

## SECURITIES AND EXCHANGE BOARD OF INDIA

## ORDER

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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

## Against

NAME OF THE NOTICEE	SEBI REGISTRATION NO.
Mavji Haribhai Commodities	INZ000079526

## In the matter of trading at the National Spot Exchange Limited

## BACKGROUND

1. The Securities and Exchange Board of India (“SEBI”) vide communique dated September 24, 2018 had appointed a Designated Authority ( “DA”) to enquire into and to submit a report on the activities of Mavji Haribhai Commodities (**Mavji/“Noticee”**) as a stock broker bearing Registration No. INZ000079526 in the matter of its alleged trading on the spot exchange platform provided by the National Spot Exchange Limited (“NSEL”) resulting in the possible violation by the Noticee of Regulations 5(e), 9(b) and 9(f) of the SEBI (Stock Brokers) Regulations, 1992 (“**Stock Brokers Regulations**”) read with Schedule II of the SEBI (Intermediaries) Regulations, 2008 (“**Intermediaries Regulations**”).
2. Upon conclusion of the enquiry in the manner envisaged under Regulation 25 of the Intermediaries Regulations, the DA submitted a report dated August 24, 2020 (“**Enquiry Report**”) in terms of Regulation 27 of the Intermediaries Regulations as it read at the relevant point of time prior to its amendment vide SEBI (Intermediaries) (Amendment) Regulations, 2021, w.e.f. January 21, 2021, wherein based on various factual findings and observations as recorded in the Enquiry Report, the DA recommended that the registration of the Noticee as a stock broker may be cancelled.

3. The relevant excerpt of the Enquiry Report is reproduced below:

*“30. In view of the facts and circumstances of the case and material placed before me, I am of the view that the Noticee is not a fit and proper person in terms of Regulation 5(e) read with Regulation 27(iv) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations. Therefore, in terms of Regulation 27 of the Intermediaries Regulations, I recommend that the registration of the Noticee i.e. Mavji Haribhai Commodities [Registration No. INZ000079526] as a commodities derivatives broker may be cancelled.”*

4. A notice dated September 10, 2020 (“**SCN**”) enclosing the Enquiry Report and certain other documents referred to 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 recommendation of the DA of cancelling its certificate of registration should not be accepted or any other action as may be considered appropriate, should not be taken against it. The SCN further advised the Noticee to submit its reply, if any, within 21 days of receipt of the said SCN.
5. At this juncture, it would be relevant to refer to certain developments that ensued that have a bearing on the case under consideration. Against five separate orders earlier passed by SEBI in February 2019 rejecting the applications filed by five separate entities seeking registration as commodity brokers on the ground of being involved in the trades on the platform provided by NSEL, the five entities filed separate appeals before the Securities Appellate Tribunal which, vide its common order dated June 9, 2022, remanded these matters for being reconsidered within six months from June 9, 2022 and, *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...”*

6. On the basis of this order and other subsequent orders passed in a similar set of cases by the Securities Appellate Tribunal, relevant additional documents/ material was provided to the Noticee vide a supplementary notice dated February 17, 2023 (“**SSCN**”, which along with the original notice, is collectively referred to as the “**SCNs**”), with an advice to submit its reply/ comments/ clarifications in addition to its earlier replies, if any, within 15 days of the receipt of the SSCN. The Noticee submitted its reply to the SCNs vide letter dated March 15, 2023.
7. It is pertinent to mention that Regulation 27 of the Intermediaries Regulations was amended with effect from January 21, 2021. Pursuant thereto, the procedure for action on receipt of the recommendation of the DA (which was earlier provided under Regulation 28 of the Intermediaries Regulations) was duly incorporated in the amended Regulation 27 of the Intermediaries Regulations. Thus, these proceedings are being considered under the amended Regulation 27 of the Intermediaries Regulations.
8. A notice of hearing dated April 10, 2023 was sent to the Noticee for a personal hearing on April 21, 2023 and make its submissions if so desired. On the scheduled date of hearing, the Authorised Representatives of the Noticee appeared through virtual mode and made its submissions in line with the reply earlier filed by the Noticee.
9. The gist of the reply dated March 15, 2023 filed by the Noticee and the oral submissions advanced during the course of the personal hearing held on April 21, 2023 are summarized hereunder:
  - 9.1 The Noticee had traded in paired contracts on the NSEL platform on behalf of its clients during the period 2009-2013.
  - 9.2 The Noticee was earlier a member of NSEL and after the merger of FMC with SEBI, it was granted certificate of registration by SEBI on December 28, 2016

as a commodity derivatives broker and at present is a member of National Commodity and Derivatives Exchange Limited (NCDEX)..

9.3 On September 28, 2015, FCRA was amended by the Finance Act, 2015. By virtue of this amendment, an exchange recognized under FCRA was given deemed recognition under the Securities Contracts (Regulation) Act, 1956 and was brought under the administration of SEBI. NSEL was not an exchange under FCRA and therefore was not brought under the administration of SEBI by the Finance Act.

9.4 SEBI does not have the jurisdiction to issue a show cause notice under Regulation 28(1) read with Regulation 27(1) of the intermediaries Regulations as such a notice can only be issued against those persons who hold a certificate of registration.

9.5 The Noticee was not registered with SEBI under the Intermediaries Regulations. The Noticee was also not registered with SEBI at the time of NSEL default scam. There is no merit in the stand of SEBI that the issue of jurisdiction has been considered and decided by the Division Bench of Hon'ble Bombay High Court in its judgement dated October 04, 2018.

9.6 The Intermediaries Regulations could only be invoked if there was non-compliance of any conditions of certificate of registration which in its case does not arise as the Noticee was not holding a registration certificate at the time of the alleged violation.

9.7 The Notification dated September 28, 2015 was prospective in nature and SEBI had no jurisdiction to issue a show cause notice raising the allegations related to the acts committed prior to September 28, 2015.

9.8 Certain documents as sought for were not provided. Consequently, the principles of natural justice are violated.

9.9 The Serious Fraud Investigation Office ("SFIO"), Ministry of Corporate Affairs had forwarded an Investigation Report dated August 31, 2018 to SEBI on November 01, 2018 based on which SEBI issued a second show cause notice dated February 17, 2023 alleging that in view of the various observations made by the courts and certain authorities including the SFIO, the Noticee was not a fit and proper person.

9.10 Since no order has been passed by any court of law against the Noticee, the observations made by various Courts / Authorities including SFIO but not against the Noticee, cannot be used against the Noticee for holding it to not be a fit and proper person.

9.11 For determining whether the Noticee is a fit and proper person, SEBI may take into account the following criteria namely, integrity, reputation and character. The language used in Regulation 7 of the Stock Broker Regulations read with Schedule II makes it clear that the concept of fit and proper is of vital amplitude and subjective satisfaction and discretion is given to the authority. But exercise of such subjective satisfaction should be judicious and should be based on some material which satisfies a rational mind and should not be based on surmises and conjectures nor should it be arbitrary.

9.12 SEBI has initiated proceedings only against a few brokers even though more than 600 brokers were trading on the NSEL platform who have not been issued any notice. Therefore, the Noticee has been discriminated against by SEBI.

## **CONSIDERATION OF ISSUES**

10. I have carefully perused the contents of the Enquiry Report, the SCNs issued to the Noticee and the reply dated March 15, 2023 filed by the Noticee as well as the oral submissions advanced on its behalf during the personal hearing and other material/information available on record. The principal issue which arises for my consideration is whether the present proceedings are maintainable

against the Noticee and whether the Noticee satisfies all the 'fit and proper person' criteria as laid down under Schedule II of the Intermediaries Regulations for functioning as a registered stock broker in the securities market.

11. Before I proceed to examine these issues, it would be appropriate to refer to the relevant provisions of law, alleged to have been violated by the Noticee and/ or referred to in the present proceedings which are reproduced for ease of reference:

**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*

***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 Securities and Exchange Board of India (Intermediaries) Regulations, 2008.***

*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. It is a matter of record that prior to the merger of the Forward Market Commission (“FMC”) with SEBI on September 28, 2015, the commodity brokers including the Noticee were not required to be registered with either the FMC or any other regulatory authority under the FCRA. The Parliament sought to rectify this regulatory vacuum through the enactment of the Finance Act, 2015, which repealed the FCRA and brought the entities dealing with commodity derivatives under the regulatory supervision of SEBI with effect from September 28, 2015.
13. Pursuant thereto, SEBI was empowered through the Finance Act, 2015, *inter alia*, to regulate commodity derivatives brokers, which included granting them registration as a commodity derivatives broker with SEBI. Section 131B of the Finance Act, 2015, provided a transitory period of 3 months to all intermediaries associated with the commodity derivatives market under the erstwhile FCRA to continue to deal in commodity derivatives as a commodity derivatives broker, provided they applied for registration from SEBI within 3 months from September 28, 2015.

14. Thus every commodity derivatives broker was mandatorily required to obtain a certification of registration from SEBI in case it sought to remain associated with the securities market as a commodity derivatives broker and SEBI is suitably empowered to initiate action against the brokers for any violation committed by them.
15. The ambit of SEBI on the violation of the provisions of FCRA flows from the Finance Act, 2015, which amended the provisions of the FCRA through Section 29A of FCRA, as inserted by the Finance Act, 2015, and reads as follows:

*“(1) The Forward Contracts (Regulation) Act, 1952 is hereby repealed.*

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

*(a)....*

*(b)....*

*(c)....*

*(d)....*

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

*(f) no court shall take cognizance of any offence under the Forward Contracts Act from the date on which that Act is repealed, except as provided in clause (d) and (e);*

*(g) clause (d), (e), (f) shall not be held to or affect the general application of section 6 of the General Clauses Act, 1897 with regard to the effect of repeal to matters not covered under these sub-sections.”*

16. These aspects were highlighted by the Hon'ble Bombay High Court in its Order dated October 04, 2018 while dealing with 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* wherein the following was observed:

*“ ...*

*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”.*

17. It is thus clear that SEBI has been statutorily empowered to initiate a fresh proceeding with respect to the offences under FCRA within a period of three years from the date on which FCRA is repealed. Accordingly, since pursuant to the merger of FMC with SEBI, it was well within the powers of SEBI to initiate proceedings under Chapter V of FCRA against entities for their activities undertaken by them of executing paired contracts on the NSEL platform, SEBI filed the criminal complaint dated September 24, 2018 against such entities before the Economic Offence Wing (“**EOW**”) and requested the EOW to take appropriate action under Sections 20 and 21 and other provisions of FCRA against the brokers/ members of NSEL and other persons mentioned in the complaint.
18. Admittedly, the Noticee had executed the paired contracts offered on the NSEL platform on behalf of its clients as evident from the trading data provided by EOW, also provided to the Noticee. However, the Noticee has sought to justify the execution of such trades in the paired contracts on the NSEL platform and instead challenged the action proposed against it by raising the grounds summarized in paragraph 9, particularly the maintainability of the present proceedings.
19. With regard to the contention of the Noticee that it was not registered with SEBI during the period from September 2009 to August 2013 when the alleged default on the NSEL platform was committed, it is matter of record that the Noticee was granted a certificate of registration from SEBI as a stock broker with effect from December 28, 2016 and even as on date, continues to function as a registered stock broker.
20. It is also a settled position of law that every registered intermediary in the securities market is required to fulfil the fit and proper criteria at all points of its functioning including any additional criteria statutorily provided for, from time to

time. Else, there would arise an anomalous situation where an entity that has obtained a certificate of registration after fulfilling the said criteria, fails the 'fit and proper person' test after a period of time and yet continues to function in the securities market despite not fulfilling the criteria.

21. This is why the requirement of being a 'fit and proper' person, is a continuing 'eligibility criteria'/ statutory requirement, which ought to be satisfied by the registered entities at all points of time. This condition 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 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. Therefore, the criteria of 'fit and proper person', is an ongoing requirement throughout the period during which an entity remains operational in the securities market as a registered intermediary.
22. The present proceedings have been initiated to adjudge the 'fit and proper person' status of the Noticee under the Stock Brokers Regulations and the Intermediaries Regulations in light of the registered status and the activities undertaken by it on the NSEL platform and the consequent action taken by FMC and SEBI. The argument of the Noticee that since it was not registered with SEBI during the period from September 2009 to August 2013 when it traded in the paired contracts and hence the question of it violating the provisions of the Stock Brokers Regulations and Intermediaries Regulations would not arise is not tenable in view of the principles mentioned above. If the continued applicability of the fit and proper criteria to the functioning of an entity is challenged, there would exist a market where the overall interest of all the investors would stand compromised. Further, the due presumption on the constitutional and legal validity of the said amended Schedule II of the Intermediaries Regulations holds the field even till date and any arguments to the contrary are not maintainable. The Noticee is obligated to maintain the fit and proper person criteria on a continuous basis and it is well within the jurisdiction and powers of SEBI to

adjudge the said 'fit and proper' status of all market intermediaries in the interest of the securities market.

23. It has also been contended by the Noticee that it had requested for certain documents which were not provided to it and consequently, the principles of natural justice had been violated. I also note that the Noticee has not mentioned anywhere in its reply the list of specific documents which it intends to seek or inspect. I also note that sub-regulations (3) and (4) of Regulation 25 of the Intermediaries Regulations specifying that copies of the documents relied upon by SEBI along with the extracts of relevant portions of the reports containing the findings arrived at in an inquiry, investigation or inspection, if any, shall be provided to the Noticee. On perusal of the SCNs, Enquiry Report and material/information available on record, I find that all the documents relied upon by SEBI for levelling charges against the Noticee have been provided to the Noticee along with the SCNs.
24. In this regard, I note from the Enquiry Report that the show cause notice dated September 25, 2018 issued by the DA was duly served upon the Noticee and that in response, the Noticee vide its letter dated October 15, 2018 had sought extension of time to file its reply but did not submit it even after the expiry of the requested time period. Subsequently, the trading data of paired contracts dealt by the Noticee was also provided to the Noticee vide email dated July 07, 2020 with an advice to submit the reply by July 21, 2020. Yet, the Noticee chose not to respond to the show cause notice dated September 25, 2018 and thus the Enquiry Report was prepared by the DA on the basis of material available on record. Interestingly, during the personal hearing before me, the Noticee did not submit that it had not been provided with the relevant documents in the matter. Thus, I am inclined to hold that the Noticee was provided with all the necessary documents relied upon by SEBI and those relevant to the alleged violations against the Noticee and that all the principles of natural justice have been adhered to while conducting the proceedings under the Intermediaries Regulations.

25. As regards the Noticee's submission that it has been discriminated since SEBI had initiated Enquiry proceedings only against certain stock brokers, I have noted that the proceedings were proposed and initiated against entities based on the trades executed in the paired contracts on the NSEL platform and the accompanying facts and circumstances of their respective cases and solely relying on material available on record. Since the Noticee was one of such entity that had facilitated the trading in paired contracts on behalf of its clients, the present proceedings have been initiated against it. In any case, regardless of the action against other entities/brokers, there was adequate scope for the Noticee to counter the same which was not done. The extent of the role of the Noticee has been clearly brought out in the SCNs issued to it and as a quasi-judicial authority, the issue before me is to adjudicate the gravity of the allegations in the SCNs and arrive at a finding. Thus, the contention of the Noticee that it has been discriminated against is devoid of any merit.
26. The Noticee has contended that SEBI issued the second show cause notice dated February 17, 2023, simply on account of the various observations made by the courts and certain authorities including the SFIO, of it not being a fit and proper person, I see no merit in such a contention. The supplementary SCN was issued to the Noticee pursuant to the order passed by SAT on June 9, 2022, as mentioned in the earlier part of the order ("SAT Order"). Vide the SSCN, the Noticee was called upon to show cause why the following information/ material along with the Enquiry Report should not be considered against it for determining whether the Noticee satisfies the '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 (hereinafter referred to as the "FIR") dated September 28, 2018; and
  - c. Amended Schedule II of the Intermediaries Regulations.

There was no reference to the Order of any court or authority including the SFIO Investigation Report. Accordingly, the submission of the Noticee in this regard is unfounded and liable to be rejected.

27. The Noticee has referred to the fit and proper criteria provided in Schedule II of the Intermediaries as it read prior to its amendment on January 21, 2021 to state that for considering the fit and proper criteria, the subjective satisfaction and discretion given to SEBI should be judiciously applied and based on some material which satisfies a rational mind. To this I note that the criteria mentioned is not exhaustive and that the Noticee's contention is based on an incorrect understanding of the issues raised in the SCNs. The SSCN clearly mentioned and called upon the Noticee to show cause as to why amongst other issues, the 'amended Schedule II of the Intermediaries Regulations' should not be considered against it for determining its fit and proper criteria. As mentioned earlier, the trades executed by the Noticee warranted suitable action for not acting in a fit and proper manner which is required to be adhered to by a registered intermediary on a continuous basis and not only at the time of grant of certificate of registration.
28. Before moving forward to consider the other issues on merits and test the extent of 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 26 above, the background facts necessary to be referred to for a proper appreciation of the present proceedings are narrated in brief, hereunder:
  - a. NSEL was incorporated in May, 2005 as a Spot Exchange, for trading in commodities. In exercise of the powers conferred under Section 27 of the FCRA, the Central Government vide its 2007 Notification granted exemption to all forward contracts of 'one-day duration'; from the operations of the provisions of the FCRA, for the sale and purchase of commodities traded on the NSEL, subject to fulfilment of certain conditions, inter alia, that "no short sale by the members of the exchange shall be allowed" and that "all outstanding positions of the trades at the end of the day shall result in

delivery". Thus, NSEL was given permission to be setup as a Spot Exchange for trading in commodities and was essentially meant to only offer forward contracts having on its trading platform one-day duration as per 2007 Notification.

- b. In October 2008, NSEL commenced operations for providing an electronic trading platform to its participants for spot trading of commodities, such as bullion, agricultural produce, metals, etc. NSEL introduced the concept of 'paired contracts' in September 2009 which allowed buy and sell in the 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 the same time and at different prices, but involving the same counterparties. The transactions were structured in a manner that the buyer of the short duration contract always ended up making profits.
- c. On February 06, 2012, 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 Notification, and was authorized to collect the trade data from NSEL and to examine the same for taking appropriate measures, if needed, to protect investors' interest.
- d. FMC accordingly called for the trade data from different spot exchanges, including NSEL in the prescribed reporting formats. It was observed that the 55 contracts offered for trade on the NSEL were with settlement periods exceeding 11 days. After analyzing the trade data received from the NSEL, FMC passed an Order No. 4/5/2013-MKT-1/B dated December 17, 2013 (FMC Order) wherein it was, inter alia, observed that 55 contracts offered for trade on the NSEL platform were in violation of the relevant provisions of the FCRA and that the condition of '*no short sale by members of the exchange shall be allowed*' was not being complied with by the NSEL and its members. FMC further observed that the 'paired contracts' offered for trading in the NSEL platform were in violation of the provisions of the FCRA and the conditions specified by the Government of India in its 2007 Notification, while



granting exemption to the one day forwards contracts for sale and purchase of commodities traded on the NSEL, from the purview of the FCRA.

29. More specifically, the FMC Order in respect of the 'paired contracts', which were traded on the NSEL platform during the relevant period, observed that the following conditions stipulated in the 2007 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. Yet, 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 which were not allowed were in violation of 2007 Exemption Notification.

30. 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 these definitions in the FCRA, FMC was of the view that all the contracts traded on the NSEL which provided settlement schedule exceeding 11 days were to be treated as Non-Transferable Specific Delivery contracts. It is, therefore, seen that even though the Ministry of Consumer Affairs had stipulated in the 2007 Notification that only forward contracts of 'one-day were permitted to be offered on the NSEL, the FMC, in its order, relying on the definition of the "forward contract" under FCRA, held that the NSEL was allowed to only trade in

forward contracts of 'one-day duration' and was obligated to ensure delivery and settlement within 11 days. There is however no doubt to the fact that 55 paired contracts of various commodities, having a duration, longer than 11 days involving crores of rupees were executed in contravention of the exemption granted to NSEL.

31. 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. vs. Union of India & Others* (Civil Appeal No. 4476 of 2019 decided on April 30, 2019) ("**merger petition**"), wherein it was, *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..."*

It would also be necessary to place on record the reference to the order of the Hon'ble Bombay High Court in the matter of *63 Moons' Technologies Limited vs. State of Maharashtra* dated August 22, 2019, wherein it was held that the paired contracts were not financial transactions but were trades in commodity as per the regulations and bye laws of NSEL. Upon appeal, the Hon'ble Supreme Court in the matter of the ***State of Maharashtra vs. 63 Moons Technologies Ltd.*** (Civil Appeal No. 2748-49 of 2022) ("**MPID matter**"), while drawing reference to the representations made by the NSEL in respect of the paired contracts, *inter alia*, held as follows:

"...

*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.*

*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...”*

32. Thus, the Hon'ble Supreme Court has well described the nature of the 'paired contracts' offered on the NSEL platform. In the merger petition (*63 Moons Technologies Ltd. vs. UOI*), the Hon'ble 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 enlarged the interpretation and held that such transactions come within the definition of 'deposits' under the MPID Act. While extensively referring to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources, the Hon'ble Court also observed that the NSEL were advertising assured and uniform returns of 16% per annum for the 'paired contracts' traded on the NSEL platform where the return offered was the same across the commodities. It was further observed that the return remained the same irrespective of the duration of the contract. At paragraph 45 of the said order, the Hon'ble Supreme Court also depicted certain examples of 'paired contracts', which offered assured returns. For example, a T+2 and T+25 paired contract in Steel had the same offered rate of return as a T+5 and T+35 paired contract in Castor Oil. Thus, the judgement of the Hon'ble Supreme Court in the MPID matter held that the 'paired contracts' were being marketed as an alternative to fixed deposits and 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.
33. In this regard, it is pertinent to note that the reference of the earlier mentioned FMC Order is to take cognizance of the trades of the Noticee given the nature of contracts being traded on the NSEL and to determine the violations of the relevant provisions of law, if any, in order to ascertain its fit and proper status under the Intermediaries Regulations. For ascertaining the fit and proper status of the Noticee, it is not a pre-condition that the Noticee should be party to the FMC Order. These facts are merely highlighted from the order(s) of the Hon'ble Supreme Court to emphasise the point that the paired contracts were not

contracts in commodity but in the nature of financing transactions which were not envisaged under the 2007 Exemption Notification.

34. Despite the above and the discussion in the context of the facts of the case, in order to give the benefit of doubt to the submissions made by the Noticee, I have further examined whether while facilitating transactions in paired contracts, the Noticee could have been under the bonafide belief that such transactions were actually spot contracts in commodities or alternatively that since 'paired contracts' were offered and that meant that NSEL was offering contracts which were not resulting in compulsory delivery, the Noticee should have been aware that such a product was not actually a spot contract in commodities. After all, such contracts were being advertised as an alternative to fixed deposits returns, and offered fixed returns (e.g. @16%) across all commodities, irrespective of the nature of the contract or the duration and were structured in a manner which ensured that the buyer always made pre-determined profits. Thus, any prudent person (including the Noticee, who is an intermediary and well versed with financial and commercial knowledge) would have or should have come to the conclusion that what was being offered were not spot contracts in commodities rather had trappings of a financial product which offered fixed and assured returns, as has been already observed by the Hon'ble Supreme Court in *State of Maharashtra vs. 63 Moons Technologies Ltd.* which was contrary to the FCRA and the 2007 Notification and which caused loss to the market stated to be to the extent of ₹ 5,500 Crore.
35. In the undeniable background that there was a settlement default at NSEL, the Noticee being a member of NSEL ought to have been aware about the illegality of the contracts being offered on the platform of NSEL. There appeared to be enough red flags which should have alerted the Noticee when these products were first offered by NSEL. The Noticee being an intermediary was expected to exercise due diligence on the products which it offered for trading to its clients. The stated assumption by the Noticee as to the legality of 'paired contracts' is indicative of the fact that the Noticee not only failed to exercise adequate due diligence but even failed to take note of the 2007 Exemption Notification regarding approval of only spot contracts/ forwards of one-day duration,

permitted on NSEL which was in the public domain and the fact that FMC had never approved the 'paired contracts'. Paired contracts were introduced only in 2009 when NSEL was not regulated under the FCRA. Assuming that NSEL referred to any approval of FMC for the purpose of introduction of any contracts in its bye-laws is irrelevant when in fact, it was clear that the FMC was not even the relevant authority for NSEL when paired contracts were introduced and had in fact never approved the same. This is a clear indication of complete lack of due diligence by the Noticee of operating in a manner without following the rules. I note that irrespective of its lack of association with NSEL, for the clients, the Noticee was the face of the NSEL and the 'paired contracts' which could not have been executed in large volumes, across several clients without the association or active engagement of the Noticee in the 'paired contracts'. This whole pattern of functioning displays lack of integrity in its functioning and has a serious bearing on its reputation.

36. The argument being raised by the Noticee against any action by SEBI on the grounds that it was granted a Certificate of Registration INZ000079526 by SEBI in terms of provisions of the amended provisions of the FCRA and SEBI Circular No. CIR/MIRSD/4/2015 dated September 29, 2015, holds no ground considering that at the point of time when registration was granted, SEBI was yet to determine any violation of law by the brokers. As mentioned in the earlier part of the order, it was only when certain events and their related documents/ material came to light that SEBI formed an opinion to examine their certificate of registration to the extent of fulfilment of the conditions for their continuance of registration as an intermediary as specified in regulation 5(e) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations as applicable at the relevant time. Accordingly, the decision was taken as was legally permissible to file the Complaint dated September 24, 2018 based on which the FIR dated September 28, 2018 was filed by EOW and has been provided to the Noticee vide the SSCN.
37. 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, was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021 with effect from November 17, 2021.

38. As and when any of the 'fit and proper' criteria change, the Noticee would also be required to comply with the revised criteria, including as in this instance, the criteria as revised vide the amendment in November 2021. It is noted that the parameters provided under paragraph 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations lay down a list of disqualifications which, *inter alia*, include the following:

“(1).....

(2).....

(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:*

*(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;*

...”

39. As detailed in the SSCN, based on the complaint filed by SEBI, an FIR has also been registered with the MIDC Police Station, Mumbai, against the Noticee under section 154 of the CrPC on September 28, 2018. This has not been challenged, quashed or stayed by any competent court *qua* the Noticee till date. The disqualifications listed under paragraph 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations are unambiguously clear and no exemptions from such criteria has been provided to anyone. Once the disqualification is triggered; the 'fit and proper' person criteria is open for determination by SEBI. The disqualification provided in paragraph 3(b)(i) under the amended Schedule II of the Intermediaries Regulations has also been triggered *vis-à-vis* the Noticee.
40. The Noticee by its conduct and as a member of NSEL acted as an instrument in promoting and/or dealing in 'paired contracts' which were in the nature of financing transaction (as held by the Hon'ble Supreme Court of India referred

*supra*) and by trading and by providing access for taking exposure to 'paired contracts', the Noticee exposed its clients to the risk involved in trading in a product that did not have regulatory approval and thereby raises doubts on its competence to act as a registered securities market intermediary. Thus, I am of the view that such trading activities of the Noticee seriously jeopardized its reputation as also SEBI's belief in its character, competence and integrity which compelled SEBI to file the criminal complaint against it as also against several other brokers.

41. I note that when provisions of law specify certain acts to be done in a particular manner, the same is required to be honoured in letter and spirit. Law does not provide any exception to any person to perform such acts that are not permissible under an extant legal framework as per their whims and fancies. Therefore, if an exemption is granted in respect of all forward contracts of one-day duration for the sale and purchase of commodities traded on NSEL from the operations of the provisions of the FCRA subject to compliance with certain conditions, then it is obligatory on the part of a market intermediary to execute forward contracts of one-day duration only, subject to strict compliance with the said conditions. As noted earlier, the principle of *'ignorantia juris non excusat'* or that *'ignorance of law is no excuse'* becomes squarely applicable.
42. Thus, while examining the consequences of the conduct of the Noticee, the fact that is undeniably clear to me is that the conduct as has been displayed by the Noticee in its trading on the NSEL platform which was detrimental to the interest of the investors in the securities market resulted in the filing of a criminal complaint by SEBI. Thus, the Noticee has also incurred the disqualification under Clause 3(b)(i) of the amended provisions of Schedule II of the Intermediaries Regulations on account of the complaint filed by SEBI and the FIR that was registered by the EOW based on the said complaint of SEBI.
43. Given the same, I am inclined to conclude that the Noticee, presumably driven by its desire to earn brokerage and/ or profit, provided access to its clients to participate in an illegal product, which raises serious questions on its ability to

conduct proper and effective due diligence regarding any product. Such activities of the Noticee as a registered broker cannot be condoned and deserves to be met with appropriate measures to prevent such wrong doings from recurring.

## **CONSIDERATION OF THE RECOMMENDATION OF THE DA**

44. In the Enquiry Report, the DA has after determining that the Noticee is not “fit and proper”, recommended that the certificate of registration of the Noticee be cancelled.
45. As discussed in the preceding paragraphs, the facts and circumstances in the instant matter also lead to the conclusion that since the Noticee attracts the disqualification provided in paragraph 3(b)(i) under the amended Schedule II of the Intermediaries Regulations, the Noticee does not fulfil the “fit and proper” criteria. Once an entity is declared to not fulfil the “fit and proper” criteria, in the interest of the securities market, such an entity should not be allowed to continue to act as an intermediary till the time it does not regain its “fit and proper” status. In this context, it is pertinent to mention that in several scenarios, a defect which is the reason for holding an intermediary as not “fit and proper” is curable at the hands of the intermediary, while in certain scenarios it is not.
46. In the present case, the Noticee has been found to be not “fit and proper” for the reason that its conduct, integrity and reputation has been found wanting on account of the Noticee’s involvement in trading of “paired contracts” on the NSEL platform and also for the reason that since the FIR dated September 28, 2018 has been registered by EOW, which is yet to be finally determined by a Court of competent jurisdiction, the disqualification provided in paragraph 3(b) under the amended Schedule II of the Intermediaries Regulations stands invoked.
47. Schedule II of the Intermediaries Regulations, in clause 4 provides that “*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*”. This clause, in my



view, covers scenarios of 'cancellation' or 'suspension' of the certificate of registration of the intermediary.

48. Thus, the Intermediaries regulations envisage a deeming time limit of 5 years or specification of a time limit by the deciding authority, within which the intermediary may cure the defects which led to the determination of its status, if the same is done at its end. The said specification of period also serves as a reformatory direction against the intermediary.
49. Considering the above, the question that now arises for determination is whether the certificate of registration of the Noticee should be cancelled as recommended by the DA or whether it should be suspended for a specific period. A direction of cancellation, even when the EOW charge sheet is the subject matter of *lis* before the MPID Court, would entail the complete winding up of the business of the Noticee. On the other hand, "suspension for a specific period" would serve the purpose of keeping the Noticee out of the securities market for a specified period, after which, the Noticee may resume its business, upon curing the issues that have led to such an action.
50. Given the peculiar facts and circumstances of the case, I am of the considered view that a direction of suspension of certificate of registration of the Noticee for a period of three months or till discharge/ acquittal of the Noticee by a Court of competent jurisdiction, whichever is later, would be more appropriate and commensurate to the violations brought out in the present case.

## **ORDER**

51. In view of the foregoing discussions, I, in exercise of powers conferred upon me under Section 12(3) and Section 19 of the SEBI Act read with Regulation 27 of the Intermediaries Regulations, suspend the Certificate of Registration (bearing No. INZ000079526) of the Noticee i.e. Mavji Haribhai Commodities, for a period of three months from the date of this Order or till such time an order is passed by

a Court of competent jurisdiction, discharging or acquitting the Noticee, whichever is later.

52. The Noticee shall after receipt of this order, inform its existing clients, if any, immediately about the aforesaid direction in paragraph 51 above.
53. The Order shall come into force with immediate effect. A copy of this order shall be served upon the Noticee and the recognized Market Infrastructure Institutions for necessary compliance.

**Sd/-**

**Place: Mumbai**

**Date: August 07, 2023**

**BABITHA RAYUDU**

**EXECUTIVE DIRECTOR**

**SECURITIES AND EXCHANGE BOARD OF INDIA**