

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

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

In respect of –

Modex Commodity Trades Private Limited

[Registration No. INZ000036038]

In the matter of National Spot Exchange Limited

BACKGROUND

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

allowed; that all outstanding positions of the trade at the end of the day shall result in delivery and that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency”.

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

NSEL had not made it mandatory for the seller to deposit goods in its warehouse before taking a sell position. Hence, the condition of “*no short sale by members of the NSEL shall be allowed*” was not being met by

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

b. Contracts with Settlement Period going beyond 11 days

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

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

ENQUIRY BY DESIGNATED AUTHORITY

8. A Designated Authority (hereinafter referred to as “**DA**”) was appointed by SEBI vide order dated September 21, 2018 to conduct an enquiry against the Noticee and submit a report and make recommendation in terms of Regulation 27 of the

Intermediaries Regulations (as applicable at the relevant time) in respect of the violations alleged to have been committed by the Noticee mentioned at para 7 above.

9. After conducting the enquiry as envisaged under Regulation 25 of the Intermediaries Regulations, the DA submitted an Enquiry Report dated December 17, 2020 (hereinafter referred to as the **“Enquiry Report”**) which, *inter alia*, observed and recommended as under:

“In view of the facts and circumstances of the case and material placed before me, I am of the view that the Noticee is not a fit and proper person in terms of Regulation 5(e) read with Regulation 27(iv) of the Stock Broker Regulations read with Schedule II of the Intermediaries Regulations. Therefore, in terms of Regulation 27 of the Intermediaries Regulations, I recommend that the registration of the Noticee i.e. Modex Commodities Trades Pvt. Ltd. [Registration No. INZ000036038] as a commodities derivatives broker may be cancelled.”

POST ENQUIRY PROCEEDINGS

Show Cause Notice, Reply and Personal Hearing

10. After considering the Enquiry Report, a post-enquiry Show Cause Notice dated January 15, 2021 (hereinafter referred to as the **“SCN”**) was issued to the Noticee under Regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) enclosing therewith (a) copy of the Enquiry Report, (b) copy of the letter dated December 30, 2014 of the Department of Economic Affairs (DEA), Ministry of Finance; and (c) a copy of the order dated August 22, 2014 passed by the Hon’ble Bombay High Court in Criminal Bail Application No. 1263 of 2014 in the case of *Jignesh Prakash Shah Vs. The State of Maharashtra*. The SCN was issued to the Noticee calling upon it, as to why action as recommended by the DA including any other action as deemed fit should not be taken against the Noticee, by the Competent Authority.
11. While the extant proceedings in the present matter were ongoing, SEBI passed five separate orders during February, 2019, rejecting the applications filed by five other entities for registration as commodity brokers who were involved in the NSEL matter.

Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "**Hon'ble SAT**"). The Hon'ble SAT, vide common order dated June 9, 2022 (hereinafter referred to as the "**SAT order**"), remanded the aforesaid orders to SEBI to decide these matters afresh within six months from the date of the said SAT order. While remanding the aforesaid SEBI orders, the Hon'ble SAT, *inter alia*, held as under:

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

12. During the pendency of the proceedings, due to administrative reasons, the competent authority of SEBI, reallocated cases and transferred the present matter to the undersigned on August 11, 2022 for further proceedings.
13. In the light of the aforesaid SAT Order and certain other orders passed by the Hon'ble SAT in similar set of cases, it was felt necessary to furnish certain additional documents/material to the Noticee before concluding the present proceedings. Accordingly, a supplementary show cause notice (hereinafter referred to as "**SSCN**") dated October 12, 2022 enclosing therewith a copy of the SEBI Complaint dated September 24, 2018 filed with EoW, Mumbai, a copy of the First Information Report (hereinafter referred to as "**FIR**") dated September 28, 2018 and a copy of the amended Schedule II of the Intermediaries Regulations was issued to the Noticee and the Noticee was granted 15 days' time to file its reply, if any from the date of receipt of the said SSCN.

14. The Noticee did not file any reply despite service of the SSCN. Further, hearing in the matter was also scheduled on December 21, 2022, however, the Noticee neither appeared nor sought any adjournment. In the interest of natural justice, one more opportunity of personal hearing was accorded to the Noticee and hearing was scheduled on January 18, 2023, yet the Noticee did not appear. One last opportunity of personal hearing was accorded to the Noticee and hearing was scheduled on February 22, 2023. Vide newspaper publication dated February 04, 2023, the hearing notice was published in Hindustan Times and Navbharat Times. However, the Noticee failed to appear and accordingly, the hearing was concluded in the matter.

CONSIDERATION OF ISSUES AND FINDINGS

15. I have carefully perused the post enquiry SCN, SSCN along with all the documents attached therewith, along with the material/ information available on record. After considering the allegations made/ charges levelled against the Noticee in the instant case, I note that the only issue that arises for consideration in the present proceedings is whether the Noticee satisfies the '*fit and proper person*' criteria as laid down under Schedule II of the Intermediaries Regulations.
16. Before considering the issue on its merits, I note that the Noticee has not filed any reply to the post enquiry SCN and the SSCN which were issued on its registered address and were served upon them. As noted above, multiple attempts for delivery of the SCN and hearing notice were made on the registered address of the noticee, failing which, the SCN and the hearing notice were published. In conformity with the principles of natural justice, an opportunity of personal hearing was provided to the Noticee by scheduling the personal hearing on December 21, 2022 which was rescheduled to January 18, 2023 and further rescheduled to February 22, 2023, as the Noticee failed to avail the same. Hearing Notice was also published in Hindustan Times and Navbharat Times, vide newspaper publication dated February 04, 2023. However, the Noticee neither responded to the SCN or the SSCN nor to the hearing notice. Accordingly, in this context, I find it apt to refer to and rely on the observation of the Hon'ble SAT in the case of ***Sanjay Kumar Tayal & Others vs SEBI***¹, wherein the Hon'ble SAT has observed that—

¹ (Appeal No. 68 of 2013-Order dated February 11, 2014)

“...appellants have neither filed reply to show cause notices issued to them nor have availed opportunity of personal hearing offered to them in the adjudication proceedings and, therefore, appellants are presumed to have admitted charges levelled against them in the show cause notices...”

Under the circumstances, even though the Noticee has remained ex parte, I observe that the principles of natural justice have been adequately complied with, in the present matter, and as the Noticee has preferred not to participate in the present proceedings before me, I am constrained to deal with the matter on merits based on the material available on record.

17. It is to be noted that the SCN dated January 15, 2021 called upon the Noticee to show cause as to why action as recommended by the DA, including passing of appropriate direction should not be taken against the Noticee in terms of Regulation 28 of the Intermediaries Regulations. I note that by the amendments made to the Intermediaries Regulations on January 21, 2021, Regulation 27 which dealt with recommendations for actions which could be made by DA in case of default, has been substituted and Regulation 28, which dealt with procedure for action on receipt of the recommendation from DA, has been omitted and these matters now stand governed by the Regulations 26 and 27, respectively. In the present case, I note that prior to the aforesaid amendment, procedure for conduct of enquiry proceedings before DA and Competent Authority (CA) was provided under Regulations 25 to 28 of the Intermediaries Regulations wherein Regulation 25 dealt with issue of SCN by the DA, Regulation 26 dealt with reply of SCN by the Noticee, Regulation 27 dealt with recommendation for actions which could be made by the DA and Regulation 28 dealt with conduct of proceedings before the CA, like issue of SCN, hearing and passing of final order. After the aforesaid amendment, Regulation 25, as substituted, deals with holding of enquiry proceedings before DA, Regulation 26 deals with recommendation for actions which can be made by the DA and Regulation 27 deals with conduct of enquiry proceedings before the CA and passing of order by the CA. Thus, the proceedings before CA which were earlier governed by the provisions of Regulation 28 are now governed by the provisions of Regulation 27 with certain modifications. Therefore, the new Regulation 27 is regarded having force continuously (by virtue of pre-existing Regulation 28) and the modification or changes

are treated as amendment coming into force with effect from the date of enforcement of new Regulation 27, i.e., January 21, 2021. Accordingly, I note that the present proceedings can be concluded under the amended provisions of the Intermediaries Regulations and for the violations committed by the Noticee, directions under Regulation 27 of the Intermediaries Regulations can be issued.

18. Prior to moving forward with considering the said issue as stated at para 15 above, it is pertinent to refer to the common order dated June 09, 2022² passed by the Hon'ble SAT which is also referred in the preceding paragraph 11. The Hon'ble SAT, while setting aside and remanding the earlier WTM Orders passed during February 2019, had made the following observations (relevant to the present case as well):
- (a) Observations of the Bombay High Court in the matter of *63 Moons vs. Union of India*³ cannot be relied upon as the said judgement has been set aside in appeal⁴ by the Hon'ble Supreme Court vide judgment dated April 30, 2019.
 - (b) Observation from the Order dismissing the Writ Petition filed by NSEL against the invocation of the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 ("MPID Act") (*NSEL vs. State of Maharashtra*)⁵ cannot be relied upon, as in a subsequent Writ Petition⁶ moved by 63 Moons, a Division Bench of the Hon'ble Bombay High Court has held that NSEL is not a financial establishment and therefore, the provisions of the MPID Act are not applicable. The prima facie observations cannot be the basis to judge the reputation, character or integrity of NSEL.
 - (c) Observations in the bail rejection order dated August 22, 2014, passed by the Hon'ble Bombay High Court in the matter of ***Jignesh Prakash Shah vs. The State of Maharashtra***, cannot also be relied upon as the observations made in a bail order were limited to the fact as to whether the bail should be granted or not.
 - (d) Reliance placed on decisions of the Hon'ble Tribunal in the matter of ***Jermyn Capital vs. SEBI***⁷ and ***Mukesh Babu Securities vs. SEBI***⁸ is misplaced, as decisions in the said matters are distinguishable on facts. Jermyn Capital was held

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

³ Writ Petition No. 2743 of 2014

⁴ Civil Appeal No. 4467 of 2019

⁵ Writ Petition No. 1403 of 2015

⁶ Writ Petition No. 1181 of 2018

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

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

to be in relation to an Interim Order passed by SEBI, and the Tribunal was of the view that the criteria for passing an Ad Interim Order are based on a different criterion, namely prima facie case, the balance of convenience and irreparable injury which are distinct and different while considering an application for grant of Certificate of Registration. The decision in the matter of *Mukesh Babu Securities* was of a criminal complaint filed against the Chairman of the Company. The Tribunal noted that there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.

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

19. As noted above, taking cognizance of the order passed by the Hon'ble SAT on June 09, 2022 (*supra*), a SSCN dated October 12, 2022 was issued to the Noticee calling upon the Noticee to show cause as to why the following information/material along with the Enquiry Report dated December 17, 2020 should not be considered against it for determining whether the Noticee satisfies 'fit and proper person' criteria as laid down under Schedule II of the Intermediaries Regulations:

- a) SEBI complaint dated September 24, 2018 filed with Economic Offence Wing ('EOW');

- b) First Information Report ('FIR') dated September 28, 2018; and
- c) Schedule II of the Intermediaries Regulations (Amended with effect from November 17, 2021).

20. Before considering the matter on merits and test the compliance of the Noticee with the '*fit and proper person*' criteria, on the basis of the material that has been brought on record, it would be appropriate to look at the background and understand the nature of the '*paired contracts*' that were offered on the NSEL – which ultimately is the cause / genesis of the current proceedings. While undertaking this exercise, I will not be independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings. I will, however, be relying on the observations made by other authorities including the Hon'ble Supreme Court in the matters of **63 Moons Technologies Ltd. vs. UOP⁹** (hereinafter referred to as the "**merger petition**") and **The State of Maharashtra Vs. 63 Moons Technologies Ltd¹⁰** (hereinafter referred to as the "**MPID Matter**"), wherever appropriate.

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

21. The spot exchanges were envisaged as a platform for providing transparent and secure trading in commodities with a view to boost the agriculture sector in the country. NSEL was incorporated in 2005 as an electronic exchange for spot trading of commodities. On June 5, 2007, the Ministry of Consumer Affairs ("MCA"), Government of India, issued a Notification SO 906(E) under Section 27 of the FCRA granting conditional exemption from the provisions of that Act with respect to (i) forward contracts, (ii) for sale and purchase of commodities, of one-day duration traded on NSEL. The conditions, *inter alia*, placed an absolute bar on short sales and stipulated that all outstanding positions at the end of the day must result in delivery. It was also stipulated that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency. Thereafter, NSEL commenced operations in October 2008.

⁹ Civil Appeal no. 4476 of 2019

¹⁰ Civil Appeal No. 2748-49 of 2022

22. As noted from the FMC order, NSEL introduced, on its platform, the concept of '*paired contracts*', in September 2009, which involved buying and selling the same commodity through two different contracts at two different prices wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In other words, the '*paired contract*' involved two simultaneous transactions being undertaken at the same time with the same counterparty—one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at different prices on the platform of NSEL. The transactions were structured in such a manner that buyer of the short duration contract always ended up making profits.
23. As mentioned at para 4 above, FMC, after analysing the trade data as received from NSEL, vide order No. 4/5/2013-MKT/B dated December 17, 2013 observed that: "55 contracts offered for trade on NSEL were with settlement period exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA" and "the condition of 'no short sale by members of the exchange shall be allowed' was not being met by NSEL".
24. Further, in the above mentioned Order, FMC, *inter alia*, held that the contracts traded on NSEL have violated certain conditions stipulated in the 2007 Exemption Notification, which granted permission to NSEL to offer spot trading in commodities which, *inter alia*, included "*no short sale by members of the exchange shall be allowed; that all outstanding positions of the trade at the end of the day shall result in delivery*" and that "*all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency*".
25. It is clear from the order of FMC that NSEL was given permission to setup as a spot exchange for trading in commodities. It was essentially meant to only offer forward contracts having one-day duration as per 2007 Exemption Notification. I note from the FMC Order¹¹ that the 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of the provisions of FCRA. I further note from the FMC Order that under the FCRA, a "*forward contract*" is defined as a "*contract for delivery of goods and which is not a*

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

ready delivery contract”. A ‘ready delivery contract’ is defined as “a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days”. Given the said definition as contained in FCRA, I note that FMC was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as Non-Transferable Specific Delivery contracts.

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

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

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

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

28. I, therefore, note that the Hon'ble Supreme Court has already commented on the nature of the 'paired contracts' offered on the NSEL platform. In the case of *63 Moons Technologies Ltd. vs. UOI*, the Hon'ble Supreme Court held that these contracts were in the nature of financing transactions. In the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon'ble Supreme Court has held that such transactions come within the definition of 'deposits' under the MPID Act.
29. It is further noted that the Hon'ble Supreme Court, in the MPID matter, had extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. As seen from the order of the Hon'ble Supreme Court, NSEL was advertising an annualized return of about 16% p.a. for the 'paired contracts' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the

contract. For example, a T+2 & T+25 paired contract in steel had the same offered return as a T+ 2 & T + 35 paired contract in castor oil. The '*paired contracts*', it is noted, were being marketed as an alternative to fixed deposits.

30. In view of the above, I note that the FMC Order and both the judgments of the Hon'ble Supreme Court discuss in detail that, NSEL was permitting short sales, i.e., permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite amount of commodity is available in the warehouse. As noted above, the Hon'ble Apex Court in the merger petition has held that these contracts were in the nature of financing transactions. Further, the Hon'ble Supreme Court in the MPID matter has held that the overwhelming majority of the sale leg of the '*paired contracts*' which were executed were naked short sales i.e. the commodities to back such sales were not available at the designated warehouses of NSEL.

Fit and proper person criteria

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

SEBI Act

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

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

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

Broker Regulations

Consideration of application for grant of registration.

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

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

Conditions of registration.

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

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

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

Liability for action under the Enquiry Proceeding Regulations.

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

(i)

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

SCHEDULE II

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

CODE OF CONDUCT FOR STOCK BROKERS

[Regulation 9]

A. General.

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

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

(3)

(5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government,

the Board and the Stock Exchange from time to time as may be applicable to him.”

Intermediaries Regulations:

SCHEDULE II

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

[See regulation 7]

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

- (a) the competence and capability in terms of infrastructure and manpower requirements; and*
- (b) the financial soundness, which includes meeting the net worth requirements.*

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

- (a) the applicant or the intermediary;*
- (b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and*
- (c) the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:*

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

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

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

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

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

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

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

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

(iv) recovery proceedings have been initiated by the Board against such person and are pending

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

(vi) any winding up proceedings have been initiated or an order for winding up has been passed against such person;

(vii) such person has been declared insolvent and not discharged;

(viii) such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;

(ix) such person has been categorized as a wilful defaulter;

(x) such person has been declared a fugitive economic offender; or

(xi) any other disqualification as may be specified by the Board from time to time.

(4) Where any person has been declared as not 'fit and proper person' by an order of the Board, such a person shall not be eligible to apply for any registration during the period provided in the said order or for a period of five years from the date of effect of the order, if no such period is specified in the order.

(5) *At the time of filing of an application for registration as an intermediary, if any notice to show cause has been issued for proceedings under these regulations or under section 11(4) or section 11B of the Act against the applicant or any other person referred in clause (2), then such an application shall not be considered for grant of registration for a period of one year from the date of issuance of such notice or until the conclusion of the proceedings, whichever is earlier.*

(6) *Any disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub -clause (b) of clause (3), shall not have any bearing on the 'fit and proper person' criteria of the applicant or intermediary unless the applicant or intermediary or any other person referred in clause (2), is also found to incur the same disqualification in the said matter: Provided that if any person as referred in sub-clause (b) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall replace such person within thirty days from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against the intermediary:*

Provided further that if any person as referred in sub -clause (c) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall ensure that such person does not exercise any voting rights and that such person divests their holding within six months from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against such intermediary.

(7) *The 'fit and proper person' criteria shall be applicable at the time of application of registration and during the continuity of registration and the intermediary shall ensure that the persons as referred in sub -clause s (b) and (c) of clause (2) comply with the 'fit and proper person' criteria.*

32. I note that Regulation 5(e) of the Broker Regulations provides that for the purpose of grant of Certificate of Registration, the applicant has to be a 'fit and proper person' in terms of Schedule II of the Intermediaries Regulations. I further note that

the '*fit and proper person*' criteria specified in Schedule II of the Intermediaries Regulations, 2008 was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021 with effect from November 17, 2021.

33. From the records, I note that SEBI has filed a complaint with EOW Mumbai on September 24, 2018, against brokers who facilitated access to '*paired contracts*' traded on NSEL, including the Noticee. On the basis of this complaint, FIR dated September 28, 2018, was registered with the MIDC Police Station, Mumbai, against the Noticee. I note from the records that the Noticee is holding a certificate of registration No. INZ000036038. In order to continue to hold such Certificate of Registration from SEBI, the Noticee is also required to satisfy the conditions of eligibility, which, *inter alia*, included, continuance of its status as a '*fit and proper person*'. The above condition to be fit and proper person is not a onetime condition applicable only at the time of seeking registration. Rather, the provisions governing the criteria show that this is a condition which each and every registered intermediary is required to fulfil on a continuous basis as long as the entity remains associated with the Securities Market as a registered intermediary.
34. In this context, after perusal of the enquiry report, I note that vide email dated July 20, 2020, the Noticee was provided with the trading data of paired contract by SEBI. Further, the DA has observed that as per the EOW Report, the Noticee had outstanding obligations of ₹4,48,89,041. On perusal of the Grant Thornton Report, it is observed that NSEL had a pay-out obligation to the extent of ₹3,85,74,898/- towards the Noticee. It is also observed from the NSEL circular dated March 10, 2015 that NSEL had made a special pay-out amounting to ₹71,99,696/-to the Noticee. It is also observed from the aforesaid NSEL circular that the noticee had 29 clients. In view of the same, I am of the view that it is not in dispute that the Noticee was, in fact, involved in facilitating the trading in the alleged '*paired contracts*' on NSEL Platform.
35. I note that the act of the Noticee in offering access to '*paired contracts*' by facilitating trading in such contracts, seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee. As recorded in the FMC order and the judgements of the Hon'ble Supreme Court (*supra*), these

contracts, were *ex facie* offered in violation of the 2007 Exemption Notification and were not spot contracts in commodities which were permitted to be traded on NSEL. The '*paired contracts*' were nothing but financing transactions masquerading as spot contracts in commodities. The execution of the trades in '*paired contracts*' was not permitted under the 2007 Exemption Notification and the said contracts were purely financial contracts, promising assured returns under the garb of spot trading in commodities, as observed by FMC in its Order. Therefore, the Noticee by its conduct and as a member of NSEL has facilitated trading in '*paired contracts*' which were in the nature of financing transaction, as held by the Hon'ble Supreme Court. The Noticee, by providing access for taking exposure to '*paired contracts*' has exposed its clients to the risk involved in trading in a product that did not have regulatory approval and thereby raising doubts on the competence of the Noticee to act as a registered Securities Market intermediary. Thus, I am of the view that the trading activities of the Noticee in '*paired contracts*' for its clients and for itself on the NSEL platform have serious ingredients amounting to jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the Noticee in the Securities Market.

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

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

37. As discussed above, the Noticee has facilitated its clients to trade in '*paired contracts*'. As the paired contracts were violative of the conditions stipulated in the 2007 Exemption Notification, a complaint was filed by SEBI with Economic Offences Wing, Mumbai (EoW) on September 24, 2018, against the brokers who participated/ facilitated access to '*paired contracts*' traded on NSEL, including the Noticee within the time limit, as specified under section 29A(2)(e) of the FCRA. On the basis of the said complaint of SEBI, FIR dated September 28, 2018 was registered with MIDC Police Station, Mumbai and the same are subsisting. I note that the name of the Noticee is reflected in the complaint and the FIR. I also note

that the copies of the said complaint and the FIR were provided to the Noticee along with the SSCN dated October 12, 2022.

38. It is pertinent to note that the criteria of '*fit and proper person*', is an ongoing requirement throughout the period during which the Noticee remains operational in the Securities Market as a registered intermediary. In case, pursuant to the grant of registration by SEBI, any evidence comes to the notice of SEBI that casts a doubt on the integrity, reputation and character of the registered intermediary, SEBI is well within its powers to examine the '*fit and proper person*' status of such entity based on various parameters. It is noted that parameters provided under Clause 3(b) of the amended criteria of Schedule II of the Intermediaries Regulations lays down a list of disqualifications which includes a pending criminal complaint or information under Section 154 of CrPC filed against such an entity by the Board. It is, therefore, noted that the Noticee attracts the disqualification provided in Clause 3(b)(i) of the Schedule II of the Intermediaries Regulations.

39. The '*fit and proper*' person criteria, being a continuing requirement under the Intermediaries Regulations ought to be complied with at all times as long as an entity desires to remain associated with the securities market as a registered intermediary. The present proceedings intend to examine the '*fit and proper person*' status of the Noticee as per the Intermediaries Regulations. Therefore, I am of the view that the Noticee must satisfy the fit and proper person criteria as it exists on date. Further, due presumption on the constitutional and legal validity of the said amended Schedule II of the Intermediaries Regulations holds the field till date which is binding upon SEBI

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

the product itself. By failing to disassociate itself from, and continuing to facilitate participation in the said paired contracts, the Noticee failed to act with due diligence.

41. Furthermore, as mentioned in paragraph 38 above, the Noticee has also earned disqualification under Clause 3(b)(i) of the amended Schedule II of the Intermediaries Regulations on account of the complaint filed by SEBI and the FIR registered against the Noticee. In this regard it is pertinent to note that the said FIR is subsisting and has not been challenged, quashed or stayed by any competent court qua the Noticee. In this context, as observed above, I reiterate that being a '*fit and proper person*' is a continuing 'eligibility criteria' which must be satisfied by the Noticee including the amended criteria, at all times.

42. I am also of the view that, the principle of '*ignorantia juris non excusat*' or '*ignorantia legis neminem excusat*' or '*ignorance of law is no excuse*' becomes applicable in the situation, since trading in 'paired contracts' was in violation of the 2007 Exemption Notification and ignorance of the conditions of the said 2007 Exemption Notification cannot be claimed. As held by the Hon'ble Supreme Court, 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 of appropriateness and suitability of the continuance of the registration of the Noticee as a broker. Clearly, the actions of the Noticee have been detrimental to the interest of the Securities Market and accordingly the Noticee can no longer be called a '*fit and proper person*' for holding the Certificate of Registration as a broker in the Securities Market, which is one of the conditions for continuance of registration as specified in Regulation 5(e) of the Broker Regulations read with the provisions of Schedule II of the Intermediaries Regulations.

43. 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 and any deviation from the above noted objective could have a cascading adverse impact on the development of the Securities Market and interests of investors. Thus, undisputedly a broker is obligated to act in a transparent manner and comply with all applicable regulatory requirements which are in the best interests of its clients and which will uphold the integrity of the Securities Market.

44. I am also aware that SEBI has passed certain orders¹² in the related NSEL matters where the Noticees therein have been debarred from making a fresh application seeking registration for a specified period from the date of the said order or till acquittal of the said Noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier. I find that present matter at hand is different from that of those cases, as in the extant matter the Noticee is already holding a Certificate of Registration whereas in those cases, the entities had filed applications seeking certificate of registration. As already noted above, '*fit and proper person*' criteria is a continuing requirement under the Intermediaries Regulations which the Noticee ought to comply with at all times so long it desires to remain associated with the Securities Market as a registered intermediary. Further, I note that the Hon'ble SAT in its order dated June 09, 2022 (pertaining to entities whose application for registration was rejected) has observed that the period for which the noticees cannot apply for registration needs to be specified by SEBI. Having noted the aforesaid observation of the Hon'ble SAT, I am of the view that since the recommendation in the present matter is of cancellation and not of

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

rejection of the application, the necessity of specifying a period of time may not arise in this order (as in the case of entities desiring to be registered as market intermediaries) as this forum cannot presume whether such entity wishes to reapply to be a market intermediary or not. If it chooses to do so, it will have to be assessed at such point of time if it is fit and proper as per the extant and applicable regulations.

45. The limited scope of the present proceedings is to see whether the indulgence, engagement and promotion of such activities could be held to be beneficial to the development of Securities Market or the same contain elements that are potentially dangerous and detrimental to the interest, integrity, safety and security of the Securities Market. In this respect, the undisputed fact, as recorded in the FMC order and Orders of the Hon'ble Supreme Court (as mentioned supra), that the scheme of '*paired contracts*' traded on the NSEL ultimately has caused loss to the market which itself casts serious aspersion on the conduct, integrity and reputation of, *inter alia*, the Noticee who facilitated such '*paired contracts*' and therefore, its continuing role in the Securities Market cannot be viewed as good and congenial for the interest of the investors or of the Securities Market.

46. 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 in view of the complaint filed by SEBI and the pending FIR against the Noticee which is subsisting/pending as on date. Further, it is also not the case of the Noticee that said FIR filed is either stayed or quashed by any competent court qua the Noticee or otherwise. In view of the above, I hold that the Noticee does not satisfy the '*fit and proper person*' criteria specified in Schedule II of the Intermediaries Regulations and hence, the continuance of the Noticee as a registered broker will be detrimental to the interest of the Securities Market. Therefore, activities of the Noticee, as discussed in the preceding paragraphs, as a registered broker cannot be condoned and deserve appropriate measure to prevent such wrong doings recurring to the detriment of the interest of the Securities Market.

47. In view of the above, I concur with the recommendation made by the DA, i.e., registration of the Noticee, Modex Commodity Trades Private Ltd., registered as a commodities derivatives Broker may be cancelled.

ORDER

48. I, therefore, in exercise of powers conferred under Section 12(3) and Section 19 of the SEBI Act, 1992 read with Regulation 27 of the Intermediaries Regulations, 2008 cancel the Certificate of Registration (bearing no. INZ000036038) of the Noticee viz. Modex Commodity Trades Private Limited.

49. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 48 above.

50. Notwithstanding the direction at paragraph 48 above, the Noticee shall allow its existing clients, if any to withdraw or transfer their securities or funds held in its custody, within 15 days from the date of this order. In case of failure of any clients to withdraw or transfer their securities or funds within the said 15 days, the Noticee shall transfer the funds and securities of such clients to another broker registered with SEBI within a period of next 15 days thereon, under advice to the said clients.

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

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

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

DATE: OCTOBER 23, 2023

PLACE: MUMBAI

Sd/-

S.V. MURALI DHAR RAO

EXECUTIVE DIRECTOR

SECURITIES AND EXCHANGE BOARD OF INDIA