QJA/PR/MIRSD/DOP/26066 /2023-24

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Section 12(3) of the Securities and Exchange Board of India Act, 1992 read with Regulation 27 of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

In respect of

Sr. No.	Name of the Noticee	SEBI Registration No.
1.	Pragya Commodity Brokers Pvt. Ltd.	INZ000030635

In the matter of National Spot Exchange Limited (NSEL)

BACKGROUND

1. The present proceedings originate from the Enquiry Report dated April 26, 2019, submitted by the Enquiry Officer in terms of regulation 27 of the SEBI (Intermediaries) Regulations, 2008 as it stood at the relevant point of time prior to its amendment vide SEBI (Intermediaries) (Amendment) Regulations, 2021, w.e.f. January 21, 2021 (hereinafter referred as **"Intermediaries Regulations"**), wherein the Designated Authority (hereinafter referred to as **"DA"**), based on various factual findings and observations so recorded in the said Enquiry Report, recommended that the registration of Pragya Commodity Brokers Pvt. Ltd. (hereinafter referred to as **"Pragya Commodity / Noticee"**) as a commodity derivative broker may be cancelled. Pursuant to the same, a Post Enquiry Show Cause Notice dated June 10, 2019 was served upon the *Noticee* to which the *Noticee* replied vide its letter dated July 30, 2019. Further, a second show cause notice dated September 20, 2019 containing therewith the letter dated December 30, 2014 of DEA, Ministry of Finance and a copy of the decision of the Hon'ble Bombay High Court dated August 22, 2014 was also issued to the *Noticee*. After providing an opportunity of personal hearing to the *Noticee* on October 3, 2019 and taking into consideration the written submissions made vide letters dated October 30, 2018 April 2, 2019, July 30, 2019 and October 23, 2019, the Ld. Whole Time Member of SEBI (hereinafter referred to as "**WTM**"), vide order dated September 24, 2021, cancelled the Certificate of Registration granted to the *Noticee*.

2. While the aforesaid proceedings were pending, Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") had also passed five separate orders rejecting the applications filed by five other entities for registration as commodity brokers in NSEL matter during February 2019. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "**Hon'ble SAT**"). The Hon'ble SAT vide its common order dated June 9, 2022, remanded the aforesaid SEBI 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……"*

3. The *Noticee* also, aggrieved by the Order dated September 24, 2021, passed by the Ld. WTM, appealed to the Hon'ble SAT and the Hon'ble SAT vide its order dated July 20, 2022[1] remitted the matter back to SEBI for deciding the matter afresh in light of its observations made in the order dated June 9, 2022[2], as noted above. The relevant excerpt from the decision of the Hon'ble SAT dated July 20, 2022 is hereunder:

> *"Thus, for the reasons stated in our order dated June 9, 2022 in Appeal no. 214 of 2022 and other connected companion appeals, the impugned orders passed by the WTM against the brokers / appellants in the present appeals cannot be sustained and are quashed. The appeals of the brokers are allowed. The matters are remitted to the WTM to decide the matter afresh in the light of the observation made in our order dated June 9, 2022 in accordance with law after giving an opportunity of hearing to the brokers…."*

4. Thereafter, the competent authority of SEBI has allocated the present matter to me for further proceedings. In light of the aforesaid SAT orders, it was felt necessary to furnish certain additional documents/material to the *Noticee* and granting an opportunity of personal hearing, before concluding the present proceedings. Accordingly, SEBI vide

1 Appeal No. 672 of 2021, Also available at - https://sat.gov.in/english/pdf/E2022_JO2021672_22.PDF
2 Appeal No. 214 of 2019, Also available at - https://sat.gov.in/english/pdf/E2022_JO2019214.PDF

Supplementary SCN dated October 11, 2022 (hereinafter referred to as "**SSCN**") provided certain additional documents/material (as indicated in the SSCN) to the *Noticee* and advised it to submit its reply/comments/clarifications in addition to its earlier replies, if any, within 15 days of receipt of the SSCN. The *Noticee* was further informed that if no reply is received within 15 days of receipt of this SSCN, it shall be presumed that it has no additional comments/reply to submit and the matter would be proceeded in terms of the provisions contained in the Intermediaries Regulations. I note that the SSCN has been sent to the *Noticee* through *Speed Post Acknowledgement Due* (for short '**SPAD**') vide letter dated October 11, 2022. Further, the scanned copy of the SSCN was served upon the *Noticee* vide email dated October 13, 2022 and proof of delivery is available on record. Further, the hearing in the matter was scheduled on October 20, 2022 which was rescheduled to November 10, 2022 at 3.30 PM on the request of the *Noticee*.

5. On the scheduled date of hearing, Mr. Kishor Kansagra, Director of the *Noticee* appeared on behalf of the *Noticee* and requested time to file the reply to the SSCN and further requested to reschedule the hearing. The request of the *Noticee* was acceded to and accordingly the matter was adjourned to December 1, 2022. The said hearing was further adjourned to December 2, 2022 on account of administrative exigencies. On the scheduled date of hearing, Shri Kushal Shah, Authorized Representative of the *Noticee* appeared in person and requested to avail the opportunity of hearing in person. The request of the *Noticee* was acceded to and the hearing was accordingly rescheduled December 8, 2022. Further, the *Noticee* was advised to provide certain data by SEBI vide email dated December 2, 2022 which was duly submitted by the *Noticee* vide its letter dated December 7, 2022.

6. On the scheduled date of hearing, i.e., December 8, 2022, Advocate Shri Prakash Shah along with M. Kishor Kansagra, Director of the *Noticee* appeared in person and made submissions on the lines of the replies submitted earlier. Accordingly, the *Noticee* was intimated that the hearing in the matter is concluded and post hearing submissions, if any, may be filed by the *Noticee* within one week from the date if hearing. I note from the record that no such submissions were made by the *Noticee* within the given time.

7. Further, the *Noticee*, vide email dated March 4, 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 aforesaid settlement application filed by the *Noticee*

got rejected and the said rejection was communicated to the *Noticee* by SEBI vide its email dated March 24, 2023.

8. Pursuant to the rejection of the Settlement Application, the *Noticee* vide its letter date April 3, 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*[3] wherein Hon'ble SAT has imposed a stay on the 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 delay 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.

9. As regard the request of the *Noticee* to grant another opportunity of personal hearing, I deem it appropriate to refer to the latin maxim "*Interest republicae ut sit finis litium*", i.e., it is in the interest of the state that there should be an end to a litigation. The said maxim is largely relied upon to submit that the once a competent court has concluded on a matter, the same must not be further agitated or litigated further in the interest of state. Drawing from the said principle, I am of the considered view that even as 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. 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 principle of natural justice is complied with especially when the submissions of the *Noticee* made vide its letter dated April 3, 2023 along with its other replies have been taken on record and are being dealt

[3] Appeal No. 282 of 2023, Decided on March 24, 2023, Also available on- https://sat.gov.in/english/pdf/E2023_JO2023282_6.PDF

with. Hence, given the conclusion of the proceedings as noted, the request for personal hearing at this stage is rejected.

10. In view of the above discussed facts and circumstances of the matter, I observe that the matter can be and is fit to be proceeded with on merit.

11. The written submissions filed by the *Noticee* vide letters dated October 30, 2018, April 2, 2019, July 30, 2019, October 23, 2019, October 22, 2022, November 9, 2022, November 30, 2022, December 7, 2022 and April 3, 2023 and the oral submissions made during the course of the personal hearing held on December 8, 2022, are summarized hereunder:

    i. The show cause notice issued by the DA suffers from serious legal lacunae as it does not provide any details of actions/ instances which constitute the alleged violations of the Broker Regulations and Intermediaries Regulations by the *Noticee*;

    ii. The show cause notice makes a sweeping allegation and no information/ data is provided in respect of the alleged trading by the *Noticee*, in absence of which, it is practically impossible for the *Noticee* to give an effective response;

    iii. The term '*paired contracts*' has been coined by the authorities for easy reference and the same has no legal significance and the buy and sell contracts were independent of each other. Further, the term '*paired contracts*' have not been defined by NSEL Bye Laws, business rules, circulars or other rules/ regulations;

    iv. The show cause notice is violative of regulation 25(3) of the Intermediaries Regulations as copies of documents relied upon in the show cause notice were not provided to the *Noticee*;

    v. The show cause notice is bad in law as it alleges the violation of SEBI Regulations which were not applicable to the *Noticee* at the relevant time. The *Noticee* came under the regulatory umbrella of SEBI only after September 28, 2015 and thus, cannot be made liable for act/ omissions committed prior to September 28, 2015;

    vi. At the relevant time, the *Noticee* was regulated by FMC and even if it is assumed that the paired contracts were violative of the Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as the **"FCRA"**), appropriate proceedings should have been initiated under FCRA and not Intermediaries Regulations, as is the case in the present matter;

    vii. The *Noticee* had no say in designing the commodities contracts including the alleged paired contracts as the same was entirely within the domain of NSEL and the

paired contracts were introduced by NSEL with the prior concurrence of FMC. The *Noticee* as a commodity broker, in the normal course of business was not required to assess the legality of the product introduced by the exchange and it was the responsibility of the government/ regulator to ensure that the exchange was operating within the parameters of law;

viii. The *Noticee* was trading in the commodities contracts including the alleged paired contracts on behalf of its clients as the said contracts were specified by the Board of NSEL;

ix. NSEL had always projected the alleged paired contracts as legal and permissible within the ambit of the 2007 Exemption Notification;

x. The *Noticee* can be held liable for violation of regulation 9(b) of the Broker Regulations for breach of rules, regulations and bye laws of the stock exchange but the show cause notice does not specify the rules, regulations or byelaws of the NSEL which have been allegedly violated by the *Noticee*. Further, NSEL was not a stock exchange within the meaning of the Broker Regulations as it was not recognized by the Central Government under Section 4 of the Securities Contracts (Regulation) Act, 1956;

xi. The allegation that the *Noticee* has breached the Code of Conduct as specified in Schedule II of the Broker Regulations and the '*fit and proper*' person criteria is vague and sweeping in nature;

xii. Regulation 5(e) is applicable at the time of grant of Certificate of Registration and the same is not relevant in the present case as the *Noticee* has already been granted the Certificate of Registration;

xiii. The appointment of the DA, which has been done by the Whole Time Member is bad in law and in violation of regulation 24(2) of the Intermediaries Regulations as the same should have been done by the Executive Director;

xiv. The *Noticee* is being proposed to be declared as not '*fit and proper*' person without taking into account the number/ value of trades entered by the *Noticee* which is in violation of the doctrine of proportionality;

xv. The show cause notice does not provide the Annexure A to the '*communication of the order appointing the Designated Authority*' and therefore it is not clear to the *Noticee* that on what basis the Whole Time Member was satisfied to appoint the Designated Authority;

xvi. The show cause notice does not provide a copy of the observations of the Central Government that NSEL violated exemption conditions permitting it to allow trades in one day forward contracts;

xvii. Only few transactions were carried out by the *Noticee* for a total of 21 days during the period February, 2013 to May, 2013 for 9 clients and few transactions in the proprietary account. However, by June, 2013, all the outstanding positions of the *Noticee* were squared off and there were no outstanding obligations receivable/ payable from/ to NSEL and/ or from/ to any of the clients;

xviii. The *Noticee* did not issue any product brochure/ pamphlet or other document to the clients relating to the alleged paired contracts and all the transactions in the client account were carried out at the behest of and as per the instructions of the clients;

xix. The *Noticee* was only dealing in the E-series products of NSEL till February 2013 but started trading in the alleged paired contracts pursuant to the constant requests of its clients. The *Noticee* started with trading in the prop account initially and in absence of any adverse reasons, the *Noticee* allowed few of its clients to trade in the paired contracts. The *Noticee* had a total of 12000 clients registered with it in the equity and the commodity segment but it executed trades for only nine clients which shows that the *Noticee* never marketed the product to its clients;

xx. The *Noticee* traded in the paired contract only on 21 days during the period from February 2013 to May 2013 with only 72 trades involving funds of Rs. 68.47 lakhs for 7 clients, Rs. 98.86 lakhs for 2 group companies and Rs. 30.03 lakhs from prop account, aggregating to a total of Rs. 197.36 lakhs. The total brokerage earned by the *Noticee* was Rs. 11, 073 and the *Noticee* has never lent any funds to its clients;

xxi. Although there was no official communication from NSEL/ FMC/ DCA, the *Noticee* persuaded its clients to not trade in the paired contracts pursuant to adverse media reports and by June 2013 all the outstanding positions had been squared off by the *Noticee*;

xxii. The *Noticee's* action of timely winding up of clients positions itself is a testimony of the *Noticee's* sincere efforts to adhere to the Code of Conduct in letter and in spirit;

xxiii. The findings of the DA are erroneous, contrary to the facts and law, arbitrary and without any bases and the show cause notice issued by the DA did not provide any

details of actions/ instances which constituted the alleged violations of the Broker Regulations and the Intermediaries Regulations;

xxiv. The DA, without referring to any specific letter, has recorded that the relevant material has already been provided to the *Noticee* whereas no such material has been provided to the *Noticee*;

xxv. The reliance on the decision of the Hon'ble Supreme Court in the matter of *Kanwar Natwar Singh Vs. Directorate of Enforcement*[4] by the DA to observe that the documents not relied upon in the matter need not be provided to the *Noticee* is misplaced as the documents sought by the *Noticee* have been relied upon by SEBI and are relevant in the present matter;

xxvi. The DA while observing that the Whole Time Member can exercise the powers exercised by the Executive Director and therefore the appointment of the DA by the Whole Time Member is in accordance with the law has ignored Section 3(1) of the SEBI (Delegation of Powers) Order, 2015 which stipulates that the said order is in addition to and not in derogation of powers/ functions specified under the Securities Laws;

xxvii. In terms of Section 29A(2)(e) of the FCRA, SEBI could initiate prosecution proceedings against the members of the NSEL for alleged violation of FCRA and could not initiate enquiry proceedings under the Intermediaries Regulations;

xxviii. The DA has not answered the contentions of the *Noticee* as regard the retrospective application of the SEBI Regulations and has wrongly relied upon the decision of the Hon'ble SAT in the matter of *Jermyn Capital LLC Vs. SEBI*[5];

xxix. The DA has not paid heed to the objection of the *Noticee* that SEBI has no jurisdiction over spot market, for which, reliance has been placed on the letter dated November 20, 2015 of the Ministry of Finance wherein it had been stated that SEBI is not expected to deal with matters not dealt by FMC and since spot market was not dealt with by FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets;

xxx. The reliance on the decisions of Jermyn Capital LLC Vs. SEBI and *Mukesh Babu Securities Vs. SEBI*[6] to establish close connection with NSEL is misplaced as in the instant case there is no allegation of any of the directors/ key managerial persons

[4] (2010) 2 SCC 497, Also available at- https://indiankanoon.org/doc/1321704/
[5] Appeal No. 26 of 2006, decided on September 06, 2006, Also available at - https://indiankanoon.org/doc/1511076/
[6] Appeal No. 53 of 2007, decided on December 10, 2007, Also available at- https://indiankanoon.org/doc/129504/

of the *Noticee* having any close association with anyone against whom CBI or any other intelligence agencies have initiated prosecution proceedings. Further, the show cause notice also does not allege that the Chairman/ Whole Time Director/ managing Director of the *Noticee* are involved in any criminal case which affects their reputation and thereby makes the *Noticee* not a '*fit and proper*' person;

xxxi. Although the DA has placed reliance on FMC Order dated December 17, 2013, decision of the Hon'ble Bombay High Court in the matter of 63 Moons' Technologies, interim report of EoW etc., the same has not been provided to the *Noticee* and therefore cannot be relied upon. Further, the aforesaid FMC order found fault with the operations of NSEL for launching the paired contracts and the neither *Noticee* was a party to the said proceedings nor the court had considered the role/ activities of the *Noticee* as a member of NSEL. Similarly, the *Noticee* was also not a party to the aforesaid Hon'ble Bombay High Court Order;

xxxii. There are no specific charges against the *Noticee* in the interim EoW report and as on date of closure, there was no amount payable/ receivable to/ from NSEL;

xxxiii. The DA has erroneously observed that *Noticee* as a commodity broker took advantage of the scheme of financing transactions through paired contracts and thus contributed in promoting illegal paired contracts as the said contracts were introduced by NSEL with the approval of its Board and *Noticee* as a member had no option but to trade in such contracts by observing business rules of the NSEL;

xxxiv. The DA has not taken into account the submission of the *Noticee* that there were no outstanding obligations and has observed that '*unsettled obligation of the Noticee is sufficient evidence of its dealings on the platform of NSEL*';

xxxv. The DA has not dealt with the following contentions, namely:

a) Clients who dealt through the *Noticee* were duly registered clients with proper KYC, Member Client Agreement etc.;

b) All trades were carried out as per the NSEL system from time to time and the contract notes were issued to the clients as per the formats and the terms and conditions and bye laws of NSEL;

c) 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 the product launched by NSEL;

d) The paired contracts were launched in 2007 but the *Noticee* started in the said product only in February 2013 and till then the *Noticee* was only trading in E-series products;

e) That out of 12000 clients registered with the *Noticee*, the *Noticee* executed trades only for 9 clients who had approached on their own and the *Noticee* never marketed the product to the clients, nor it had the intention to do the same;

f) The *Noticee* traded in the paired contracts for a period of 21 days during the period from Feb 2013 to May 2013 with only 72 number of trades involving funds of Rs. 68.47 lakhs for 7 clients, Rs. 98.86 lakhs for 2 of its group companies and Rs. 30.03 lakhs for the prop trades, aggregating ot a total of Rs. 197.36 lakhs. The total brokerage earned by the *Noticee* was Rs. 11, 073 and the *Noticee* never lent any funds to its clients;

g) Though there was no official communication from NSEL/FMC/DCA, the *Noticee* persuaded its clients to discontinue the trades in light of certain adverse media reports in April/ May 2013;

h) The *Noticee* was not a party to the SAT Order dated June 9, 2022, pursuant to which the SSCN has been issued to the *Noticee*. Further, vide order dated July 20, 2022, the Hon'ble SAT had quashed the WTM order dated September 24, 2021 and while doing the same no such direction with respect to issuance of SSCN or rely upon other material such as complaint letters of NSEL, EoW report, EoW charge-sheet etc., has been given by the Hon'ble tribunal;

xxxvi. The *Noticee* had executed contracts under the instructions and the authorizations of its clients and no advice, presentation or inducement of any nature was provided or extended to the clients;

xxxvii. The *Noticee* has not been provided with all the relevant and vital materials as available with SEBI, in absence of which, the *Noticee* is not in a position to present the facts of the case in a comprehensive manner;

xxxviii. The *Noticee* received the NSEL membership in January, 2011 and therefore the assertion in the enquiry report that the *Noticee* executed trades from September 2009 to August 2013 is erroneous;

xxxix. Trades for clients such as Metals and Minerals Trading Corporation of India Limited, Food Corporation of India, Cotton Corporation of India Limited etc.

were carried out and Ernst & Young was the auditor of NSEL but no adverse remark/ red flags/ allegations have been raised against any of such entities and therefore, the *Noticee's* trading may be considered on similar lines;

xl. There was a gross failure on part of FMC in performing its duties as the regulator which is the root cause of the present proceedings;

xli. The *Noticee* was acting as a 'Trading – Cum Clearing Member' and thus, on execution of Buy order, the *Noticee* made full payment of consideration of Buy contracts. Any post trade activity was carried out by the clearing and settling mechanism of NSEL and by making full payment of the buy contracts, the *Noticee* has complied with its obligation;

xlii. The *Noticee* has traded in the alleged paired contracts on behalf of its clients as well as in its prop account;

xliii. The clients of the *Noticee* have not filed any complaint prior to July 31, 2013 or anytime thereafter and the amounts deployed in the NSEL by the clients were their own funds;

xliv. The *Noticee's* total turnover in the alleged paired contracts in comparison to the entire turnover of paired contracts at NSEL was 0.002% and 0.008% in the year 2012-13 and 2013-14 which is very miniscule to draw any adverse inference;

xlv. The clients of the *Noticee* had voluntarily submitted affidavit, *inter alia*, stating that they executed the trades on their own and no funding/ financing were given to them;

xlvi. Pursuant to the merger of SEBI with FMC, the *Noticee* was granted a registration, sans any condition, despite the facts which were well known in public domain and more specific to SEBI;

xlvii. The insinuation that brokers were not regulated by FMC is incorrect as they were required to obtain a 'Unique Member Code' from the FMC and since FMC was the regulator at the relevant time and not SEBI, SEBI ought not to initiate any action under regulation 23 of the Intermediaries Regulation for contravention of provisions of securities laws;

xlviii. The designated authority has not provided an opportunity of hearing to the *Noticee* which is against the principles of natural justice and also in violation of regulation 25(6) of the Intermediaries Regulations, as amended on January 21, 2021;

xlix. The extant proceedings are based on the events that occurred in 2012-13 and the same would have been taken into account while granting the certificate of registration to the *Noticee* on April 4, 2016. Further, the certificate granted to the *Noticee* was unconditional and therefore the present proceedings are tantamount to the certificate granted earlier;

l. NSEL always presented the '*paired contracts*' to be legal and permissible and the *Noticee* traded in the said contracts in accordance with the business rules and regulations of NSEL;

li. NSEL launched the contracts in 2007 and the *Noticee* became the member of NSEL on January 10, 2011;

lii. Though there was no communication from NSEL/FMC as regard the potential violation of regulatory framework by NSEL, the *Noticee* took immediate measures by requesting its clients to discontinue trading in such contracts after the *Noticee* came across adverse media reports;

liii. The *Noticee* had no connection/ relation/ contact or association with any defaulting brokers/ clients or other involved entities and a mere membership with the Exchange cannot be stretched to establish a 'close association' with the Exchange;

liv. The alleged breach of conditions of the exemption notification was not known to the *Noticee* and neither did the Government of India or FMC allege that there had been any such breach/ violation;

lv. The fact that the *Noticee* was a non-defaulting member is a substantially relevant fact as the *Noticee* had complied with all the trade obligations and the same ought to be one of the most crucial factors to determine the fit and proper status in the present case;

lvi. NSEL had huge insurance policies and even the insurance companies would have checked the goods before issuing such large policies and there was no allegation/ finding that the goods covered by the *Noticee's* were missing;

lvii. The submissions as regard the conditions stipulated in the 2007 Exemption Notification are as under:

a) The first condition stipulated that '*No Short Sales and All outstanding positions at the end of the day shall result in delivery* and NSEL Circular dated August 31, 2012 clarified that short sales were prohibited and directed that the seller must be in possession of commodities or equivalent buy position. The first transaction for

all alleged '*paired contracts*' was always 'purchase' and therefore there is no question of 'short sale';

b) It was incomprehensible and impractical to contend that when thousands of clients were participating in alleged pair contracts, all of them would be taking physical delivery for their positions across multiple warehouses across the country;

c) The second condition stipulated, i.e., "*All outstanding positions of the trade at the end of the day shall result in delivery...* ", only meant that the open positions at the end of the day had to result in delivery but on the Exchange, such delivery was by delivery of requisite documents/ Delivery Allocation Letter, and not by actual physical delivery of commodities. The buyer could either take physical delivery or sell the goods and deliver the said documents and pay in but in either case, the exemption condition did not mean that the delivery had to be on the same day;

d) The third condition which stipulated that the "*the National Spot Exchange Ltd. shall organize spot trading subject to regulation by the authorities regulating spot trade in the areas where such trading takes place*", only put a compliance requirement on NSEL and the *Noticee* understands that NSEL must have complied with the same;

e) The fourth condition pertaining to providing all information/ return relating to trade to the Central Government/ Designated Agency, only pertained to NSEL and not to brokers. Further, it is an admitted positon that fortnightly reports were being filed by NSEL with FMC;

f) The fifth condition which allowed the Central Government to impose additional condition and no condition was imposed that the settlement period of all contracts had to be less than 11 days and that trading in paired contracts would not be permitted;

g) While withdrawing the exemption notification under the sixth condition of the exemption notification, the government did not allege that there was any violation of any of the exemption conditions. Further, since the trading was in knowledge of FMC/ DCA and they permitted the same to go on without any objection, the same amounts to waiver of breach. In fact, the same also amounted to estoppel as to the correct interpretation of the 2007 Exemption Notification;

h) The fulfilment of the conditions of the 2007 Exemption Notification was the duty/ obligation of NSEL and not of the brokers/ clients and it was the responsibility of NSEL, FMC, DCA to ensure that the contracts launched on NSEL were in compliance with the conditions of the 2007 Exempting Notification;

lviii. It was NSEL which introduced the paired contracts and not the broker members of NSEL and the said contracts were being traded openly for more than 3 years without any objection or demur by any authority before the *Noticee* commenced the trading on the NSEL;

lix. As per bye-law 5.26 of NSEL Bye-Laws, the relevant authority of the exchange had the authority to withdraw the exchange as a legal counterparty if the transactions were financial transactions and since vide letter dated August 16, 2013, the FMC had directed NSEL to settle all trades and hence at that time such trades were not considered as financing transactions;

lx. The Hon'ble SAT in its order has stated that the decisions in the ***Jermyn Capital LLC*** and ***Mukesh Babu Securities***[7] cannot be treated as a precedent in the present set of facts as they have their own distinguishable facts;

lxi. The *Noticee* was not a party to the FMC order dated December 17, 2013 and the said order makes no reference to the *Noticee* or the trades executed by the *Noticee* and is therefore irrelevant qua the issue as to whether the *Noticee* is a '*fit and proper*' person or not. Further, the said order is pending by way of writ petitions before the Hon'ble Bombay High Court and therefore the same cannot be said to have attained finality and cannot be held to be binding on the *Noticee*;

lxii. As regards the reliance of the DA on the decision of the Hon'ble Bombay High Court in the matter of ***Jignesh Shah Vs The State of Maharashtra***[8], the Hon'ble Tribunal in the order dated June 9, 2022 has clarified that the said order depends on certain clarifications. The observations made in the said order of the Hon'ble Bombay High Court cannot be utilized to judge the reputation, integrity or character of the applicant;

[7] MANU/SB/0030/2007, Also available at- https://indiankanoon.org/doc/129504/
[8] Criminal Bail Application No.1263 Of 2014, Also available at -http://www.nationalspotexchange.com/HC-order.pdf

lxiii. The reliance on the decision dated April 30, 2019 passed by the Hon'ble Supreme Court to label the alleged '*paired contracts*' as financing transactions by the designated authority is not sustainable in view of the following:

(a) All contracts were launched after taking prior concurrence of FMC in terms of the Bye-Laws of NSEL which has not yet been disputed by anyone;

(b) There was no 'pre-determination' of price between the *Noticee* and the counter-party brokers and the prices were prevailing market prices;

(c) Similar paired trading, commonly referred to as the 'calendar spreads' are openly and regularly traded in equity and commodities derivatives markets and treated as legal by SEBI. Thus, features of trading on NSEL in the alleged '*paired contracts*' with commodities as underlying was not considered to be a financing business by the *Noticee*;

(d) Additional costs such as VAT, Sales Tax, Octroi, APMC Cess, Warehouse Charges etc., were being paid to the State Governments/ other authorities and therefore at the relevant time the transactions seemed to be genuine to the *Noticee* and not mere financing transactions;

(e) At the time, there was no law, rule, regulation which prohibited execution of trades in NSEL even if the same amounted to a financing business;

(f) NSEL was regularly submitting detailed reports to FMC in respect of all trades carried out and therefore, FMC was fully aware about the nature of the alleged '*paired contracts*' and yet it never held them to be financial transactions;

lxiv. As regard the reliance placed by the DA on the Ministry of Finance, Department of Economic Affairs letter dated December 30, 2014, following is submitted:

(a) In the said letter, there is a reference to an earlier letter dated June 19, 2014 which is supposed to be an enclosure to the letter dated December 30, 2014 but the same has not been provided to the *Noticee*;

(b) The said letter was issued one year after the FMC Order date December 17, 2013 and one and half year after NSEL had defaulted and the fraud perpetrated by NSEL had become public knowledge;

(c) It is observed from the letter that alleged violation of 2007 Exemption Notification were still being examined and it was through this letter that DEA concurred that NSEL had violated the first two conditions;

(d) The said letter advised FMC to initiate appropriate action against NSEL and does not make any allegations or suggest any action against the *Noticee*;

(e) Since SEBI has merged with FMC, SEBI is obliged to follow the instructions in the said DEA letter and only take action against NSEL;

lxv. As regard the reliance on the EoW letter dated April 4, 2015 by the DA, the following is submitted:

(a) The said EoW report has not been provided to the *Noticee* and therefore the *Noticee* is not in a position to comment on the same;

(b) On perusal of orders passed by SEBI in case of brokers, the *Noticee* understands that pursuant to the receipt of the said report, auditors were appointed by SEBI to carry out inspection/ performance audit of the brokers but no such action was taken in respect of the *Noticee* and thus it is understood that the said EoW report does not include the name of the *Noticee*;

lxvi. The words used in Scheduled II of the Intermediaries Regulations '*the Board may*' which has the effect of leaving decision on the '*fit and proper*' person to the discretion of the Competent Authority;

lxvii. SEBI has initiated proceedings against non-defaulting brokers, including the *Noticee*, which is bad in law for following reasons:

a) On November 20, 2015, the Ministry of Finance directed SEBI not to exercise any 'regulatory function' in respect of NSEL;

b) On February 11, 2016, the review meeting of special teams of secretaries which was set up by GoI to examine the violation of NSEL decided that SEBI should take action against the defaulting brokers;

c) On April 29, 2016, the Hon'ble Finance Minister informed Lok Sabha that directions had been given to SEBI to examine and take action against defaulting brokers;

lxviii. As regards the *Noticee's* 'close association' with NSEL, the following is submitted:

a) It is absurd to gold that merely acting as broker amounts to acting as a 'facilitator of trades' as no clients were permitted to executed trades directly on the NSEL and had to do so through a registered broker;

b) The trading in NSEL was open and transparent and there was nothing surreptitious about it and no authority had ever questioned the legitimacy or validity of any contracts/ trades;

c) The entire ecosystem of NSEL was similar to all other Exchanges and there were no 'red flags' to arouse any suspicion;

d) Till the time the *Noticee* continued to act as a broker of NSEL, the reputation of NSEL had not been tarnished;

e) The *Noticee* was not on any committee or Advisory Board of NSEL and there was no relationship between NSEL and the *Noticee* apart from member and exchange;

f) MCX and NSEL had common directors and common shareholding and thus the two were closely associated but no proceedings have been initiated against MCX;

lxix. The principal of proportionality has totally been ignored in the *Noticee* case as even in co-location matter, large brokers have been imposed penalty in the range of Rs. 2 lakhs to Rs. 10 lakhs. Further, the punishment imposed by SEBI in similar cases has ranged from just a warning or token punishment for a day to the imposition of a fine;

lxx. The punishment of being declared as unfit is the ultimate punishment that can be imposed on an intermediary and therefore the said weapon in SEBI's arsenal must be used sparingly;

lxxi. The criteria for deciding '*fit and proper person*' under Schedule II of the Intermediaries Regulations stipulated the '*absence of convictions and restraint orders*' despite the fact that there are no convictions/ restraint orders against the *Noticee*, the Enquiry Report/ SCN purports that the *Noticee* is not a '*fit and proper person*';

lxxii. While SEBI has wide discretion in deciding the '*fit and proper*' status of an entity, the said discretion must be exercised in accordance with the settled principles of law and the SCN/ enquiry report does not comply with the same;

lxxiii. Even the FMC in its order dated December 17, 2013 had mentioned that market participants like *Noticee* were not aware about the fraud undertaken by the NSEL;

lxxiv. The parameters to determine fit and proper status are ex facie untenable and unsustainable as the same insinuate that a party can be deprived of the right to

trade merely on the specious grounds that in the subjective opinion of SEBI such party was 'associated' with another party which did not have a good reputation;

lxxv. The reputation of NSEL got tarnished only after the settlement default on July 31, 2013. Further, it is unfair on the part of SEBI to hold that the *Noticee's* reputation/ integrity/ honesty has been tarnished;

lxxvi. The *Noticee* states and declares that the *Noticee* had no 'association with NSEL' and it is absurd to hold that merely acting as a broker of NSE amounted to 'facilitation' and that the same automatically amounted to *Noticee's* reputation being tarnished;

lxxvii. In terms of regulation 5(e) of the Brokers Regulations, the '*fit and proper person*' criteria is looked into at the time of granting of certificate of registration and the *Noticee* was duly compliant with the criteria at the time of grant of certificate of registration;

lxxviii. The *Noticee* has executed the contracts with utmost integrity and adhered to soundness, moral principles and character in terms of Clause A(1) of the Code of Conduct under the Brokers Regulations;

lxxix. Clause A(2) of the Code of Conduct of Brokers Regulations mandates a stock broker to act with due skill, care and diligence and the *Noticee* has duly exercised such due skill, care and diligence as a man of ordinary prudence is expected to do.

lxxx. In the ordinary course of business, Exchanges launch various products/ contracts and the duty to investigate and assess the legality of the said products cannot be upon the brokers;

lxxxi. Although FMC was the regulator of NSEL at the time, it never cautioned NSEL, brokers or the investors/ public that NSEL was in violation of the exemption conditions. Further, no authority, regulator or government cautioned the brokers/ clients/ public that the alleged '*paired contracts*' were in violation of the exemption notification;

lxxxii. NCDEX Spot Exchange was also given a similar exemption but it also offered contracts with settlement periods exceeding 11 days and no action has been taken against NCDEX;

lxxxiii. As regards the FIR filed by SEBI, it is submitted that:

a) The *Noticee* has furnished all information and documents as required by EoW and thus the *Noticee* has complied with the requirements of EoW during the course of investigation;

b) The said FIR was registered with the MIDC Police Station, Mumbai on September 28, 2018, i.e., prior to the amendment in the Intermediaries Regulations on November 17, 2021;

c) The FIR is first instance of reporting of complaint lodged with the police which is a preliminary document based on one-sided statements without any adjudication and there is no final determination;

d) The main plank of the said FIR is that the *Noticee* has traded in the alleged paired contracts like other 300 brokers, against whom the FIR has been filed and it is illogical to contend that anyone who dealt in the alleged paired contracts as a member of NSEL would be declared as not '*fit and proper*' person;

e) The complaint filed by SEBI pursuant to Section 29A(2)(e) was filed few days before the expiry of 3 years period specified therein, implying that the alleged violations are not serious in nature or else SEBI would have taken the action promptly;

f) SEBI cannot rely on its own complaint dated September 24, 2018 pursuant to which the FIR dated September 28, 2018 has been filed as the observations/ allegations in the FIR has been made by SEBI and thus SEBI would be judging the very same allegation;

g) The FIR filed by SEBI does not prove the commission of the offence by the *Noticee*. Further, no charge sheet has been filed on the said FIR and thus the allegation in the said FIR may not survive against the *Noticee* but if in the meantime, the *Noticee* is declared as not '*fit and proper*' person, it would irreparable damage to the business and reputation of the *Noticee*;

h) The *Noticee* craves to place reliance on the order dated march 24, 2023 of the Hon'ble SAT in the matter of ***B.N. Rathi Comtrade Vs. SEBI***[9] wherein the Hon'ble SAT, in a similar NSEL matter, has granted a stay on the ground that

[9] Appeal No. 282 of 2023 Decided on March 24, 2023, Also available at- https://sat.gov.in/english/pdf/E2023_JO2023282_6.PDF

the noticee therein was already granted a certificate of registration and the show cause notice was issued on September 25, 2018 for the trades of 2011;

i) The *Noticee* places reliance 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;

j) The law is settled that an innocent person can become guilty only after detailed analysis of following factors:

   a) The circumstances from which the conclusion of guilt is to be drawn should be fully established;

   b) The facts established should be consistent with the hypothesis of guilt of the accused;

   c) The circumstances should be conclusive in nature and tendency should be to exclude every possible hypothesis except the one to be proved;

   d) Chains of evidence should be so complete as to not leave any reasonable ground for the conclusion consistent with the innocence of the accuse;

   e) The *Noticee* places reliance on the decision of the Hon'ble Supreme Court in the matter of *Pradeep Kumar Vs, State of Chattisgarh (Criminal Appeal No. 1304 of 2018)* to support the submission made hereinabove.

CONSIDERATION OF ISSUE AND FINDINGS

12. I have carefully perused the SCN including the Enquiry Report issued to the *Noticee,* the replies dated October 30, 2018, April 2, 2019, July 30, 2019, October 23, 2019, October 22, 2022, November 9, 2022, November 30, 2022, December 7, 2022 and April 3, 2023, the oral submissions made by the made by the *Noticee* during the personal hearing held on December 8, 2022 and other materials/information as available in the public domain and also made available to the *Noticee* vide SSCN dated October 11, 2022. After considering the allegations made/charges levelled against the *Noticee* in the instant matter as spelt out in the SCN/SSCN, the 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.

13. At this juncture, it is relevant to deal with the contention of the *Noticee* that the power to appoint a Designated Authority (DA) has been vested in the Executive Director while in the instant case the DA has been appointed by the Whole Time Member of SEBI thereby raising a concern about the irregularity in the appointment of DA. In this regard, I note that Section 3(2) of the Securities and Exchange Board of India (Delegation of Powers) Order, 2015 (hereinafter referred to as the **"DoP Order"**) 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, rank and position to the Executive Director of SEBI, is devoid of any 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 Securities Laws. 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 Securities Laws. 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.

14. I also note from the submissions of the *Noticee* that the DA has not provided the *Noticee* with an opportunity of hearing which is allegedly in violation of regulation 25(6) of the Intermediaries Regulations. In this regard, it is noted that while the said regulation 25(6) was introduced in the Intermediaries Regulations with effect from January 21, 2021, the recommendation was made by the DA on April 26, 2019 when the requirement of personal hearing was not mandated by the statute. Thus, I see no merit in the submission of the *Noticee*.

15. Before I proceed to examine the charges vis-à-vis the evidences available on record, it would be appropriate at this stage to refer to the relevant provisions of the laws, 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:

THE SEBI ACT, 1992

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

12.(3) The Board may, by order, suspend or cancel a certificate of registration in such manner as may be determined by regulations:
Provided that no order under this sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard.

THE STOCK BROKERS REGULATIONS, 1992

Consideration of application for grant of registration.

5. The Board shall take into account for considering the grant of a certificate, all matters relating to trading, settling or dealing in securities and in particular the following, namely, whether the applicant,
(e) is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

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

SCHEDULE II

Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992
CODE OF CONDUCT FOR STOCK BROKERS [Regulation 9]
A. General.

(1) Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.
(2) Exercise of due skill and care: A stock-broker shall act with due skill, care and diligence in the conduct of all his business.
(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.

Liability for action under the Enquiry Proceeding Regulations.

27. A stock broker shall be liable for any action as specified in Chapter V of the Securities and Exchange Board of India (Intermediaries)Regulations, 2008 including suspension or cancellation of his certificate of registration as a stock broker, if he —
(iv) has been found to be not a fit and proper person by the Board under these or any other regulations;

THE INTERMEDIARIES REGULATIONS, 2008

SCHEDULE II

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

[See regulation 7]

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

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

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

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

(a) the applicant or the intermediary;

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

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

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

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

(3) For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but not limited to the following:

(a) integrity, honesty, ethical behaviour, reputation, fairness and character of the person;

(b) the person not incurring any of the following disqualifications:

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

(ii) charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences and is pending;

(iii) an order of restraint, prohibition or debarment has been passed against such person by the Board or any other regulatory authority or enforcement agency in any matter concerning securities laws or financial markets and such order is in force;

(iv) recovery proceeding s 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.

16. Admittedly, prior to the merger of FMC with SEBI (w.e.f. September 28, 2015), the *Noticee* was not required to be registered under the FCRA or any other regulation to be a commodity derivatives broker. However, after the merger of FMC with SEBI, a commodity derivatives broker is required to mandatorily have a certification of registration from SEBI in case it is desirous to remain associated with the Securities Market as a commodity derivatives broker. It is seen that the Finance Act, 2015 (as notified on May 14, 2015) conferred the power of regulation over intermediaries dealing in commodity derivatives to SEBI and also mandated regulation of commodity derivatives brokers by SEBI, which included their registration as commodity derivatives broker with SEBI. In this regard, vide Section 131B of the Finance Act, 2015, a transitory period of 3 months was provided to all the intermediaries which were associated with commodity derivatives market under the erstwhile FCRA, 1952 but did not require a registration certificate earlier, to continue to deal in commodity derivatives as a commodity derivatives broker, provided it made an application of registration to the SEBI within 3 months from

September 28, 2015. Accordingly, the *Noticee* submitted an application to be registered as a Stock Broker and was subsequently registered as a broker *w.e.f.* April 4, 2016 and since then it has been acting as a market intermediary registered with the SEBI.

Scope of the present proceedings vis-à-vis orders passed by the Hon'ble SAT on June 09, 2022 and July 20, 2022

17. As noted above, taking cognizance of the orders passed by the Hon'ble SAT on June 09, 2022 (hereinafter referred to as "**SAT Order**") and July 20, 2022, in NSEL matters, a SSCN dated October 11, 2022, *inter alia*, enclosing a copy of the SAT Order 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 April 26, 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 Economic Offence Wing ('**EOW**');
    b. First Information Report ('**FIR**') dated September 28, 2018; and
    c. Amended Schedule II of the Intermediaries Regulations.

18. In this regard, I find it apposite to encapsulate and list the grounds on which the SEBI orders were set aside by the Hon'ble SAT which consequently led to issuance of the aforesaid SSCN to the *Noticee* in the present matter:

    a. The observations of the Hon'ble Bombay High Court in the matter of ***63 Moons vs. Union of India***[10] cannot be relied upon as the said judgement has been set aside in appeal[11] by the Hon'ble Supreme Court vide judgment dated April 30, 2019.
    b. The 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 (for short "**MPID Act**") (***NSEL vs. State of Maharashtra***[12]) cannot be relied upon, as in a subsequent Writ Petition[13] moved by 63 Moons, a Division Bench of the Hon'ble Bombay High Court has allowed the prayer and held that NSEL is not a financial establishment and

[10] Writ Petition No. 2743 of 2014, Also available at - https://indiankanoon.org/doc/66704740/
[11] (2019) 18 SCC 401, Also available at - https://indiankanoon.org/doc/169098295/
[12] Writ Petition No. 1403 of 2015, Also available at - https://bombayhighcourt.nic.in/generatenewauth.php?bhcpar=cGF0aD0uL3dyaXRlcmVhZGRhdGEvZGF0YS9qdWRnZW1lbnRzLzIwMTUvJmZuYW1lPUNSV1AxNDAzMTUucGRmJnNtZmxhZz1OJnJqdWRkYXRlPSZ1cGxvYWRkdD0wMS8xMC8yMDE1JnNwYXNzcGhyYXNlPTA5MDIyMzEyMzU0Ng==
[13] MANU/MH/2309/2019, Also available at - https://indiankanoon.org/doc/178307788/

therefore the provisions of the MPID Act are not applicable. The Division Bench also observed that the *prima facie* observations made by the single bench while dismissing NSEL petition could not be relied upon as they were preliminary observations and such observations do not foreclose the issue about the applicability of the provisions of the MPID Act. The Hon'ble Tribunal, I note, was of the opinion that *prima facie* observations cannot be utilized to judge the reputation, character or integrity of NSEL.

c. The 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***[14], cannot also be relied upon as the observations made in a bail order were limited to the fact as to whether the bail should be granted or not.

d. Reliance on the SFIO Report, the Tribunal has held, was misplaced. The report only directs EOW/Police to initiate appropriate proceedings against NSEL and its directors/promoters. Based on the SFIO Report, the Special Sessions Judge took cognizance of the matter by an Order dated July 29, 2019. But this Order was challenged by NSEL and two other accused and has since been stayed by the Hon'ble Bombay High Court. Also, no complaint yet has been filed against the Appellants pursuant to the SFIO Report.

e. Effect of SFIO Report under the Code of Criminal Procedure, 1973, as to whether such report could be treated as evidence, was not considered by SEBI.

f. Reliance placed on decisions of the Hon'ble Tribunal in the matter of ***Jermyn Capital vs. SEBI***[15] and ***Mukesh Babu Securities vs. SEBI***[16] 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 distinguished by the Hon'ble Tribunal on the basis that in the matter a criminal complaint was filed against the Chairman of the Company. The Hon'ble Tribunal noted that there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.

[14] Criminal Bail Application No.1263 Of 2014, Also available at -http://www.nationalspotexchange.com/HC-order.pdf
[15] Appeal No. 26 of 2006, decided on September 06, 2006, Also available at - https://indiankanoon.org/doc/1511076/
[16] Appeal No. 53 of 2007, decided on December 10, 2007, Also available at- https://indiankanoon.org/doc/129504/

g. Reputation of the applicant cannot be lightly considered based on observations which are not directly related to the applicant.
h. Grant Thornton Forensic report commissioned by SEBI does not find any close connection between applicant and NSEL. This was overlooked by SEBI.
i. 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.

19. It is also noted from the SAT Order that the matter was remanded back to SEBI, taking into consideration the contention made by the counsel appearing on behalf of SEBI that there was additional material available, which had come into existence after the SEBI orders, based on which the findings in the said order could be sustained. The Hon'ble Tribunal, taking into consideration the submissions made on behalf of SEBI, held that:

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

20. I deem it appropriate to deal with the submission made by the *Noticee*, vide its reply dated July 30, 2019 before the then Competent Authority, that it has not been provided with the relevant material by the DA. In this regard, I note that the material relied upon by the DA is not under consideration and is not being relied upon. Pursuant to the orders of the Hon'ble SAT dated July 20, 2022 and June 9, 2022, the relevant material, as relied upon in the present proceedings has been duly provided to the *Noticee* vide SSCN dated October 11, 2022. Thus, the contention of the *Noticee* as regard non-supply of documents by the DA is infructuous and rejected.

21. Before moving forward to consider the matter on merits and test the compliance of the *Noticee* with the *'fit and proper person'* criteria, on the basis of the additional material that has been brought on record post the SEBI order (as detailed at paragraph 17 above), the background facts necessary for the present proceedings are narrated in brief, hereunder:

i. The *Noticee,* Pragya Commodity Brokers Private Limited, is a commodity derivatives broker registered with SEBI having Registration No. INZ000030635 with effect from

April 4, 2016 and is currently a member of the Multi Commodity Exchange of India Limited (hereinafter referred to as "**MCX**").

ii. NSEL was incorporated in May 2005 as a Spot Exchange *inter alia* with a purpose of developing an electronic Spot Exchange for trading in commodities. In exercise of powers conferred under Section 27 of the FCRA, the Central Government vide its 2007 Exemption Notification, granted an exemption to all forward contracts of one-day duration for the sale and purchase of commodities traded on 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*".

iii. 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 had 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 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.

iv. On February 06, 2012, the erstwhile Forward Markets Commission (hereinafter referred to as "**FMC**") was appointed by the Department of Consumer Affairs, Government of India as the 'designated agency' as stipulated in one of the conditions prescribed under the said 2007 Exemption Notification, authorizing it to collect the trade data from NSEL and to examine the same for taking appropriate measure, if needed, to protect investors' interest. The FMC had accordingly called for the trade data from different Spot Exchanges, including NSEL in the prescribed reporting formats. After analyzing the trade data received from 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 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 on NSEL platform were in violation of the provisions of

the FCRA and also in violations of the conditions specified by the Government of India in its 2007 Exemption Notification, while granting exemptions to the one day forwards contract for sale and purchase of commodities traded on NSEL, from the purview of the FCRA.

22. From the perusal of the FMC Order in respect of the '*paired contracts*', which were traded on NSEL platform during the relevant period, I note that the FMC had *inter alia*, observed that the following conditions stipulated in the 2007 Exemption Notification were violated:

a. <u>Short Sale</u>

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 NSEL and its trading/clearing members who traded in the '*paired contracts'* during the relevant period.

b. <u>Contracts with Settlement Period going beyond 11 days</u>

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 NSEL, which provided settlement schedule for a period exceeding 11 days were not allowed and were in violation of 2007 Exemption Notification.

23. Thus, I note that NSEL was granted conditional exemption from the provisions of the FCRA by the Department of Consumer Affairs, Ministry of Consumer Affairs (for short "**MCA**"), Food and Public Distribution, Government of India, vide Gazette Notification No. S0906(E) dated June 05, 2007, in exercise of the powers conferred under Section 27 of the FCRA, for (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.

24. In this regard, the relevant observations of the FMC as recorded in its Order dated December 17, 2013 and also captured in the SCN are reproduced as under:

> *"….a large number of NSEL exchange trades were carried out with paired back-to-back contracts. Investors simultaneously entered into a "short term buy contract" (e.g. T+2, i.e. 2 day settlement) and a "long term sell contract" (e.g. T + 25 i.e. 25day settlement). The contracts were taken by the same parties at a pre-determined price and always registering a profit on the long-term positions. Thus, there existed a financing business where a fixed rate of return was guaranteed on investing in certain products on the NSEL....."*
>
> *NSEL conducted its business not in accordance with the conditions stipulated in the notification dated 05.06.2007 granting it exemption from the operation of FCRA, 1952, with regard to the one-day forward contracts to be traded on its exchange platform. As noted in the SCN, the condition of 'no short-sell' and 'compulsory delivery of outstanding position at the end of the day' stipulated in the notification were violated by NSEL. NSEL Board allowed launching of paired back-to-back contracts on its exchange platform comprising a short-term buy contract (T+2 settlement) and a long-term sell contract (T+25 settlement) with predetermined price and profit for the buyer and seller, which violated the very concept of spot market of commodities and the transactions ultimately were in the nature of financial transactions" (emphasis supplied)*

25. It is therefore, clear 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 Order that FMC had observed 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 provisions of FCRA. I further note from the FMC Order that under the FCRA, a "*forward contract*" is defined as a "*contract for delivery of goods and which is not a ready delivery contract*". A '*ready delivery contract*' is defined as "*a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days*". Given the said definition contained in FCRA, FMC, I note, was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as *Non-Transferable Specific Delivery contracts*. It is therefore, noted that even though MCA had 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 only trade in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. Therefore, even going by the interpretation adopted by FMC, what is beyond doubt is that NSEL had permitted 55 contracts of various commodities having duration longer

than 11 days and these contracts were *ex facie* in contravention of the exemption granted to NSEL.

26. At this stage, it is also pertinent to refer to the judgment of the Hon'ble Supreme Court of India passed in the matter of ***63 Moons Technologies Ltd. (formerly known as Financial Technologies India Ltd.) & Ors. v. Union of India & Others***[17] *(Civil Appeal No. 4476 of 2019 decided on April 30, 2019)*, wherein it *inter alia* held that:

> *"There is no doubt that such Paired Contracts were, in fact, financing transactions which were distinct from sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL, and the FCRA".*

27. It is further pertinent to refer to the judgement dated April 22, 2022 passed by the Hon'ble Supreme Court in the matter of ***The State of Maharashtra vs. 63 Moons Technologies Ltd.***[18] (hereinafter referred to as "**MPID matter**"), wherein the Hon'ble Supreme Court while drawing reference to the presentations made by NSEL in respect of the '*paired contracts*' has *inter alia* held that:

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

28. I, therefore, note that the Hon'ble Supreme Court has already commented on the nature of the '*paired contracts*' offered on 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***

[17] (2019)18 SCC 401. Also available at https://indiankanoon.org/doc/169098295/
[18] Civil Appeal No. 2748-49 of 2022. Also available at https://indiankanoon.org/doc/184205229/

Technologies Ltd.), the Hon'ble Supreme Court has held that such transactions come within the definition of '*deposits*' under the MPID Act.

29. It is further noted that the Hon'ble Supreme Court in the MPID matter, had extensively referred to the claims made on the website of NSEL and the contents of the publicity material and other investor resources. In this regard, it can be noted that NSEL was advertising a uniform return of 16% p.a. for the '*paired contracts*' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, a T+2 & T+25 paired contract in steel had the same offered return as a T+ 2 & T + 35 paired contract in castor oil. The *'paired contracts'*, it is noted, were being marketed as an alternative to fixed deposits.

30. I note that the FMC Order and both judgments of the Hon'ble Supreme Court go into abundant detail regarding NSEL permitting short sales, i.e., permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite amount of commodity is available in the warehouse. It is further noted from the judgement of the Hon'ble Supreme Court in the MPID matter that the overwhelming majority of the sale leg of the '*paired contracts*' which were executed were short sales – and naked short sales at that - the commodities to back such sales were not available at the designated warehouses of NSEL.

31. Considering the deliberations and discussions recorded above, it essentially leads to the moot question as to whether the *Noticee* while facilitating such transactions for its clients was under the *bonafide* belief that the *'paired contracts'* 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 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.

32. 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, especially those summarized at paragraphs 25, 26 and 27, 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 a trappings of a financial product which offered fixed and assured returns, as the Hon'ble Supreme Court has already held.

33. As recorded in the SSCN, it is not in dispute that SEBI has filed a complaint dated September 24, 2018, against brokers who facilitated access to *'paired contracts'* traded on NSEL, including the *Noticee*, with EOW, Mumbai. On the basis of this complaint, subsequently, an FIR dated September 28, 2018 came to be registered with the MIDC Police Station, Mumbai, against the *Noticee*, which is validly subsisting and has not been challenged, quashed or stayed by any competent court qua the *Noticee*.

34. In the background of the aforesaid discussion pertaining to *'paired contract'* as captured in the preceding paragraphs, I now move on to examine whether the *Noticee* satisfies the *'fit and proper person'* criteria as laid down under Schedule II of the Intermediaries Regulations.

35. In this context, as per replies of the *Noticee*, I note that it is an admitted position that the *Noticee* has indulged in trading of '*paired contracts*' on behalf of its clients. The *Noticee* in its reply dated November 30, 2022 has admitted that "*The transactions were entered on the instructions of the respective clients and we had no role to play except executing the transactions as per instructions of clients*" and "*At the relevant time, we had around 920 Clients dealing in the commodity markets on regular basis. Out of those, 50 Clients were registered on NSEL and only 9 clients had traded in the alleged Paired Contracts*". The *Noticee* has further submitted that "*We had traded only on 21 days during the period from February 2013 to May 2013 which comprised of 73 trades involving total funds of Rs 197.46 lakhs and earned a meagre brokerage of Rs. 11, 073/-*". Thus, as per the admissions of the *Noticee* in its reply, it is clear that the *Noticee* has indulged into trading in 'paired contracts' on behalf of its clients.

36. Having established that the *Noticee* has traded in '*paired contracts*' on behalf of its clients, I now proceed to examine the allegations levelled against the *Noticee* in the SCN and the SSCN. It is noted that the main allegation against the *Noticee,* as levelled in the SCN, is that by participating/facilitating in the trading in *'paired contracts'* on NSEL platform during the relevant period as a Trading Member/Clearing Member, the *Noticee* has, *prima facie*, violated the conditions stipulated in the 2007 Exemption Notification and consequently also the provisions of the FCRA. Therefore, it was alleged in the SCN that 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 strength of certain documents/material (such as SEBI Complaint dated September 24, 2018 and FIR dated September 28, 2018 etc.) as provided to the *Noticee* vide SSCN dated October 11, 2022, further alleged that in light of the aforesaid documents filed against the *Noticee* by SEBI as well as observations/ findings against the *Noticee* in the Enquiry Report dated April 26, 2019, the *Noticee* is no longer 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.

37. 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.

38. In this context, as noted above, I note that the *Noticee* is holding a Certificate of Registration No. INZ000030635 granted by SEBI on April 4, 2016. 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* include, continuance of its status as a '*fit and proper person'*. The above condition to be a 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.

39. Therefore, 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 the powers to examine the '*fit and proper*' status of such entity based on various parameters. Therefore, even if the *Noticee* was found to have fulfilled the '*fit and proper person*' criteria while granting the Certificate of Registration, in 2016, it can still be assessed on being *fit and proper* at a later date. Furthermore, as and when the '*fit and proper'* criteria changes, the *Noticee* will be required to comply with the revised criteria, and in this instance criteria as revised vide the amendments in November 2021. 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, *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;*

40. As already recorded in SSCN and captured above, an FIR has been registered with the MIDC Police Station, Mumbai, against the *Noticee* under section 154 of the Code of Criminal Procedure, 1973 ('CrPC') on September 28, 2018 and the same is pending as on date and is validly subsisting and has not been challenged, quashed or stayed by any competent court qua the *Noticee*. It is, therefore, noted that the disqualification provided in clause 3(b) (i) under the amended Schedule II of the Intermediaries Regulations is also triggered vis-à-vis the *Noticee*.

41. In this regard, it is noted that the *Noticee* has admittedly traded in *'paired contracts'* on behalf of its clients as well as from its proprietary account. I note that 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 2007 Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities. Therefore, the *Noticee* by its conduct and as a member of NSEL has acted as an instrument of NSEL in promoting and/or dealing in *'paired contracts'* which were in the nature of financing transaction (as held by the Hon'ble Supreme Court of India to be so as noted above). 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 also undertaking such exposure itself on account of its proprietary trades thereby raises serious 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 NSEL platform have serious ingredients amounting jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the *Noticee* in the Securities Market.

42. Therefore, looking holistically I find that the said conduct of the *Noticee* is detrimental to the Securities Market being not in conformity with the applicable code of conduct. It may also be noted that the scope of the instant proceeding is not to analyze 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*. In my considered view, it is immaterial if the *Noticee* has no outstanding investor complaints or that the brokerage / profit earned by the *Noticee* is meagre. 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 2007 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.

43. Further, as noted above, the *Noticee* has also earned disqualification under 3(b)(i) of the amended Schedule II of the Intermediaries Regulations on account of the FIR registered against the *Noticee*. In this regard it is pertinent to note that the said FIR is validly subsisting and has not been challenged, quashed or stayed by any competent court qua the *Noticee*. In this context, as observed above, I note that being a '*fit and proper person*' is a continuing '*eligibility criteria*' which must be satisfied by the *Noticee* including the amended criteria. I am of the considered view that the due presumption on the constitutional and legal validity of the said amended Schedule II hold the field which are binding upon me, and arguments, if any, to the contrary are not maintainable.

44. At this juncture, I note that the *Noticee* has contended that SEBI could initiate prosecution proceedings against the members of the NSEL for alleged violation of FCRA and could not initiate enquiry proceedings under the Intermediaries Regulations. With respect to the same, 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 FCRA *inter alia* 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, Mumbai and the same is validly subsisting.

45. The *Noticee* has also stated that in view of Section 29(A) of FCRA, the present proceedings for violation of SEBI Act/ Regulations are not maintainable under FCRA. At this juncture, it is significant to reproduce the relevant excerpt of section 29A(2)(e) of the FCRA which is as under:

> *"(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;"*

The said provision 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, *inter alia*, filed complaint against the *Noticee* within the period as specified by the wisdom of the legislature.

46. I note that the present proceedings have been initiated to adjudge whether the *Noticee* satisfies the criteria for '*fit and proper person*' as specified in the Broker Regulations and the Intermediaries Regulations. The *Noticee* is obliged to maintain the '*fit and proper person*' criteria on a continuous basis and it is well within SEBI's jurisdiction and powers to adjudge the said fit and proper status of the market intermediaries in the interest of securities market. I therefore find no merit in the said submission of the *Noticee*.

47. I am also aware that on November 29, 2022, SEBI has passed 5 separate orders[19] in the related NSEL matters where the noticees therein have been debarred from making a fresh application seeking registration for a specified period from the date of the said order or till acquittal of the said noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier. I find that present matter at hand is different from that of those 5 cases as in the extant matter the *Noticee* is already holding a Certificate of Registration whereas in those 5 cases, the entities had filed applications seeking certificate of registration. Therefore, I am of the measured opinion that the present case stands at a different footing than that of those 5 cases where the applications for grant of certificate of registration were pending at the time of passing those orders whereas in the extant matter the *Noticee* is already having registration with SEBI. 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 of registration, and not of rejection of the application, the necessity of specifying a period of time may not arise in this order (as did arise 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

[19] 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.

will have to be assessed at such point of time if it is fit and proper as per the extant and applicable regulations. If it chooses not to, such issue becomes moot.

48. I would also like to address the objection of the *Noticee* with respect to issuance of the SSCN dated October 11, 2022 which was issued pursuant to and on the basis of the SAT Order on account of the fact that the said SAT Order, dated June 9, 2022, is not applicable to the *Noticee* as the *Noticee* was not a party before the Hon'ble SAT in those 5 appeals where the said SAT Order was passed. However, I find that the said objection, is totally misplaced as the essence of the said SAT Order is that it advises SEBI to provide the documents which it intends to use/rely in the present proceedings so that the entity would have an opportunity to prepare its defense pertaining to these documents and which is also in adherence to the principles of natural justice. Further, I also deem it important to place reliance on the SAT Order dated July 20, 2022 wherein the Hon'ble SAT has, *inter alia*, observed as under:

> "… *The appeals of the brokers are allowed. The matters are remitted to the WTM to decide the matter afresh in the light of the observations made in our order dated June 9, 2022 in accordance with law after giving an opportunity of hearing to the brokers*"

On the basis of the above observations of the Hon'ble SAT, I am of the view that the legality of the SSCN issued to the *Noticee* cannot be questioned. Further, the purpose behind issuance of such SSCN was to provide due opportunity to evaluate the materials and to be heard to the *Noticee* and thereby adhere to the principles of natural justice. In any case, as recorded above, the Hon'ble SAT had already granted permission to SEBI to issue SSCN which was complied with by SEBI in this regard.

49. The *Noticee* has also submitted that a FIR or a Criminal Complaint under Section 154 of the CrPC is only the starting point of an investigation and a skeleton and cannot be construed as the accused being guilty as it is a settled position of law that a person is innocent until proven guilty beyond reasonable doubt as held in by the Hon'ble Supreme Court in the matter of ***Pradeep Kumar Vs. State of Chhattisgarh***. To such a protest, I am of the considered view that there is no assertion of guilt made in the SCNs as the present proceedings pertains to test the continuing *'eligibility criteria'* of *'fit and proper criteria'* of the *Noticee*. Besides, no material has been brought on record by the *Noticee* to dispute the fact that the said FIR validly subsists as on date. Accordingly, the relied upon case laws cited to support the said submissions also do not come to the rescue of the *Noticee*.

50. In view of the above observations and admission of the *Noticee* having traded in these *'paired contracts'* on NSEL, I have no hesitation in holding that the *Noticee* has

participated/facilitated in the trading in *'paired contracts'* on NSEL platform during the relevant period as a Trading Member/Clearing Member and has violated the conditions of the 2007 Exemption Notification. Further, as noted above, the *Noticee* has also attracted disqualifications under point 3(b)(i) of Schedule II and the act of *Noticee* in offering access to *'paired contracts'*, as detailed above, also seriously calls into question the integrity, honesty and lack of ethical behavior on its part. These contracts, as stated earlier, were *ex facie* offered in violation of the 2007 Exemption Notification issued by MCA and far removed from the spot contracts in commodities which were permitted to be traded on NSEL. Here it is pertinent to note that the principle of '*ignorantia juris non excusat*' or '*ignorantia legis neminem excusat*' or '*ignorance of law is no excuse*' also becomes applicable in the situation since trading in '*paired contracts*' was in violation of the 2007 Exemption Notification and ignorance of the conditions of the said Exemption Notification cannot be claimed. The *'paired contracts'* were nothing but financing transactions which were portrayed as spot contracts in commodities. Therefore, giving go-by to the terms of the 2007 Exemption Notification and attempting to camouflage the nature of the transactions brings into question, the appropriateness and suitability of the continuance of the registration of the *Noticee,* as a broker. Equally, any argument deflecting the responsibility to NSEL, MCA or FMC 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 and could be 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 Stock Brokers Regulations read with the provisions of Schedule II of the Intermediaries Regulations.

51. In the context of Securities Market, I note that the role of a registered intermediary including a broker is not only sensitive and predominantly fiduciary in nature but also demands from it honesty, transparency, fairness and integrity which are essentially the hallmarks of such market intermediaries. Given the fact that one of the avowed objects of the SEBI Act is the protection of interest of investors apart from promotion and development of the Securities Market, the legislature through enactment, empowers SEBI to grant registration to several class of entities including brokers, which are not only required to act as an intermediary simplicitor i.e., a bridge or a connector between the markets and investors, but also have a very important role to play in creating an ecosystem of trust and fairness so as to provide a fair and secure market to the investors as 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.

52. It would not be material for the *Noticee* to submit that there is no loss caused to the investors on account of its trades since the limited scope of the present proceeding is to examine the conduct of the *Noticee* in the background of its active participation in the trading platform of NSEL in contraventions of the 2007 Exemption Notification and provisions of the FCRA and also attracting disqualification under amended Schedule II of the Intermediaries Regulations so as to decide on its continuing role in the Securities Market. From the above, it is evident that the *Noticee* was part of a scheme that was contrary to the permissible activities prescribed by the Central Government. Under the garb of *'paired contracts'* the *Noticee* had indulged in facilitating impermissible financing transactions, and such illegal activities as well as participation of the *Noticee* therein are certainly detrimental to the interest of the promotion and development of the Securities Market.

53. It is a trite law that when provisions of law prescribe certain acts to be done in a particular manner, the same is required to be honored 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.

54. It further needs appreciation that the issue under consideration is not to gauge the profit/loss incurred or likely to be incurred by an individual, but 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 INR 5,500 Crore itself casts serious aspersion on the conduct,

integrity and reputation of, *inter alia*, the *Noticee* who participated in or 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.

55. Under the circumstances, I therefore note that there were enough red flags for a reasonable or prudent person to come to the conclusion that what was being offered as *'paired contracts'* on NSEL were not spot contracts in commodities. 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 clause 3(b) (i) under the amended Schedule II of the Intermediaries Regulations insofar an FIR against the *Noticee* under section 154 of CrPC has been registered with the MIDC Police Station, Mumbai and the same is validly 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 and hence, the continuance of the *Noticee* as a broker will be detrimental to the interest of the Securities Market. Therefore, such activities of the *Noticee* as a registered broker cannot be condoned and deserve appropriate remedial measure to prevent such wrong doings from recurring to the detriment of the interest of the Securities Market.

56. Here, I deem it appropriate to deal with the submissions of the *Noticee* wherein it has relied on the decision of the Hon'ble SAT in the matter of ***Almondz Global Securities Limited Vs. SEBI***, to submit that SEBI must be absolutely certain that by not declaring the *Noticee* as not '*fit and proper*' person, irreparable harm would be caused to the securities market as the said declaration is an ultimate punishment and must be used sparingly. I am of the considered view that the said decision cautions SEBI to use the power to declare an entity as not '*fit and proper*' sparingly and only when it is certain that not doing the same would cause irreparable damage to the securities market. In the present matter, having held above that the *Noticee* has undisputedly traded in the '*paired contracts*' and has also incurred disqualification in terms of clause 3(b)(i) of the Schedule II of the Intermediaries Regulations, I am of the considered view that the present matter is a fit case for declaring the *Noticee* as not '*fit and proper*'.

57. Having examined and dealt with all the contentions raised by the *Noticee* in the preceding paragraphs, I concur with the recommendation made by the DA.

ORDER

58. In view of the foregoing discussions, in exercise of powers conferred upon me under Section 12 (3) and Section 19 of the SEBI Act, 1992 read with regulation 27 of the SEBI (Intermediaries) Regulations, 2008 and upon considering the gravity of the violations committed by the *Noticee* viz. Pragya Commodity Brokers Pvt. Ltd., Certificate of Registration (bearing No. INZ000030635) of the *Noticee* i.e., Pragya Commodity Brokers Pvt. Ltd., is hereby cancelled.

59. The *Noticee* shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 58 above.

60. Notwithstanding the direction at paragraph 58 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 within a period of next 15 days thereon, under advise to the said clients.

61. The Order shall come into force with the immediate effect.

62. It is clarified that in view of the amendment made *w.e.f.* January 21, 2021 in the Intermediaries Regulations, 2008, powers that were exercised under regulation 28 of the Intermediaries Regulations, 2008 are now being exercised under regulation 27 of the Intermediaries Regulations, 2008. It is also noted that the above Order is without prejudice to the criminal complaint filed by SEBI in NSEL matter and/or any proceedings pending before any authority in respect of similar matter concerning the *Noticee* or other relevant persons.

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

Sd/-

DATE: APRIL 28, 2023
PLACE: MUMBAI

PRAMOD RAO
EXECUTIVE DIRECTOR
SECURITIES AND EXCHANGE BOARD OF INDIA