Hence, alleging close association between the Noticee and '*paired contracts*' is conceptually a flawed argument.
- (xiii) The Hon'ble Bombay High Court, vide its order dated August 22, 2019, has clearly held that the paired contracts were not financial transactions but were trades in commodity as per regulations and bye laws of NSEL;
- (xiv) The DA has not dealt with the following contentions, namely:
- a) Clients who dealt through the *Noticee* were duly registered clients with proper KYC, Member Client Agreement etc.;
 - b) All trades were carried out as per the NSEL system from time to time and the contract notes were issued to the clients as per the formats and the terms and conditions and bye laws of NSEL;
 - c) No brochures/ pamphlets/ presentations on NSEL products were issued or provided to the clients by the *Noticee*;
 - d) NSEL was functioning in complete public knowledge and was permitted to provide the trading platform for paired contracts and thus, there was no reason for the *Noticee* to question the legality of the product launched by NSEL;
 - e) The paired contracts were launched in 2007 but the *Noticee* became a member of NSEL on October 29, 2012 and allowed only few clients to trade in the 'paired contracts' who approached the *Noticee* on their own;
 - f) The *Noticee* earned brokerage of barely ₹3,81,286/- pertaining to activities conducted during October 2012 to June 2013 and there has been no complaints/ grievances against the *Noticee*;
- (xv) The DA has not found the *Noticee* guilty of the alleged violation of regulation 9(b) and 9(f) read with clause A(1), A(2) and A(5) of Schedule II of the Stock Broker Regulations and has straight away observed that the *Noticee* is not a fit and proper person as the *Noticee* trading in paired contracts can be viewed as having close association with NSEL. Basis above, the DA has recommended that the Certificate of Registration of the *Noticee* may be cancelled and such a recommendation is not tenable in law;

11. While the extant proceedings in the present matter were ongoing, SEBI passed five separate orders during February, 2019, rejecting the applications filed by five other entities for registration as commodity brokers in the NSEL matter. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble SAT. The Hon'ble SAT, vide its common order dated June 9, 2022 (hereinafter referred to as "**SAT Order**"), remanded the aforesaid orders to SEBI to decide these matters afresh within six months from the date of the said SAT order. While remanding the aforesaid SEBI orders, the Hon'ble SAT, inter alia, held as under:

"42...The matters are remitted to the WTM to decide the matter afresh in the light of the observations made aforesaid in accordance with law after giving an opportunity of hearing to the brokers. All issues raised by the brokers for which a finality has not been reached remains open for them to be raised before the WTM. It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice..."

12. Subsequently, in August 2022, the present matter was allocated to me. In the light of the aforesaid SAT Order and certain other orders passed by the Hon'ble SAT in similar set of cases, it was felt necessary to furnish certain additional documents/material to the Noticee before concluding the present proceedings. Accordingly, a supplementary show cause notice (hereinafter referred to as "**SSCN**") dated October 12, 2022 along with the SEBI Complaint dated September 24, 2018 filed with EOW, Mumbai, FIR dated September 28, 2018 and the amended Schedule II of the Intermediaries Regulations was issued to the Noticee and the Noticee was advised to file its reply, if any, within 15 days of receipt of the said notice. Accordingly, the Noticee vide its letter dated October 28, 2022 made certain submissions with respect to the SSCN and the same are summarised as under:

- (i) In terms of section 29(A)(2)(e) of the FCRA, SEBI is empowered to initiate fresh proceedings related to an offence under FCRA by bringing the same to the notice of the concerned police authorities and by filing a complaint dated

September 24, 2018 and an FIR dated September 28, 2018, SEBI has done the same. SEBI is not empowered to investigate alleged violations of FCRA and thus, SEBI cannot assume the power to declare the Noticee as not fit and proper on the basis of its own complaint alleging violation of FCRA and cannot initiate the enquiry proceedings;

- (ii) The FIR is first instance of reporting of complaint lodged with the police which is a preliminary document based on one-sided statements without any adjudication and thus, no reliance can be placed on any FIR, particularly an FIR which has been filed by SEBI itself. Any such reliance, to the Noticee's detriment, ought to be declared as unlawful;
- (iii) The Intermediaries Regulations were amended with effect from November 17, 2021 and any retrospective reliance on the same would be in gross violation of principles of natural justice.

13. In compliance with the principles of natural justice, an opportunity of personal hearing was granted to the Noticee on November 16, 2022 through video conferencing.

14. On the date of hearing, the Noticee was represented by Mr. Gyan Prakash, compliance officer of the Noticee (Authorised Representative), who reiterated the submissions made by the Noticee vide its letters dated March 05, 2021 and October 28, 2022. Further, as requested, one week's time was granted to the Noticee to make additional submissions, if any. Accordingly, vide letter dated November 22, 2022, the Noticee, while reiterating its previous submissions, made additional submissions in the matter which are summarized as under:

- (i) The Hon'ble SAT, in its order dated June 9, 2022, has observed that the Whole Time Member, is required to consider/ determine if the documents such as EOW Report, Charge sheet etc., would bring any conclusion on the reputation, integration and character of the Noticee but no such determination has been made whether the documents forwarded to the Noticee along with the SSCN would bring any conclusive finding on the reputation, integrity and character of the Noticee;
- (ii) The Hon'ble Supreme Court in the matter of State of Maharashtra Vs. 63 Moons Technologies Limited (dated April 22, 2022) has held that '*...the*

trading members were duped by a conspiracy hatched by a few trading members along with NSEL’.

CONSIDERATION OF ISSUES AND FINDINGS

15. I have carefully perused the post enquiry SCN, SSCN along with all the documents attached therewith, the replies submitted by the Noticee, the oral submissions made by the Noticee during the course of the personal hearing along with the material/ information available on record. After considering the allegations made/ charges levelled against the Noticee in the instant case, I note that the only issue that arises for consideration in the present proceedings is whether the Noticee satisfies the ‘*fit and proper person*’ criteria as laid down under Schedule II of the Intermediaries Regulations.
16. Before considering the issue on its merits, I note that the SCN dated January 15, 2021 called upon the Noticee to show cause as to why action as recommended by the DA, including passing of appropriate direction should not be taken against the Noticee in terms of regulation 28 of the Intermediaries Regulations. I note that by the amendments made to Intermediaries Regulations on January 21, 2021, regulation 27, which dealt with recommendations for actions which could be made by DA in case of default, has been substituted and regulation 28, which dealt with procedure for action on receipt of the recommendation from DA, has been omitted and these matters now stand governed by the Regulations 26 and 27, respectively. In the present case, I note that prior to the aforesaid amendment, procedure for conduct of enquiry proceedings before DA and Competent Authority (hereinafter referred to as “**CA**”) was provided under regulations 25 to 28 of the Intermediaries Regulations, wherein, regulation 25 dealt with issue of SCN by the DA, regulation 26 dealt with reply of SCN by the Noticee, regulation 27 dealt with recommendation for actions which could be made by the DA and regulation 28 dealt with conduct of proceedings before the CA, like issue of SCN, hearing and passing of final order. After the aforesaid amendment, regulation 25, as substituted, deals with holding of enquiry proceedings before DA, regulation 26 deals with recommendation for actions which can be made by the DA and regulation 27 deals with conduct of enquiry proceedings before the CA and passing of order by the CA. Thus, the proceedings before CA which were earlier governed by the provisions of

regulation 28 are now governed by the provisions of regulation 27 with certain modifications. Therefore, the new regulation 27 is regarded having force continuously (by virtue of pre-existing regulation 28) and the modification or changes are treated as amendment coming into force with effect from the date of enforcement of new regulation 27, i.e., January 21, 2021. Accordingly, I note that the present proceedings can be concluded under the amended provisions of the Intermediaries Regulations and for the violations committed by the Noticee, directions under regulation 27 of the Intermediaries Regulations can be issued.

17. The Noticee has argued that in terms of Section 29A(2)(e) of the FCRA, SEBI could only initiate prosecution proceedings against the members of NSEL and not proceed under the Intermediaries Regulations. In this regard, I note that SEBI had filed a complaint dated September 24, 2018 with the concerned police authorities for initiating appropriate action for the violations of the provisions of FCRA, *inter alia*, alleged to have been committed by the Noticee. I also note from the records that on the basis of the said complaint of SEBI, a FIR dated September 28, 2018 was registered with MIDC Police Station. In the background of these facts, it is pertinent to see the scope and scheme of Section 29A(2)(e) of the FCRA which is reproduced as under for ease of reference:

“29A. Repeal and savings. — (1) The Forward Contracts (Regulation) Act, 1952 (74 of 1952) is hereby repealed.

(2) On and from the date of repeal of Forward Contracts Act—

(e) a fresh proceeding related to an offence under the Forward Contracts Act, may be initiated by the Security Board under that Act within a period of three years from the date on which that Act is repealed and be proceeded with as if that Act had not been repealed;”

18. A bare perusal of the aforesaid provision would reveal that it is an enabling provision which enables SEBI to initiate fresh proceedings within a period of three years from the date on which the FCRA is repealed. As stated above, SEBI has filed complaint, *inter alia*, against the Noticee within the stipulated period as specified in the FCRA. Accordingly, I note that SEBI has taken appropriate steps for the alleged violation of the provisions of the FCRA and, the contention that transactions done by the Noticee prior to September, 2015 are beyond the regulatory ambit of SEBI is misplaced as

Section 29A(2)(e) of the FCRA mandates SEBI to initiate appropriate proceedings within the given timeframe for the offences committed under the FCRA.

19. Further, as stated above, the present proceedings pertain to examination of the '*fit and proper*' person status of the Noticee under the Intermediaries Regulations and it is a settled position of law that as a statutory body, SEBI is well within its regulatory purview to examine the '*fit and proper*' person status of the intermediaries registered with SEBI. Accordingly, the submission of the Noticee as regard maintenance of the present proceedings under the Intermediaries Regulations is also without merit.
20. Prior to moving forward with considering the said issue as stated at para 15 above, it is pertinent to refer to the common order dated June 09, 2022³ passed by the Hon'ble SAT which is also referred in the preceding paragraph 11. The Hon'ble SAT, while setting aside and remanding the earlier WTM Orders passed during February 2019, had made the following observations (relevant to the present case as well):
 - (a) Observations of the Bombay High Court in the matter of **63 Moons vs. Union of India**⁴ cannot be relied upon as the said judgement has been set aside in appeal⁵ by the Hon'ble Supreme Court vide judgment dated April 30, 2019.
 - (b) Observation from the Order dismissing the Writ Petition filed by NSEL against the invocation of the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 ("MPID Act") (*NSEL vs. State of Maharashtra*)⁶ cannot be relied upon, as in a subsequent Writ Petition⁷ moved by 63 Moons, a Division Bench of the Bombay High Court has allowed the prayer and held that NSEL is not a financial establishment and therefore, the provisions of the MPID Act are not applicable. The Division Bench also observed that the prima facie observations made by the single bench while dismissing the NSEL petition could not be relied upon as they were preliminary observations and such observation does not foreclose the issue about the applicability of the provisions of the MPID Act. I note that the Hon'ble Tribunal was of the opinion that prima facie observations cannot be the basis to judge the reputation, character or integrity of NSEL.

³ Appeal No. 214 of 2019 Geofin Comtrade Ltd Vs. SEBI, Appeal No. 217 of 2019 Philip Commodities India Pvt. Ltd Vs. SEBI, Appeal No. 218 of 2019 IIFL Commodities Ltd Vs. SEBI, Appeal No. 288 of 2019 Anand Rathi Commodities Ltd Vs. SEBI and Appeal No. 288 of 2019 Anand Rathi Commodities Ltd Vs. SEBI

⁴ Writ Petition No. 2743 of 2014

⁵ Civil Appeal No. 4467 of 2019

⁶ Writ Petition No. 1403 of 2015

⁷ Writ Petition No. 1181 of 2018

- (c) Observations in the bail rejection order dated August 22, 2014, passed by the Hon'ble Bombay High Court in the matter of **Jignesh Prakash Shah vs. The State of Maharashtra**, cannot also be relied upon as the observations made in a bail order were limited to the fact as to whether the bail should be granted or not.
- (d) Reliance placed on decisions of the Hon'ble Tribunal in the matter of **Jermyn Capital vs. SEBI**⁸ and **Mukesh Babu Securities vs. SEBI**⁹ is misplaced as decisions in the said matters are distinguishable on facts. Jermyn Capital was held to be in relation to an Interim Order passed by SEBI, and the Tribunal was of the view that the criteria for passing an Ad Interim Order are based on a different criterion, namely prima facie case, the balance of convenience and irreparable injury which are distinct and different while considering an application for grant of Certificate of Registration. The decision in the matter of **Mukesh Babu Securities** was distinguished by the Hon'ble Tribunal on the basis that in the matter a criminal complaint was filed against the Chairman of the Company. The Tribunal noted that there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.
- (e) Reputation of the applicant cannot be lightly considered based on observations which are not directly related to the applicant.
- (f) The SEBI Order does not state for how long the rejection of application will continue. The Hon'ble Tribunal was of the view that the rejection cannot continue indefinitely, and in such cases, a time period should be provided during which the applicant will become ineligible to seek fresh registration.
- (g) Grant Thornton Forensic report does not find any close connection between the applicant and the NSEL. This is overlooked by SEBI.
- (h) With respect to the additional material available, the Hon'ble SAT observed that, "It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice. It will also be open to SEBI if it considers necessary, to

⁸ Appeal No. 26 of 2006 decided on September 06, 2006

⁹ Appeal No. 53 of 2007 decided on December 10, 2007

conduct an independent enquiry proceeding against the connected entities and persons associated with the brokers against whom evidence is available.”

21. As noted above, taking cognizance of the order passed by the Hon'ble SAT on June 09, 2022 in the NSEL matters, a SSCN dated October 12, 2022, *inter alia*, enclosing a copy of the SAT Order was issued to the Noticee calling upon the Noticee, to show cause as to why the following information/material along with the Enquiry Report dated December 17, 2020 should not be considered against it for determining whether the Noticee satisfies '*fit and proper person*' criteria as laid down under Schedule II of the Intermediaries Regulations:
- a) SEBI complaint dated September 24, 2018 filed with EOW;
 - b) First Information Report ('FIR') dated September 28, 2018; and
 - c) Schedule II of the Intermediaries Regulations (Amended with effect from November 17, 2021).
22. Before considering the matter on merits and test the compliance of the Noticee with the '*fit and proper person*' criteria, on the basis of the material that has been brought on record, it would be appropriate to look at the background and understand the nature of the '*paired contracts*' that were offered on the NSEL – which ultimately is the cause / genesis of the current proceedings. While undertaking this exercise, I will not be independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings. I will, however, be relying on the observations made by other authorities including the Hon'ble Supreme Court in the matters of **63 Moons Technologies Ltd. vs. UOI**¹⁰ (hereinafter referred to as the “**merger petition**”) and **The State of Maharashtra Vs. 63 Moons Technologies Ltd**¹¹ (hereinafter referred to as the “**MPID Matter**”), wherever appropriate.

Transactions in the nature of '*paired contracts*' on NSEL:

23. The spot exchanges were envisaged as a platform for providing transparent and secure trading in commodities with a view to boost the agriculture sector in the country. NSEL was incorporated in 2005 as an electronic exchange for spot trading

¹⁰ Civil Appeal no. 4476 of 2019

¹¹ Civil Appeal No. 2748-49 of 2022

of commodities. On June 5, 2007, the Ministry of Consumer Affairs (“MCA”), Government of India, issued a Notification SO 906(E) under Section 27 of the FCRA granting conditional exemption from the provisions of that Act with respect to (i) forward contracts, (ii) for sale and purchase of commodities, of one-day duration traded on NSEL. The conditions, *inter alia*, placed an absolute bar on short sales and stipulated that all outstanding positions at the end of the day must result in delivery. It was also stipulated that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency. Thereafter, NSEL commenced operations in October 2008.

24. As noted from the FMC order, NSEL introduced, on its platform, the concept of ‘*paired contracts*’, in September 2009, which involved buying and selling the same commodity through two different contracts at two different prices wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In other words, the ‘paired contract’ involved two simultaneous transactions being undertaken at the same time with the same counterparty—one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at different prices on the platform of NSEL. The transactions were structured in such a manner that buyer of the short duration contract always ended up making profits.
25. As mentioned at para 4 above, FMC, after analysing the trade data as received from NSEL, vide order No. 4/5/2013-MKT/B dated December 17, 2013 (“FMC Order”) observed that: “55 contracts offered for trade on NSEL were with settlement period exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA” and “the condition of ‘no short sale by members of the exchange shall be allowed’ was not being met by NSEL”.
26. Further, in the above mentioned Order, FMC, *inter alia*, held that the contracts traded on NSEL have violated certain conditions stipulated in the 2007 Exemption Notification, which granted permission to NSEL to offer spot trading in commodities which, *inter alia*, included “no short sale by members of the exchange shall be allowed; that all outstanding positions of the trade at the end of the day shall result in delivery” and that “all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency”.

27. It is clear from the order of FMC that NSEL was given permission to setup as a spot exchange for trading in commodities. It was essentially meant to only offer forward contracts having one-day duration as per 2007 Exemption Notification. I note from the FMC Order¹² that the 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of the provisions of FCRA. I further note from the FMC Order that under the FCRA, a *“forward contract”* is defined as a *“contract for delivery of goods and which is not a ready delivery contract”*. A *‘ready delivery contract’* is defined as *“a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days”*. Given the said definition as contained in FCRA, I note that FMC was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as Non-Transferable Specific Delivery contracts.
28. Therefore, it is noted that even though it was stipulated in the 2007 Exemption Notification that, only contracts of one-day duration were permitted to be offered on NSEL, FMC, in its Order, relying on the definition of *“forward contract”* under FCRA held that, NSEL was allowed to trade only in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. I note the observation in the FMC order that NSEL had permitted 55 contracts of various commodities having duration longer than 11 days and these contracts were, *ex facie*, in contravention to the exemption granted to NSEL. It is pertinent to note that all the 55 contracts that were advertised by NSEL, and which are captured in the Hon’ble Supreme Court’s Judgement in the matter of MPID matter, were for durations exceeding 11 days.
29. I note that the Hon’ble Supreme Court in the matters of NSEL has also extensively commented on the nature of the *‘paired contracts’* traded on NSEL. The said observations made by the Hon’ble Supreme Court are as under:
- a. the Two-Judge Bench of the Hon’ble Supreme Court in the course of determining the validity of the amalgamation order in the merger petition, vide judgment dated April 30, 2019, had observed as under:
- “55. We have seen that neither FTIL nor NSEL has denied the fact that ‘paired contracts’ in commodities were going on, and by April to July, 2013,*

¹² Order No. 4/5/2013-MKT-1/B dated December 17, 2013

99% (and excluding E-series contracts), at least 46% of the turnover of NSEL was made up of such 'paired contracts'. **There is no doubt that such 'paired contracts' were, in fact, financing transactions which are distinct from the sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL and the FCRA.**" (emphasis supplied)

- b. the Hon'ble Supreme Court in the MPID matter, vide judgement dated April 22, 2022, has drawn reference to the presentations made by NSEL in respect of the 'paired contracts'. Upon analysing the presentations made, the Hon'ble Supreme Court has observed that:

*"The above representation indicates that 'paired contracts' were designed as a unique trading opportunity by NSEL under which a trader would, for instance, purchase a T+2 contract (with a pay-in obligation on T+2) and would simultaneously sell a T+25 contract (with a pay-out of funds on T+25). The price differential between the two settlement dates was represented to offer an annualized return of about 16%. NSEL categorically represented that all trades were backed by collaterals in the form of stocks and its management activities included selection, accreditation, quality testing, fumigation and insurance. **Therefore, NSEL represented that on receiving money and commodities, the members would receive assured returns and a service.** Though NSEL has been receiving deposits, it has failed to provide services as promised against the deposits and has failed return the deposits on demand. Therefore, the State of Maharashtra was justified in issuing the attachment notifications under Section 4 of the MPID Act."* (emphasis supplied)

30. I, therefore, note that the Hon'ble Supreme Court has already commented on the nature of the 'paired contracts' offered on the NSEL platform. In the case of *63 Moons Technologies Ltd. vs. UOI*, the Hon'ble Supreme Court held that these contracts were in the nature of financing transactions. In the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon'ble Supreme Court has held that such transactions come within the definition of 'deposits' under the MPID Act.

31. It is further noted that the Hon'ble Supreme Court, in the MPID matter, had extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. As seen from the order of the Hon'ble Supreme Court, the NSEL was advertising an annualized return of about 16% p.a. for the '*paired contracts*' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, a T+2 & T+25 paired contract in steel had the same offered return as a T+ 2 & T + 35 paired contract in castor oil. The '*paired contracts*', it is noted, were being marketed as an alternative to fixed deposits.
32. In view of the above, I note that the FMC Order and both the judgments of the Hon'ble Supreme Court discuss in detail that, NSEL was permitting short sales, i.e., permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite amount of commodity is available in the warehouse. As noted above, the Hon'ble Apex Court in the merger petition has held that these contracts were in the nature of financing transactions. Further, the Hon'ble Supreme Court in the MPID matter has held that the overwhelming majority of the sale leg of the '*paired contracts*' which were executed were naked short sales i.e. the commodities to back such sales were not available at the designated warehouses of NSEL.
33. At this juncture, in light of the above observations of the Hon'ble Supreme Court, I note that submission of the Noticee that the Hon'ble Bombay Court, vide its decision dated August 22, 2019, has clearly held that the paired contracts were not financial transactions is misplaced. It is also pertinent to note that the decision of the Hon'ble Bombay High Court which has been relied upon in the matter by the Noticee was overruled by the Hon'ble Apex Court in the MPID matter and thus, the submission of the Noticee in this regards is not tenable in law.

Objections raised by the Noticee:

34. The Noticee has further submitted that the appointment of the DA in the present matter is bad in law as the same was done by the Whole Time Member and not the Executive Director, as is required under the Intermediaries Regulations. In this regard, I note that Section 3(2) of the Securities and Exchange Board of India (Delegation of Powers) Order, 2015 specifically provides that, "*The powers and*

functions delegated to any member or officer of the Board or authority under the Order can be exercised by any officer or authority higher in grade or rank or position to him".

Thus, in presence of a valid delegation conferred upon by the statute, I find that the Noticee's challenge to the appointment of DA by the Whole Time Member of SEBI, who is an authority higher in grade to the Executive Director of SEBI, is devoid of merit. Further, the Noticee has also argued that the aforesaid stance as regard the appointment of DA is not valid in view of Section 3(1) of the DOP Order to submit that said order cannot be in derogation of powers/ functions specified under the Intermediaries Regulations. From the submissions of the Noticee, it appears to be a bald assertion without substantiation as to how the same is in derogation of the functions/ powers specified under the Intermediaries. While the Intermediaries Regulations provide for appointment of DA by an Executive Director, the same, when read along with the aforementioned Section 3(2) of the DOP Order, empower the Whole Time Member also to make the appointment. Accordingly, the submissions of the Noticee in this regard are rejected.

35. The Noticee has further submitted that SEBI does not have the jurisdiction to deal with the Spot Market in terms of letter dated November 20, 2015 of the Ministry of Finance. Since spot markets/ ready delivery contracts were not being regulated by the FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets. Accordingly, the merger of FMC with SEBI cannot empower SEBI to regulate the Spot Market. In this regard, without going into the merits of the contention that whether SEBI has the authority to regulate Spot Market or not, I note, that the issue under consideration in the present proceedings is limited to the determination of fit and proper status of the Noticee under the Intermediaries Regulations. It is a settled position of law that SEBI has statutory authority to determine the fit and proper status of the intermediaries registered with it. Since the Noticee is an intermediary registered with SEBI, I am of the view that SEBI is within its jurisdiction to determine the fit and proper status of the Noticee.
36. The Noticee has further argued that it has not been provided with all the documents which have been relied upon while issuing the notice and the same amounts to violation of the principle of natural justice. The Noticee has submitted that only those documents have been provided to the Noticee which were available in public domain

and case specific documents have not been provided to the Noticee. In this regard, I note that the trade details of the Noticee were duly provided by the DA, to the Noticee, vide email dated July 22, 2020. Further, the Noticee has specifically argued that material such as the FMC order and the judgment of the Hon'ble Supreme Court in the merger petition has not been provided to the Noticee. In this regard, I note that such publicly available material has not been relied upon in the present matter to draw any adverse inference against the Noticee and has only been relied upon to explain the nature of the paired contracts which were being traded on the NSEL platform. I note that vide email dated July 22, 2020, SCN dated January 15, 2021 and SSCN dated October 12, 2022 the Noticee has been provided with the relevant and relied upon documents, including trade data in the matter. Accordingly, I am of the view that the principles of natural justice have been duly complied with in the matter and the Noticee's contention with regard to non-supply of relevant documents in the matter and is misplaced.

37. The Noticee has also submitted that the Hon'ble Supreme Court, in its judgment dated April 22, 2022, in the matter of MPID matter, has held that “...*The two-judge Bench of this Court took note of the modus operandi through which the trading members were duped by a conspiracy hatched by a few trading members along with NSEL*” and considering the above, even the Apex Court has held that the controversy in question was devised by a few trading members along with NSEL. I have perused the decision of the Hon'ble Supreme Court relied upon by the Noticee and I note that the quoted excerpt refers to the decision of the Hon'ble Supreme Court in the merger petition. In this regard, I am of the view that quoted excerpt cannot be used to draw a conclusion that the brokers trading on NSEL platform were not at fault and further the reliance placed by the Noticee does not prove that the Noticee was duped by the other trading members. Accordingly, I am not inclined to accept the contention of the Noticee in this regard.

‘Fit and proper person’ criteria

38. Now, I would be proceeding to deal with the main issue in hand in the present case that is whether the Noticee satisfies the *‘fit and proper person’* criteria laid down under Schedule II of the Intermediaries Regulations. Before moving forward, it would be

appropriate to take a look at the relevant provision of the SEBI Act, Broker Regulations and the Intermediaries Regulations (as they exist on date) which are reproduced as under for reference:

SEBI Act

Registration of stock brokers, sub-brokers, share transfer agents, etc.

12.(3) *The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations:*

Provided that no order under this sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard.

Broker Regulations

Consideration of application for grant of registration.

5. *The Board shall take into account for considering the grant of a certificate, all matters relating to trading, settling or dealing in securities and in particular the following, namely, whether the applicant,*

(e) is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Conditions of registration.

9. *Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely, -*

(b) he shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him.....

(f) he shall at all times abide by the Code of Conduct as specified in Schedule II

Liability for action under the Enquiry Proceeding Regulations.

27. *A stock broker or a sub-broker shall be liable for any action as specified in Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 including suspension or cancellation of his certificate of registration as a stock broker or a sub-broker, as the case may be, if he—*

(i)

(iv) has been found to be not a fit and proper person by the Board under these or any other regulations; ...”

SCHEDULE II

**Securities and Exchange Board of India (Stock Brokers and Sub-brokers)
Regulations, 1992**

CODE OF CONDUCT FOR STOCK BROKERS

[Regulation 9]

A. General.

- (1) *Integrity:* A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.
- (2) *Exercise of due skill and care:* A stock-broker shall act with due skill, care and diligence in the conduct of all his business.
- (3)
- (5) *Compliance with statutory requirements:* A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.”

Intermediaries Regulations:

SCHEDULE II

SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES)

REGULATIONS, 2008

[See regulation 7]

- (1) *The applicant or intermediary shall meet the criteria, as provided in the respective regulations applicable to such an applicant or intermediary including:*
- (a) *the competence and capability in terms of infrastructure and manpower requirements; and*
 - (b) *the financial soundness, which includes meeting the net worth requirements.*
- (2) *The ‘fit and proper person’ criteria shall apply to the following persons:*
- (a) *the applicant or the intermediary;*
 - (b) *the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and*

- (c) *the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:*

Provided that in case of an unlisted applicant or intermediary, any person holding twenty percent or more voting rights, irrespective of whether they hold controlling interest or exercise control, shall be required to fulfill the 'fit and proper person' criteria.

Explanation–*For the purpose of this sub-clause, the expressions “controlling interest” and “control” in case of an applicant or intermediary, shall be construed with reference to the respective regulations applicable to the applicant or intermediary.*

- (3) *For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but not limited to the following:*

(a) *integrity, honesty, ethical behaviour, reputation, fairness and character of the person;*

(b) *the person not incurring any of the following disqualifications:*

(i) *criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;*

(ii) *charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences and is pending;*

(iii) *an order of restraint, prohibition or debarment has been passed against such person by the Board or any other regulatory authority or enforcement agency in any matter concerning securities laws or financial markets and such order is in force;*

(iv) *recovery proceedings have been initiated by the Board against such person and are pending*

(v) *an order of conviction has been passed against such person by a court for any offence involving moral turpitude;*

(vi) *any winding up proceedings have been initiated or an order for winding up has been passed against such person;*

- (vii) such person has been declared insolvent and not discharged;*
 - (viii) such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;*
 - (ix) such person has been categorized as a wilful defaulter;*
 - (x) such person has been declared a fugitive economic offender; or*
 - (xi) any other disqualification as may be specified by the Board from time to time.*
- (4) Where any person has been declared as not 'fit and proper person' by an order of the Board, such a person shall not be eligible to apply for any registration during the period provided in the said order or for a period of five years from the date of effect of the order, if no such period is specified in the order.*
- (5) At the time of filing of an application for registration as an intermediary, if any notice to show cause has been issued for proceedings under these regulations or under section 11(4) or section 11B of the Act against the applicant or any other person referred in clause (2), then such an application shall not be considered for grant of registration for a period of one year from the date of issuance of such notice or until the conclusion of the proceedings, whichever is earlier.*
- (6) Any disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub -clause (b) of clause (3), shall not have any bearing on the 'fit and proper person' criteria of the applicant or intermediary unless the applicant or intermediary or any other person referred in clause (2), is also found to incur the same disqualification in the said matter: Provided that if any person as referred in sub-clause (b) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall replace such person within thirty days from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against the intermediary:*
- Provided further that if any person as referred in sub -clause (c) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall ensure that such person does not exercise any voting rights and that such person divests their holding within six months from the date of such disqualification*

failing which the 'fit and proper person' criteria may be invoked against such intermediary.

(7) The 'fit and proper person' criteria shall be applicable at the time of application of registration and during the continuity of registration and the intermediary shall ensure that the persons as referred in sub -clause s (b) and (c) of clause (2) comply with the 'fit and proper person' criteria.

39. I note that regulation 5(e) of the Broker Regulations provides that for the purpose of grant of Certificate of Registration, the applicant has to be a '*fit and proper person*' in terms of Schedule II of the Intermediaries Regulations. I further note that the '*fit and proper person*' criteria specified in Schedule II of the Intermediaries Regulations, 2008 was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021 with effect from November 17, 2021.
40. From the records, I note that SEBI has filed a complaint with EOW Mumbai on September 24, 2018, against brokers who had traded/facilitated access to '*paired contracts*' traded on NSEL, including the Noticee. On the basis of this complaint, an FIR dated September 28, 2018, was registered with the MIDC Police Station, Mumbai, against the Noticee. I note that the Noticee is holding a certificate of registration No. INZ000032536 granted by SEBI on March 18, 2016. In order to continue to hold such Certificate of Registration from SEBI, the Noticee is also required to satisfy the conditions of eligibility, which, *inter alia*, included, continuance of its status as a '*fit and proper person*'. The above condition to be fit and proper person is not a one-time condition applicable only at the time of seeking and obtaining registration. Rather, the provisions governing the criteria show that this is a condition which each and every registered intermediary is required to fulfil on a continuous basis as long as the entity remains associated with the Securities Market as a registered intermediary.
41. In this context, I note that the Noticee vide its reply dated March 05, 2021 has, *inter alia*, submitted that "...the Noticee as a member of NSEL had no other option but to trade in such contracts by observing the business rules and regulations of NSEL. There is no allegation whatsoever that the Noticee has committed any breach of the business rules and regulations of NSEL as applicable to the trading in '*paired contracts*'". Further, the Noticee has also stated in the said reply that "...the Noticee

executed trades only for few clients who had approached it at their own instance. The Noticee neither marketed this product nor it had intention to do so. The Noticee earned brokerage of barely Rs.3,81,286/- pertaining to activities conducted only during Oct 2012 to June 2013. There has been no complaints or grievances or allegations of any violations of regulations against the Noticee". Thus, it is clear from the admissions of the Noticee that the Noticee has indulged in facilitating trading in 'paired contracts' for its clients.

42. I note that the act of the Noticee in offering access to 'paired contracts' by facilitating trading in such contracts, seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee. As recorded in the FMC order and the judgements of the Hon'ble Supreme Court (*supra*), these contracts, were ex facie offered in violation of the 2007 Exemption Notification and were not spot contracts in commodities which were permitted to be traded on NSEL. The 'paired contracts' were nothing but financing transactions masquerading as spot contracts in commodities. The execution of the trades in 'paired contracts' were not permitted under the 2007 Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities, as observed by FMC in its Order. Therefore, the Noticee by its conduct and as a member of NSEL has facilitated and/or dealt in 'paired contracts' which were in the nature of financing transaction as held by the Hon'ble Supreme Court. The Noticee, by providing access for taking exposure to 'paired contracts' has exposed its clients to the risk involved in trading in a product that did not have regulatory approval and thereby raising doubts on the competence of the Noticee to act as a registered Securities Market intermediary. Thus, I am of the view that the trading activities of the Noticee in 'paired contracts' for its clients and for itself on the NSEL platform have serious ingredients amounting to jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the Noticee in the Securities Market.
43. I further note that Clause 3(b) of Schedule II of the Intermediaries Regulations, as amended with effect from November 17, 2021 lays down a list of disqualifications which includes the following:

i) criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;

44. As discussed above, the Noticee has facilitated its clients to trade in '*paired contracts*'. As the '*paired contracts*' were violative of the conditions stipulated in the 2007 Exemption Notification, a complaint was filed by SEBI with Economic Offences Wing, Mumbai on September 24, 2018, against the brokers who participated/ facilitated access to '*paired contracts*' traded on NSEL, including the Noticee within the time limit, as specified in the relevant provisions of the FCRA. On the basis of the said complaint of SEBI, FIR dated September 28, 2018 was registered with MIDC Police Station, Mumbai. I note that the name of the Noticee is reflected in the complaint and the FIR. I also note that the copies of the said complaint and the FIR were provided to the Noticee along with the SSCN dated October 12, 2022.
45. It is pertinent to note that the criteria of 'fit and proper person', is an ongoing requirement throughout the period during which the Noticee remains operational in the Securities Market as a registered intermediary. In case, pursuant to the grant of registration by SEBI, any evidence comes to the notice of SEBI that casts a doubt on the integrity, reputation and character of the registered intermediary, SEBI is well within its powers to examine the 'fit and proper person' status of such entity based on various parameters. Further, as and when the 'fit and proper person' criteria changes, the Noticee will be required to comply with the revised criteria, and in the instant case, criteria as revised vide the amendment in November, 2021. It is noted that parameters provided under Clause 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations lays down a list of disqualifications which includes a pending criminal complaint or information under Section 154 of the Code of Criminal Procedure, filed against such an entity by the Board. It is, therefore, noted that the Noticee attracts the disqualification provided in Clause 3(b)(i) of the Schedule II of the Intermediaries Regulations.
46. At this juncture, I deem it apposite to deal with the submission of the Noticee that SEBI cannot be permitted to use its own FIR as evidence in a proceeding and that since an FIR is a first instance of reporting of complaint, reliance on the same would be in gross violation of the principles of natural justice. As regard usage of FIR as

evidence in the present matter, I note that being a '*fit and proper*' person is a continuing '*eligibility criteria*' statutory requirement, which must be satisfied by the Noticee including the amended criteria, at all times. I am of the considered view that the due presumption on the constitutional and legal validity of the said amended Schedule II of the Intermediaries Regulations holds the field which is binding upon SEBI, and arguments to the contrary are not maintainable.

47. The Noticee has also submitted that the fit and proper criteria was amended with effect from November 17, 2021, i.e., after initiation of the proceedings against the Noticee and thus cannot be applied retrospectively. In this regard, as noted above, the '*fit and proper*' person criteria, being a continuing requirement under the Intermediaries Regulations ought to be complied with at all times as long as an entity desires to remain associated with the securities market as a registered intermediary. The present proceedings intend to examine the '*fit and proper person*' status of the Noticee as per the Intermediaries Regulations. Therefore, I am of the view that the Noticee must satisfy the fit and proper person criteria as it exists on date and accordingly, I do not find any merit in the argument of the Noticee.
48. Therefore, looking holistically, I find that the conduct of the Noticee is detrimental to the Securities Market, being not in conformity with the applicable code of conduct. I note that there were enough red flags for a reasonable person to come to conclude that what was being offered as '*paired contracts*' on NSEL were not spot contracts in commodities. Given the above, I am constrained to conclude that the Noticee provided a platform for its clients to access a product, which was in violation of the 2007 Exemption Notification, raised serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the product itself. By failing to disassociate itself from, and facilitating participation in the said '*paired contracts*', the Noticee failed to act with due diligence.
49. Furthermore, as mentioned in paragraph 45 above, the Noticee has also earned disqualification under Clause 3(b)(i) of the amended Schedule II of the Intermediaries Regulations on account of an FIR registered against the Noticee based on the complaint filed by SEBI. In this regard it is pertinent to note that the said FIR is subsisting and has not been challenged, quashed or stayed by any competent court *qua* the Noticee. In this context, as observed above, I note that being a '*fit and proper*'

person' is a continuing 'eligibility criteria' which must be satisfied by the Noticee including the amended criteria, at all times.

50. The Noticee has also submitted that NSEL was functioning in complete public knowledge and was permitted to provide the trading platform for '*paired contracts*' and hence there was no reason for the Noticee to question the legality of such product launched by NSEL thereby implying that the Noticee was under a legitimate expectation that the products launched by the Exchange are legal and valid. In this regard, I am of the view that, the principle of '*ignorantia juris non excusat*' or '*ignorantia legis neminem excusat*' or '*ignorance of law is no excuse*' becomes applicable in the situation, since trading in '*paired contracts*' was in violation of the 2007 Exemption Notification and ignorance of the conditions of the said Exemption Notification cannot be claimed. As held by the Hon'ble Supreme Court, the '*paired contracts*' were nothing but financing transactions which were portrayed as spot contracts in commodities. Therefore, giving go-by to the terms of the 2007 Exemption Notification and attempting to camouflage the nature of the transactions brings into question of appropriateness and suitability of the continuance of the registration of the Noticee as a broker. Equally, any argument deflecting the responsibility to NSEL, MCA or FMC is misplaced and hereby rejected, as the primary onus of diligence enjoined on an intermediary, which diligence any reasonable or prudent person would also perform, has not been undertaken by the Noticee. Clearly, the actions of the Noticee have been detrimental to the interest of the Securities Market and accordingly, the Noticee can no longer be called a '*fit and proper person*' for holding the Certificate of Registration as a broker in the Securities Market, which is one of the conditions for continuance of registration as specified in regulation 5(e) of the Broker Regulations read with the provisions of Schedule II of the Intermediaries Regulations.
51. In the context of Securities Market, I note that the role of a registered intermediary including a broker is not only sensitive and predominantly fiduciary in nature but also demands from it honesty, transparency, fairness and integrity which are essentially the hallmarks of such market intermediaries. Given the fact that one of the avowed objects of the SEBI Act is the protection of interest of investors apart from promotion and development of the Securities Market, the legislature through enactment, empowers SEBI to grant registration to several class of entities including brokers,

which are not only required to act as an intermediary simplicitor i.e., a bridge or a connector between the markets and investors, but also have a very important role to play in creating an ecosystem of trust and fairness so as to provide a fair and secure market to the investors and any deviation from the above noted objective could have a cascading adverse impact on the development of the Securities Market and interests of investors. Thus, undisputedly a broker is obligated to act in a transparent manner and comply with all applicable regulatory requirements which are in the best interests of its clients and which will uphold the integrity of the Securities Market.

52. I am also aware that SEBI has passed various orders in the related NSEL matters where the Noticees therein have been debarred from making a fresh application seeking registration for a specified period from the date of the said order or till acquittal of the said Noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier. I find that the present matter at hand is different from that of those cases as in the extant matter the Noticee is already holding a Certificate of Registration whereas in those cases, the entities had filed applications seeking certificate of registration. As already noted above at paragraph 45, '*fit and proper person*' criteria is a continuing requirement under the Intermediaries Regulations which the Noticee ought to comply with at all times so long it desires to remain associated with the Securities Market as a registered intermediary. Further, I note that the Hon'ble SAT in its order dated June 09, 2022 (pertaining to entities whose application for registration was rejected) has observed that the period for which the noticees cannot apply for registration needs to be specified by SEBI. Having noted the aforesaid observation of the Hon'ble SAT, I am of the view that since the recommendation in the present matter is of cancellation and not of rejection of the application, the necessity of specifying a period of time may not arise in this order (as did arise in the case of entities desiring to be registered as market intermediaries) as this forum cannot presume whether such entity wishes to reapply to be a market intermediary or not. If it chooses to do so, it will have to be assessed at such point of time if the Noticee is fit and proper as per the extant and applicable regulations.
53. The limited scope of the present proceedings is to see whether the indulgence, engagement and promotion of such activities could be held to be beneficial to the

development of Securities Market or the same contain elements that are potentially dangerous and detrimental to the interest, integrity, safety and security of the Securities Market. In this respect, the undisputed fact, as recorded in the FMC order and Orders of the Hon'ble Supreme Court (*supra*), that the scheme of '*paired contracts*' traded on the NSEL ultimately has caused huge loss to the market which itself casts serious aspersion on the conduct, integrity and reputation of, *inter alia*, the Noticee who facilitated such '*paired contracts*' and therefore, its continuing role in the Securities Market cannot be viewed as good for the interest of the investors or of the Securities Market.

54. Given the above discussions and deliberations, I am constrained to conclude that the act of the Noticee providing access to its clients to participate in a product, which was in violation of the 2007 Exemption Notification, raises serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the said product itself presumably, driven by its desire to earn brokerage. Further, as per findings recorded above, the Noticee also attracts the disqualification provided in Clause 3(b)(i) under the amended Schedule II of the Intermediaries Regulations insofar an FIR against the Noticee has been registered with MIDC Police Station, Mumbai and the same is subsisting/pending as on date. Further, it is also not the case of the Noticee that said FIR filed is either stayed or quashed by any competent court *qua* the Noticee or otherwise. In view of the above, I hold that the Noticee does not satisfy the '*fit and proper person*' criteria specified in Schedule II of the Intermediaries Regulations and hence, the continuance of the Noticee as a registered broker will be detrimental to the interest of the Securities Market. Therefore, activities of the Noticee, as discussed in the preceding paragraphs, as a registered broker cannot be condoned and deserve appropriate measures to prevent such wrong doings from recurring, to the detriment of the interest of the Securities Market.
55. In view of the above, I concur with the recommendation of the DA, i.e., the registration of the Noticee, MK Commodity Brokers Limited, may be cancelled.

ORDER

56. I, therefore, in exercise of powers conferred under Section 12(3) and Section 19 of the SEBI Act, 1992 read with Regulation 27 of the Intermediaries Regulations, 2008

cancel the Certificate of Registration (bearing no. INZ000032536) of the Noticee viz. MK Commodity Brokers Limited.

57. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 56 above.
58. Notwithstanding the direction at paragraph 56 above, the Noticee shall allow its existing clients, if any, to withdraw or transfer their securities or funds held in its custody, within 15 days from the date of this order. In case of failure of any clients to withdraw or transfer their securities or funds within the said 15 days, the Noticee shall transfer the funds and securities of such clients to another broker registered with SEBI within a period of next 15 days thereon, under advice to the said clients.
59. This Order shall come into force with immediate effect.
60. The above Order is without prejudice to the criminal complaint filed by SEBI in the NSEL matter and/or any proceedings pending before any authority in respect of similar matter concerning the Noticee or other relevant persons.
61. A copy of this order shall be served upon the Noticee and the recognized Market Infrastructure Institutions for necessary compliance.

DATE: SEPTEMBER 06, 2023

PLACE: MUMBAI

Sd/-

S.V. MURALI DHAR RAO

EXECUTIVE DIRECTOR

SECURITIES AND EXCHANGE BOARD OF INDIA