

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 SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008

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In respect of –

CNB Commodities Pvt. Ltd  
[Registration No. INZ000034438]

In the matter of National Spot Exchange Limited

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**BACKGROUND**

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

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

a. **Short Sale**

NSEL had not made it mandatory for the seller to deposit goods in its warehouse before taking a sell position. Hence, the condition of “*no short sale by members of the NSEL shall be allowed*” was not being met by the NSEL and its trading/clearing members who traded in the paired contracts during the relevant period.

b. **Contracts with Settlement Period going beyond 11 days**

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

6. Hence, it was alleged that the NSEL organised trading in ‘*paired contracts*’ in violation of the Notification SO 906(E) dated June 05, 2007 issued under Section 27 of the FCRA. It was also alleged that the Trading Members and Clearing members of the NSEL facilitated and/or participated in trading in such paired contracts which were in alleged violation of the Notification dated June 05, 2007 issued under the FCRA. Thus, by participating in / facilitating trading in paired contracts, such entities, allegedly, had acted in a manner detrimental to the interest of the securities market.
7. As per information available with SEBI, the Noticee, being a Trading and Clearing member of the NSEL, participated in / facilitated trading in paired contracts on the platform of NSEL in alleged violation of the provisions of Regulation 9(b) and 9(f) read with Clauses A(1), A(2) and A(5) of the Schedule II of the Stock Broker Regulations. Based on this information, SEBI was *prima facie* satisfied that there were sufficient grounds to enquire into whether the Noticee, was ‘*fit and proper*’ to continue to hold certificate of registration as Trading and Clearing Member in terms of Regulation 5(e) of the Stock Broker Regulations read with Regulation 27(iv) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations.

## ENQUIRY BY DESIGNATED AUTHORITY

8. A Designated Authority (hereinafter referred to as “DA”) was appointed by SEBI vide communique dated September 24, 2018 to conduct an enquiry against the Noticee and submit a report and make recommendation/s in compliance with Regulation 27 of the Intermediaries Regulations. The DA, accordingly, issued a Show Cause Notice dated September 25, 2018 (hereinafter referred to as “Enquiry SCN”) to the Noticee under Regulation 25(1) of the Intermediaries Regulations (as applicable at the relevant time) calling upon it to show cause as to why appropriate recommendation should not be made against it under Regulation 27 of the Intermediaries Regulations (as applicable at that time) read with Section 12(3) of the SEBI Act for the alleged violation of the provisions of Regulation 9(b) and 9(f) read with Clauses A(1), A(2) and A(5) of the Schedule II of the Stock Broker Regulations and being not a ‘*fit and proper person*’ for holding the certificate of registration as trading / clearing member in terms of Regulation 5(e) read with Regulation 27(iv) of the Broker Regulations read with Schedule II of the Intermediaries Regulations.
9. The Noticee, while acknowledging receipt of the Enquiry SCN, vide letter dated October 15, 2018, sought 4 weeks’ time to file a reply to the said Enquiry SCN and thereafter, vide letter dated October 29, 2018, filed a detailed reply to the Enquiry SCN. Vide the said letter, the Noticee sought certain documents to further substantiate its case. Accordingly, SEBI, vide letter dated January 15, 2019 had forwarded copies of relied upon documents in a CD to the Noticee. The Noticee, vide its letter dated January 28, 2019, acknowledged receipt of the said documents and sought further 4 weeks’ time to file its reply in the matter. Vide letters dated February 15, 2019, the Noticee filed its additional submissions in the matter.
10. Upon completion of the enquiry, the DA submitted an Enquiry Report dated September 24, 2019 (“Enquiry Report”) to the Competent Authority, *inter alia*, observing as under:

*“41. In view of the facts and circumstances of the case and the material available on record, it is determined 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. Therefore, in terms of Regulation 27 of the Intermediaries*

*Regulations, it is recommended that the certificate of registration of the Noticee, i.e. CNB Commodities Pvt. Ltd, registered with SEBI as a trading and clearing member bearing Registration No. INZ000034438 may be cancelled in the interest of the securities market.”*

## **POST ENQUIRY PROCEEDINGS**

### **Show Cause Notice, Reply and Personal Hearing**

- 11.** After considering the Enquiry Report, a post-enquiry Show Cause Notice dated October 15, 2019 (“SCN”) was issued to the Noticee under Regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) enclosing therewith (a) copy of the Enquiry Report, (b) copy of the letter dated December 30, 2014 of the Department of Economic Affairs (DEA) Ministry of Finance and (c) a copy of the order dated August 22, 2014 passed by the Hon’ble Bombay High Court in Criminal Bail Application No. 1263 of 2014 in the case of *Jignesh Prakash Shah Vs. The State of Maharashtra*. The SCN was issued to the Noticee calling upon it as to why action as recommended by the DA including any other action should not be taken against it, as deemed fit, by the Competent Authority. The Noticee, vide letter dated November 12, 2019, acknowledged receipt of the SCN and requested for certain reports / documents as relied upon in the matter. Vide letter dated November 13, 2019, copies of certain documents viz. (a) Grant Thornton Report dated September 21, 2013 along with the annexures, (b) Fortnightly Report submitted by NSEL to FMC and (c) EOW Report dated April 04, 2015 were provided to the Noticee. Further, vide email dated December 30, 2019, it was clarified that all the documents relied upon have been provided to the Noticee in the matter and the Noticee was requested to file its reply on or before January 03, 2020. Vide letter dated January 13, 2020, the Noticee submitted a detailed reply to the SCN dated October 15, 2019. Further, as requested, an opportunity of inspection of documents was granted and availed by the Noticee on January 29, 2020 and the record of inspection of documents is available on record.
- 12.** The submissions made by the Noticee vide its letter dated January 13, 2020 are summarized as under:

  - (i)** The Noticee is into broking business for more than 15 years and has an absolutely clean track record. The Noticee was earlier registered with FMC as a commodity

broker and had membership of MCX since 2003; NCDEX since 2004 and obtained membership of NSEL in the year 2008.

- (ii)** The Noticee has always traded for itself in proprietary account only and no trading was ever done for any clients.
- (iii)** Pursuant to the merger of FMC with SEBI, the Noticee got registered with SEBI as a Commodity Broker as well.
- (iv)** The Noticee states that there is no evidence or material to show any violation on part of the Noticee. Absence of Noticee's name in any of the documents / records warrants disposing of the proceedings against the Noticee without taking any action against it.
- (v)** The Enquiry Report erroneously treats the submissions made vide letter dated October 29, 2018 as admission and the DA has proceeded to recommend the gravest penalty under Regulation 27 of the Intermediaries Regulations.
- (vi)** The Noticee states that it does not have the trading details on NSEL including the contract notes, commodities traded, period of contract, nature of contract, etc. In the absence of the trading details, it is impossible to assess whether the trades, if any, were in the nature of "paired contracts" or not.
- (vii)** There has been no misrepresentation to any clients. The Noticee has had no client dealings at all during the entire period of registration. Therefore, no client / investor money was put to risk.
- (viii)** The present enquiry proceedings are not tenable and liable to be disposed of w.r.t. violation of the provisions of Code of Conduct as specified under the Broker Regulations as the same were not applicable to the Noticee during the financial years 2012-13 and 2013-14. Owing to the amendment in Finance Act, 2015, the applicability of Broker Regulations and Code of Conduct thereunder cannot be made applicable retrospectively.
- (ix)** The Government exemption Notification dated June 05, 2007 was granted to NSEL and therefore, the obligation to comply with the same was on NSEL. The Noticee cannot be held liable for the paired contracts on the NSEL platform only because it was a registered intermediary with NSEL.
- (x)** The FMC order dated December 17, 2013 had held that NSEL and its management for issuing alleged paired contracts along with other members also

known as defaulting members which had acted in connivance with NSEL. There is no reference of the Noticee therein. Further, name of the Noticee does not occur in any of the reports/ documents relied upon by SEBI.

- (xi) The Noticee states that the DA in his Enquiry Report has mentioned that due to non-availability of the trading details, the DA cannot substantiate that *quantum of trades undertaken by the Noticee i.e. details of trades carried out in the paired contracts in NSEL during the period September 2009 to August 2013*. Therefore, without being in possession of the trade details, the DA has recommended such a grave action against the Noticee.
- (xii) There is no evidence on record that the Noticee executed any paired contracts. In the absence of concrete evidence, the Noticee cannot be alleged to be in violation of either the FCRA or SEBI Regulations and cannot be said to be not “fit and proper”.
- (xiii) Though the requirement of being ‘fit and proper’ may be continuous, but an entity cannot be said to be not ‘fit and proper’ without establishing it to be in violation of the applicable law. The Noticee reiterates that the Broker Regulations were not even applicable to it during the relevant period.
- (xiv) The Noticee submits that out of the various rules guiding how a legislation has to be interpreted, one established rule is that unless a contrary intention appears, a legislation is presumed not to be intended to have a retrospective operation. In support of the said submission reliance is placed by the Noticee on the case laws *SMS Holdings and Ors Vs. SEBI and Others* (SAT Order) and *SEBI Vs. Alliance Finstock Ltd and Ors* (Supreme Court Order).
- (xv) The SCN and the Enquiry Report are vague to an extent that it does not specify as to which clause of Schedule II the Noticee is not complying with.
- (xvi) The DA has placed reliance upon the judgments by Hon’ble SAT in the matter of *Jermyn Capital LLC and Mukesh Babu Securities Vs. SEBI* without there being any cogent evidence / records against the Noticee.
- (xvii) FMC and Ministry of Finance, Department of Economic Affairs was restricted to NSEL and its management. Further, with respect to the observations of the Hon’ble Supreme Court in the matter of *63 Moons Technologies Ltd Vs. Union of India* in its order dated April 30, 2019, the same pertain to merger of FTIL and

NSEL and their responsibilities in offering paired contracts on its exchange platform from 2009. The Noticee is not a party to this writ petition. No inference has been drawn in the said order of Noticee having executed or being involved in paired contracts and therefore, the same is inapplicable in the present matter.

- (xviii) The EOW Report also does not have any reference of the Noticee being involved in paired contracts.
- (xix) There is no close association of the Noticee with NSEL and there is nothing on record to substantiate otherwise on the allegation of close association made against the Noticee.
- (xx) The Noticee has had no clients at any point of time. Reliance placed on the Hon'ble Bombay High Court's Order on Criminal Bail Application No. 1236 of 2014 in the matter of *Jignesh Prakash Shah Vs. The State of Maharashtra* is in respect of Jignesh Shah's arrest by EOW in 2014 and totally irrelevant. The Noticee was neither a party to the said proceedings nor was any order passed against it.
- (xxi) No wrong is done by the Noticee. The Noticee as a group is a market intermediary ever since 2002. Any action against the Noticee will also leave a stigma and impact upon its equity broking business and its market repute.
- (xxii) Further, the Noticee states that there has been an inordinate delay in initiation of the present proceedings. The cause of action pertains to the year 2012 and 2013. As per Section 29A of the FCRA, SEBI was empowered to take action within 3 years from the date on which the act was repealed. After the appointment of the DA in the matter, the DA without putting any time to enquire into the matter issued the SCN on September 25, 2018 i.e. just before the expiry of the timeline provided under Section 29A of FCRA. The same shows that the proceedings have been initiated against the Noticee in haste and without actually reasonably analysing whether there is any material on record to establish the alleged violation or relationship against the Noticee.

13. Thereafter, in compliance with the principles of natural justice, the then Competent Authority had granted an opportunity of personal hearing to the Noticee on April 28, 2020 which was adjourned to July 02, 2020 due to official exigencies. Further,



considering the COVID-19 situation, the Noticee had sought for an adjournment of the personal hearing scheduled on July 02, 2020 to any date in the month of August 2020.

14. While the extant proceedings in the present matter were ongoing, SEBI passed five separate orders, rejecting the applications filed by five other entities for registration as commodity brokers in the NSEL matter. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble 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....."*

15. Thereafter, in August 2022, the present matter was allocated to me. In the light of the aforesaid SAT Order passed by the Hon'ble SAT in similar set of cases, it was felt necessary to furnish certain additional documents/material to the Noticee before concluding the present proceedings. Accordingly, vide letters dated October 06, 2022 and November 02, 2022, certain additional documents were provided to the Noticee and the Noticee was requested to file its reply, if any, within 15 days of receipt of the said letters. Furthermore, an opportunity of personal hearing was granted to the Noticee on December 05, 2022. However, the Noticee did not respond to any of these SEBI letters. Thereafter, attempts were made to communicate with the Noticee via email address/s available on record. Vide email dated January 10, 2023, the Accounts and Taxation Manager of the Noticee responded to the SEBI email and requested for all the communications to be sent on its changed registered address

viz. “302-303, EMCA House, 20/20B, Ansari Road, New Delhi-110002”. Thereafter, an opportunity of hearing was granted to the Noticee on February 07, 2023. However, vide email dated February 04, 2023, the Noticee requested for an opportunity of inspection of documents in the matter. The said request of the Noticee was acceded to and the same was granted and availed on February 07, 2023. Pursuant to the same, another opportunity of personal hearing was granted to the Noticee on March 10, 2023 wherein the Authorized Representative (AR) made oral submissions. Also, as requested, additional time till March 20, 2023 was granted to the Noticee to file its additional submissions, if any. The Noticee, vide email dated March 20, 2023, made additional submissions in the matter which are summarized as under:

- (i) There is no evidence to show that the Noticee participated in the alleged paired contracts. The Grant Thornton Report, EOW Report and fortnightly reports of NSEL to FMC do not show the Noticee’s participation in any paired contracts.
- (ii) The Enquiry Report submitted by the DA on September 24, 2019 also lacks any evidence or finding that the Noticee had participated in the so-called paired contracts.
- (iii) The Noticee has been roped in the matter based on misunderstanding.
- (iv) From the submissions made by the Noticee vide its letter dated October 29, 2018, attempt has been made to fasten guilt on the Noticee by cherry picking some sentences and terming them to be ‘admission’. The Noticee has relied on a recent order passed by the Hon’ble Supreme Court in the case of *Premchand Vs. State of Maharashtra (Criminal Appeal No. 211/2023 decided on March 03, 2023)* and *Nikhil Chandra Mondal Vs. State of West Bengal (2023 SCC Online SC 225 decided on March 03, 2023)* in support of its submission.
- (v) There must be a strict interpretation of the term ‘fit and proper’ and without the presence of any inculpatory evidence against the Noticee, guilt cannot be fastened on it.
- (vi) The Noticee further submits that no specific allegation has been made out against it in the FIR filed by SEBI. No data or record has been produced against the Noticee in the SEBI complaint letter dated September 24, 2018.
- (vii) The SEBI complaint only alleges that some of the trading members have declared that they were trading in commodities on NSEL platform while submitting

applications for membership of SEBI without providing the said applications for perusal. It is not SEBI's case that Noticee had admitted in its application for registration that it dealt with illegal contracts, nor any independent evidence or information has been brought out against the Noticee.

- (viii) The basis for registering FIR qua the Noticee is erroneous. A piece of cryptic information cannot be considered an FIR. It must contain essential and relevant details of the incident. In support of the said submission, the Noticee has placed reliance on *Pandurang Chandrakant Mhatre Vs. State of Maharashtra (2010 1 SCC (Cri) 413 decided on October 08, 2009.*
- (ix) Further, the Noticee states that there is an inordinate delay in communicating the FIR and other documents to the Noticee without which the Noticee was in the dark about the charges levelled against it. The said documents were sent by SEBI on its old registered address in Haryana.
- (x) Also, mere existence of an FIR which does not even contain Noticee's name does not justify holding it guilty. It is pertinent to mention that the SCN is dated September 25, 2018 i.e. before the amendment to the Intermediaries Regulations. Therefore, an amendment to a provision or a new provision prescribing greater punishment or charging yardstick cannot apply retrospectively. In support of the said submission, the Noticee has relied upon orders passed by the Hon'ble Supreme Court in the cases of *Superintendent NCB Vs. Paras Singh ((2008) 13 SCC 499)* and *State Vs. Gian Singh ((1999) 9 SCC 312).*
- (xi) No summons or warrants from any court have been received by the Noticee. There is no chargesheet, no evidence and no recovery made from the Noticee and therefore, no pending proceedings stand against the Noticee. Mere registration of an FIR cannot have an adverse inference. FIR has no evidentiary value unless corroborated. In support of the said submission, Noticee has placed reliance in the order passed by the Hon'ble SAT in the case of *DLF Ltd Vs. SEBI (2015 SCC Online SAT 54 decided on March 13, 2015).* Reliance is also placed on the judgement of Hon'ble Supreme Court in *Baldev Singh Vs. State of Punjab ((1995) 6 SCC 593).*

- (xii) It is the case of the Noticee that it has not been provided with all the relevant material for preparation of its defence.
- (xiii) The Noticee reiterated that there is no close connection with NSEL and merely being its member does not establish any connection.

16. Thereafter, vide email dated April 18, 2023, the Noticee requested for certain documents in the matter. Accordingly, after examining the list of documents requested for, vide email dated April 25, 2023, the Noticee was provided with the trade data showing the trades executed by the Noticee on NSEL platform. Further, the Noticee was requested to submit its comments on the same. Vide email dated April 26, 2023, the Noticee, while acknowledging receipt of the trade data as forwarded by SEBI, again requested for documents or grant of inspection of all the documents requested for so as to make further submissions in the matter.

## **CONSIDERATION OF ISSUES AND FINDINGS**

17. I have carefully perused the post enquiry SCN including the Enquiry Report issued to the Noticee, the replies submitted by the Noticee along with all the other material / information available in public domain and also made available to the Noticee vide letters dated October 06, 2022 and November 02, 2022 and emails dated December 14, 2022 and January 09, 2023. After considering the allegations made/ charges levelled against the Noticee in the instant case, I note that the only issue that arises for consideration in the present proceedings is whether the Noticee satisfies the '*fit and proper person*' criteria as laid down under Schedule II of the Intermediaries Regulations.
18. However, before moving forward with considering the said issue, it is pertinent to refer to the common order dated June 09, 2022<sup>1</sup> passed by the Hon'ble SAT also referred in the preceding paragraph no. 14. The Hon'ble SAT, while setting aside the earlier WTM Orders, had made the following observations (relevant to the present case as well) remanding the matters to SEBI:

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<sup>1</sup> Appeal No. 214 of 2019 Geofin Comtrade Ltd Vs. SEBI, Appeal No. 217 of 2019 Philip Commodities India Pvt. Ltd Vs. SEBI, Appeal No. 218 of 2019 IIFL Commodities Ltd Vs. SEBI, Appeal No. 288 of 2019 Anand Rathi Commodities Ltd Vs. SEBI and Appeal No. 289 of 2019 Motilal Oswal Commodities P. Ltd Vs. SEBI

- (a) Observations of the Bombay High Court in the matter of *63 Moons vs. Union of India*<sup>2</sup> cannot be relied upon as the said judgement has been set aside in appeal<sup>3</sup> by the Hon'ble Supreme Court vide judgment dated April 30, 2019.
- (b) Observation from the Order dismissing the Writ Petition filed by NSEL against the invocation of the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 ("MPID Act") (*NSEL vs. State of Maharashtra*<sup>4</sup>) cannot be relied upon, as in a subsequent Writ Petition<sup>5</sup> moved by 63 Moons, a Division Bench of the Bombay High Court has allowed the prayer and held that NSEL is not a financial establishment and therefore, the provisions of the MPID Act are not applicable. The Division Bench also observed that the prima facie observations made by the single bench while dismissing the NSEL petition could not be relied upon as they were preliminary observations and such observation does not foreclose the issue about the applicability of the provisions of the MPID Act. The Hon'ble Tribunal, I note, was of the opinion that prima facie observations cannot be the basis to judge the reputation, character or integrity of NSEL.
- (c) Observations in the bail rejection order dated August 22, 2014, passed by the Hon'ble Bombay High Court in the matter of ***Jignesh Prakash Shah vs. The State of Maharashtra***, cannot also be relied upon as the observations made in a bail order were limited to the fact as to whether the bail should be granted or not.
- (d) Reliance placed on decisions of the Hon'ble Tribunal in the matter of ***Jermyn Capital vs. SEBI***<sup>6</sup> and ***Mukesh Babu Securities vs. SEBI***<sup>7</sup> is misplaced as decisions in the said matters are distinguishable on facts. Jermyn Capital was held to be in relation to an Interim Order passed by SEBI, and the Tribunal was of the view that the criteria for passing an Ad Interim Order are based on a different criterion, namely prima facie case, the balance of convenience and irreparable injury which are distinct and different while considering an application

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<sup>2</sup> Writ Petition No. 2743 of 2014

<sup>3</sup> Civil Appeal No. 4467 of 2019

<sup>4</sup> Writ Petition No. 1403 of 2015

<sup>5</sup> Writ Petition No. 1181 of 2018

<sup>6</sup> Appeal No. 26 of 2006 decided on September 06, 2006

<sup>7</sup> Appeal No. 53 of 2007 decided on December 10, 2007

for grant of Certificate of Registration. The decision in the matter of *Mukesh Babu Securities* was distinguished by the Hon'ble Tribunal on the basis that in the matter a criminal complaint was filed against the Chairman of the Company. The Tribunal noted that there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.

- (e) Reputation of the applicant cannot be lightly considered based on observations which are not directly related to the applicant.
- (f) The SEBI Order does not state for how long the rejection of application will continue. The Hon'ble Tribunal was of the view that the rejection cannot continue indefinitely, and in such cases, a time period should be provided during which the applicant will become ineligible to seek fresh registration.
- (g) Grant Thornton Forensic report commissioned by SEBI does not find any close connection between the applicant and the NSEL. This is overlooked by SEBI.
- (h) With respect to the additional material available, the Hon'ble SAT observed that, "It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice. It will also be open to SEBI if it considers necessary, to conduct an independent enquiry proceeding against the connected entities and persons associated with the brokers against whom evidence is available."

**19.** In view of the above, the following additional documents were provided to the Noticee in the present case in hand:

- (a) Copy of the SFIO Complaint dated May 15, 2019 filed before the Court of Special Judge at Greater Mumbai, and
- (b) Copy of the FIR dated September 28, 2018 filed by SEBI against 300 trading members of NSEL.
- (c) Copy of the amended Schedule II of the Intermediaries Regulations.

20. Before considering the matter on merits and test the compliance of the Noticee with the '*fit and proper person*' criteria, on the basis of the material that have been brought on record, it would be appropriate to look at the background and understand the nature of the '*paired contracts*' that were offered on NSEL – which ultimately is the cause / genesis of the current proceedings. While undertaking this exercise, I will not be independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings. I will, however, be relying on the observations made by other authorities including that of the Hon'ble Supreme Court, wherever appropriate.

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

21. NSEL was incorporated in 2005 as an electronic exchange for spot trading of commodities. On June 5, 2007, the Ministry of Consumer Affairs ("MCA"), Government of India, issued a Notification SO 906(E) under Section 27 of the FCRA granting conditional exemption from the provisions of that Act for (i) forward contracts, (ii) for sale and purchase of commodities, of one-day duration traded on NSEL. The conditions, inter alia, placed an absolute bar on short sales and stipulated that all outstanding positions at the end of the day must result in delivery. It was also stipulated that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency. 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.

22. As evident from the FMC order, NSEL introduced, on its platform, the concept of 'paired contracts', in September 2009, which involved buying and selling the same commodity through two different contracts at two different prices wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In other words, the 'paired contract' involved two simultaneous transactions being undertaken at the same time with the same counterparty—one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at

different prices on the platform of NSEL. The transactions were structured in a manner that buyer of the short duration contract always ended up making profits.

23. Thereafter, FMC, vide an order No. 4/5/2013-MKT/B dated December 17, 2013 (“FMC Order”) observed that: “55 contracts offered for trade on NSEL were with settlement period exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA” and “the condition of ‘no short sale by members of the exchange shall be allowed’ was not being met by NSEL”.
24. Further, in the above mentioned Order, FMC, *inter alia*, held that the contracts traded on NSEL violated the following conditions stipulated in the MCA Notification SO906(E) dated June 5, 2007, that granted permission to NSEL to offer spot trading in commodities which, *inter alia*, included “no short sale by members of the exchange shall be allowed; that all outstanding positions of the trade at the end of the day shall result in delivery” and that “all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency”.
25. It is, therefore, clear from the order of FMC that, NSEL was given permission to setup as a spot exchange for trading in commodities. It was essentially meant to only offer forward contracts having one –day duration as per the Notification dated June 05, 2007. I note from the FMC Order, that FMC had observed<sup>8</sup> that the 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of the provisions of FCRA. I further note from the FMC Order that under the FCRA, a “forward contract” is defined as a “contract for delivery of goods and which is not a ready delivery contract”. A ‘ready delivery contract’ is defined as “a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days”. Given the said definition contained in FCRA, FMC, I note, 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.

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<sup>8</sup> Order No. 4/5/2013-MKT-1/B dated December 17, 2013



26. Therefore, it is noted that even though MCA had stipulated in the exemption Notification in 2007 that only contracts of one-day duration were permitted to be offered on NSEL, FMC, in its Order, relying on the definition of “*forward contract*” under FCRA held that NSEL was allowed to only trade in one day forward contracts and was obliged to ensure delivery and settlement within 11 days. I note the observation in the FMC order that NSEL had permitted 55 contracts of various commodities having duration longer than 11 days and these contracts were *ex facie* in contravention of the exemption granted to NSEL. It is pertinent to note that all the 15 contracts that were advertised by NSEL, and which are captured in the Hon’ble Supreme Court’s Judgement in the matter of *The State of Maharashtra Vs. 63 Moons Technologies Ltd*<sup>9</sup>, were for durations exceeding 11 days.
27. I note that the Hon’ble Supreme Court in the matter of NSEL (*supra*) has also extensively commented on the nature of the ‘paired contracts’ traded on NSEL. The said observations by:
- a. the Two-Judge Bench of the Hon’ble Supreme Court in the course of determining the validity of the amalgamation order in the matter of 63 Moons (*supra*) vide judgment dated April 30, 2019, had observed as under:

*“55. We have seen that neither FTIL nor NSEL has denied the fact that ‘paired contracts’ in commodities were going on, and by April to July, 2013, 99% (and excluding E-series contracts), at least 46% of the turnover of NSEL was made up of such ‘paired contracts’. **There is no doubt that such ‘paired contracts’ were, in fact, financing transactions which are distinct from the sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL and the FCRA.**” (emphasis supplied)*
  - b. the Hon’ble Supreme Court in the MPID matter vide judgement dated April 22, 2022, has drawn reference to the presentations made by NSEL in respect of the ‘paired contracts’. Upon analysing the presentations made, the Hon’ble Supreme Court has observed that,

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<sup>9</sup> Civil Appeal No. 2748-49 of 2022

*"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)*

28. I, therefore, note that the Hon'ble Supreme Court has already commented on the nature of the 'paired contracts' offered on the NSEL platform. In the case of *63 Moons Technologies Ltd. vs. UOI*, the Hon'ble Supreme Court held that these contracts were in the nature of financing transactions. In the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon'ble Supreme Court has held that such transactions come within the definition of 'deposits' under the MPID Act.
29. It is further noted that the Hon'ble Supreme Court, in the MPID matter, had extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. As seen from the order of the Supreme Court, the 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 return as a T+ 2 & T + 35 paired contract in castor oil. The 'paired contracts', it is noted, were being marketed as an alternative to fixed deposits.
30. I note that the FMC Order and both the judgments of the Hon'ble Supreme Court discuss in detail, the NSEL permitting short sales i.e. permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite amount of commodity is available in the warehouse. It is further noted from 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 naked short sales i.e. the commodities to back such sales were not available at the designated warehouses of the NSEL.

**Preliminary objection raised by the Noticee:**

31. The Noticee has submitted that the cases referred to in the Enquiry Report viz. SAT Order in *Jermyn Capital LLC Vs. SEBI* and *Mukesh Babu Securities Ltd Vs. SEBI* and the order of the Bombay High Court in *Jignesh Prakash Shah Vs. State of Maharashtra* are totally irrelevant and the Noticee was neither a party to the said proceedings nor was any order passed against it. Considering the observations made by the Hon'ble SAT with respect to the said orders, I do not wish to place any reliance on the said orders while dealing with the issue in the present case in hand.
32. Further, the Noticee has submitted that the observations made by the various courts / authorities are against NSEL and its management and the Noticee's name does not appear in any of the said proceedings / orders. It is pertinent to mention that the said orders and reports of the authorities have been considered in the present proceedings in order to state that the 'paired contracts' executed on the NSEL platform were in violation of the Government Notification dated June 05, 2007. Therefore, even though the Noticee's name does not form part of these orders and proceedings of other authorities, mention of such orders and reports of other authorities with respect to the establishment of paired contracts being in violation of the said notification is of importance in the present proceedings.
33. The Noticee has also submitted that the present proceedings initiated against it are vitiated due to inordinate delay. The cause of action pertains to the year 2012 and 2013. I note that FMC, the regulator of the commodity derivatives market, under powers conferred upon it vide Notification 228(E) dated February 06, 2012, had called for trade data from the NSEL with respect to the trades being executed on its platform. On analysis of data received from NSEL, FMC observed 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*" and "*the condition*

*of 'no short sale by members of the exchange shall be allowed' was not being met by NSEL". Subsequently, FMC, while dealing with the facts relating to mismanagement and poor governance of NSEL, in its order No.4/5/2013-MKT-1/B dated December 17, 2013, inter alia, observed that the conditions laid down in the Government Notification dated June 07, 2007 had been contravened by NSEL. Thereafter, in the Union Budget for the FY 2015-16 it was announced that FMC would be merged with SEBI. The Finance Act, 2015, provided that *any person dealing in commodity derivatives prior to the aforesaid merger of FMC with SEBI may continue to do so provided they have made an application for registration with SEBI within a period of three months from the date of such merger.* The merger of FMC and SEBI took effect only on September 28, 2015. The transactions on the platform of NSEL were examined by various authorities including FMC, Courts, EOW, SFIO, etc., which *prima facie* found them to be illegal.*

34. Therefore, I note that considering the above and the chronology in which the present proceedings have been conducted, the submission of delay in initiating action against the Noticee is not tenable.
35. I also note that the Noticee has submitted that the additional documents such as the SFIO Report, SEBI FIR and the amended Schedule II of the Intermediaries Regulations were sent to the old registered address of the Noticee and that there was delay on SEBI's side to forward the relevant additional documents. It is pertinent to mention here that the Noticee, despite an enforcement proceeding pending against it, did not inform SEBI about the change in its registered / correspondence address and only upon sending an email to the Accounts and Taxation Manager of the Noticee on January 09, 2023 attaching therewith additional documents that the said officer, vide email dated January 10, 2023, informed SEBI of its changed address for correspondence. The delay, if any, cannot be attributed to SEBI and has to be cast upon the Noticee for not keeping SEBI informed about its change of address. I note that sufficient opportunities have been granted to the Noticee to defend its case. Therefore, the submission of the Noticee that there was delay on SEBI's side to forward the relevant additional documents is totally misplaced and therefore, not tenable.

- 36.** The Noticee has also submitted that all the relevant documents have not been provided to it for preparation of its defence. Here, it is pertinent to note that during the enquiry proceedings, the DA, vide letter dated January 15, 2019, had provided additional documents and clarification on certain documents sought. Further, vide letter dated November 13, 2019, certain documents, namely, (a) Grand Thorton Report dated September 21, 2013 along with annexures thereto, (b) Fortnightly Report submitted by NSEL to FMC and (c) EOW Report dated April 04, 2015, as sought by the Noticee, were provided by SEBI to the Noticee. Vide email dated December 30, 2019, it was even clarified to the Noticee that all the relied upon documents have been provided to the Noticee and the Noticee was requested to file its submissions, if any. Thereafter, vide letter dated January 13, 2020, the Noticee has filed a detailed reply in the matter. As mentioned in the preceding paragraphs, additional documents viz. SFIO Complaint, FIR filed by SEBI and amended Schedule II of the Intermediaries Regulations have also been provided to the Noticee. Also, as requested, opportunities of inspection of documents were also granted and availed by the Noticee on January 29, 2020 and February 07, 2023. In view of the same, the submission of the Noticee that it has not been provided with relied upon / relevant documents does not hold any merit.
- 37.** I further note that the Noticee, vide its emails dated April 18, 2023 and April 26, 2023, has again requested for certain documents in order to make further submissions in the matter. In the alternative, the Noticee has requested for an opportunity to inspect the documents requested for. I note that, SEBI, vide its email dated April 25, 2023, had provided the trade data (as received from EOW in January 2020) to the Noticee showing the details of the trades executed by the Noticee on the NSEL platform during the relevant period. The Noticee was requested to furnish its comments, if any on the same. I find that the Noticee, instead of giving its comments on the said trade data, has doubted the authenticity of the same and has sought for further opportunity of inspection of documents. Infact, the trade data shared with the Noticee was the data for trades carried out in his own account. I note that the Noticee in its earlier submissions has specifically stated that the trading done by the Noticee on NSEL platform was in consonance with the circulars issued by NSEL and in accordance

with the bye-laws of NSEL. The Noticee has even stated that it cannot be held liable just because it participated in paired contracts. I note that all the documents relied upon by SEBI, including the trade data, have been provided to the Noticee and he has availed inspection on two occasions during the current proceeding. I am of the view that further inspection would only result in further delay in the proceedings. The Noticee was given documents and he was afforded sufficient opportunities to defend his case.

### **Fit and proper person criteria**

**38.** Now, I would be proceeding to deal with the main issue in hand in the present case which is whether the Noticee satisfies the '*fit and proper person*' criteria laid down under Schedule II of the Intermediaries Regulations. Before moving forward, it would be appropriate to take a look at the relevant provision of the SEBI Act, Broker Regulations and the Intermediaries Regulations (as they exist on date) which are reproduced as under for reference:

#### ***SEBI Act***

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

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

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

#### ***Broker Regulations***

##### ***Consideration of application for grant of registration.***

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

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

##### ***Conditions of registration.***

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

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

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

***Liability for action under the Enquiry Proceeding Regulations.***

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

(i) ....

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

**SCHEDULE II**

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

**CODE OF CONDUCT FOR STOCK BROKERS**

**[Regulation 9]**

**A. General.**

(1) *Integrity:* A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

(2) *Exercise of due skill and care:* A stock-broker shall act with due skill, care and diligence in the conduct of all his business.

(3) ....

(5) *Compliance with statutory requirements:* A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.”

***Intermediaries Regulations:***

**SCHEDULE II**

**SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES)  
REGULATIONS, 2008**

**[See regulation 7]**

(1) The applicant or intermediary shall meet the criteria, as provided in the respective regulations applicable to such an applicant or intermediary including:

(a) the competence and capability in terms of infrastructure and manpower requirements; and

(b) the financial soundness, which includes meeting the net worth requirements.

(2) The ‘fit and proper person’ criteria shall apply to the following persons:

(a) the applicant or the intermediary;

(b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and

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

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

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

*(3) For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but no 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 (b) and (c) of clause (2) comply with the 'fit and proper person' criteria.*

**39.** I note that regulation 5(e) of the 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 Intermediaries Regulations, 2008 was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021 with effect from November 17, 2021.

**40.** From the records, I note that SEBI has filed a complaint with EOW Mumbai dated September 24, 2018, against brokers who facilitated access to 'paired contracts'

traded on NSEL, including the Noticee. On the basis of this complaint, an FIR dated September 28, 2018, was registered against the Noticee. I note that the Noticee is holding a certificate of registration No. INZ000034438 granted by SEBI. In order to continue to hold such Certificate of Registration from SEBI, the Noticee is also required to satisfy the conditions of eligibility, which *inter alia* included, continuance of its status as a 'fit and proper person'. The above condition to be fit and proper is not a onetime 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 as long as the entity remains associated with the Securities Market as a registered intermediary.

41. The Noticee has, however, contended that the revised criteria introduced in 2021 should not be made applicable retrospectively as the present proceedings essentially pertain to the alleged transactions carried out by the Noticee on the NSEL platform during the financial years 2012-13 and 2013-14. I note that the trade data available on record clearly shows the Noticee's participation in paired contracts on NSEL platform. As mentioned in the preceding paragraphs, the said data has even been shared with the Noticee. The Noticee, in its reply, has made certain submissions which have been captured in detail in the Enquiry Report and mentioned in brief in the preceding paragraph which clearly establish that the Noticee had participated in contracts on the NSEL platform. I note that the act of the Noticee in participating in 'paired contracts' by trading in such contracts, seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee. As recorded in the FMC order and the judgements of the Supreme Court, these contracts, as stated earlier, were *ex facie* offered in violation of the exemption Notification issued by MCA and far removed from the spot contracts in commodities which were permitted to be traded on NSEL. The 'paired contracts' were nothing but financing transactions masquerading as spot contracts in commodities. The execution of the trades in 'paired contracts' were not permitted under the 2007 Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities, as observed by FMC in its Order. Therefore, the Noticee, by its conduct and as a member of the NSEL, has promoted and/or dealt in 'paired

contracts' which were held to be in the nature of financing transaction by the Hon'ble Supreme Court. Thus, I am of the view that the trading activities of the Noticee in 'paired contracts' on the NSEL platform have serious ingredients amounting to jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the Noticee in the Securities Market.

- 42.** Also, the Noticee has further contended that during the said period, the Code of Conduct under the Broker Regulations cannot be made applicable to the Noticee. I note that, as mentioned in the preceding paragraphs, before merger of FMC with SEBI, the Noticee was functioning as 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 Finance Act, 2015, recognized the said fact and also that the commodity derivative brokers should be regulated by SEBI. Considering the same, it was made mandatory for all commodity derivative brokers, who wished to continue their activities, to apply for registration with SEBI within a period of 3 months from September 28, 2015. Thus, all the commodity derivative brokers, who applied to SEBI and whose application was in process, were allowed to carry on their functions as commodity derivative brokers till the disposal of their respective application. Thus, by virtue of provisions of Finance Act, 2015, all those entities, who were functioning as commodity derivatives brokers, after having made their application within 3 months from September 28, 2015, were under the supervision and control of SEBI like any other intermediary holding a certificate of registration. 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, I note that pursuant to the merger of FMC with SEBI, the Noticee had applied for a certificate of registration as a commodity broker and was granted a certificate of registration by SEBI. Therefore, the Noticee has become a SEBI registered intermediary from the said date and falls under the definitions of a 'stock broker' and thus, the code of conduct under the Broker Regulations is applicable to it.

43. In addition to the above, I find it relevant to refer to the observations of the order dated October 04, 2018 of the Hon'ble Bombay High Court in *Anand Rathii Commodities Limited v. SEBI*(W.P. (L) no. 3262 of 2018) wherein it was argued that the alleged deeds or misdeeds prior to September 29, 2015 by the petitioners who were acting as commodity brokers are beyond the jurisdiction of SEBI. The said argument was rejected by the Court and while interpreting Section 28A of the Finance Act, 2015, the Court 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."*

44. I also find no merit in the submissions of the Noticee that the amended Schedule II of the Intermediaries Regulations would not be applicable in the present case. It is noted that paragraph 3(b) of the amended criteria lays down a list of disqualifications which includes the following:

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

45. As noted in the preceding paragraphs, it can be seen from the submissions made by the Noticee that it had participated in certain contracts launched by NSEL on its platform which were paired contracts (as already observed by the Hon'ble Supreme Court). As the paired contracts were violative of the conditions stipulated in the Government Notification dated June 05, 2007, a complaint was filed by SEBI with Economic Offences Wing, Mumbai (EOW) on September 24, 2018, against the brokers who participated / facilitated access to 'paired contracts' traded on NSEL, including the Noticee within the time limit as specified in the aforementioned provision of the Finance Act, 2015. On the basis of the said complaint of SEBI, FIR dated

September 28, 2018 was registered with MIDC Police Station, Mumbai. I note that the name of the Noticee is reflected in the complaint and the FIR.

46. It is pertinent to note that the criteria of '*fit and proper person*', is an ongoing requirement throughout the period during which the Noticee remains operational in the Securities Market as a registered intermediary. In case, pursuant to the grant of registration by SEBI, any evidence comes to the notice of SEBI that casts a doubt on the integrity, reputation and character of the registered intermediary, the SEBI is well within the powers to examine the 'fit and proper' status of such entity based on various parameters. Therefore, even if the Noticee was found to have fulfilled the 'fit and proper person' criteria when SEBI granted it the Certificate of Registration in 2017, such an intermediary can still be assessed on being fit and proper at a later date. Furthermore, as and when the 'fit and proper' criteria changes, the Noticee will be required to comply with the revised criteria, and in the instant case, criteria as revised vide the amendments in November 2021. It is noted that parameters provided under paragraph 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations lays down a list of disqualifications which includes a criminal complaint or information under section 154 of Code of Criminal Procedure filed against such an entity by the Board and which is pending. It is, therefore, noted that the Noticee attracts the disqualification provided in paragraph 3(b) (i) of the Schedule II of the Intermediaries Regulations. I note that though the Noticee has submitted that no charge sheet has been filed or no warrant/ summons has been received from any authority till date and mere filing of an FIR does not amount to a violation, as mentioned above, as the Noticee has to statutorily comply with the revised criteria to be fit and proper person, a criminal complaint or information under section 154 of Code of Criminal Procedure filed against such an entity by the Board and which is pending forms a part of the disqualification list under Schedule II of the Intermediaries Regulations, the said submission of the Noticee does not have any merit in the present facts of the case.

47. Therefore, looking holistically I find that the said conduct of the Noticee is detrimental to the Securities Market, being not in conformity with the applicable code of conduct. I, therefore, note that there were enough red flags for a reasonable person to come

to conclude that what was being offered as 'paired contracts' on NSEL were not spot contracts in commodities. Given the above, I am constrained to conclude that the Noticee's participation in paired contracts offered on NSEL platform raises serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the product itself. In failing to dissociate itself from, and continuing to participate in the said paired contracts, the Noticee failed to act with due diligence.

48. Furthermore, as mentioned in paragraphs 45 and 46, the Noticee has also earned disqualification under 3(b)(i) of the amended Schedule II of the Intermediaries Regulations on account of an FIR filed by SEBI. In this regard it is pertinent to note that the said FIR was filed by SEBI on September 28, 2018 and is validly subsisting and has not been challenged, quashed or stayed by any competent court qua the Noticee. In this context, as observed above, I note that being a 'fit and proper person' is a continuing 'eligibility criteria' which must be satisfied by the Noticee including the amended criteria.
49. Here, it is pertinent to note that the principle of '*ignorantia juris non excusat*' or '*ignorantia legis neminem excusat*' or '*ignorance of law is no excuse*' also becomes applicable in the situation since trading in 'paired contracts' was in violation of the 2007 Exemption Notification and ignorance of the conditions of the said Exemption Notification cannot be claimed. The 'paired contracts' were nothing but financing transactions which were portrayed as spot contracts in commodities. Therefore, giving go-bye to the terms of the 2007 Exemption Notification and attempting to camouflage the nature of the transactions brings into question appropriateness and suitability of the continuance of the registration of the Noticee as a broker. Clearly, the actions of the Noticee has been detrimental to the interest of the Securities Market and accordingly the Noticee can no longer be called a 'fit and proper person' for holding the Certificate of Registration as a broker in the Securities Market, which is one of the conditions for continuance of registration as specified in regulation 5(e) of the Brokers Regulations read with the provisions of Schedule II of the Intermediaries Regulations.

50. In the context of Securities Market, I note that the role of a registered intermediary including a broker is not only sensitive and predominantly fiduciary in nature but also demands from it honesty, transparency, fairness and integrity which are essentially the hallmarks of such market intermediaries. Given the fact that one of the avowed objects of the SEBI Act is the protection of interest of investors apart from promotion and development of the Securities Market, the legislature through enactment, empowers SEBI to grant registration to several class of entities including brokers, which are not only required to act as an intermediary simplicitor i.e., a bridge or a connector between the markets and investors, but also have a very important role to play in creating an ecosystem of trust and fairness so as to provide a fair and secure market to the investors. Any deviation from the above noted objective could have a cascading adverse impact on the development of the Securities Market and interests of investors. Thus, undisputedly a broker is obligated to act in a transparent manner and comply with all applicable regulatory requirements which are in the best interests of its clients and which will uphold the integrity of the Securities Market.
51. I am also aware that recently SEBI has passed 5 separate orders<sup>10</sup> in the related NSEL matters where the Noticees therein have been debarred from making a fresh application seeking registration for a specified period from the date of the said order or till acquittal of the said Noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier. I find that present matter at hand is different from that of those 5 cases as in the extant matter the Noticee is already holding a Certificate of Registration whereas in those 5 cases, the entities had filed applications seeking certificate of registration. One may assume that at the time of grant of Certificate of Registration to the Noticee, it was already adjudged as a 'fit and proper person' by SEBI and therefore the said criteria are already satisfied by the Noticee.

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<sup>10</sup> Orders dated November 29, 2022 in respect of Motilal Oswal Commodities Brokers Pvt. Ltd.(at [https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-respect-of-motilal-oswal-commodities-broker-pvt-ltd-\\_65602.html](https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-respect-of-motilal-oswal-commodities-broker-pvt-ltd-_65602.html)), Anand Rathi Commodities Ltd.(at [https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-anand-rathi-commodities-ltd-\\_65604.html](https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-anand-rathi-commodities-ltd-_65604.html)), Geofin Comtrade Limited (previously known as Geojit Comtrade Limited) (at [https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-geofin-comtrade-limited-previously-known-as-geojit-comtrade-limited\\_65597.html](https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-geofin-comtrade-limited-previously-known-as-geojit-comtrade-limited_65597.html)), India Infoline Commodities Ltd.(at [https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-india-infoline-commodities-ltd-\\_65595.html](https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-india-infoline-commodities-ltd-_65595.html)) and Phillip Commodities India Pvt. Ltd. (at [https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-phillip-commodities-india-pvt-ltd-\\_65593.html](https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-phillip-commodities-india-pvt-ltd-_65593.html)) in the matter of NSEL.

However, as noted above 'fit and proper person' criteria is a continuing requirement under the Intermediaries Regulations which the Noticee ought to comply with at all times so long it desires to remain associated with the Securities Market as a registered intermediary. Necessity of specifying a period of time may also not arise in this order (as did arise in the case of entities desiring to be registered as market intermediaries) when dealing with an entity holding a certificate of registration which is cancelled as this forum cannot presume whether such entity wishes to reapply to be a market intermediary or not. If it chooses to do so, it will have to be assessed at such point of time if it is fit and proper as per the extant and applicable regulations.

- 52.** The limited scope of the present proceedings is to see whether the indulgence, engagement and promotion of such activities could be held to be beneficial to the development of Securities Market or the same contain elements that are potentially dangerous and detrimental to the interest, integrity, safety and security of the Securities Market. In this respect, the undisputed fact recorded in FMC order and Hon'ble SC order that the scheme of 'paired contracts' traded on the NSEL ultimately has caused loss to the market to the extent of INR 5,500 Crore itself casts serious aspersion on the conduct, integrity and reputation of, inter alia, the Noticee who participated in such 'paired contracts' and therefore, its continuing role in the Securities Market cannot be viewed as good and congenial for the interest of the investors or of the Securities Market.
- 53.** Given the above discussions and deliberations, I am constrained to conclude that the Noticee participated in a product which raises serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the said product itself. Further, as per findings recorded above, the Noticee also attracts the disqualification provided in paragraph 3(b)(i) under the amended Schedule II of the Intermediaries Regulations insofar as SEBI has filed an FIR against the Noticee under section 154 of Cr. P C with EOW, Mumbai and the same is validly subsisting/pending as on date. Further, it is also not the case of the Noticee that said FIR filed by SEBI is either stayed or quashed by any competent court qua the Noticee or otherwise. In view of the above, I hold that the Noticee does not satisfy the 'fit and proper person' criteria specified in Schedule II of the Intermediaries Regulations and hence, the



continuance of the Noticee as a broker will be detrimental to the interest of the Securities Market. Therefore, such activities of the Noticee as a registered broker cannot be condoned and deserve appropriate remedial measure to prevent such wrong doings from recurring to the detriment of the interest of the Securities Market.

## **ORDER**

- 54.** I, therefore, in exercise of powers conferred under Section 12(3) and Section 19 of the SEBI Act, 1992 read with Regulation 27 of the Intermediaries Regulations, 2008 and upon considering the gravity of the violations committed by the Noticee viz. CNB Commodities Pvt. Ltd, the Certificate of Registration (bearing no. INZ000034438) of the Noticee i.e. CNB Commodities Pvt. Ltd, is hereby cancelled.
- 55.** The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 54 above.
- 56.** Notwithstanding the direction at paragraph 54 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 clients to withdraw or transfer their securities or funds within the said 15 days, the Noticee shall transfer the funds and securities of such clients to another broker within a period of next 15 days thereon, under advice to the said clients.
  - (b) The Noticee shall square off open positions, if any, within 30 days from the date of this order.
- 57.** This Order shall come into force with immediate effect.
- 58.** It is clarified that in view of the amendment made w.e.f. January 21, 2021 in the Intermediaries Regulations, powers that were exercised under Regulation 28 of the Intermediaries Regulations, 2008 are now being exercised under Regulation 27 of the Intermediaries Regulations, 2008. It is also noted that the above Order is without prejudice to the criminal complaint filed by SEBI in the NSEL matter and/or any

proceedings pending before any authority in respect of similar matter concerning the Noticee or other relevant persons.

- 59.** A copy of this order shall be served upon the Noticee and the recognized Market Infrastructure Institutions for necessary compliance.

**Date: April 28, 2023**

**Place: Mumbai**

**Dr. ANITHA ANOOP  
CHIEF GENERAL MANAGER  
SECURITIES AND EXCHANGE BOARD OF INDIA**