

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Section 12(3) of the 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

Sr. No.	Name of the Noticee	PAN
1.	M/s Sugal Commodity Brokers Private Limited	AABCJ2604H

In the matter of National Spot Exchange Limited

BACKGROUND

1. The instant proceedings were initiated on the basis of an Enquiry Report dated November 25, 2019, submitted by the Designated Authority (hereinafter referred to as “**DA**”) in terms of regulation 27 of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as “**Intermediaries Regulations**”). The DA, based on facts noted in the said enquiry report, has recommended that the application of M/s Sugal Commodity Brokers Private Limited (hereinafter referred to as “**SCBPL/noticee**”) seeking registration as a commodity derivatives broker may not be considered in the interest of securities market and may be rejected. It was also recommended that the noticee may be restrained from acting as a commodity broker.
2. The DA submitted the enquiry report pursuant to an enquiry proceeding initiated against the noticee by the Securities and Exchange Board of India (hereinafter referred to as “**SEBI**”) based on the finding that SCBPL, as a Trading and Clearing Member of the National Spot Exchange Limited (hereinafter referred to as “**NSEL**”), had dealt/facilitated in the trading of the ‘paired contracts’ at the exchange platform of NSEL during the period from September 2009 to August 2013 (hereinafter referred to as “**relevant period**”) which was in violation of the applicable provisions of erstwhile Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as “**FCRA**”) and the conditions prescribed in the Government of India Notification dated June 05, 2007 (hereinafter referred to as “**2007 Exemption Notification**”). It was also observed that the noticee is not a ‘fit and proper person’ in terms of regulation 5(e) of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as “**Stock Brokers**”).

Regulations”) read with Schedule II of the SEBI (Intermediaries) Regulations, 2008 (hereafter referred to as “**Intermediaries Regulations**”) and granting registration to the noticee as a market intermediary in the Securities Market would be detrimental to the interest of the Securities Market.

3. The DA was appointed to enquire into the above allegations and to submit a report in this regard. Accordingly, the DA issued a show cause notice dated September 26, 2018 to the noticee under regulation 25(1) of the Intermediaries Regulations (as applicable at the relevant time), *inter alia*, alleging that the noticee did not meet the ‘fit and proper person’ criteria, which was one of the conditions for consideration of the application for grant of registration as an intermediary under regulation 5(e) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations read with regulation 27(iv) of the Stock Brokers Regulations. In response to the same, the noticee vide letter dated January 31, 2019 submitted its reply.
4. On the basis of the aforesaid factual details, material available on records and after considering the reply filed by the noticee, the DA has, *inter alia*, observed the following in the report:

“32.Thus, on perusal of the material available on record and the reasons mentioned in preceding paragraphs, I conclude that the Noticee is not a fit and proper person in terms of Regulation 5(e) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations. Consequently, in terms of Regulation 27 of the Intermediaries Regulations and Regulation 27 Stock Beakers Regulations, the application of the Noticee submitted for registration as a Commodity Derivatives Brokers may not be considered in the interest of securities market and the application of Sugal Commodity Brokers Pvt. Ltd. may be rejected and the Noticee may be restrained from acting as a commodity broker.”

5. A Show Cause Notice dated January 28, 2020 (hereinafter referred to as “**SCN**”) enclosing therewith the enquiry report of the DA and certain other documents as specified in the said SCN, was issued to the noticee under regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) calling upon it to show cause as to why the action of non-consideration and rejection of the application seeking registration as a commodity derivatives broker filed by the noticee as recommended by the DA or any other action as may be considered appropriate by the Competent Authority, should not be taken against it in terms of regulation 28(2) of the Intermediaries Regulations. The SCN further advised the noticee to submit its reply, if any within 21 days of receipt of the said SCN. The noticee filed its reply vide letter dated February 24, 2020.
6. Meanwhile, SEBI passed five separate orders rejecting the applications filed by five other entities for registration as commodity brokers based on similar findings in relation to

trading on the NSEL platform. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "**Hon'ble SAT**"). The Hon'ble SAT vide its common order dated June 9, 2022, 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....."

7. In light of the aforesaid SAT order and certain other subsequent orders passed by the Hon'ble SAT in similar set of cases from time to time, it was felt necessary to furnish certain additional documents/material to the noticee before concluding the present proceedings against the noticee. Accordingly, SEBI vide Supplementary SCN dated October 11, 2022 (hereinafter referred to as "**SSCN**") and collectively SCN and SSCN referred to as "**SCNs**") provided certain additional documents/material (as indicated in the SSCN) to the noticee and advised it to submit its reply/comments/clarifications in addition to its earlier replies, if any, within 15 days of receipt of the SSCN. The noticee was further informed that if no reply was received within 15 days of receipt of this SSCN, it shall be presumed that the noticee had no additional comments/reply to submit and the matter would be decided in accordance with law and on the basis of material available on record. The SSCN was sent to the noticee by *Speed Post Acknowledgement Due* (for short '**SPAD**') vide letter dated October 11, 2022. Subsequently, vide email dated October 14, 2022 the scanned copy of the SSCN was also served upon the noticee and the noticee was intimated that an opportunity of personal hearing had been granted to the noticee on November 15, 2022. In response to the SSCN, the noticee vide its letter dated October 27, 2022 submitted its reply.
8. On the scheduled date of hearing which was held through video conferencing on November 15, 2022, Mr. Mahesh Chandak, Director of the noticee appeared and made submissions in line with its earlier replies dated February 24, 2020 and October 27, 2022.

9. The replies filed by the noticee vide letters dated February 24, 2020 and October 27, 2022 and the oral submissions made during the course of the personal hearing held on November 15, 2022, are summarized hereunder:
- i. The noticee has surrendered the Multi Commodity Exchange of India Ltd. (**MCX**) membership and the same has been accepted by the MCX on February 17, 2017.
 - ii. The noticee is the member of the NSEL and governed by its Bye-Laws and Circulars.
 - iii. The noticee has traded on the platform provided by the NSEL while fully complying with the rules, regulations and circulars of the NSEL.
 - iv. The *'paired contracts'* were introduced and promoted by the management of the NSEL. The noticee has only followed the system introduced by the exchange.
 - v. The noticee did not know that *'paired contracts'* were illegal. All the trades were executed on behalf of the clients as per their instruction and the noticee at no point induced its clients by any means to take positions in the *'paired contracts'*.
 - vi. All the trades were settled in accordance with the established market practice of exchange.
 - vii. The noticee is a very small broker and does not have a separate legal team.
 - viii. The noticee has not colluded with the NSEL. The noticee has always acted in good faith and has never indulged in any illegal acts.

No specific submissions were made in relation to material given to the noticee vide the SSCN, discussed later in paragraph 13 of the order.

CONSIDERATION OF ISSUE AND FINDINGS

10. I have carefully perused the SCN including the enquiry report issued to the noticee, the replies dated February 24, 2020 and October 27, 2022 filed by the noticee and other materials/information available on record and also made available to the noticee vide supplementary SCN dated October 11, 2022. After considering the allegations made/charges levelled against the noticee in the instant matter as spelt out in the SCNs, the issues which arise for my 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 and whether the application filed by the noticee for registration as commodity derivatives broker, should be rejected.

11. Before I proceed to examine the issues vis-à-vis the materials available on record, it would be appropriate at this stage to refer to the relevant provisions of law, which are alleged not to have been fulfilled by the noticee and/or are referred to in the present proceedings. The same are reproduced below for ease of reference:

THE SEBI ACT, 1992

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.

THE STOCK BROKERS REGULATIONS, 1992

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

Liability for action under the Enquiry Proceeding Regulations.

27. A stock 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, if he —

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

THE INTERMEDIARIES REGULATIONS, 2008

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 fulfil 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."*

Recommendation of action

26. (1) *After considering the material available on record and the reply, if any, the designated authority may by way of a report, recommend the following measures, –*

- (i) disposing of the proceedings without any adverse action;*
- (ii) cancellation of the certificate of registration;*
- (iii) suspension of the certificate of registration for a specified period;*
- (iv) prohibition of the noticee from taking up any new assignment or contract or launching a new scheme for such the period as may be specified;*
- (v) debarment of an officer of the noticee from being employed or associated with any registered intermediary or other person associated with the securities market for such period as may be specified;*
- (vi) debarment of a branch or an office of the noticee from carrying out activities for such period as may be specified;*
- (vii) issuance of a regulatory censure to the noticee:*

Provided that in respect of the same certificate of registration, not more than five regulatory censures under these regulations may be recommended to be issued, thereafter, the action as detailed in clause (ii) to (vi) of this sub-regulation may be considered.

Order.

27. (5) After considering the facts and circumstances of the case, material on record and the written submission, if any, the competent authority shall endeavor to pass an appropriate order within one hundred and twenty days from the date of receipt of submissions under sub-regulation (2) or the date of personal hearing, whichever is later.

12. In this regard, I note that prior to merger of FMC with SEBI on September 28, 2015, the noticee was required to be a member of recognized commodity derivative exchanges and was not required to be registered with either FMC or any other regulatory authority under the FCRA. The Parliament, noticing that the intermediaries dealing with commodities derivatives market were not required to be registered under FCRA and thus were not under control of any competent authority, rectified the same through the Finance Act, 2015 by bringing them under the regulatory supervision of SEBI. The Hon'ble Bombay High Court while dealing with the Writ Petition Nos. 3262, 3266, 3294 and 3295 of 2018 in the matter of *Anand Rathi Commodities Limited, Motilal Oswal Commodities Broker Private Limited, Geofin Comtrade Limited and IIFL Commodities Limited vs. SEBI* vide its Order dated October 04, 2018, observed as under:

"It is not in dispute that prior to the coming into effect of the Finance Act, 2015, the intermediaries dealing with the commodity derivatives were not required to be registered under any of the provisions of law including the FCR Act. We find that the said mischief was noticed by the Parliament. As such, by virtue of the Finance Act, 2015, the said intermediaries dealing with commodity derivatives have been brought under the control of SEBI. We find that the reason as to why by Finance Act, 2015, the said intermediaries were brought under the control of SEBI appears to be that the Parliament found that the activities of intermediaries dealing in commodity derivatives should not remain uncontrolled and they should be brought under the control of competent authority".

Thus, it is an admitted position that prior to the date of merger of FMC with SEBI (i.e., September 28, 2015), the noticee was not required to be registered under the FCRA or any other regulation to be a commodity derivatives broker. However, after the merger of FMC with SEBI a commodity derivatives broker mandatorily needs to have a certification of registration from SEBI in case it seeks to remain associated with the Securities Market as a commodity derivatives broker. It is seen that the Finance Act, 2015 (as notified on May 14, 2015) conferred the power of regulation over intermediaries dealing in commodity derivatives to SEBI and also mandated regulation of commodity derivatives

brokers by SEBI, which included their registration as commodity derivatives broker with SEBI. In this regard, vide Section 131B of the Finance Act, 2015, a transitory period of 3 months was provided to all the intermediaries which were associated with commodity derivatives market under the erstwhile FCRA, 1952 but did not require a registration certificate earlier, to continue to deal in commodity derivatives as a commodity derivatives broker, provided it made an application of registration to the SEBI within 3 months from September 28, 2015. Accordingly, within the aforesaid transitory period of 3 months, MCX forwarded application no. 2015/SEBI COMMODITY/APPN/1857 filed by the noticee to SEBI for its consideration and approval to grant of certificate of registration to the noticee.

13. As noted above, taking cognizance of the order passed by the Hon'ble SAT on June 9 2022 (hereinafter referred to as "**SAT Order**") in the NSEL matters, a SSCN dated October 11, 2022 enclosing a copy of the SAT Order was issued to the noticee calling upon the noticee to show cause why the following information/material along with the enquiry report dated June 28, 2019 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 (for short '**FIR**') dated September 28, 2018; and
 - c. Amended Schedule II of the Intermediaries Regulations.
14. Before moving forward to consider the matter on merits and test the fulfilment of the '*fit and proper person*' criteria by the noticee, on the basis of available material including the additional material as detailed at paragraph 13 above, the background facts necessary for the present proceedings are narrated in brief, hereunder:
 - i. The noticee was member of NSEL.
 - ii. MCX has accepted the surrender of membership of the noticee with effect from February 08, 2017 and the noticee is no longer a member of the MCX.
 - iii. NSEL was incorporated in May 2005 as a Spot Exchange *inter alia* with a purpose of developing an electronic exchange for trading in commodities. In exercise of powers conferred under Section 27 of the FCRA, the Central Government vide its 2007 Exemption Notification granted an exemption to all forward contracts of one-day duration for the sale and purchase of commodities traded on the NSEL from operations of the provisions of the FCRA subject to certain conditions, *inter alia*,

including “no short sale by the members of the exchange shall be allowed” and “all outstanding positions of the trades at the end of the day shall result in delivery”.

- iv. In October 2008, NSEL commenced operations providing an electronic trading platform to its participants for spot trading of commodities, such as bullion, agricultural produce, metals, etc. It is observed that NSEL introduced the concept of ‘paired contracts’ in September 2009 which allowed *buy and sell in same commodity through two different contracts at two different prices on the exchange platform wherein the investors could buy a short duration contract and sell a long duration contract and vice versa at the same time and at a pre-determined price. The trades for the Buy contract (T+2 / T+3) and the Sell contract (T+25/ T+36) used to happen on the NSEL on the same day at same time and at different prices, involving the same counterparties.* The transactions were structured in a manner that buyer of the short duration contract always ended up making profits.
- v. 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’ as stipulated in one of the conditions prescribed under the said 2007 Exemption Notification, authorizing it to collect the trade data from NSEL and to examine the same for taking appropriate measure, if needed, to protect investors’ interest. FMC had accordingly called for the trade data from different Spot Exchanges, including NSEL in the prescribed reporting formats. After analyzing the trade data received from the NSEL, 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 being not 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, while granting exemptions to the one day forwards contract for sale and purchase of commodities traded on the NSEL, from the purview of the FCRA.

15. From the 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 the 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 and were in violation of 2007 Exemption Notification.

16. Thus, I note that the NSEL was granted conditional exemption from the provisions of the FCRA by the Department of Consumer Affairs, Ministry of Consumer Affairs (for short “**MCA**”), Food and Public Distribution, Government of India, vide Gazette Notification No. S0906(E) dated June 05, 2007, in exercise of the powers conferred under Section 27 of the FCRA, for forward contracts for sale and purchase of the commodities, (of one-day duration) traded on NSEL subject to certain conditions which, *inter alia*, included that ‘*no short sale by members of the NSEL shall be allowed*’ and that all ‘*outstanding positions of the trade at the end of the day shall 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. 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. Thereafter, NSEL commenced operations in October 2008.
17. In this regard, the relevant observations of the FMC as recorded in its Order dated December 17, 2013 and also captured in the SCN are reproduced as under:

“....a large number of NSEL exchange trades were carried out with paired back-to-back contracts. Investors simultaneously entered into a “short term buy contract” (e.g. T+2 — i.e. 2 day settlement) and a “long term sell contract” (e.g. T + 25 i.e. 25 day settlement). The contracts were taken by the same

parties at a pre-determined price and always registering a profit on the long-term positions. Thus, there existed a financing business where a fixed rate of return was guaranteed on investing in certain products on the NSEL.....”

NSEL conducted its business not in accordance with the conditions stipulated in the notification dated 05.06.2007 granting it exemption from the operation of FCRA, 1952, with regard to the one-day forward contracts to be traded on its exchange platform. As noted in the SCN, the condition of ‘no short-sell’ and ‘compulsory delivery of outstanding position at the end of the day’ stipulated in the notification were violated by NSEL. NSEL Board allowed launching of paired back-to-back contracts on its exchange platform comprising a short-term buy contract (T+2 settlement) and a long-term sell contract (T+25 settlement) with predetermined price and profit for the buyer and seller, which violated the very concept of spot market of commodities and the transactions ultimately were in the nature of financial transactions” (emphasis supplied)

18. It is, therefore, clear that the 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. In its Order, FMC had observed that the 55 contracts offered for trade on the NSEL were with settlement periods exceeding 11 days and all such contracts traded on the NSEL were in violation of provisions of FCRA. I 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 contained in FCRA, FMC was of the view that all the contracts traded on the NSEL which provided settlement schedule exceeding 11 days were treated as *Non-Transferable Specific Delivery contracts*. It is, therefore, seen that even though MCA had stipulated in the 2007 Exemption Notification that only contracts of one-day duration were permitted to be offered on the NSEL, FMC, in its Order, relying on the definition of “forward contract” under FCRA held that the NSEL was allowed to only trade in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. However, what is beyond doubt is that the NSEL had permitted 55 contracts of various commodities having duration longer than 11 days and these contracts were in contravention of the exemption granted to NSEL.
19. At this stage, it is also pertinent to refer to the judgment of the Hon'ble Supreme Court of India passed in the matter of *63 Moons Technologies Ltd. (formerly known as Financial Technologies India Ltd.) & Ors. v. Union of India & Others*¹ (Civil Appeal No. 4476 of 2019 decided

¹ (2019)18 SCC 401

on April 30, 2019) (hereinafter referred to as “**merger petition**”), wherein it *inter alia* held that:

“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”.

20. It is also necessary to refer to the judgement dated April 22, 2022 passed by the Hon’ble Supreme Court in the matter of *The State of Maharashtra vs. 63 Moons Technologies Ltd.*² (hereinafter referred to as “**MPID matter**”), wherein the Hon’ble Supreme Court while drawing reference to the representations made by the NSEL in respect of the ‘paired contracts’ *inter alia*, held 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)*

21. Thus, the Hon’ble Supreme Court has already described the nature of the ‘paired contracts’ offered on the NSEL platform. In the merger petition (*63 Moons Technologies Ltd. vs. UOI*), it was 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.
22. 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. In this regard, it can be seen that NSEL was advertising a uniform return of 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

² Civil Appeal No. 2748-49 of 2022

return as a T+ 2 & T + 35 paired contract in castor oil. The *'paired contracts'* were being marketed as an alternative to fixed deposits.

23. It was also noted in the judgement of the Hon'ble Supreme Court in the MPID matter that the overwhelming majority of the sale leg of the *'paired contracts'* which were executed were short sales i.e., commodities to back such sales were not available at the designated warehouses of the NSEL.
24. The aforesaid discussion shows how *'paired contracts'* were not in the nature of spot trading, which was permitted on NSEL's platform. Further, as stated above, the NSEL itself was advertising such contracts as an alternative to fixed deposits and 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.
25. When MCA vide its letter dated July 12, 2013, on the recommendation of FMC, asked the NSEL to settle contracts on the due dates and to give an undertaking that no fresh contract shall be launched, NSEL failed to do so and defaulted. It appears from the nature of contracts that the NSEL was not functioning like a spot exchange for commodities but rather as a spot exchange for unsecured borrowing and lending. Investors lost money as all the underlying warehouse receipts were bogus and there was no underlying security. As noted in the judgement of the Hon'ble Supreme Court in the MPID matter, the exchange publicized that it provided counter party guarantee risk but, in reality, failed to do so.
26. As recorded in the SSCN, SEBI has filed a complaint dated September 24, 2018, against brokers who facilitated access to *'paired contracts'* traded on the NSEL, including the noticee, with EOW, Mumbai. On the basis of this complaint, subsequently, an FIR dated September 28, 2018 has been filed by SEBI against the noticee with EOW, Mumbai.
27. In the background of the discussion on *'paired contract'* in the preceding paragraphs, I now proceed on to examine whether the noticee satisfies the *'fit and proper person'* criteria as laid down under Schedule II of the Intermediaries Regulations.
28. The enquiry report states that no details pertaining to trades done in *'paired contracts'* by the noticee are available on record. However, from the details of outstanding positions of the noticee as mentioned in the Grant Thornton Report and recorded in the SCN, I note that as on September 19, 2013 the NSEL had a pay-out obligation to the noticee to the tune of INR (23,33,37,380) for the trades carried out by the noticee in the *'paired contracts'*. Further, a special payout of INR 11,55,043 was made to the noticee by NSEL in terms of

NSEL Circular dated March 10, 2015 in which the details of the payout made to the brokers vide special payout made in August 2013 are mentioned. Also, as per replies of the noticee, the noticee has claimed that all the trades in the '*paired contracts*' were executed on behalf of the clients as per their instruction and the noticee at no point induced its clients by any means to take positions in the '*paired contracts*'. Further, all the trades were settled in accordance with the established market practice of exchange. Also, the noticee did not know that '*paired contracts*' were illegal. Thus, it is not disputed that the noticee has traded in '*paired contracts*' on behalf of its clients.

29. Having found that the noticee has traded in '*paired contracts*' for its clients, I note that the main allegation against the noticee as levelled in the SCN is that by participating/facilitating in the trading in '*paired contracts*' on the NSEL platform during the relevant period as a Trading Member/ Clearing Member, the noticee has, *prima facie*, violated the conditions stipulated in the 2007 Exemption Notification and consequently also the provisions of the FCRA. Therefore, in the SCN the noticee was asked to state as to why its application for grant of certificate of registration as a commodity derivatives broker, may not be rejected as the noticee is not a '*fit and proper person*' for holding the certificate of registration as a commodity derivatives broker in the Securities Market, which is one of the conditions for registration as specified in regulation 5(e) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations. Subsequently, SEBI, on the basis of certain documents/material such as SEBI's Complaint dated September 24, 2018 and SEBI's FIR dated September 28, 2018 as provided to the noticee vide SSCN dated October 11, 2022, further alleged that in light of the aforesaid documents as well as observations against the noticee in the SCN dated January 28, 2020 the noticee is not a '*fit and proper person*' for holding the certificate of registration. The noticee's submissions have been summarized in paragraph 9 above. Its main contention is that it did not know that the '*paired contracts*' were illegal and it had not induced its clients to trade in the said contracts. No specific contentions have been made against the SSCN, SEBI's complaint and FIR provided along with the same and the amended provisions dealing with the '*fit and proper criteria*' in Schedule II of the Intermediaries Regulations.
30. It is pertinent to state that regulation 5(e) of the Stock Brokers 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 SEBI (Intermediaries) Regulations, 2008, were amended vide SEBI(Intermediaries)(Third Amendment) Regulations, 2021 with effect from November 17, 2021.

31. The above condition to be a fit and proper is not a one time condition applicable only at the time of seeking 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 right from the time of filing such application to the time the entity wishes to remain associated with the Securities Market as a registered intermediary, after obtaining such registration.
32. In this regard, it is evident that the noticee has admittedly traded in *'paired contracts'* on behalf of its clients. The noticee, as a commodity derivatives broker, represented the face of NSEL for regular investors. The execution of the trades in *'paired contracts'* by the noticee shows the participation of the noticee in the said scheme perpetrated by NSEL to provide its platform for trading in *'paired contract'* that were not permitted under the 2007 Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities. Therefore, the noticee by its conduct and as a member of NSEL had promoted and/or dealt in *'paired contracts'* which were in the nature of financing transaction as held by the Hon'ble Supreme Court of India as noted above. The noticee, by providing a platform for taking exposure to *'paired contracts'* exposed its clients to the risk involved in trading in a product that did not have regulatory approval thereby raising doubts on the competence of the noticee to act as a registered securities market intermediary. As already recorded in SSCN and discussed above, SEBI has filed an FIR against the noticee under section 154 of Cr. P C with EOW, Mumbai on September 28, 2018 and the same is pending as on date. Therefore, the noticee attracts the disqualification provided in paragraph 3(b)(i) under the amended Schedule II of the Intermediaries Regulations.
33. In view of the above observations and admission of the noticee having traded in these *'paired contracts'* on the NSEL, I have no hesitation in holding that the noticee has participated/facilitated in the trading in *'paired contracts'* on the NSEL platform during the relevant period as a Trading Member/Clearing Member and has violated the conditions of the 2007 Exemption Notification and also the provisions of the FCRA. Consequently, the noticee has attracted disqualification under paragraph 3(b)(i) of Schedule II and the act of noticee in offering access to *'paired contracts'*, as detailed above, casts serious doubts on the integrity, honesty and ethical behavior of the noticee. These contracts, as stated earlier, were totally different from the spot contracts in commodities which were permitted to be traded on the NSEL. The *'paired contracts'* were nothing but financing transactions which were portrayed as spot contracts in commodities. In view of the above facts and taking into consideration the involvement of the noticee in the *'paired contracts'*

and the FIR pending against the noticee, I hold that the noticee does not satisfy '*fit and proper person*' criteria as laid down in Schedule II of the Intermediaries Regulations.

34. I note from details available on record that while the application no. 2015/SEBICOMMODITY/APPN/1857 filed by the noticee and as forwarded by MCX to SEBI for grant of certificate of registration was pending with SEBI, MCX vide its letter dated October 13, 2016 informed SEBI that the noticee had simultaneously applied for surrender of its membership of MCX. Accordingly, MCX requested SEBI not to proceed with the aforesaid pending application of the noticee for grant of certificate of registration. The surrender application filed by the noticee has been accepted by MCX with effect from February 08, 2017 and therefore the noticee is no longer a member of MCX.
35. The application for grant of certificate of registration pending before SEBI has become infructuous on account of acceptance of its surrender of membership by MCX with effect from February 08, 2017. It is a prerequisite for an applicant to be a member of any of the recognized exchanges before it can file an application for grant of certificate of registration with SEBI as the said application has to be forwarded to SEBI by the exchange concerned (whose membership the broker applicant is holding at the time of forwarding the said application) for approval of SEBI. Therefore, the pending application (for grant of certificate of registration) having become infructuous, the noticee cannot continue any business activities using the said pending application.
36. While the surrender of membership of MCX and the fact that the pending application of the noticee before SEBI has become infructuous now prohibits the noticee from conducting business as a commodity broker it does not affect the appraisal of its eligibility as a '*fit and proper*' applicant. As noted above, SEBI has filed complaints within the time stipulated in the Finance Act, 2015 against NSEL members who have traded in the illegal forward contracts, including the noticee and hence it has been held that the noticee does not satisfy the conditions of '*Fit and Proper person*' as stipulated under the Intermediaries Regulations, 2008. Thus, the noticee is not eligible for registration as a broker/intermediary. At this stage it would not be out of place to state that the noticee was called upon to show cause as to why the action recommended by the DA or any other action as deemed fit by the Competent Authority should not be taken against it under regulation 28(2) of the Intermediaries Regulations. The DA has recommended that the application of the noticee submitted for registration as a commodity derivatives broker may not be considered in the interest of the securities market and the application of noticee may be rejected and the noticee may be restrained from acting as commodity broker. As discussed above, the applicant is not acting as a commodity broker as it has

surrendered its membership of MCX. However, while the noticee has surrendered its membership of MCX, it has not withdrawn its application before SEBI. Hence, though the application has become infructuous, it needs to be decided upon based on the fulfilment of the eligibility criteria by the applicant/noticee.

ORDER

37. In view of the foregoing discussions and deliberations, I, in exercise of powers conferred upon me under Section 12 (3) and Section 19 of the SEBI Act, 1992 read with regulation 27 of the SEBI (Intermediaries) Regulations, 2008, hereby reject the application of Sugal Commodity Brokers Private Limited for registration as a commodity broker finding it not to be a '*fit and proper person*'.
38. 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 involving the noticee.
39. It is clarified that in view of the amendment made *w.e.f.* January 21, 2021 in the Intermediaries Regulations, 2008, the procedure for action on receipt of recommendation of a DA prescribed under regulation 28 of the Intermediaries Regulations, 2008 has now been incorporated in the amended regulation 27 of the Intermediaries Regulations, 2008. Accordingly, this order is passed under the amended regulation 27 of the Intermediaries Regulations, 2008.
40. A copy of this order shall be served upon the noticee, the recognized Exchanges and the Depositories for necessary compliance.

Sd/-

DATE: JANUARY 25, 2023
PLACE: MUMBAI

ANAND R BAIWAR
EXECUTIVE DIRECTOR
SECURITIES AND EXCHANGE BOARD OF INDIA