

QJA/SVMDR/MIRSD/DOP/29831/2023-24
SECURITIES AND EXCHANGE BOARD OF INDIA
ORDER

**UNDER SECTION 12(3) AND SECTION 19 OF SECURITIES AND EXCHANGE
BOARD OF INDIA ACT, 1992 READ WITH REGULATION 27 OF SECURITIES
AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008**

In respect of –

Ajay Natavarlal Commodities Private Limited

[Registration No. INZ000091531]

In the matter of National Spot Exchange Limited

BACKGROUND

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

to as “**2007 Exemption Notification**”), in exercise of powers conferred under Section 27 of FCRA subject to certain conditions which, *inter alia*, included “*no short sale by members of the exchange shall be allowed; that all outstanding positions of the trade at the end of the day shall result in delivery and that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency*”.

3. In September 2009, NSEL allegedly introduced the concept of '*paired contracts*', i.e. buying and selling the same commodity through two different contracts at two different prices on its platform wherein investors could buy a short duration settlement contract and sell a long duration settlement contract and vice versa at the same time. It entailed occurrence of Buy Trades (T+2 / T+3) and Sell Trades (T+25 / T+36) on the same day at different prices on the platform of NSEL.
4. On February 6, 2012, the erstwhile Forward Markets Commission (hereinafter referred to as “**FMC**”) was appointed by the Department of Consumer Affairs, Government of India as the ‘designated agency’, authorizing it to collect the trade data from NSEL and to examine the same for taking appropriate measure, if needed, to protect investors’ interest. The FMC had accordingly, *inter alia*, called for the trade data from NSEL in the prescribed reporting formats. After analysing the trade data received from the NSEL, the FMC passed Order No. 4/5/2013-MKT-1/B dated December 17, 2013 in the matter (hereinafter referred to as “**FMC Order**”) wherein it was, *inter alia*, observed that 55 contracts offered for trade on the NSEL platform were in violation of the relevant provisions of the FCRA and that the condition of ‘*no short sale by members of the exchange shall be allowed*’ was being not complied with by NSEL and its members. FMC further observed that the ‘*paired contracts*’ offered for trading in the NSEL platform were in violation of the provisions of the FCRA and also in violation of the conditions specified by the Government of India in its 2007 Exemption Notification.

5. On perusal of the FMC Order, I note that the FMC had, *inter alia*, observed that the following conditions stipulated in the 2007 Exemption Notification were violated by NSEL:

a. **Short Sale**

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

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

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

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

Member in terms of Regulation 5(e) of the Stock Broker Regulations read with Regulation 27(iv) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations.

ENQUIRY BY DESIGNATED AUTHORITY

8. A Designated Authority (hereinafter referred to as “**DA**”) was appointed by SEBI vide order dated September 24, 2018 to conduct an enquiry against the Noticee and submit a report and make recommendation in terms of Regulation 27 of the Intermediaries Regulations (as applicable at the relevant time) in respect of the violations alleged to have been committed by the Noticee mentioned at para 7 above.
9. After conducting the enquiry as envisaged under Regulation 25 of the Intermediaries Regulations, the DA submitted an Enquiry Report dated May 29, 2020 (hereinafter referred to as the “**Enquiry Report**”) which, *inter alia*, observed and recommended as under:

“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 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 viz. Ajay Natavarlal Commodities Pvt. Limited (SEBI Registration nos. INZ000091531) as a commodity derivatives broker may be cancelled.”

POST ENQUIRY PROCEEDINGS

Show Cause Notice, Reply and Personal Hearing

10. After considering the Enquiry Report, a post-enquiry Show Cause Notice dated July 2, 2020 (hereinafter referred to as the “**SCN**”) was issued to the Noticee under Regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) enclosing therewith (a) copy of the Enquiry Report, (b) copy of

the letter dated December 30, 2014 of the Department of Economic Affairs (DEA), Ministry of Finance; and (c) a copy of the order dated August 22, 2014 passed by the Hon'ble Bombay High Court in Criminal Bail Application No. 1263 of 2014 in the case of *Jignesh Prakash Shah Vs. The State of Maharashtra*. The SCN was issued to the Noticee calling upon it, as to why action as recommended by the DA including any other action as deemed fit should not be taken against the Noticee, by the Competent Authority. The Noticee, while denying the allegations contained in the SCN, vide its letter dated July 24, 2020, filed its reply which is summarized hereunder:

- i. The Noticee was not provided with the relevant information, data, trade/order log, investigation/inspection report or any other material relied upon by SEBI for issuing the SCN and was advised to refer to publically available documents such as FMC order;
- ii. The reliance of SEBI on the FMC order dated December 17, 2013 is completely misconceived and misplaced as neither the Noticee was a party to the said Order nor the trades of Noticee in paired contracts were matter under consideration of FMC;
- iii. The DA has grossly erred in holding that the appointment of DA by the Whole Time Member is valid and legal. The powers delegated to the SEBI officers under the SEBI (Delegation of Powers) Order, 2015 cannot be in derogation of delegation of power which have been delegated under the SEBI Regulations;
- iv. In terms of Section 29A(2)(e) of the Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as "**FCRA**"), SEBI could initiate prosecution proceedings against the members of NSEL for alleged violation of FCRA and could not initiate enquiry proceedings under the Intermediaries Regulations;
- v. FCRA does not fall within the definition of 'Securities laws' as given in regulation 2(1)(k) of the Intermediaries Regulations;
- vi. The DA did not consider Noticee's objection on SEBI's jurisdiction on spot market. It is submitted the letter dated November 20, 2015 of the Ministry of Finance states that "*...SEBI is not expected to deal with matters which were not dealt with by the erstwhile FMC.... It is further clarified that since spot markets/ready delivery contracts were*

not being regulated by the FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets.” Thus, SEBI is not expected to take upon itself any regulatory function with respect to spot markets;

- vii. The DA has wrongly relied upon the case of ***Jermyn Capital LLC vs SEBI***¹. It is submitted that in the instant case, there is no allegation that any of the directors of the Noticee is having any close association with anyone against whom CBI or any other intelligence agencies have initiated prosecution proceedings. Thus, the reliance on said case by the DA is wrong and without any basis;
- viii. The DA has set out certain observations made by Courts and certain authorities including the observations made by the Economic Offence Wing (“EOW”) which were not pertaining to the Noticee. The reliance has been placed upon the proceedings which were *sub-judice* or to which the Noticee was not privy;
- ix. The Hon’ble Bombay High Court, vide its Order dated August 22, 2019, in the matter of ***63 Moons; technologies Limited Vs. State of Maharashtra***, has held that paired contracts were not financial transactions but were trades in commodities as per regulations and bye laws of NSEL. Consequently, upon finding of Hon’ble High Court that NSEL is not a ‘Financial Establishment’ and the paired contracts are not ‘financial transactions’ under MPID Act, the EOW case and SFIO Report, as far as they allege paired contracts were financial transactions have become redundant and infructuous;
- x. It is not clear how the observations of the various agencies and Courts on the role of NSEL or the mismanagement of NSEL by its promoters/KMPs can have bearing on the Noticee’s ‘*fit and proper*’ person status. FMC order found fault with the operations of NSEL for launching paired contracts and the role of its promoters and KMPs. Neither the Noticee was a party to said proceedings nor the FMC considered the role/activities of the Noticee as member of NSEL. Hence, the said order has no relevance so far as the Noticee is concerned;

¹ SAT Appeal No. 21 of 2006

- xi. The reliance of DA on the interim report of EOW is erroneous and misplaced and there are no specific charges made against the Noticee in the interim report. The Noticee had traded in/facilitated in the paired contracts as a member of NSEL in accordance with the business rules and regulations of NSEL and as on date of closure of business of NSEL, there was no payout obligations and Noticee is not a defaulting member;
- xii. The DA has failed to appreciate that the paired contracts were introduced by NSEL with the approval of NSEL and the Noticee as a member of NSEL had no other option but to trade in such contracts by observing the business rules and regulations of NSEL;
- xiii. The DA has not dealt with or given due consideration to various contentions like the Noticee's clients were duly registered with proper KYC, trades were carried out as per NSEL system and no brochure/ pamphlets/ presentations on NSEL were issued or provided to its clients by the Noticee. NSEL was functioning in complete public knowledge and was permitted to provide the trading platform for '*paired contracts*' and thus, there was no reason for the Noticee to question the legality of such product;
- xiv. Out of around 20,000 registered clients with the Noticee in the equity and commodity broking entities, the Noticee executed trades only for around 45 clients who had approached it at their own instance. The Noticee earned brokerage of barely ₹43,850. There has been no complaints or grievances or allegations of any violations of regulations against the Noticee;
- xv. It is clear from the contents of the Government of India letter dated December 30, 2014 that NSEL had violated the first two conditions of exemption and FMC was advised to initiate appropriate actions against NSEL. The letter is conspicuously silent on the activities of member of NSEL or any contemplated action against them;
- xvi. The Hon'ble Supreme Court in its Judgment dated April 30, 2019 has held that the '*paired contracts*' were in breach of the 2007 Exemption Notification but the said judgment has no relevance as regards the role of members of NSEL or the Noticee

11. While the extant proceedings in the present matter were ongoing, SEBI passed five separate orders during February, 2019, rejecting the applications filed by five other entities for registration as commodity brokers who were involved in the NSEL matter. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "**Hon'ble SAT**"). The Hon'ble SAT, vide common order dated June 9, 2022 (hereinafter referred to as the "**SAT order**"), remanded the aforesaid orders to SEBI to decide these matters afresh within six months from the date of the said SAT order. While remanding the aforesaid SEBI orders, the Hon'ble SAT, *inter alia*, held as under:

"42...The matters are remitted to the WTM to decide the matter afresh in the light of the observations made aforesaid in accordance with law after giving an opportunity of hearing to the brokers. All issues raised by the brokers for which a finality has not been reached remains open for them to be raised before the WTM. It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice....."

12. During the pendency of the proceedings, due to administrative reasons, the competent authority of SEBI, reallocated cases and transferred the present matter to the undersigned on August 11, 2022 for further proceedings.

13. In the light of the aforesaid SAT Order and certain other orders passed by the Hon'ble SAT in similar set of cases, it was felt necessary to furnish certain additional documents/material to the Noticee before concluding the present proceedings. Accordingly, a supplementary show cause notice (hereinafter referred to as "**SSCN**") dated October 12, 2022 enclosing therewith a copy of the SEBI Complaint dated September 24, 2018 filed with EoW, Mumbai, a copy of the First Information Report (hereinafter referred to as "**FIR**") dated

September 28, 2018 and a copy of the amended Schedule II of the Intermediaries Regulations was issued to the Noticee and the Noticee was granted 15 days' time to file its reply, if any from the date of receipt of the said SSCN. Further, hearing in the matter was also scheduled on November 23, 2022. Meanwhile the Noticee, vide its letter October 20, 2022, requested for an opportunity of inspection in the matter which was provided and availed by the Noticee on November 18, 2022.

14. On the scheduled date of hearing, i.e., November 23, 2022, Mr. Mahavir Toshniwal and Ms. Mitravinda Chunduru, Authorized Representatives of the Noticee, appeared and requested time to file reply to the SSCN and scheduling of hearing thereafter. The request of the Noticee was acceded to and hearing in the matter was scheduled on December 21, 2022. Meanwhile, the Noticee, vide its letter dated December 5, 2022, filed its reply to the SSCN. The submissions made vide letter dated December 5, 2022 are summarised as under:

- i. The SAT Order has effectively vitiated the findings of the Enquiry Report and therefore the information and material relied upon by SEBI are no longer to be relied upon by SEBI to arrive at any conclusion;
- ii. The allegations/observations against NSEL, relied upon in the Enquiry Report have been expunged and therefore the premise of 'close association' is no longer open to be contended by SEBI;
- iii. The SSCN is lacking in material particulars and there is no basis for any allegations against the Noticee. Apart from SEBI Complaint and the FIR, there is no other material provided along with the SSCN to allege or demonstrate any wrongdoing by the Noticee. Even the SEBI complaint and FIR do not contain any allegation or demonstrate any active role of the Noticee but simply are array of proceedings which are ongoing against NSEL;
- iv. The amendment to schedule II of the Intermediaries Regulation has come into effect only from November 17, 2021 and thus cannot be

retrospectively applied in the case of the Noticee, where the FIR is prior to the said amendment;

15. The hearing scheduled on December 21, 2023 was adjourned to January 3, 2023 on the request made by the Noticee. On the scheduled date of hearing, Advocate Ravichandra Hegde, Parinam Law Associates, (Authorized Representative), appeared and made submissions on the line of reply submitted earlier. Further, as requested, one week's time was granted to the Noticee to make post-hearing submissions, if any. Accordingly, vide letter dated January 16, 2023, the Noticee, filed post hearing submissions in the matter, which are summarized as under:

- i. The Noticee had no role, involvement or association with the conduct of NSEL and denies that it had intended to influence, incentivize or motivate its clients to undertake trading activities on the NSEL platform. There was no overarching profit motive for the Noticee to direct investors to trade in NSEL;
- ii. The Noticee has provided detailed breakdown of its turnover on various commodity exchange platforms in paired contracts as well as E Series Contracts. The Noticee has also done proprietary trades and the bonafide nature of the trades executed by the Noticee as an investor (proprietary trades) has been overlooked;
- iii. The Noticee executed trades for 38 clients in the financial years 2012-13 and 2013-14 in the NSEL commodities segment;
- iv. Noticee has not been named in any of the 11 charge sheets filed by EOW and that none of the Noticee's clients has been named as witness in the final or any of the charge sheet(s). None of the clients of the Noticee has submitted any complaints pertaining to mis-selling of the NSEL products with any authority;

16. Subsequently, the Noticee, vide email dated March 14, 2023, intimated that it has filed a settlement application in the present proceedings under the SEBI (Settlement Proceedings) Regulations, 2018. The Noticee further requested to keep the proceedings in abeyance till the said application is disposed.

Accordingly, passing of the order in the matter was kept in abeyance in terms of regulation 8(1) of the SEBI (Settlement Proceedings) Regulations, 2018. Subsequently, the said settlement application filed by the Noticee was rejected and the same was communicated to the Noticee vide email dated March 24, 2023.

17. Pursuant to the rejection of the aforesaid settlement application, the Noticee filed further written submissions, vide letter dated March 29, 2023, which are summarised as under:

- i. The Hon'ble SAT in a similar NSEL matter of ***B.N. Rath Comtrade Vs. SEBI***, has granted a stay on the ground that the noticee therein was already granted a certificate of registration and the show cause notice was issued on September 25, 2018 for the trades executed in 2011. In the present case also, the Noticee was granted registration on December 16, 2016 and first show cause notice was issued on September 25, 2018 for trades executed from April 1, 2012 to July 24, 2013. The Noticee also requested another opportunity of hearing in the matter;
- ii. Reliance is placed on the decision of the Hon'ble SAT dated May 13, 2016 in the matter of ***Almondz Global Securities Ltd. vs SEBI*** (Appeal No. 222 of 2015) to submit that the SEBI must be absolutely certain that by not declaring the Noticee as unfit, irreparable harm would be caused to the securities market for the simple reason that the punishment of declaring an intermediary as unfit is the ultimate punishment and thus must be imposed sparingly only in cases of repeated offences committed with impunity by the intermediary;

CONSIDERATION OF ISSUES AND FINDINGS

18. I have carefully perused the post enquiry SCN, SSCN along with all the documents attached therewith, the replies submitted by the Noticee, the oral submissions made by the Noticee during the course of the personal hearing and the post hearing submissions, along with the material/ information available on record. After considering the allegations made/ charges levelled

against the Noticee in the instant case, I note that the only issue that arises for consideration in the present proceedings is whether the Noticee satisfies the '*fit and proper person*' criteria as laid down under Schedule II of the Intermediaries Regulations.

19. Before considering the issue on its merits, I note that the SCN dated July 2, 2020 called upon the Noticee to show cause as to why action as recommended by the DA, including passing of appropriate direction should not be taken against the Noticee in terms of Regulation 28 of the Intermediaries Regulations. I note that by the amendments made to Intermediaries Regulations on January 21, 2021, Regulation 27 which dealt with recommendations for actions which could be made by DA in case of default, has been substituted and Regulation 28, which dealt with procedure for action on receipt of the recommendation from DA, has been omitted and these matters now stand governed by the Regulations 26 and 27, respectively. In the present case, I note that prior to the aforesaid amendment, procedure for conduct of enquiry proceedings before DA and Competent Authority (CA) was provided under Regulations 25 to 28 of the Intermediaries Regulations wherein Regulation 25 dealt with issue of SCN by the DA, Regulation 26 dealt with reply of SCN by the Noticee, Regulation 27 dealt with recommendation for actions which could be made by the DA and Regulation 28 dealt with conduct of proceedings before the CA, like issue of SCN, hearing and passing of final order. After the aforesaid amendment, Regulation 25, as substituted, deals with holding of enquiry proceedings before DA, Regulation 26 deals with recommendation for actions which can be made by the DA and Regulation 27 deals with conduct of enquiry proceedings before the CA and passing of order by the CA. Thus, the proceedings before CA which were earlier governed by the provisions of Regulation 28 are now governed by the provisions of Regulation 27 with certain modifications. Therefore, the new Regulation 27 is regarded having force continuously (by virtue of pre-existing Regulation 28) and the modification or changes are treated as amendment coming into force with effect from the date of enforcement of new Regulation 27, i.e., January 21, 2021. Accordingly, I note that the present proceedings

can be concluded under the amended provisions of the Intermediaries Regulations and for the violations committed by the Noticee, directions under Regulation 27 of the Intermediaries Regulations can be issued.

20. The Noticee has argued that in terms of Section 29A(2)(e) of the FCRA, SEBI could only initiate prosecution proceedings against the members of NSEL and not proceed under the Intermediaries Regulations. In this regard, I note that SEBI had filed a complaint dated September 24, 2018 with the concerned police authorities for initiating appropriate action for the violations of the provisions of FCRA alleged to have been committed by the Noticee. I also note from the records that on the basis of the said complaint of SEBI, a FIR dated September 28, 2018 was registered with MIDC Police Station. In the background of these facts, it is pertinent to see the scope and scheme of Section 29A(2)(e) of the FCRA which is reproduced as under for ease of reference:

“29A. Repeal and savings. — (1) The Forward Contracts (Regulation) Act, 1952 (74 of 1952) is hereby repealed.

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

(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;”

21. A bare perusal of the aforesaid provision would reveal that it is an enabling provision which enables SEBI to initiate fresh proceedings within a period of three years from the date on which the FCRA is repealed. As stated above, SEBI has filed complaint, *inter alia*, against the Noticee within the stipulated period as specified in the FCRA. Accordingly, I note that SEBI has taken appropriate steps for the alleged violation of the provisions of the FCRA.
22. Further, as stated above, the present proceedings pertain to examination of the ‘fit and proper’ person status of the Noticee under the Intermediaries Regulations and it is a settled position of law that as a statutory body, SEBI is

well within its regulatory purview to examine the '*fit and proper*' person status of the intermediaries registered with SEBI. Accordingly, the submission of the Noticee as regard maintenance of the present proceedings under the Intermediaries Regulations is also without merit.

23. Prior to moving forward with considering the said issue as stated at para 18 above, it is pertinent to refer to the common order dated June 09, 2022² passed by the Hon'ble SAT which is also referred in the preceding paragraph 11. The Hon'ble SAT, while setting aside and remanding the earlier WTM Orders passed during February 2019, had made the following observations (relevant to the present case as well):

- (a) Observations of the Bombay High Court in the matter of *63 Moons vs. Union of India*³ cannot be relied upon as the said judgement has been set aside in appeal⁴ by the Hon'ble Supreme Court vide judgment dated April 30, 2019.
- (b) Observation from the Order dismissing the Writ Petition filed by NSEL against the invocation of the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 ("MPID Act") (*NSEL vs. State of Maharashtra*⁵) cannot be relied upon, as in a subsequent Writ Petition⁶ moved by 63 Moons, a Division Bench of the Hon'ble Bombay High Court has held that NSEL is not a financial establishment and therefore, the provisions of the MPID Act are not applicable. The prima facie observations cannot be the basis to judge the reputation, character or integrity of NSEL.
- (c) Observations in the bail rejection order dated August 22, 2014, passed by the Hon'ble Bombay High Court in the matter of ***Jignesh Prakash Shah vs. The State of Maharashtra***, cannot also be relied upon as the

² Appeal No. 214 of 2019 Geofin Comtrade Ltd Vs. SEBI, Appeal No. 217 of 2019 Philip Commodities India Pvt. Ltd Vs. SEBI, Appeal No. 218 of 2019 IIFL Commodities Ltd Vs. SEBI, Appeal No. 288 of 2019 Anand Rathii Commodities Ltd Vs. SEBI and Appeal No. 288 of 2019 Anand Rathii Commodities Ltd Vs. SEBI

³ Writ Petition No. 2743 of 2014

⁴ Civil Appeal No. 4467 of 2019

⁵ Writ Petition No. 1403 of 2015

⁶ Writ Petition No. 1181 of 2018

observations made in a bail order were limited to the fact as to whether the bail should be granted or not.

- (d) Reliance placed on decisions of the Hon'ble Tribunal in the matter of ***Jermyn Capital vs. SEBI***⁷ and ***Mukesh Babu Securities vs. SEBI***⁸ is misplaced, as decisions in the said matters are distinguishable on facts. Jermyn Capital was held to be in relation to an Interim Order passed by SEBI, and the Tribunal was of the view that the criteria for passing an Ad Interim Order are based on a different criterion, namely prima facie case, the balance of convenience and irreparable injury which are distinct and different while considering an application for grant of Certificate of Registration. The decision in the matter of *Mukesh Babu Securities* was of a criminal complaint filed against the Chairman of the Company. The Tribunal noted that there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.
- (e) Reputation of the applicant cannot be lightly considered based on observations which are not directly related to the applicant.
- (f) SEBI Order does not state for how long the rejection of application will continue. The Hon'ble Tribunal was of the view that the rejection cannot continue indefinitely, and in such cases, a time period should be provided during which the applicant will become ineligible to seek fresh registration.
- (g) Grant Thornton Forensic report does not find any close connection between the applicant and the NSEL. This is overlooked by SEBI.
- (h) With respect to the additional material available, the Hon'ble SAT observed that,

"It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice. It will also be open to SEBI if it considers necessary, to conduct an independent enquiry proceeding

⁷ Appeal No. 26 of 2006 decided on September 06, 2006

⁸ Appeal No. 53 of 2007 decided on December 10, 2007

against the connected entities and persons associated with the brokers against whom evidence is available.”

24. As noted above, taking cognizance of the order passed by the Hon’ble SAT on June 9, 2022 (*supra*), a SSCN dated October 12, 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 29, 2020 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 Economic Offence Wing (‘EOW’);
- b) First Information Report (‘FIR’) dated September 28, 2018; and
- c) Schedule II of the Intermediaries Regulations (Amended with effect from November 17, 2021).

25. Before considering the matter on merits and test the compliance of the Noticee with the ‘*fit and proper person*’ criteria, on the basis of the material that has been brought on record, it would be appropriate to look at the background and understand the nature of the ‘*paired contracts*’ that were offered on the NSEL – which ultimately is the cause/genesis of the current proceedings. While undertaking this exercise, I will not be independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings. I will, however, be relying on the observations made by other authorities including the Hon’ble Supreme Court in the matters of **63 Moons Technologies Ltd. vs. UOI**⁹ (hereinafter referred to as the “**merger petition**”) and **The State of Maharashtra Vs. 63 Moons Technologies Ltd**¹⁰ (hereinafter referred to as the “**MPID Matter**”), wherever appropriate.

Transactions in the nature of ‘paired contracts’ on NSEL:

⁹ Civil Appeal no. 4476 of 2019

¹⁰ Civil Appeal No. 2748-49 of 2022

26. 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. NSEL was incorporated in 2005 as an electronic exchange for spot trading of commodities. On June 5, 2007, the Ministry of Consumer Affairs (“MCA”), Government of India, issued a Notification SO 906(E) under Section 27 of the FCRA granting conditional exemption from the provisions of that Act with respect to (i) forward contracts, (ii) for sale and purchase of commodities, of one-day duration traded on NSEL. The conditions, *inter alia*, placed an absolute bar on short sales and stipulated that all outstanding positions at the end of the day must result in delivery. It was also stipulated that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency. Thereafter, NSEL commenced operations in October 2008.
27. As noted from the FMC order, NSEL introduced, on its platform, the concept of ‘*paired contracts*’, in September 2009, which involved buying and selling the same commodity through two different contracts at two different prices wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In other words, the ‘*paired contract*’ involved two simultaneous transactions being undertaken at the same time with the same counterparty—one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at different prices on the platform of NSEL. The transactions were structured in such a manner that buyer of the short duration contract always ended up making profits.
28. As mentioned at para 4 above, FMC, after analysing the trade data as received from NSEL, vide order No. 4/5/2013-MKT/B dated December 17, 2013 observed that: “55 contracts offered for trade on NSEL were with settlement period exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA” and “the condition of ‘no short sale by members of the exchange shall be allowed’ was not being met by NSEL”.

29. Further, in the above mentioned Order, FMC, *inter alia*, held that the contracts traded on NSEL have violated certain conditions stipulated in the 2007 Exemption Notification, which granted permission to NSEL to offer spot trading in commodities which, *inter alia*, included “*no short sale by members of the exchange shall be allowed; that all outstanding positions of the trade at the end of the day shall result in delivery*” and that “*all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency*”.
30. It is clear from the order of FMC that NSEL was given permission to setup as a spot exchange for trading in commodities. It was essentially meant to only offer forward contracts having one-day duration as per 2007 Exemption Notification. I note from the FMC Order¹¹ that the 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of the provisions of FCRA. I further note from the FMC Order that under the FCRA, a “*forward contract*” is defined as a “*contract for delivery of goods and which is not a ready delivery contract*”. A ‘*ready delivery contract*’ is defined as “*a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days*”. Given the said definition as contained in FCRA, I note that FMC was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as Non-Transferable Specific Delivery contracts.
31. Therefore, it is noted that even though it was stipulated in the 2007 Exemption Notification that, only contracts of one-day duration were permitted to be offered on NSEL, FMC, in its Order, relying on the definition of “*forward contract*” under FCRA held that, NSEL was allowed to trade only in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. I note the observation in the FMC order that NSEL had permitted 55 contracts of various commodities having duration longer than 11 days and

¹¹ Order No. 4/5/2013-MKT-1/B dated December 17, 2013

these contracts were, *ex facie*, in contravention to the exemption granted to NSEL. It is pertinent to note that all the 55 contracts that were advertised by NSEL, and which are captured in the Hon'ble Supreme Court's Judgement in the matter of MPID matter, were for durations exceeding 11 days.

32. I note that the Hon'ble Supreme Court in the matters of NSEL has also extensively commented on the nature of the 'paired contracts' traded on NSEL. The said observations made by the Hon'ble Supreme Court are as under:

- a. the Two-Judge Bench of the Hon'ble Supreme Court in the course of determining the validity of the amalgamation order in the matter of merger petition, vide judgment dated April 30, 2019, had observed as under:

*"55. We have seen that neither FTIL nor NSEL has denied the fact that 'paired contracts' in commodities were going on, and by April to July, 2013, 99% (and excluding E-series contracts), at least 46% of the turnover of NSEL was made up of such 'paired contracts'. **There is no doubt that such 'paired contracts' were, in fact, financing transactions which are distinct from the sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL and the FCRA.**" (emphasis supplied)*

- b. the Hon'ble Supreme Court in the MPID matter vide judgement dated April 22, 2022, has drawn reference to the presentations made by NSEL in respect of the 'paired contracts'. Upon analysing the presentations made, the Hon'ble Supreme Court has observed that:

"The above representation indicates that 'paired contracts' were designed as a unique trading opportunity by NSEL under which a trader would, for instance, purchase a T+2 contract (with a pay-in obligation on T+2) and would simultaneously sell a T+25 contract

*(with a pay-out of funds on T+25). The price differential between the two settlement dates was represented to offer an annualized return of about 16%. NSEL categorically represented that all trades were backed by collaterals in the form of stocks and its management activities included selection, accreditation, quality testing, fumigation and insurance. **Therefore, NSEL represented that on receiving money and commodities, the members would receive assured returns and a service.** Though NSEL has been receiving deposits, it has failed to provide services as promised against the deposits and has failed return the deposits on demand. Therefore, the State of Maharashtra was justified in issuing the attachment notifications under Section 4 of the MPID Act."* (emphasis supplied)

33. I, therefore, note that the Hon'ble Supreme Court has already commented on the nature of the 'paired contracts' offered on the NSEL platform. In the case of *63 Moons Technologies Ltd. vs. UOI*, the Hon'ble Supreme Court held that these contracts were in the nature of financing transactions. In the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon'ble Supreme Court has held that such transactions come within the definition of 'deposits' under the MPID Act.
34. It is further noted that the Hon'ble Supreme Court, in the MPID matter, had extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. As seen from the order of the Hon'ble Supreme Court, NSEL was advertising an annualized return of about 16% p.a. for the 'paired contracts' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, a T+2 & T+25 paired contract in steel had the same offered return as a T+ 2 & T + 35 paired contract in castor oil. The 'paired contracts', it is noted, were being marketed as an alternative to fixed deposits.

35. In view of the above, I note that the FMC Order and both the judgments of the Hon'ble Supreme Court discuss in detail that NSEL was permitting short sales, i.e., permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite amount of commodity is available in the warehouse. As noted above, the Hon'ble Apex Court in the merger petition has held that these contracts were in the nature of financing transactions.
36. At this juncture, in light of the above observations of the Hon'ble Supreme Court, I note that submission of the Noticee that the Hon'ble Bombay Court, vide its decision dated August 22, 2019, has clearly held that the paired contracts were not financial transactions is misplaced. It is also pertinent to note that the decision of the Hon'ble Bombay High Court which has been relied upon in the matter by the Noticee was overruled by the Hon'ble Apex Court in the MPID matter and thus, the submission of the Noticee in this regards is not tenable in law.
37. As regards the Noticee's submissions that the merger petition has no relevance as regards the role of member or the Noticee and that the FMC Order has no relevance as the Noticee was not a party to the same, I note that the said orders have been relied upon in the present proceedings to explain the nature of the '*paired contracts*' which were being traded on the NSEL platform and not to draw any adverse inference against the Noticee. Similarly, the submission of the Noticee as regards the irrelevancy of the DEA, Government of India letter dated December 30, 2014 is also not tenable as the said document has also been relied upon in the present proceedings to only explain the nature of the paired contracts. Accordingly, the submissions of the Noticee in this regard are not tenable.

Objections raised by the Noticee:

38. The Noticee has submitted that the appointment of the DA in the present matter is bad in law as the same was done by the Whole Time Member and not the Executive Director, as is required under the Intermediaries Regulations. In this regard, I note that Section 3(2) of the Securities and Exchange Board of India

(Delegation of Powers) Order, 2015 specifically provides that, "*The powers and functions delegated to any member or officer of the Board or authority under the Order can be exercised by any officer or authority higher in grade or rank or position to him*". Thus, in presence of a valid delegation conferred upon by the statute, I find that the Noticee's challenge to the appointment of DA by the Whole Time Member of SEBI, who is an authority higher in grade to the Executive Director of SEBI, is devoid of merit. Further, the Noticee has also argued that the aforesaid stance as regard the appointment of DA is not valid in view of Section 3(1) of the DOP Order to submit that said order cannot be in derogation of powers/ functions specified under the Intermediaries Regulations. From the submissions of the Noticee, it appears to be a bald assertion without substantiation as to how the same is in derogation of the functions/ powers specified under the Intermediaries Regulations. While the Intermediaries Regulations provide for appointment of DA by an Executive Director, the same, when read along with the aforementioned Section 3(2) of the DOP Order, empower the Whole Time Member also to make the appointment. Accordingly, the submissions of the Noticee in this regard are rejected.

39. The Noticee has further submitted that SEBI does not have the jurisdiction to deal with the Spot Market in terms of letter dated November 20, 2015 of the Ministry of Finance. Since spot markets/ ready delivery contracts were not being regulated by the FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets. Accordingly, the merger of FMC with SEBI cannot empower SEBI to regulate the Spot Market. In this regard, without going into the merits of the contention that whether SEBI has the authority to regulate Spot Market or not, I note, that the issue under consideration in the present proceedings is limited to the determination of fit and proper status of the Noticee under the Intermediaries Regulations. It is a settled position of law that SEBI has statutory authority to determine the fit and proper status of the intermediaries registered with it. Since the Noticee is an intermediary registered with SEBI, I am of the view that SEBI is within its jurisdiction to determine the fit and proper status of the Noticee. Thus, the submission of the Noticee, in this regards, is not tenable.

40. The Noticee has also argued that it has not been provided with the relevant information, data, trade/order log etc., and the same amounts to violation of the principle of natural justice. In this regard, I note that vide letter dated July 26, 2019, the Noticee was provided with the relevant material such as the extract of the Grant Thornton report, FMC order etc., by the DA. Further, by letter dated February 26, 2020, the Noticee was also provided with the relevant NSEL circulars and the data pertaining to the trades of the Noticee in the '*paired contracts*'. It is also noted from the material available on record that the Noticee has also conducted an inspection of documents on November 18, 2022. The Noticee has not specified as to what case specific documents have not been provided to the Noticee which has caused prejudice to the it, if any. I note that vide letters dated July 26, 2019 and February 26, 2020, SCN dated July 2, 2020 and SSCN dated October 12, 2022, the Noticee has been provided with the relevant and relied upon documents and therefore, I am of the view that the principles of natural justice have been duly complied with in the matter and the Noticee's contention with regard to non-supply of relevant documents in the matter is not tenable.
41. Further, the noticee has also submitted that FCRA does not fall within the definition of 'securities laws' as given in regulation 2(1)(k) of the Intermediaries Regulations. The said contention of the noticee, is misplaced. It is a settled position that SEBI, as a market regulator, is within its four walls to adjudge the fit and proper status of intermediaries registered with it. The intent of the Intermediaries Regulations, as regards judging the fit and proper status of a registered intermediary, is that any entity who is not fit and proper, should not remain active/ enter in the securities market ecosystem. It is very much possible that a registered intermediary is declared as not fit and proper for violation/ activities not pertaining to securities market/securities laws. To further strengthen the said understanding, I deem it fit to place reliance on clause 3(b)(v) of Schedule II of the Intermediaries Regulations which states as under:

“(v) an order of conviction has been passed against such person by a court for any offence involving moral turpitude;”

On a bare perusal of the above requirement, it is clear that disqualification as not being fit and proper can come into play for violations not specifically pertaining to securities laws and thus, it is immaterial whether or not the FCRA falls within the definition of ‘securities laws’ as defined under regulation 2(1)(k) of the Intermediaries Regulations. As noted above, the present proceedings have initiated to test the ‘fit and proper’ person status of the Noticee and not to adjudge the violations under FCRA and thus, the submissions of the Noticee in this regard are not tenable.

42. The Noticee has also submitted that the SAT order has vitiated the findings of the Enquiry Report and therefore, the information and material relied upon in the Enquiry Report can no longer be relied upon. In this regard, the observations of the Hon’ble SAT have been summarized above at para 23 and as directed by the Hon’ble SAT, no reliance is being placed on material such as the SFIO report, the orders in the matter of **Jignesh Prakash Shah vs The State of Maharashtra, Jermyn Capital LLC Vs. SEBI** and **Mukesh Babu Securities Vs. SEBI** etc. The Hon’ble SAT in its order dated June 9, 2022 has noted that “...It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations...”. In accordance with the same, reliance has been placed on material such as interim EOW report, Grant Thornton report, FMC Order etc.

43. I note that pursuant to the rejection of the Settlement Application, the Noticee, vide its letter date March 29, 2023 made additional submissions and requested for another opportunity of personal hearing after more than three months of conclusion of hearing in the matter. In the said reply, the Noticee, *inter alia*, placed reliance on the decision of the Hon’ble SAT in the matter of **B.N. Rathi Private Limited Vs. SEBI** wherein Hon’ble SAT has imposed a stay on a SEBI order on account of the fact that the noticee therein was already granted a certificate of registration and the show cause notice was issued to the noticee in

2018 for the trades executed in 2011. In this regard, I am of the view that the aforesaid submission of the Noticee appears to be merely an attempt to not conclude the present proceedings. From a perusal of the aforementioned SAT order, I note that the stay granted by the Hon'ble SAT is specific to that particular matter and there is nothing brought on record by the Noticee to suggest that the present proceedings have any relevance to the said order or are impacted in any manner by the said SAT order. In any case, the said SAT order has stayed the effect and operation of the impugned order passed in the said proceedings and has not given/passed any observations/directions with respect to the present proceedings.

44. As regard the request of the Noticee to grant another opportunity of personal hearing, I am of the considered view that even though the opportunity of personal hearing is an integral part of the principles of natural justice, the same cannot be stretched to unreasonably allow the Noticee to raise request of personal hearing post conclusion of the proceedings. I note that the fact that a stay has been granted by the Hon'ble SAT in a different matter cannot be a ground in itself for the Noticee to request for another opportunity. Further, the Noticee has also not made out any ground as to justify the grant of opportunity of personal hearing after final conclusion of proceedings. As such, the Noticee has already been provided with the opportunities of personal hearing on three separate occasions, as per the convenience and the requests of the Noticee and therefore, I am satisfied that the principles of natural justice are complied with especially when the submissions of the Noticee made vide its letter dated March 29, 2023 along with its other replies have been taken on record and are being dealt with. Hence, given the conclusion of the proceedings as noted, the request for personal hearing at this stage is rejected.

Fit and proper person criteria

45. Now, I would be proceeding to deal with the issue in hand in the present case which is whether the Noticee satisfies the '*fit and proper person*' criteria laid down under Schedule II of the Intermediaries Regulations. Before moving forward, it would be appropriate to take a look at the relevant provision of the

SEBI Act, Broker Regulations and the Intermediaries Regulations (as they exist on date) which are reproduced as under for reference:

SEBI Act

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

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

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

Broker Regulations

Consideration of application for grant of registration.

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

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

Conditions of registration.

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

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

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

Liability for action under the Enquiry Proceeding Regulations.

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

(i)

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

SCHEDULE II

Securities and Exchange Board of India (Stock Brokers) Regulations, 1992

CODE OF CONDUCT FOR STOCK BROKERS

[Regulation 9]

A. General.

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

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

(3)

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

Intermediaries Regulations:

SCHEDULE II

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

[See regulation 7]

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

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

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

- (2) The 'fit and proper person' criteria shall apply to the following persons:
- (a) the applicant or the intermediary;
 - (b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and
 - (c) the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:

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

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

- (3) For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but 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.

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

47. From the records, I note that SEBI has filed a complaint with EOW Mumbai on September 24, 2018, against brokers who facilitated access to '*paired contracts*' traded on NSEL, including the Noticee. On the basis of this complaint, FIR dated September 28, 2018, was registered with the MIDC Police Station, Mumbai, against the Noticee. I note from the records that the Noticee is holding a certificate of registration No. INZ000091531. In order to continue to hold such Certificate of Registration from SEBI, the Noticee is also required to satisfy the conditions of eligibility, which, *inter alia*, included,

continuance of its status as a '*fit and proper person*'. The above condition to be fit and proper person is not a onetime condition applicable only at the time of seeking registration. Rather, the provisions governing the criteria show that this is a condition which each and every registered intermediary is required to fulfil on a continuous basis as long as the entity remains associated with the Securities Market as a registered intermediary.

48. In this context, I note that the Noticee, vide its reply dated January 16, 2023 had, *inter alia*, submitted that '*...in addition to the trades on behalf of its clients, the Noticee had also done proprietary trades...*' and '*...there were 38 clients who had traded in both FYs 2012-13 and 2013-14...*'. Further, vide its reply dated July 24, 2020, the Noticee has submitted that '*...The Noticee earned brokerage of barely Rs. 43,850/-. There has been no complaints or grievances or allegations of any violations of regulations against the Noticee...*'. Further, as per the Grant Thornton report, NSEL had a pay-out obligation to the extent of ₹5,93,26,944/- towards the Noticee, and as noted from the Enquiry Report, as per the interim EOW Report, the Noticee had money exposure to the tune of ₹6,23,98,897/-. It is also observed from the Enquiry Report and the NSEL circular dated March 10, 2015 that NSEL had made a special pay-out amounting to ₹57,87,399/- to the Noticee for its 22 clients. As noted above, the name of the Noticee is appearing in the interim EOW Report and thus, the submission of the Noticee that the observation made by the EOW did not pertain to the Noticee is not tenable. Further, the interim EOW Report has been used to bring on record the money exposure of the Noticee and not to level charges against the Noticee and thus, the submission of the Noticee that there are no specific charges against the Noticee in the interim EOW Report is also not tenable. In view of the same, I am of the view that it is not in dispute that the Noticee, in fact, itself participated and also facilitated its clients the trading in the alleged '*paired contracts*' on NSEL Platform.

49. I note that the act of the Noticee in participating and offering access to '*paired contracts*' by facilitating trading in such contracts, seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee.

As recorded in the FMC order and the judgements of the Hon'ble Supreme Court (*supra*), these contracts, were *ex facie* offered in violation of the 2007 Exemption Notification and were not spot contracts in commodities which were permitted to be traded on NSEL. The '*paired contracts*' were nothing but financing transactions masquerading as spot contracts in commodities. The execution of the trades in '*paired contracts*' were not permitted under the 2007 Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities, as observed by FMC in its Order. Therefore, the Noticee by its conduct and as a member of NSEL has facilitated trading in '*paired contracts*' which were in the nature of financing transaction, as held by the Hon'ble Supreme Court. 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 and 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 and for itself on the NSEL platform have serious ingredients amounting to jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the Noticee in the Securities Market.

50. I further note that Clause 3(b) of Schedule II of the amended Intermediaries Regulations lays down a list of disqualifications which includes the following:

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

51. As discussed above, the Noticee has itself participated and also facilitated its clients to trade in '*paired contracts*'. As the '*paired contracts*' were violative of the conditions stipulated in the 2007 Exemption Notification, a complaint was filed by SEBI with Economic Offences Wing, Mumbai (EoW) on September 24, 2018, against the brokers who participated/ facilitated access to '*paired contracts*' traded on NSEL, including the Noticee within the time limit, as

specified under section 29A(2)(e) of the FCRA. On the basis of the said complaint of SEBI, FIR dated September 28, 2018 was registered with MIDC Police Station, Mumbai and the same are subsisting. I note that the name of the Noticee is reflected in the complaint and the FIR. I also note that the copies of the said complaint and the FIR were provided to the Noticee along with the SSCN dated October 12, 2022.

52. It is pertinent to note that the criteria of '*fit and proper person*', is an ongoing requirement throughout the period during which the Noticee remains operational in the Securities Market as a registered intermediary. In case, pursuant to the grant of registration by SEBI, any evidence comes to the notice of SEBI that casts a doubt on the integrity, reputation and character of the registered intermediary, SEBI is well within its powers to examine the '*fit and proper person*' status of such entity based on various parameters. It is noted that parameters provided under Clause 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations lays down a list of disqualifications which includes a pending criminal complaint or information under Section 154 of CrPC filed against such an entity by the Board. It is, therefore, noted that the Noticee attracts the disqualification provided in Clause 3(b)(i) of the Schedule II of the Intermediaries Regulations. The Noticee has submitted that the SSCN is lacking in material particulars and apart from the SEBI complaint and FIR, there is nothing to demonstrate any wrongdoing by the Noticee. In this regard, as noted above, filing of complaint by SEBI and the FIR against the Noticee, in itself, attracts the disqualification under clause 3(b)(i) of Schedule II of the Intermediaries Regulations and renders the Noticee as not '*fit and proper*'. Thus, the contention of the Noticee that there is no other material in the SSCN to demonstrate the wrongdoings of Noticee is misplaced and not tenable.

53. At this juncture, I deem it fit to deal with the submission of the Noticee that the amended '*fit and proper*' person criteria came into effect from November 17, 2021, i.e., after initiation of the proceedings against the Noticee and thus, cannot be applied retrospectively. In this regard, as noted above, the '*fit and*

proper person criteria, being a continuing requirement under the Intermediaries Regulations ought to be complied with at all times as long as an entity desires to remain associated with the securities market as a registered intermediary. The present proceedings intend to examine the '*fit and proper person*' status of the Noticee as per the Intermediaries Regulations. Therefore, I am of the view that the Noticee must satisfy the fit and proper person criteria as it exists on date and accordingly, I do not find any merit in the argument of the Noticee.

54. Therefore, looking holistically, I find that the conduct of the Noticee is detrimental to the Securities Market, being not in conformity with the applicable code of conduct. I, therefore, note that there were enough red flags for a reasonable person to come to conclude that what was being offered as '*paired contracts*' on NSEL were not spot contracts in commodities. Given the above, I am constrained to conclude that the Noticee facilitated its clients to access a product, which was in violation of the 2007 Exemption Notification, raises serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the product itself. By failing to disassociate itself from, and continuing to facilitate participation in the said paired contracts, the Noticee failed to act with due diligence.

55. Furthermore, as mentioned in para 52 above, the Noticee has also earned disqualification under Clause 3(b)(i) of the amended Schedule II of the Intermediaries Regulations on account of the complaint filed by SEBI and the FIR registered against the Noticee. In this regard it is pertinent to note that the said FIR is subsisting and has not been challenged, quashed or stayed by any competent court qua the Noticee. In this context, as observed above, I note that being a '*fit and proper person*' is a continuing 'eligibility criteria' which must be satisfied by the Noticee including the amended criteria, at all times.

56. The Noticee has also submitted that the '*paired contracts*' were launched by NSEL and NSEL was functioning in complete public knowledge and was permitted to provide the trading platform for '*paired contracts*' and hence, there was no reason for the Noticee to question the legality of such product launched

by NSEL. In this regard, I am of the view that, the principle of *'ignorantia juris non excusat'* or *'ignorantia legis neminem excusat'* or *'ignorance of law is no excuse'* becomes applicable in the situation, since trading in *'paired contracts'* was in violation of the 2007 Exemption Notification and ignorance of the conditions of the said 2007 Exemption Notification cannot be claimed. As held by the Hon'ble Supreme Court, *'paired contracts'* were nothing but financing transactions which were portrayed as spot contracts in commodities. Therefore, giving go-by to the terms of the 2007 Exemption Notification and attempting to camouflage the nature of the transactions brings into question of appropriateness and suitability of the continuance of the registration of the Noticee as a broker. Equally, any argument deflecting the responsibility to NSEL is misplaced and hereby rejected, as the primary onus of diligence enjoined on an intermediary, which diligence any reasonable or prudent person would also perform, has not been undertaken by the Noticee. Clearly, the actions of the Noticee has been detrimental to the interest of the Securities Market and accordingly the Noticee can no longer be called a *'fit and proper person'* for holding the Certificate of Registration as a broker in the Securities Market, which is one of the conditions for continuance of registration as specified in Regulation 5(e) of the Broker Regulations read with the provisions of Schedule II of the Intermediaries Regulations.

57. I am also aware that SEBI has passed certain orders¹² in the related NSEL matters where the Noticees therein have been debarred from making a fresh application seeking registration for a specified period from the date of the said order or till acquittal of the said Noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier. I find that present matter at

¹² Orders dated November 29, 2022 in respect of Motilal Oswal Commodities Brokers Pvt. Ltd. (at https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-respect-of-motilal-oswal-commodities-broker-pvt-ltd-_65602.html), Anand Rathi Commodities Ltd. (at https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-anand-rathi-commodities-ltd-_65604.html), Geofin Comtrade Limited (previously known as Geojit Comtrade Limited) (at https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-geofin-comtrade-limited-previously-known-as-geojit-comtrade-limited_65597.html), India Infoline Commodities Ltd. (at https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-india-infoline-commodities-ltd-_65595.html) and Phillip Commodities India Pvt. Ltd. (at https://www.sebi.gov.in/enforcement/orders/nov-2022/order-in-the-matter-of-phillip-commodities-india-pvt-ltd-_65593.html) in the matter of NSEL.

hand is different from that of those cases, as in the extant matter the Noticee is already holding a Certificate of Registration whereas in those cases, the entities had filed applications seeking certificate of registration. As already noted above at para 52, '*fit and proper person*' criteria is a continuing requirement under the Intermediaries Regulations which the Noticee ought to comply with at all times so long it desires to remain associated with the Securities Market as a registered intermediary. Further, I note that the Hon'ble SAT in its order dated June 09, 2022 (pertaining to entities whose application for registration was rejected) has observed that the period for which the noticees cannot apply for registration needs to be specified by SEBI. Having noted the aforesaid observation of the Hon'ble SAT, I am of the view that since the recommendation in the present matter is of cancellation and not of rejection of the application, the necessity of specifying a period of time may not arise in this order (as in the case of entities desiring to be registered as market intermediaries) as this forum cannot presume whether such entity wishes to reapply to be a market intermediary or not. If it chooses to do so, it will have to be assessed at such point of time if it is fit and proper as per the extant and applicable regulations.

58. In the context of Securities Market, I note that the role of a registered intermediary including a broker is not only sensitive and predominantly fiduciary in nature but also demands from it honesty, transparency, fairness and integrity which are essentially the hallmarks of such market intermediaries. Given the fact that one of the avowed objects of the SEBI Act is the protection of interest of investors apart from promotion and development of the Securities Market, the legislature through enactment, empowers SEBI to grant registration to several class of entities including brokers, which are not only required to act as an intermediary simpliciter i.e., a bridge or a connector between the markets and investors, but also have a very important role to play in creating an ecosystem of trust and fairness so as to provide a fair and secure market to the investors and any deviation from the above noted objective could have a cascading adverse impact on the development of the Securities Market and interests of investors. Thus, undisputedly a broker is obligated to act in a transparent manner and comply with all applicable regulatory requirements

which are in the best interests of its clients and which will uphold the integrity of the Securities Market.

59. Further, the fact that there have been no complaints against the Noticee is also not material in the present proceedings as 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, as recorded in the FMC order and Orders of the Hon'ble Supreme Court (as mentioned supra), that the scheme of '*paired contracts*' traded on the NSEL ultimately has caused loss to the market which 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.

60. Further, as per findings recorded above, the Noticee also attracts the disqualification provided in Clause 3(b)(i) under the Schedule II of the Intermediaries Regulations in view of the complaint filed by SEBI and the pending FIR against the Noticee. Further, it is also not the case of the Noticee that said FIR filed is either stayed or quashed by any competent court qua the Noticee or otherwise. In view of the above, I hold that the Noticee does not satisfy the '*fit and proper person*' criteria specified in Schedule II of the Intermediaries Regulations and hence, the continuance of the Noticee as a registered broker will be detrimental to the interest of the Securities Market. Accordingly, no reliance can be placed on the decision of the Hon'ble SAT in the matter of ***Almondz Global Securities Ltd. vs SEBI***, as the Noticee has been found to be unfit and the continuance of Noticee as a broker would be detrimental to the securities market, as noted above. Further, the Noticee's submission that the premise of 'close association' of Noticee with the NSEL is no longer available to SEBI, even if accepted, cannot come to the rescue of the Noticee. As noted above, the Noticee has dealt in a product which was in

violation of the 2007 Exemption Notification (as observed by the Hon'ble Supreme Court in the merger petition) and has also incurred disqualification in terms of regulation 3(b)(i) of Schedule II of the Intermediaries Regulations. Therefore, activities of the Noticee, as discussed in the preceding paragraphs, as a registered broker cannot be condoned and deserve appropriate measure to prevent such wrong doings recurring to the detriment of the interest of the Securities Market.

61. In view of the above, I concur with the recommendation made by the DA, i.e., registration of the Noticee, Ajay Natavarlal Commodities Private Limited, registered as a Stock Broker may be cancelled.

ORDER

62. I, therefore, in exercise of powers conferred under Section 12(3) and Section 19 of the SEBI Act, 1992 read with Regulation 27 of the Intermediaries Regulations, 2008 cancel the Certificate of Registration (bearing no. INZ000091531) of the Noticee viz. Ajay Natavarlal Commodities Private Limited.

63. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 62 above.

64. Notwithstanding the direction at paragraph 62 above, the Noticee shall allow its existing clients, if any to withdraw or transfer their securities or funds held in its custody, within 15 days from the date of this order. In case of failure of any clients to withdraw or transfer their securities or funds within the said 15 days, the Noticee shall transfer the funds and securities of such clients to another broker registered with SEBI within a period of next 15 days thereon, under advice to the said clients.

65. This Order shall come into force with immediate effect.

66. The above Order is without prejudice to the criminal complaint filed by SEBI in the NSEL matter and/or any proceedings pending before any authority in respect of similar matter concerning the Noticee or other relevant persons.

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

Sd/-

DATE: NOVEMBER 30, 2023

S.V. MURALI DHAR RAO

PLACE: MUMBAI

EXECUTIVE DIRECTOR

SECURITIES AND EXCHANGE BOARD OF INDIA