

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

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

In respect of

NAME OF THE NOTICEE	SEBI REGISTRATION NO.
ITL Commodities Private Limited	INZ000096836

In the matter of National Spot Exchange Limited

BACKGROUND

1. The present proceedings originate from the Enquiry Report dated May 23, 2019, (hereinafter referred to as the **“Enquiry Report”**), submitted by the Designated Authority (hereinafter referred to as the **“DA”**) in terms of Regulation 27 of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 as it stood at the relevant point of time prior to its amendment vide Securities and Exchange Board of India (Intermediaries) (Amendment) Regulations, 2021, with effect from January 21, 2021, (hereinafter referred to as the **“Intermediaries Regulations”**), wherein the DA, based on various factual findings and observations so recorded in the said Enquiry Report, recommended cancellation of the certificate of registration granted to ITL Commodities Private Limited (hereinafter referred to as **“Noticee”**). Pursuant to the same, a Post Enquiry Show Cause Notice dated September 11, 2019, along with the copy of the aforesaid Enquiry Report, copy of letter dated December 30, 2014 of Department of Economic Affairs, Ministry of Finance and copy of the decision of the Hon’ble Bombay High Court dated August 22, 2014, in respect of paired contracts offered on the platform provided by the National Spot Exchange Limited (hereinafter referred to as the **“NSEL”**), was also issued to the Noticee (Show Cause Notice September 11, 2019 hereinafter referred to as the **“SCN”**). Pursuant to that, on

December 10, 2019, an opportunity of personal hearing in the matter was provided to the Noticee before the Ld. Whole Time Member of SEBI (hereinafter referred to as the “**WTM**”) which was availed by it.

2. While the aforesaid proceedings were pending, Securities and Exchange Board of India (hereinafter referred to as the “**SEBI**”) also passed five separate orders during February 2019, rejecting the applications filed by five other entities for registration as commodity brokers who were involved in NSEL matter. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon’ble Securities Appellate Tribunal (hereinafter referred to as the “**Hon’ble SAT**”). The Hon’ble SAT, vide its common order dated June 09, 2022, remanded the aforesaid orders to SEBI to decide these matters afresh within six months from the date of the said 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...”

3. Thereafter, the Competent Authority of SEBI, has allocated the present matter to me for further proceedings. In light of the aforesaid SAT order, it was felt necessary to furnish certain additional documents/ material to the Noticee and grant an opportunity of personal hearing, before concluding the present proceedings. Accordingly, vide Hearing Notice dated November 11, 2022 (hereinafter referred to as the “**Hearing Notice**”), Noticee was provided an opportunity of personal hearing on December 1, 2022 along with certain additional documents/ material. Noticee was also advised to submit its reply to the Hearing Notice. On the scheduled date of hearing, the authorised representatives of the Noticee appeared on behalf of the Noticee through video

conference and made submissions on the lines of the replies submitted earlier. During the course of hearing, certain queries were raised to the Noticee and the Noticee was granted time to submit response to the said queries along with the post hearing submissions, if any. Accordingly, the Noticee vide letters dated December 27, 2022 and December 30, 2022 furnished its reply.

4. The submissions filed by the Noticee vide its letters dated November 12, 2019, December 27, 2022 and December 30, 2022 are summarized hereunder:
- (i) *All the allegations raised in the SCNs are denied.*
 - (ii) *The alleged trades have been executed during 3 financial years having four clients during this period and total revenue earned on the NSEL platform is ₹15,534/- and total outstanding dues have been settled from the Noticee's own funds.*
 - (iii) *No details have been provided on the allegation of close association with NSEL. The SCN simply alleges close association and that the Noticee has participated/facilitated on the trading platform of NSEL and violated provisions of FCRA.*
 - (iv) *SCN does not show how the Noticee has participated or facilitated 'paired contracts' and details of trades undertaken whether in proprietary or on behalf of clients have not been provided.*
 - (v) *Details of rules and regulations, bye laws not abided by the Noticee have not been provided.*
 - (vi) *No relation has been established between the alleged act carried out by the Noticee and the charges levied.*
 - (vii) *Relevant information, trade and order log, details of paired contracts were not provided. Information based on which the allegations have been framed have not been supplied by the DA.*
 - (viii) *Stock broker is only acting as an agent to the exchange and the client, hence the liability for trading cannot be extended to the broker.*
 - (ix) *It should be proved that the broker knowingly participated in the illegal contracts and merely executing the trades will not make it liable for consideration of revocation of certificate of registration.*

- (x) *After certificate of registration issued by SEBI, the Noticee has not engaged in trading activity at NSEL and hence no question should arise on the aspect of fit and proper person. Regulations cannot be made applicable with retrospective effect.*
- (xi) *Discontinuance of business of the stock broker is a serious charge and causes irreparable damage to the reputation.*
- (xii) *The trades carried out by the Noticee has not caused harm to any other market participants.*
- (xiii) *The Noticee is not connected with NSEL or its management except in the capacity as member of NSEL.*
- (xiv) *The allegation levied does not corroborate with the corresponding evidence in the matter.*
- (xv) *The Noticee received part payment vide special payout in terms of NSEL circular dated August 17, 2023.*
- (xvi) *The Noticee has not executed trades in paired contracts. Trades were executed as per obligation of physical market. The Noticee had also taken delivery.*
- (xvii) *The Noticee has not admitted to trading in paired contracts as stated in the enquiry report. The Noticee had submitted that, assuming that the Noticee had facilitated in trading in paired contracts, even then the Noticee cannot be held liable solely on the basis of its trading facility in paired contracts since it had not designed paired contracts.*
- (xviii) *The DA has failed to deal with all the preliminary objections raised in the Noticee's earlier replies and did not provide all the materials based on which the allegations have been stated.*
- (xix) *Violation purportedly committed prior to repeal of FCRA cannot be initiated under SEBI Act and/or regulations framed thereunder.*
- (xx) *Documents based on which the FIR has been filed need to be made available to the Noticee.*
- (xxi) *There is no documentary evidence which has been relied upon by the DA in connection with NSEL paired contract and the Noticee.*

(xxii) The noticee conducted due diligence by personally visiting the warehouse and verified the quality and actual delivery positions. However, the noticee is not having any evidence. The Noticee stated this in its statement to EOW to call for the visitor register at the warehouse to support its claim.

(xxiii) The Noticee admitted to have received part payment from NSEL as per NSEL circular of August 17, 2013 and further submitted that it has paid and settled account of client pertaining to NSEL trades from its own pocket.

CONSIDERATION OF ISSUE AND FINDINGS

5. I have carefully perused the SCNs issued to the Noticee and the Enquiry Report, the replies filed by the Noticee and other material/ information available on record. After considering the allegations made/charges levelled against the Noticee in the instant matter as spelt out in the SCNs and Hearing Notice, the limited issue which arises for my consideration in the present proceedings is whether the Noticee satisfies the 'fit and proper' person criteria as laid down under Schedule II of the Intermediaries Regulations and whether the Certificate of Registration granted to the Noticee should be cancelled, as recommended by the DA or any other action should be taken against the Noticee.
6. Before I proceed to examine the issue *vis-à-vis* the material available on record before me, it would be appropriate to refer to the provisions of law applicable, which are alleged to have been violated by the Noticee and/ or are referred to in the present proceedings. The same are reproduced below 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.

Stock Brokers Regulations, 1992

Consideration of application for grant of registration.

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

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

Liability for action under the 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;

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.*

7. As noted above, taking cognizance of the order passed by the Hon'ble SAT on June 09 2022 (hereinafter referred to as "**SAT Order**"), in NSEL matters, a Hearing Notice dated November 11, 2022 was issued to the Noticee calling upon the Noticee to show cause as to why the following information/ material along with the Enquiry Report dated May 23, 2019 should not be considered against it

for determining whether the Noticee satisfies 'fit and proper person' criteria as laid down under Schedule II of the Intermediaries Regulations:

- a. SEBI complaint dated September 24, 2018 filed with EOW;
- b. First Information Report dated September 28, 2018; and
- c. Amended Schedule II of the Intermediaries Regulations.

8. Before moving forward to test the fulfilment of the 'fit and proper' person criteria by the Noticee, on the basis of available material including the additional material as detailed at paragraph 7 above, the background facts necessary for the present proceedings are narrated in brief, hereunder:

- a. The Noticee is a commodity derivatives broker registered with SEBI having Registration No. INZ000096836 with effect from December 12, 2015 and is currently a member of MCX and ICEX.
- b. NSEL was incorporated in May, 2005 as a Spot Exchange, *inter alia*, as an electronic exchange for trading in commodities. In exercise of powers conferred under Section 27 of the Forward Contracts (Regulation) Act, 1952 (herein after referred to as the "**FCRA**"), the Central Government vide its Exemption Notification granted an exemption to all forward contracts of one-day duration for the sale and purchase of commodities traded on the NSEL from operations of the provisions of the FCRA subject to certain conditions, *inter alia*, including "*no short sale by the members of the exchange shall be allowed*" and "*all outstanding positions of the trades at the end of the day shall result in delivery*".
- c. In October 2008, NSEL commenced operations providing an electronic trading platform to its participants for spot trading of commodities, such as bullion, agricultural produce, metals, etc. It is observed that NSEL introduced the concept of 'paired contracts' in September 2009 which allowed buy and sell in same commodity through two different contracts at two different prices on the exchange platform wherein the investors could buy a short duration contract and sell a long duration contract and vice versa at the same time and at a pre-determined price. The trades for the Buy contract (T+2/ T+3) and the Sell contract (T+25/ T+36) used to happen on the NSEL on the same day at

same time and at different prices, involving the same counterparties. The transactions were structured in a manner that buyer of the short duration contract always ended up making profits.

- d. 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 Exemption Notification, authorizing it to collect the trade data from NSEL and to examine the same for taking appropriate measures, if needed, to protect investors' interest. FMC had accordingly called for the trade data from different spot exchanges, including NSEL in the prescribed reporting formats. After analysing the trade data received from the NSEL, FMC passed Order No. 4/5/2013-MKT-1/B dated December 17, 2013 in the matter ("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 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.
9. Noticee has contended that copies of the documents relied upon by SEBI have not been provided to it. On perusal of the SCNs, Enquiry Report and material/information available on record, I find that all the documents relied upon by SEBI and relevant for levelling charges against the Noticee have been provided to the Noticee vide letter dated March 25, 2019 and along with the SCNs. Thus, I find that all the necessary documents relied upon by SEBI and relevant for framing charges against the Noticee has been provided to the Noticee and thus, there is no merit in the contention of the Noticee.

10. I note that FMC was a statutory body set up under the FCRA and its functions were enumerated under section 4 of the Act. FCRA regulated forward contracts in notified goods entered into between the members of a recognised association or through or with any such member. An association recognised under the FCRA was empowered to make rules and bye-laws for the regulation of forward contracts subject to approval of the Central Government/ FMC. An association concerned with the regulation and control of business relating to forward contracts was also required to obtain a certificate of registration from FMC, under FCRA. I note that FMC was having jurisdiction only on the associations recognised or registered under the FCRA or any member of such association. NSEL was not an association recognised under section 6 of FCRA nor was it an association registered under section 14A of FCRA, which provided that –

"No association concerned with the regulation and control of business relating to forward contracts shall, after the commencement of the Forward Contracts (Regulation) Amendment Act, 1960 (62 of 1960) carry on such business except under, and in accordance with the conditions of a certificate of registration granted under this Act by the Commission."

11. Section 27 of the FCRA empowered the Central Government to exempt any contract or class of contracts from the operation of all or any of the provisions of the Act. In exercise of the powers conferred on under Section 27 of the FCRA, the Central Government, vide the Exemption Notification, had granted exemption to one-day forward contracts traded on NSEL from the operation of all provisions of FCRA, subject to conditions mentioned in the said Exemption Notification. Subsequently, the Central Government has issued notifications on February 06, 2012 and August 06, 2013, in partial modification of this notification dated June 05, 2007, by way of amending or inserting new conditions to the original notification, thereby assigning specific responsibility to FMC with respect to NSEL. Recognised associations were empowered to make rules and bye-laws under FCRA which shall be approved by the Central government/ FMC. However, I find that NSEL did not make any rules and bye-laws under FCRA and obtained approval of the Central Government/ FMC for regulation and control of forward contracts.

12. The noticee has submitted that it had visited NSEL warehouse twice during the year 2012-13 and found standard quality and actual delivery positions at the warehouse on both the occasions. It also submitted that after seeing the delivery status at the warehouse of NSEL, there was no thought of anything suspicious about the contracts launched. In this regard, on a perusal of the submissions of the noticee, I note that nothing has been brought on record by the noticee to establish that such goods/ stocks were actually available in the warehouse of NSEL. Further, even if the submission of the noticee that such goods were available in NSEL's warehouse, is taken on its face value, the said submission has not been substantiated by any evidence to prove that such goods were indeed tagged/ identified / earmarked separately for the noticee. It cannot reasonably be expected that a registered intermediary was indulging in trades without any assurance on the part of NSEL that the goods belonging to the noticee were indeed present and separately identified in the warehouses of NSEL. I, therefore, find that the above submissions of the noticee do not support its case in any manner.
13. I note that prior to the merger of FMC with SEBI on September 28, 2015, the Noticee was not required to be registered with either FMC or any other regulatory authority under the FCRA. The Parliament, noticing that the intermediaries dealing with commodities derivatives market were not required to be registered under FCRA and were not under control of any competent authority, rectified the same through the Finance Act, 2015, as notified on May 14, 2015, by bringing them under the regulatory supervision of SEBI. With regard to the aforesaid, the Hon'ble Bombay High Court while dealing with the Writ Petition Nos. 3262, 3266, 3294 and 3295 of 2018 in the matter of *Anand Rathi Commodities Limited, Motilal Oswal Commodities Broker Private Limited, Geofin Comtrade Limited and IIFL Commodities Limited vs. SEBI*, vide its Order dated October 04, 2018, observed the following:
- "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”.

14. I further note that the provisions in the Finance Act, 2015 effecting the merger of FMC with SEBI in September, 2015 do not, *prima facie*, confer any power on SEBI to take charge, deal, inquire and resolve NSEL settlement crisis that broke out in 2013. Pursuant to repeal of FCRA and dissolution of FMC in terms of Section 131 of Finance Act, 2015, all recognised associations under the FCRA became deemed recognised stock exchanges under the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as the “SCRA”). NSEL was not a recognised association under FCRA, therefore NSEL falling under the regulatory jurisdiction of SEBI does not arise.
15. I note that pursuant to the merger of FMC with SEBI, a commodity derivatives broker was mandatorily required to obtain a certificate of registration from SEBI in case it sought to remain associated with the securities market as a commodity derivatives broker. The Finance Act, 2015, *inter alia*, conferred the powers on SEBI to regulate commodity derivatives brokers, which included their registration as commodity derivatives broker with SEBI. In this regard, vide Section 131B of the Finance Act, 2015, a transitory period of 3 months was provided to all the intermediaries which were associated with the commodity derivatives market under the erstwhile FCRA to continue to deal in commodity derivatives as a commodity derivatives broker, provided it made an application of registration to the SEBI within 3 months from September 28, 2015. Accordingly, the Noticee applied for a certificate of registration and was registered as a broker with effect from December 12, 2015 and since then it has been acting as a market intermediary registered with SEBI.
16. The power of SEBI to investigate/ inquire into the alleged violation of FCRA flows from the Finance Act, 2015, which amended the provisions of FCRA. Section 29A of FCRA, as inserted by the Finance Act, 2015 provides as under—

“(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.”

17. I note that the aforesaid provision empowers SEBI to initiate a fresh proceeding with respect to the offences within a period of three years from the date on which FCRA is repealed. Thus, pursuant to the merger of FMC with SEBI, SEBI stepped into the shoes of FMC and was well within its powers to initiate proceedings under Chapter V of FCRA i.e., filing of the criminal complaint to the EOW. I note from the complaint dated September 24, 2018 filed by SEBI that EOW was requested 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. However, the aforesaid proceedings are different from the proceedings before me.
18. The present proceedings pertain to adjudging the ‘fit and proper person’ status specified in the Broker Regulations and the Intermediaries Regulations in light of the activities undertaken by the Noticee on the NSEL platform and consequent action taken by FMC and SEBI, i.e., filing of the criminal complaint to EOW under Section 154 of the Code of Criminal Procedure, 1973 (“CrPC”). I note that in terms of Regulation 5(e) of the Stock Brokers Regulations, every applicant/ stock broker at the time of seeking registration, and thereafter, throughout the time it holds a valid certificate of registration, has to satisfy the “fit and proper person”

criteria specified in Schedule II of the Intermediaries Regulations. I note that the Enquiry Report proceeds on the basis that the past conduct of the Noticee in facilitating access to the “paired contracts” traded on NSEL calls into question the compliance of the Noticee with ‘fit and proper person’ criteria. Further, SEBI while examining the compliance of an applicant, or even a registered intermediary, with the ‘fit and proper person’ criteria can take into consideration not just contravention of the provisions of securities laws, but also the general conduct of the Noticee which may have a bearing on its functioning as a registered intermediary. The ‘fit and proper criteria including the amended criteria must be satisfied by the Noticee, at the time of making application of registration under the Stock Brokers Regulations as well as during the continuance of the registration once granted. I am of the considered view that the due presumption on the constitutional and legal validity of the said amended Schedule II of the Intermediaries Regulations holds the field which is binding upon SEBI, and arguments to the contrary are not maintainable. To consider the application of the Noticee for the registration as a stock broker, the Noticee is required to satisfy the fit and proper person criteria as well as during the continuance of the registration, and thus, it is well within the jurisdiction and powers of SEBI to adjudge the said ‘fit and proper’ status of the market intermediaries in the interest of securities market.

19. Before moving forward to consider the matter on merits, it would be appropriate to look at the background of NSEL and understand the nature of the ‘paired contracts’ that were offered on NSEL which ultimately is the cause/ genesis of the current proceedings.
20. From the perusal of the FMC Order in respect of the ‘paired contracts’, which were traded on the NSEL platform during the relevant period, I note that the FMC had, *inter alia*, observed that the following conditions stipulated in the Exemption Notification were violated:

a. Short Sale

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

b. Contracts with Settlement Period going beyond 11 days

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

21. I note that NSEL was granted conditional exemption from the provisions of the FCRA by the Department of Consumer Affairs, Ministry of Consumer Affairs (hereinafter referred to as the “MCA”), Food and Public Distribution, Government of India, vide Gazette Notification No. S0906(E) dated June 05, 2007, in exercise of the powers conferred under Section 27 of the FCRA, for (i) forward contracts, (ii) for sale and purchase of the commodities, of one-day duration traded on NSEL subject to certain conditions which, *inter alia*, included that ‘no short sale by members of the NSEL shall be allowed’ and that all ‘outstanding positions of the trade at the end of the day shall result in delivery’. It was also stipulated that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency. The spot exchanges were envisaged as a platform for providing transparent and secure trading in commodities with a view to boost the agriculture sector in the country. Thereafter, NSEL commenced operations in October 2008.

22. It is observed 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 Exemption Notification. In its order, FMC had observed that the 55 contracts offered for trade on the NSEL were with settlement periods exceeding 11 days and all such contracts traded on the NSEL were in violation of provisions of FCRA. I note from the FMC Order that under the FCRA, a “forward contract” is defined as a “*contract for delivery of goods and which is not a ready delivery contract*”. A ‘ready delivery contract’ is defined as “*a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days*”. Given the said definition contained in the FCRA, FMC was of the view that all the contracts traded on the NSEL which provided settlement schedule exceeding 11 days were treated as Non-Transferable Specific Delivery contracts. It is, therefore, seen that even though MCA had stipulated in the Exemption Notification that only contracts of one-day duration 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 one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. However, what is beyond doubt is that the NSEL had permitted 55 contracts of various commodities having duration longer than 11 days and these contracts were in contravention of the exemption granted to NSEL.
23. 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) (hereinafter referred to as the “**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”.*
24. Further, I note that in the judgment dated April 22, 2022 passed by 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) (hereinafter referred to as the “**MPID matter**”), the Hon’ble Supreme Court while drawing reference to the representations made by NSEL in respect of paired contracts, *inter alia*, held that:

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

25. Thus, I note that the Hon’ble Supreme Court has already described the nature of the ‘paired contracts’ offered on the NSEL platform. In the merger petition (63 Moons Technologies Ltd. vs. UOI), it was held that these contracts were in the nature of financing transactions. In the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon’ble Supreme Court held that such transactions come within the definition of ‘deposits’ under the MPID Act. The Hon’ble Supreme Court in the MPID matter, has extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. The Hon’ble Supreme Court has also observed that NSEL was advertising assured and uniform return of 16% p.a. for the ‘paired contracts’ traded on its platform where the return offered was same across the commodities. The return remained the same irrespective of the duration of the contract. At Para 45 of the said order, the Hon’ble Supreme Court has 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 return as a T+5 and T+35 paired contract in castor oil. The ‘paired contracts’ were being marketed as an alternative to fixed deposits. It was also noted in the judgment of the Hon’ble Supreme Court in the MPID matter that the overwhelming majority

of the sale leg of the 'paired contracts' which were executed were short sales i.e., commodities to back such sales were not available at the designated warehouses of the NSEL.

26. I note that Noticee, vide its reply dated November 12, 2019, inter alia stated as follows: *"Total trades executed at NSEL through the noticee were miniscule %age of the total trades on the exchange. The alleged trades have been executed through noticee only during the 3 financial years i.e. 2010-11 to 2012-13."* The Noticee also stated that *"Most importantly, in order to maintain its strong credibility earned over the period, the noticee has already settled outstanding dues of the clients in respect of NSEL trades from its own funds."*
27. I note that, the total obligation outstanding against the Noticee as per the EOW report is ₹21,07,980/-. Noticee in its reply of November 12, 2019 had admitted to have traded in the alleged contracts, which was reiterated during the personal hearing held on December 1, 2022. However, the Noticee in its reply of December 30, 2022 had stated to have not traded in paired contracts. It is seen from the reply of the Noticee, that the Noticee has paid the dues to its clients out of its own funds and has also admitted to have received part payment from NSEL as per NSEL circular of August 17, 2013. From the above discussions, it is clear that the Noticee had indeed indulged in / facilitated paired contracts. Thus, while the submission regarding repayment of dues to the clients by the Noticee can be regarded as a mitigating factor in these proceedings, the same does not alter the fact that the Noticee did facilitate trading in paired contracts, which as discussed above, were not in accordance with the 2007 Exemption Notification. Considering the deliberations recorded above and irrespective of the fact that the Noticee has repaid its clients for the trades carried out, the moot question is whether the Noticee, while facilitating transactions in paired contracts for its clients, was under the bonafide belief that such transactions were actually spot contracts in commodities. Or, can it be said that the very fact that 'paired contracts' were offered meant that NSEL was offering contracts which were not resulting in compulsory delivery and, therefore, the Noticee should have been

aware that such a product was far removed from the spot trading in commodities which was permitted on NSEL's platform. Further, as stated above, NSEL itself was advertising such contracts as an alternative to fixed deposits and the return offered was fixed (e.g. 16%) across all commodities irrespective of the nature of the contract or the duration. Also, these contracts were structured in a manner which ensured that the buyer always made pre-determined profits

28. I find it pertinent to refer to the observations of Hon'ble Supreme Court in its judgment in respect of the *merger petition* (supra) that *"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."* Thus, it is clear that on NSEL (other than E-series contracts), only paired contracts were being traded (as high as 99% noted by the Hon'ble Supreme Court). It is not the Noticee's case that the transactions facilitated by it for its clients were E-series contracts. Accordingly, by inference, transactions on NSEL, which the Noticee has admitted to have facilitated for its clients, could not have been anything but "paired contracts". In view of the above, the argument of the Noticee that, is devoid of any substance and liable to be rejected.
29. In the undeniable background that there was a settlement default at NSEL, it is clear that there were enough red flags which should have alerted the Noticee when these products were first offered by NSEL. With the material on record, it is further clear that any prudent person (including the Noticee) would have come to the conclusion that what was being offered were not spot contracts in commodities and 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 the matter of *State of Maharashtra vs. 63 Moons Technologies Ltd.* The Noticee being an intermediary was expected to do due diligence on the products which it offered for trading to its clients. An assumption as to the legality of 'paired contracts' clearly shows that the Noticee failed to do adequate due diligence. The Notification regarding approval of contracts permitted on NSEL was in public

domain. Thus, I find that Noticee failed to perform basic due diligence of the contracts offered *vis-a-vis* the conditions specified in the aforesaid Notification.

30. Noticee has contended that there is no basis on which it could be said that the Noticee was closely associated with NSEL and the fact that Noticee was a trading member of NSEL and had done trade on the platform of NSEL, cannot be relied against the Noticee. In this regard, I note that for the clients, the face of the NSEL and the 'paired contracts' was the Noticee itself and the 'paired contracts' could not have been executed in large volumes, across several clients without the actions and facilitation of the Noticee. I find that such association of the Noticee in 'paired contracts' has seriously questioned the reputation, fairness, honesty, integrity and character of the Noticee in the securities market. The association of the Noticee with NSEL cannot be denied since Noticee was observed to be facilitating the clients to trade in the 'paired contracts'.
31. Having established that the Noticee has traded in 'paired contracts' for its clients, I now proceed to examine the allegations levelled against the Noticee in the SCN and the Hearing Notice. It is noted that the main allegation against the Noticee, as levelled in the SCN, is that by facilitating the trading in 'paired contracts' on NSEL platform during the relevant period as a Trading Member/ Clearing Member, the continuance of the registration of the Noticee as a broker is detrimental to the interest of the Securities Market and the Noticee is no longer 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 Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations as applicable at the relevant time. Subsequently, SEBI, on the basis of certain documents/material such as SEBI's Complaint dated September 24, 2018 and FIR dated September 28, 2018 as provided to the Noticee vide Hearing Notice, further alleged that in light of the aforesaid documents as well as observations against the Noticee in the Enquiry Report, the Noticee is not a 'fit and proper person' for holding the certificate of registration being in violation of Regulation 5(e) of the Stock Brokers Regulations

read with Schedule II of the Intermediaries Regulations. I note that regulation 5(e) of the Stock Brokers Regulations provides that for the purpose of grant of Certificate of Registration, the applicant has to be a 'fit and proper person' in terms of Schedule II of the Intermediaries Regulations. I further note that the 'fit and proper person' criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008, was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021 with effect from November 17, 2021.

32. In order to continue as a SEBI registered intermediary, the Noticee is, *inter alia*, required to satisfy the conditions of eligibility, which included 'fit and proper person' criteria. The above condition to be a fit and proper person is a preliminary condition applicable at the time of seeking registration. As and when the 'fit and proper' criteria changes, the Noticee will be required to comply with the revised criteria, and in this instance, criteria was 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 lay down a list of disqualifications which, *inter alia*, includes the following:

“(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;”

33. I note from the Hearing Notice that an FIR has been registered with the MIDC Police Station, Mumbai, against the Noticee under section 154 of the CrPc on September 28, 2018 and the same is pending as on date and is subsisting and has not been challenged, quashed or stayed by any competent court *qua* the Noticee. The disqualifications listed under paragraph 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations are unambiguously clear and no exemption from such criteria has been provided. Once the disqualification is triggered, the 'fit and proper' person criteria is open for determination by SEBI. It is, therefore, noted that the disqualification provided in paragraph 3(b)(i) under

the amended Schedule II of the Intermediaries Regulations is also triggered vis-à-vis the Noticee.

34. It is also noted that the Noticee has traded in the 'paired contracts' on behalf of its clients. The Noticee, as a broker and as a member of NSEL, represented NSEL to the regular investors. The execution of the trades in 'paired contracts' by the Noticee shows the participation of the Noticee in the said scheme perpetrated by NSEL to provide its platform for trading in 'paired contract' that were not permitted under the Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities. Therefore, the Noticee by its conduct and as a member of NSEL has acted as an instrument of NSEL in promoting and/or dealing in 'paired contracts' which were in the nature of financing transactions (as held by the Hon'ble Supreme Court of India referred *supra*). The Noticee, by providing access for taking exposure to 'paired contracts' has exposed its clients to the risk involved in trading in a product that did not have regulatory approval, thereby raising doubts on the competence of the Noticee to act as a registered Securities Market intermediary. Thus, I am of the view that the trading activities of the Noticee in 'paired contracts' for its clients on the NSEL platform have serious ingredients jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the Noticee in the Securities Market.
35. The scope of the instant proceeding is not to analyse the actual impact and consequences of the conduct of the Noticee but to examine as to whether or not, the Noticee has acted in a manner expected of a market intermediary and the answer to the same manifestly goes against the Noticee. The fact that is undeniably clear before me is that the involvement of the Noticee in trading/facilitation of trading in 'paired contracts' on NSEL is certainly a conduct which was not permitted by the Exemption Notification nor by any of the applicable provisions of the FCRA and therefore, such a conduct, as has been displayed by the Noticee in its trading on NSEL platform, is detrimental to the interest of the Securities Market.

36. I note that when provisions of law prescribe 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 anyone to perform such acts as per his whims and fancies that is not permissible under an extant legal framework. 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 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 above, the principle of *'ignorantia juris non excusat'* or that *'ignorance of law is no excuse'* becomes squarely applicable.
37. 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 that the scheme of 'paired contracts' traded on NSEL ultimately has caused loss to the market to the extent of ₹5,500 Crore itself casts serious aspersion on the conduct, integrity and reputation of, *inter alia*, the Noticee who facilitated such 'paired contracts' and therefore, its continuing role in the Securities Market cannot be viewed as good and congenial for the interest of the investors or of the Securities Market.
38. Given the above discussions and deliberations, I am constrained to conclude that the Noticee, presumably driven by its desire to earn brokerage and/ or profit, provided access to its clients to participate in a product which raises serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the 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 an FIR against the Noticee under section 154 of Code of Criminal Procedure, 1973

("CrPC"). has been registered with the MIDC Police Station, Mumbai and the same is subsisting/ pending as on date. Further, it is also not the case of the Noticee that the aforesaid FIR 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. Therefore, such activities of the Noticee as a registered broker cannot be condoned and deserve appropriate measure to prevent such wrong doings from recurring to the detriment of the interest of the Securities Market.

Consideration of DA's recommendation:

39. The DA in the Enquiry Report, after determining that the Noticee is not "fit and proper", has recommended that the certificate of registration of the Noticee be cancelled.
40. As discussed in the preceding paragraphs, the facts and circumstances in the instant matter lead to the conclusion that the Noticee is not a "fit and proper" person. Once an entity has been declared to be not "fit and proper", in the interest of securities market, it 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 not "fit and proper" is curable at the hands of the intermediary, while in certain scenarios, it is not.
41. 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 because of the Noticee's involvement in trading of "paired contracts" on the NSEL platform and also for the reason that in that regard, the FIR dated September 28, 2018 has been registered by EOW, which is subsisting as on date.
42. 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 'cancelation' or 'suspension' of the certificate of registration of the intermediary.

43. Thus, the Intermediaries Regulations envisage deeming time limit (of 5 years) or specification of a time limit by the deciding authority, within which the intermediary can cure the defects which led to determination of its status, if the same can be done at its end. The said specification of period also serves as a reformatory direction against the intermediary.
44. Considering the above, in the instant case, having held that the Noticee is not "fit and proper", the question for determination is what would be the appropriate direction in the given facts and circumstances. In my view, "suspension" of the certificate of registration of the Noticee would serve the desired purpose, as envisaged under the Intermediaries Regulations, of keeping the Noticee out of the securities market for the specified period after which the Noticee would be eligible to resume its business.
45. Given the fact that the transactions in paired contracts facilitated by the Noticee pertain to the period 2009-13, I am of the considered view that a direction of suspension of certificate of registration of the Noticee for a period of three (3) months or till the time the FIR ceases to be "pending", would be proportionate and more appropriate in the present case.

Order:

46. 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. INZ000096836) of the Noticee i.e., ITL Commodities Private Limited for a period of three (3) months from the date of this Order or till the FIR filed against

the Noticee by EOW ceases to be pending or the Noticee is discharged or acquitted by a Court in relation to the FIR, whichever is later.

47. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 46 above.
48. The Order shall come into force with the immediate effect.
49. It is clarified that in view of the amendment made with effect from January 21, 2021 in the Intermediaries Regulations, the procedure for action on receipt of recommendation of a DA specified earlier under Regulation 28 of the Intermediaries Regulations has now been incorporated in the amended Regulation 27 of the Intermediaries Regulations. Accordingly, this order is passed under the amended 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 NSEL matter and/or any proceedings pending before any authority in respect of similar matter concerning the Noticee or other relevant persons.
50. A copy of this order shall be served upon the Noticee and the recognized Market Infrastructure Institutions for necessary compliance.

Place: Mumbai
Date: July 31, 2023

Sd/-
MANOJ KUMAR
EXECUTIVE DIRECTOR
SECURITIES AND EXCHANGE BOARD OF INDIA