

**SECURITIES AND EXCHANGE BOARD OF INDIA
ORDER**

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

In respect of:

NOTICEE	SEBI REGISTRATION No.
Nine Star Commodities Private Limited	INZ000058430

In the matter of National Spot Exchange Limited

I. Background

1. Nine Star Commodities Private Limited ("**NSCPL**" / "**Noticee**") is registered with Securities and Exchange Board of India ("**SEBI**") as a Stock Broker bearing SEBI Registration No INZ000058430. The Noticee is a commodities derivative broker and member of Multi Commodity Exchange of India Ltd ("**MCX**") and National Commodity & Derivatives Exchange Ltd. ("**NCDEX**"). NSCPL was Member of the National Spot Exchange Limited ("**NSEL**")
2. As the Noticee was a member of the NSEL and had participated in/facilitated trading in 'paired contracts' on the NSEL platform, SEBI initiated enquiry proceedings against the Noticee under Chapter V of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as the "**Intermediaries Regulations**") and appointed a Designated Authority (hereinafter referred to as the "**DA**") vide order dated September 21, 2018, to enquire into whether the Noticee was a 'fit and proper person' (hereinafter referred to as "**FPP**") to continue to hold the certificate of registration as Stock Broker in terms of

Regulation 5 (e) read with Regulation 27 (iv) of the SEBI (Stock Brokers) Regulations, 1992 (hereinafter referred to as the “**Broker Regulations**”).

II. Brief History of Illegal Forward Contracts on NSEL:

3. Before considering the compliance of the Noticee with the FPP criteria, it would be appropriate to have a preliminary discussion on the background of NSEL which forms the basis of the current proceedings.
4. NSEL was incorporated in 2005 as an exchange for spot trading of commodities. I note from the FMC Order No.4/5/2013-MKT-1/B dated December 17, 2013 (“**FMC Order**”), that on June 05, 2007, the Department of Consumer Affairs (“**DCA**”), Ministry of Consumer Affairs, Food and Public Distribution, Government of India, issued a Notification S.O.906(E) under Section 27 of Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as “**FCRA**”) granting certain exemptions from the provisions of FCRA to NSEL subject to specified conditions. The relevant extract of the said notification is reproduced hereunder for ease of reference:

“...the Central Government exempts all forward contracts of one day duration for the sale and purchase of commodities traded on the National Spot Exchange Limited, from operation of the provisions of the said Act subject to the following conditions, namely:

- i. no short sale by members of the Exchange should be allowed;*
- ii. all outstanding positions of the trade at the end of the day shall result in delivery;*
- iii. the National Spot Exchange Ltd. shall organize spot trading subject to regulation by the authorities regulating spot trade in the areas where such trading takes place;*
- iv. all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency;*

.....”

5. The aforesaid notification was amended on February 6, 2012 by DCA vide Gazette Notification S.O. 228(E) specifying “Forwards Market Commission, Mumbai” as the designated agency of the Central Government.
6. NSEL commenced operations in October 2008. It is seen from the FMC Order and the Judgement dated April 22, 2022 of the Hon’ble Supreme Court, in the matter of The State of Maharashtra Vs. 63 Moons Technologies Ltd, Civil Appeal Nos. 2748-49 of 2022, that NSEL, in September 2009, introduced the concept of ‘paired contracts’, 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 short, 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. “T” indicates the trade date, that is, the date on which the trade took place; and +2 or +3 or +25 or +36, indicates the number of business days after the trading day when the delivery of the commodity and the payment of price ought to have been made. The transactions were structured in a manner that the buyer of the short duration contract always ended up making profits.
7. Further, from Para 8 of the FMC Order, I note that the DCA on April 27, 2012 directed NSEL to explain as to why action should not be initiated against NSEL for violation of the conditions of the notification dated June 05, 2007. In response to the same, NSEL submitted a reply vide their letter dated May 29, 2012. DCA, vide its letter dated May 31, 2012, sought comments of the FMC on the NSEL reply. The FMC, vide its letter dated August 02, 2012 to the DCA provided its comments on the two main issues, which are relevant for consideration of the matter at hand, as paraphrased hereunder:
 - a. Short Sale by members of the Exchange: NSEL did not insist upon ownership of goods before allowing its members to place the sale order. FMC was of the view that all those sale transactions which are not

backed by the ownership of goods were in violation of the condition of *"no short sale by the members of the Exchange shall be allowed"*.

- b. Contracts in which settlement period goes beyond 11 days: In view of the definition of forward contract under FCRA, FMC was of the view that all the contracts traded on NSEL which provide settlement schedule for a period exceeding 11 days are Non-Transferable Specific Delivery contracts. Thus even if the gazette notification does not specify the delivery period, NSEL had to settle the delivery for all open position within a period of 11 days as NSEL was allowed to only trade in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days.

- 8. I also note from Para 8 of the FMC Order that DCA, vide its letter dated July 12, 2013, directed NSEL to give an undertaking that:

- a. *No further/ fresh contracts shall be launched by NSEL until further instructions from the concerned authority; and*
 - b. *All the existing contracts will be settled on the due dates.*

- 9. To sum up, as per the original notification dated June 05, 2007, NSEL was granted conditional exemption from the provisions of FCRA for all forward contracts of one-day duration for the purchase and sale of commodities. The two main conditions were that (i) there should be no short sale and (ii) all outstanding positions at the end of the day should result in delivery. Thereafter, FMC had observed with order dated December 17, 2013 that 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 provisions of FCRA. 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"*. In view of the said definition contained in FCRA, 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. NSEL, thus, had permitted contracts of various commodities having duration longer than 11 days and these contracts were *ex facie* in contravention of the exemption granted to NSEL vide the Government Notification dated June 05, 2007.

10. Further, I note that the Hon'ble Supreme Court, in its Judgement dated April 22, 2022 in the matter of The State of Maharashtra Vs. 63 Moons Technologies Ltd, Civil Appeal Nos. 2748-49 of 2022, while drawing reference to the presentations made by NSEL in respect of 'paired contracts' had *inter alia* held that:

"44.... NSEL in the course of its brochures has held out representations about the trading and investment opportunities available for:

- a) corporate clients*
- b) high net worth individuals; and*
- c) retail investors*

45. Under the head of "contract specifications", the following representation has been held out:

<i>Commodity</i>	<i>Duration</i>	<i>Investment (lacs.)</i>	<i>Yield</i>
<i>Castor Seed</i>	<i>T+3 & T+36</i>	<i>7.5 -9 Lacs</i>	<i>16%</i>
<i>Castor Oil</i>	<i>T+5 & T+30</i>	<i>7-9</i>	<i>16%</i>
<i>Cotton Wash Oil</i>	<i>T+2 & T+25</i>	<i>10</i>	<i>16%</i>
<i>Paddy</i>	<i>T+2 & T+25</i>	<i>3.5-4.5</i>	<i>16%</i>
<i>Steel</i>	<i>T+2 & T+25</i>	<i>4.5-5</i>	<i>16%</i>
<i>Raw Wool</i>	<i>T+2 & T+25</i>	<i>3.5-4</i>	<i>16%</i>
<i>Wool Top</i>	<i>T+2 & T+25</i>	<i>1.8-2</i>	<i>16%</i>
<i>Crude Soybean Oil</i>	<i>T+2 & T+25</i>	<i>3.3.-3.5</i>	<i>16%</i>
<i>Soya DOC</i>	<i>T+2 & T+25</i>	<i>1.7-2.0</i>	<i>16%</i>
<i>Refined Mustard Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Refined Soybean Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>

<i>Refined Sunflower Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>RBD Palmolein Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Sugar</i>	<i>T+2 & T+25</i>	<i>3.0</i>	<i>16%</i>
<i>Maize</i>	<i>T+2 & T+25</i>	<i>3.0</i>	<i>16%</i>

The above representation specifies:

- (i) Commodities;*
- (ii) Duration of trades;*
- (iii) Investment; and*
- (iv) Yield.*

For example, in the case of castor seeds, NSEL held out a buy contract (T+3) and sale contract (T+36), in which the yield is stated to be 16%. Moreover, NSEL represented that:

“Opportunities

- Traders can trade and lock their return*
- Trader has to buy in near settlement contract and sell in far settlement contract simultaneously*
- Price for both settlement available*
- Exchange provides counterparty guarantee risk*
- No basis risk, No link with future contracts*

While describing the features of trading opportunity, NSEL represented that:

“Features of Trading Opportunity:

- T+2 and T+25 contract offers unique trading opportunity to traders*
- Trader purchases T+2 contract and simultaneously sells T+25 contract*
- Pay-in obligation is on T+2 while Pay-out of the funds will be on T+25. Entire settlement cycle is of 35-37 days*

- *Price differential between the two settlement dates i.e premium if annualized offers interest rate of about 16%*
- *Income arising out of such trades are treated as Business Income”*

While comparing the investment opportunities of bank fixed deposits with trading opportunities at NSEL, NSEL represented that:

“Comparison

- *Bank FD 9.25% for 390 days; NSEL Trading Opportunity 16%;*
- *Bank FD minimum duration 390 days; NSEL Trade duration 35-55 days, depending on the contract*
- *Traders have an option of rolling over their position as per their convenience*

.....

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.”

11. As such, both the FMC Order and the aforesaid order of Hon’ble Supreme Court have explicitly brought out the details as to how NSEL permitted short sales - i.e. by permitting sellers to offer contract for sale of commodities on its

platform without ensuring that requisite amount of commodity is available in the warehouse.

12. It is also pertinent to note that the Hon'ble Supreme Court in another Judgement dated April 30, 2019, titled 63 Moons Technologies Ltd Vs. Union of India, Civil Appeal No. 4476 of 2019 observed that these contracts were in the nature of "financing transactions". The relevant extract of the said order is as under: -

"55.3. 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, 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 were distinct from sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL, and the FCRA."

III. Show Cause Notice, Reply and Hearing

13. In light of the background and history narrated above, the DA issued show cause notice dated September 24, 2018 to the Noticee, calling upon it show cause as to why it should not be found to be "fit and proper person" in terms of Regulation 5(e) read with Regulation 27 of the Broker Regulations and Schedule II of the Intermediaries Regulations and hence liable for cancellation of its registration. DA, vide supplementary show cause notice dated May 13, 2020, has provided trade logs and advised the Noticee to file reply within 14 days from the date of receipt of the notice. Upon completion of the enquiry, the DA submitted its report dated May 29, 2020, recommending cancellation of the certificate of registration granted to the Noticee, since it was not a FPP.
14. Pursuant to the same, a post enquiry show cause notice (hereinafter referred to as the "**SCN-1**") dated July 10, 2020, was issued to the Noticee, under Regulation 28(1) of the Intermediaries Regulations to show cause as to why

action, as recommended by the DA or any other action as considered appropriate by the Designated Member, should not be taken against the Noticee. A copy of the DA's Report was also forwarded to the Noticee along with an advice to file a reply, if any, within 21 days from the date of receipt of the notice. Along with the DA's Report, a letter dated December 30, 2014 of the Ministry of Finance ("**MoF**"), Department of Economic Affairs ("**DEA**") addressed to the Chairman, FMC, was provided to the Noticee, wherein it was stated that the DEA was in agreement that NSEL had violated the conditions of exemptions granted to it under the FCRA. Further, the Order dated August 22, 2014 of Hon'ble Bombay High Court, in the matter of *Jignesh Prakash Shah Vs. The State of Maharashtra*, Criminal Bail Application No. 1263 of 2014, wherein it was held that the brokers through whom the paired contracts were entered into had knowledge of the illegality of such contracts, was also furnished to the Noticee. The SCN-1 also *inter alia* highlighted the observations made by the Hon'ble Supreme Court in the matter of *63 Moons Technologies Ltd. Vs. Union of India* (order dated April 30, 2019), wherein it was held that paired contracts were in fact financing transactions in breach of exemptions granted to NSEL under the FCRA. The Noticee submitted its reply to the SCN-1 vide letter dated August 07, 2020.

15. In the meantime, while the proceedings in the present matter were ongoing, Whole Time Member, SEBI ("**WTM**") passed certain orders rejecting the applications of five other entities for registration as commodity brokers. The Hon'ble Securities Appellate Tribunal ("**Hon'ble SAT**") vide its order dated June 9, 2022 remitted the matters to the WTM to decide the matter afresh after giving an opportunity of hearing to the brokers. Further, Hon'ble SAT had 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 SEBI 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".

16. In light of the order of Hon'ble SAT dated June 9, 2022, supplementary show cause notice dated October 07, 2022 (hereinafter referred to as "**SCN-2**") was issued to the Noticee. Vide the SCN-2, additional documents viz. SEBI's complaint dated September 24, 2018 to Economic Offence Wing ("**EOW**"), First Information Report ("FIR") dated September 28, 2018 filed by SEBI and the amended Schedule II of the Intermediaries Regulations were furnished to the Noticee calling upon it to show cause as to why information/material provided therein along with the Enquiry Report should not be considered against the Noticee.
17. In response to the SCN-2, the Noticee vide letter dated October 27, 2022 has submitted its reply in line with the earlier submissions made by it.
18. In order to proceed with the matter, a hearing was granted to the Noticee in terms of Regulation 27(4) of the Intermediaries Regulations as the DA had recommended cancellation of the certificate of registration of the Noticee. On request of the Noticee the hearing scheduled on November 23, 2022 and December 15, 2022 were adjourned and finally the hearing was held on January 17, 2023 which was duly availed by the Noticee through its authorized representatives viz. Ms. Rishika Harish, Advocate, Mr. Aditya Bhansali, Advocate and Mr. Suyash Bhandari, Advocate. The AR reiterated the submissions made in replies dated August 07, 2020 and October 27, 2022. Subsequent thereto, the Noticee vide letter dated February 09, 2023 filed additional submissions. The summary of the said replies of the Noticee is given hereunder:
- a. The Noticee has been engaged in the business of commodity trading activities for the last 9 years and till date, the Noticee has not been held guilty of any violations relating to securities market or commodities market. The Noticee had a registered client base of 3000 clients.
 - b. The SCN has not explained the cause of action which led to the alleged violation, the exact and specific role of the Noticee while holding the Noticee to be not 'fit and proper'.

- c. The Noticee was merely carrying out its duties as a broker and was neither associated with people at the helm of affairs of NSEL nor has ever promoted the platform of NSEL or any of its products to any of its clients. The Noticee submits that just one client out of the total client base of around 3000 clients, has actually traded on the platform of NSEL through the Noticee and that too was limited to one single day out
- d. The SCN and attached Enquiry Report is general and vague and does not provide any basis and details relating to allegations levied, therefore not valid in law. In this regard, the Noticee referred certain judicial pronouncements. The Noticee further stated that the Enquiry Report contains only a simple finding stating that the Noticee by participating in/ facilitating 'paired contract' in the trading platform as a trading/clearing member has violated the conditions of Notifications and also the provisions of FCRA. FMC, the then designated agency of the Government of India or the Government of India being the sole regulator of NSEL did not take any appropriate action at the time the alleged scam came to light and so it is clear that there was in fact no reason to issue a show cause notice or initiate any other proceedings by any forum for its alleged activities on NSEL.
- e. SEBI does not have power and jurisdiction to regulate the spot market in India. SEBI only has power to regulate securities market and commodities market in India, which is different from the 'spot market'. Further the 'spot market' is a distinct market from 'securities market' and 'commodities market'. No provision under Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "**SCRA**") or SEBI Act gives power to SEBI to regulate the spot markets in India. The regulation of the spot market in India came under the prerogative only of the Government of India.
- f. SEBI initiated the proceedings under Intermediaries Regulations and for the violation of Regulation 9(b) and 9(f) read with Clause A (1), A (2) and A(5) of Schedule II of the Broker Regulations. The regulation 9(b) of the Broker Regulations refers to the rules, regulations and bye laws of the stock exchange. NSEL, neither was nor is a 'stock exchange' within the

meaning of Broker Regulations. The Noticee submits that the Enquiry Report does not mention which rules and/or regulations of any of the exchange have been violated by the Noticee against which the violation of regulation 9(b) of the Broker Regulations have been alleged by the Designated Authority.

- g. The law does not permit any court/ tribunal/ authority/ forum to usurp jurisdiction on any ground whatsoever, in case, such an authority does not have jurisdiction on the subject matter. It is mandatory for the Court to deal with the preliminary issue of jurisdiction framed by the Court and raised in the matter. This is because a decision taken in excess of jurisdiction would render the same a nullity. In this regard, the Noticee referred certain judicial pronouncements and submitted that SEBI does not have the jurisdiction to proceed with the matter and the Notice issued to the Noticee in the present matter is null and void for the want of jurisdictions.
- h. The enquiry and the Enquiry Report are ultra vires as the scope of enquiry conducted by SEBI is beyond the scope of FCRA. SEBI has initiated the proceedings under SEBI Act/ SEBI Regulations instead of initiating the proceedings for the alleged violations under the provisions of FCRA. The immediate actions of SEBI against the Noticee are in contradiction to the express provisions of the Section 29A (d) of FCRA which mentions that all offences committed, and existing proceedings with respect to offences which may have been committed under FCRA, shall continue to be governed by the provisions of FCRA, as if FCRA has not been repealed. Since the present proceedings ought to have been initiated under provisions of FCRA, the initiation of the present proceedings under Intermediaries Regulations are erroneous and ill-placed.
- i. The requirements of FPP for being a broker are continual, the requirement as mentioned in the Broker Regulations was not applicable on the acts or omissions of the Noticee, any time before September, 2015 or on the alleged act of trading in paired contracts by the Noticee.

Hence the past acts of the Noticee cannot be scrutinized based on the prospectively applicable laws/ regulations.

- j. The conduct of the broker prior to its registration was not regulated by SEBI, the case of *Jermyn Capital* cannot be relied upon by the Designated Authority and SEBI cannot initiate any proceedings, taking into its scrutiny, the actions which had not been under its regulatory remit.
- k. The Noticee submits with respect to FPP observations that neither FMC nor Department of Finance nor Department of Consumer Affairs or any regulatory authority had any grievance against the Noticee or had raised any question as to the integrity, reputation or character of the Noticee.
- l. The term 'paired contracts' neither is nor was defined by the NSEL Byelaws, its Business Rules, Circulars or any other rules/ regulations and the term has now been coined by the Authorities for easy reference and the same has no legal significance, The shorter period contracts i.e. T+2, T+3 and T+5 settlement and longer period contracts i.e. T+25, T+30 and T+36 settlements were contracts independent of each other, It is to be noted that the buy order and the sell order for any of the above mentioned contracts were given at different time and different price. There was absolutely no relation between the short period contract and long period contracts at all. There was no restriction on the short term contract to be sold and long term contract to be brought on the trading platform of NSEL.
- m. The Noticee did not enter or execute or participated in any alleged "paired contract" on its own accord. The transactions had been executed by the Noticee for the clients for the contract on NSEL as they were duly authorized contracts by the exchange and for the same reason if the culpability of the actions of the brokers had to be established, the liability and culpability of the actions of the clients as well as NSEL has to be proven. The Noticee further stated that it was NSEL who matched the contracts and approved the transactions and hence the liability and culpability of the Exchange needs to be established before the allegation on the Noticee are to be established.

- n. The registration has been granted to the Noticee on July 11, 2016 which shows that on and till July 11, 2016, the Noticee was a FPP as per the Intermediaries Regulations. Therefore, the Noticee cannot be held liable for any alleged wrongdoing committed before July 11, 2016. SEBI is, as per the doctrine of estoppel, estopped from changing its stance and allege that on July 11, 2016 i.e. at the time of registration, the Noticee was not a FPP as per the Intermediaries Regulations or Broker Regulations.
- o. The Noticee had no reason to suspect that NSEL lacks competence or that it would be operating in breach of the exemptions etc. as sought by it from the Government. Further the non-action of Central Government for six years after the exemption gave an impression to the public at large, that the trading at NSEL platform was in consonance with the exemption granted by Central Government.
- p. The commodities contracts including alleged 'paired contracts' were introduced by the NSEL with the prior concurrence of the Commission i.e. FMC. The Noticee was of the view that if the products are being launched on NSEL after the concurrence of the FMC then the same were legal and genuine. Hence, it is very unfair to blame the members/ brokers of NSEL for the product which was introduced by NSEL with the concurrence of FMC. The Noticee, as a commodity broker, in the normal course was not required to assess the legality of the product introduced by the NSEL but was required to facilitate the trading on the platform of the NSEL in accordance with the bye laws, business rules and circulars of the NSEL.
- q. SEBI in the present case has not provided any material in the show case notice or the Enquiry Report to suggest any negligence or connivance on the part of the Noticee and has simply been stated that the brokers have participated / facilitated 'paired contracts'. Hence, the Noticee must not be held per se liable for participating or facilitating in 'paired contracts'. The Noticee referred certain judicial pronouncements in support of its claim.

- r. The Noticee was functioning as an agent, it cannot be held liable till any knowledge of the illegality can factually be attributed to the Noticee. The Noticee was functioning solely on the instructions/direction given to it from its clients and NSEL, the Noticee being an agent cannot be held liable till the principal is held liable. Further, it is submitted that an agent cannot be held liable or answerable for the acts/ omission of the principal till the deliberate act and knowledge cannot be illustrated. Since in the present case no such knowledge or intention can be illustrated, the allegations against the Noticee are not maintainable.
- s. The Noticee submit that another aspect of 'facilitating' is promoting any product or inducing the clients to enter into any contracts. The letters/ affidavits from its clients stating that they on their prior individual understanding and desire approached the Noticee to open their trading account for trading at NSEL and to provide them the broking services. The Noticee submits that the affidavit also mentioned the trading done by the Noticee was done on its client's express instructions and the Noticee had not induced or persuaded its clients to trade on the NSEL and that it was just acting as an agent of its clients.
- t. The Noticee submitted that some of its clients had made it aware to the Noticee that there was some commodity trading undergoing at NSEL and they wish to trade in the same and it was only on the client's insistence that the Noticee taken the membership at NSEL. The Noticee has never promoted any products or the fact of trading at NSEL to any of its clients. It can be judge from the mere fact that out of total 1000 Clients doing large volumes in different commodity exchanges, the Noticee has just participated in one trade and that too with a single client on its repeated requests.
- u. The Noticee submitted that the cause of action arose during the period from 2009 - 2013 and the SCN-2 has been issued in the year 2022, i.e., after a lapse of nearly 13 years, the same is a testament in the nature in which the Enquiry has been conducted. The SCN-2 has been issued by SEBI, after an inexcusable and exorbitantly inordinate delay and the

same is grossly unjust, illegal and arbitrary. Thus, the SCN-2 ought to be set aside on the grounds of the gross delay itself.

- v. The Noticee submitted that the amended Schedule II cannot be made applicable on the Noticee. It is submitted that the disqualification flowing from the registration/ filing of Criminal Complaint under Section 154 of the Code of Criminal Procedure, 1973 which has been introduced under the "fit and proper" criteria vide an amendment in the Intermediaries Regulations with effect from November 17, 2021 and hence the said amendment is applicable prospectively and cannot be made applicable retrospectively. It is stated that the Noticee was granted registration in the month of July, 2016 and hence it is only after the Noticee was registered as a Stock Broker with SEBI that the Broker Regulations and Intermediaries Regulations were made applicable on the Noticee. In the present case the cause of action arose between the years 2009-2013 and the Enquiry Report was issued in the month of April, 2019 and hence the amended Broker Regulations and Intermediaries Regulations cannot be applicable in the present case or can be relied against the Noticee in the present case.
- w. The Noticee submitted that in the SCN-2, the allegations/ charges against the Noticee have been effectively changed, as on the first instance the "fit and proper" status of the Noticee was assessed based on its association with NSEL as its Trading Member and when the said ground has been declared as unreasonable by the order of the Hon'ble Tribunal, the "fit and proper" status of the Noticee is now questioned based on the Criminal Complaint and the First Information Report filed against it by SEBI itself. It is trite law that when a specific allegation has been made against the entity, such allegation cannot be substituted by another allegation when the first allegation has been found to have failed or has been rendered unsubstantiated for want of evidence. Hence, in the present case, apart from the fact that the amended Broker Regulations and Intermediaries Regulations are not applicable on the Noticee post-facto, the fact of the filing of the Criminal Complaint and First Information Report cannot be considered against the Noticee as the

same amounts to total change in the grounds on which the present proceedings were initially commenced and are now being carried out against the Noticee.

- x. The Noticee was acting merely as a Trading Member of NSEL and broker/ agents for its clients, the NSEL (as an Exchange) as well as the clients of the Noticee (as the primary transacting parties) warrants to be nabbed first and found to be guilty of misconduct and only subsequent to such finding, the proceedings can be initiated against the broker and the broker can be held liable for misconduct. The Noticee further submits that in cases of alleged misconduct of the brokers, the brokers are held liable only in cases where knowledge of the alleged illegal/ irregular transactions can sufficiently and concretely be attributed to them as a broker. In the numerous orders of the Hon'ble Tribunal as well as the Hon' ble Supreme Court of India where it has been held that in case of illegal/ irregular transactions the brokers can only be held liable if they had the knowledge of the illegal nature and motive of actions of its clients and actively participated by facilitating the commission of such illegal trades. Absent such a finding in the present case and that no proceedings have been initiated against the clients of the Noticee, no proceedings can be initiated/ continued against the Noticee in the present case.
- y. The Noticee submits that when the Certificate of Registration was granted to the Noticee, the fact that the Noticee was a Trading Member of NSEL was known and still granted the Certificate of Registration. Based on objectively the same material, now the Certificate of Registration is sought to be cancelled. Since after grant of Certificate of Registration there was no new material placed before SEBI to revoke the said registration, the filing of the Criminal Complaint and First Information Report is inconsequential by nature and hence reliance on the same is totally illegal in the eyes of the laws. The Noticee further submitted that there was no incidence of any regulatory action reported against the Noticee by any regulator and hence the documents attached

to the SCN-2 cannot be considered against the Noticee in the present case.

- z. The Noticee submits that it had no trading in its proprietary account and had not marketed or promoted any product of NSEL to its clients. Further the alleged trades are two in number which, on the very face of it does not warrant any cancellation of registration of the Noticee.

IV. Consideration of Issues

19. I have considered the SCN-1, SCN-2, the Enquiry Report submitted by the DA, Noticee's replies dated August 07, 2020, October 27, 2022 and February 09, 2023 and other material available on record. Having regard to the same, I now proceed to deal with the issues in the present matter.
20. It is alleged that the Noticee has violated Regulation 9(b) and (f) read with Clause A(1), A(2) and A(5) of the Schedule II of the Broker Regulations and Regulation 5(e) of the Broker Regulations read with Schedule II of the Intermediaries Regulations. The relevant provisions are reproduced hereunder: -

Provisions of 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

SCHEDULE II
Securities and Exchange Board of India (Stock 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.

Provisions of 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-clauses (b) and (c) of clause (2) comply with the 'fit and proper person' criteria."

21. I note that the Noticee has contended that there is a delay in initiation of proceedings. In this regard, I note that the NSEL scam unfolded in 2013 after which several agencies such as EoW, Serious Fraud Investigation Office ("SFIO"), Directorate of Enforcement ("ED"), etc. conducted investigations into the activities of NSEL. Charge sheets are still being filed in the matter by these agencies. A large number of brokers had participated in the illegal forwards contracts at NSEL platform. After the merger of FMC with SEBI on September 28, 2015, some of these brokers applied for registration with SEBI.

Subsequently, the FMC and the Hon'ble Supreme Court had made very critical observations about the trades on NSEL being short sale of commodities without ensuring availability of commodity in the warehouse and that they were 'paired contracts' which were in fact 'financing transactions' etc. as brought out in paragraph 7 to 12 above. It is true that the trades and actions were of the year 2012-2013. However, the jurisdiction was conferred on SEBI only on September 28, 2015. Thereafter assessing all the factual circumstances available before SEBI and considering the importance of fulfilling FPP criteria by commodity brokers, action was duly initiated against the set of brokers who executed the alleged trades. Further, as noted at paragraph 15 above, while the instant matter was under consideration, the Hon'ble SAT vide its order dated June 9, 2022 remitted certain orders pertaining to some other brokers who had also participated in paired contracts on NSEL to SEBI to decide the matter afresh. The Hon'ble SAT left it open to SEBI to rely on other material like EOW charge sheet, complaint letters etc., after providing the same to the appellants therein. Keeping in line with the aforesaid order of the Hon'ble SAT, the SCN-2 was issued to the Noticee along with documents mentioned at paragraph 16 above on October 7, 2022. I note that the documents have been provided to them and the Noticees have filed detailed replies in the matter. Unlike other cases where delay may be a vitiating factor, depending on the facts and circumstances in which certain transactions were allegedly executed, the core issue in the instant case pertains to the adjudication of FPP criteria of the Noticee and the same being a continuing criteria, I am of the view that delay cannot be attributed to the initiation of the proceedings.

22. From the reply of the Noticee, it is seen that the Noticee has admitted to the fact of execution of certain trades, referred to as "paired contracts" by FMC and the Hon'ble Supreme Court, on behalf of its client on NSEL. On perusal of the reply of the Noticee, I find that as a broker with sufficient experience and knowledge, the Noticee ought to have refrained from participating in the subject contracts on such a platform, going by the very structure of the back-to-back contracts. The Noticee contended that it had no reason to suspect that NSEL lacks competence or that it was operating in breach of the exemptions granted

to it and further the non-action of Central Government, gave an impression to the public at large that the trading at NSEL platform was in consonance with the exemption granted by Central Government. In this context, I note that NSEL itself was advertising such contracts as an alternative to fixed deposits. The return offered was 16% across all commodities irrespective of the nature of the contract or the duration. Also, these contracts were structured in a manner which ensured that the buyer always made pre-determined profits. I am, therefore, of the view that while participating in such contracts, the Noticee failed to examine the basic nature of the product and also failed in understanding the source of powers relied upon by NSEL for selling such products which other exchanges were not offering. Thus, the Noticee failed to conduct proper and effective due diligence on these aspects of paired contracts which were not essentially spot contracts.

23. The Noticee has also contended that SEBI does not have the power and jurisdiction to regulate the spot market in India. The Noticee has submitted that the initiation of present proceedings under intermediaries Regulations is erroneous. I note that the Finance Act, 2015 conferred the power of regulation over intermediaries dealing in commodity derivatives to SEBI and also mandated regulation of commodity derivatives brokers by SEBI, including registration as commodity derivatives broker with SEBI. It is noted from the submission of the Noticee that the registration as intermediary was granted on July 11, 2016. I also note that as the commodity derivatives are now under the purview of SEBI, following the amendments to the FCRA and therefore, these contentions are not tenable.

24. I further note that the SCN-1 dated July 10, 2020 provided the Noticee along with the DA's Report, the letter dated December 30, 2014 of the DEA, MoF addressed to FMC and copy of 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* and the Noticee was called upon to show cause as to why information/material brought therein should not be considered along with Enquiry Report. I note that the Hon'ble SAT, in its order dated June 09, 2022,

in respect of the applications of five other entities for registration as commodity brokers, has held that the observations in the bail rejection order of the Hon'ble Bombay High Court cannot be relied upon as the observations therein are limited to the fact as to whether the bail should be granted or not. Further, I note that the Bombay High Court Judgment dated August 22, 2019 was set aside by the Hon'ble Supreme Court vide its judgment dated April 22, 2022, in the matter of The State of Maharashtra Vs. 63 Moons Technologies Ltd, Civil Appeal No. 2748 of 2022. Accordingly, I find that the said documents are not relevant for consideration in the present matter.

25. I also note that vide the SCN-2, additional documents viz. SEBI's complaint dated September 24, 2018 to EOW, FIR dated September 28, 2018 filed by SEBI and the amended Schedule II of the Intermediaries Regulations was provided to the Noticee. I note that Schedule II of the Intermediaries Regulations was amended vide SEBI(Intermediaries) (Third Amendment) Regulations, 2021, w.e.f. 17.11.2021 and the following disqualifications have been included amongst others:

“(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;”

26. I also note that as per the amendment, the disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub-clause (b) of clause (3) of Schedule II to the Intermediaries Regulations, shall not have any bearing on the FPP 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.

27. It is pertinent to note that in terms of Regulation 5(e) of Broker Regulations, the eligibility criteria for an entity to get registered as a stock broker includes that it should be a 'fit and proper person' based on the criteria specified in Schedule II of Intermediaries Regulations. I note that the Noticee has contended that the provisions of the Broker Regulations cannot be applied to it as the alleged actions were prior to registration with SEBI. The effect of insertion of Section

28A in the FCRA in the year 2015 is to grant powers to SEBI to deal with matters relating to commodities derivatives and to regulate persons “...*buying, selling or otherwise dealing in commodity derivatives as a commodity derivatives broker, or any other intermediary who may be associated with the commodity derivatives market, immediately before the transfer and vesting of rights and assets to the Securities and Exchange Board of India for which no registration certificate was necessary prior to such transfer...*”. Accordingly, the Noticee applied for registration as a broker and was granted the same w.e.f. July 11, 2016. Since then, it has been acting as a market intermediary registered with SEBI. I note that it has been specified in Clause 7 of Schedule II of Intermediaries Regulations that the FPP criterion is required to be satisfied by the intermediary at the time of registration as well as during the continuity of registration with SEBI. Therefore, even assuming that the Noticee fulfilled the eligibility requirements at the time of grant of certificate of registration, it is required to comply with the criteria continuously including those conditions which are incorporated subsequently. Hence, the submission of the Noticee in this regard is not tenable. It is also settled position that the authority which has the power to grant registration also has the power to cancel or suspend the same, if there are valid reasons for such action. Thus, the only question at this point of time is whether the Noticee can be said to be a FPP as a broker today.

28. It is a matter of record that SEBI has filed a complaint dated September 24, 2018 with EOW seeking appropriate action under Sections 20 and 21 and other applicable provisions of FCRA against the brokers/members of NSEL, mentioned in the list attached thereto. I note that the Noticee is listed at serial no. 163 in the said list. Pursuant to the SEBI complaint, FIR No. Spl LAC No. 110/18 dated September 28, 2018 under section 154 of the Code of Criminal Procedure, 1973 has been registered at the MIDC Police Station, Mumbai against the same trading members, which were listed in the SEBI complaint to EOW. I note that the said FIR is currently pending. In view thereof, I note that disqualifications contained in paragraph 3(b)(i) of Schedule II of Intermediaries Regulations are attracted against the Noticee.

29. When the pendency of a criminal complaint or FIR filed by SEBI is prescribed as a negative criterion / disqualification from eligibility under Schedule II of the Intermediaries Regulations, it is imperative for me to consider the same while adjudging the eligibility of the Noticee to continue to hold the authorization granted. In my view, the amendment of Schedule II of the Intermediaries Regulations merely encapsulates the criteria in the form of distinctly identifiable parameters, which would apply uniformly to all intermediaries. To reiterate, the fact that SEBI has filed a complaint and FIR has been registered against the Noticee and the same is pending, in itself constitutes a disqualification from satisfaction of eligibility criteria to function as an intermediary.
30. The evaluation of the facts and legal provisions as brought out above, compels me to arrive at the conclusion that the Noticee is not a 'fit and proper' person and hence is not eligible to continue its business as a stock broker using the certificate of registration no. INZ000058430 granted by SEBI.

DIRECTIONS

31. In exercise of powers conferred upon me under Section 19 read with Section 12(3) of the SEBI Act, 1992 and Regulation 27 of the Intermediaries Regulations, 2008, I do hereby, cancel the Certificate of Registration bearing no. INZ000058430 of the Noticee i.e. Nine Star Commodities Private Limited.
32. Upon receipt of this Order, the Noticee shall immediately inform its existing clients, if any, about the direction at paragraph 31 above.
33. Notwithstanding the direction at paragraph 31 above,
- a. 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 client 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 within a period of next 15 days thereon, under advise to the said clients; and

- b. the Noticee shall square off open positions, if any, within 30 days from the date of this order.

34. The Order shall come into force with immediate effect.

35. A copy of this order shall be served upon the Noticee and the recognized Stock Exchanges, Depositories and Clearing Corporations for necessary compliance.

Date: March 31, 2023

Place: Mumbai

Sd/-

GEETHA G

CHIEF GENERAL MANAGER

SECURITIES AND EXCHANGE BOARD OF INDIA