

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 27 OF SECURITIES AND EXCHANGE BOARD OF INDIA
(INTERMEDIARIES) REGULATIONS, 2008

In respect of –

Matalia Commodity (Proprietor: Shri Dipak C. Matalia)

PAN: AKEPM2003M

In the matter of National Spot Exchange Limited

BACKGROUND

1. Securities and Exchange Board of India (hereinafter referred to as, “**SEBI**”) initiated enquiry proceedings against Matalia Commodity (Proprietor: Shri Dipak C. Matalia) (hereinafter referred to as, “**the Noticee**”) under the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992 (hereinafter referred to as the “**Stock Broker Regulations**”), for the alleged violations of Regulations 5(e), 9(b) and 9(f) read with Regulation 27(iv) read with Clause A(1), A(2) and A(5) of Schedule II of the Stock Broker Regulations read with Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 (hereinafter referred to as the “**Intermediaries Regulations**”). The notice was a trading and clearing member of National Spot Exchange Limited (hereinafter referred to as “**NSEL**”). The Noticee has applied for registration as a stock broker / trading member with SEBI and the same is pending. While the application made by the Noticee seeking registration with SEBI is pending, pursuant to the merger of FMC with SEBI, by virtue of provisions of Section 131 of the Finance Act, 2015, the Noticee continues to operate as a broker in the securities market, till the disposal of the application made by the Noticee for registration with SEBI.
2. The Noticee was a Trading and Clearing Member of 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 the 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 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 not being 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 in respect of the '*paired contracts*', which were traded on the NSEL platform during the relevant period, I note that the FMC had, *inter alia*, observed that the following conditions stipulated in the 2007 Exemption Notification were violated:

a. **Short Sale**

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

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

Some of the contracts offered for trade on 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 NSEL facilitated and/or participated in trading in such paired contracts which were in alleged violation of the 2007 Exemption Notification. Thus, by participating in / facilitating trading in paired contracts, such entities, allegedly, had acted in a manner detrimental to the interest of the securities market.
7. As per information available with SEBI, the Noticee, being a Trading Member and Clearing member of NSEL, participated in / 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 '*fit and proper person*' to be granted

a 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/s in compliance with 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. The DA, accordingly, issued a Show Cause Notice dated September 25, 2018 (hereinafter referred to as “**Enquiry SCN**”) to the Noticee under Regulation 25(1) of the Intermediaries Regulations (as applicable at the relevant time) calling upon it to show cause as to why appropriate recommendation should not be made against it under regulation 27 of the Intermediaries Regulations(as applicable at the relevant time) read with Section 12(3) of the SEBI Act for the 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 and being not a ‘*fit and proper person*’ for being eligible to hold the certificate of registration as trading and clearing member in terms of Regulation 5(e) read with Regulation 27(iv) of the Broker Regulations read with Schedule II of the Intermediaries Regulations. In response to the same, the Noticee vide letter dated November 27, 2018 submitted its reply to the Enquiry SCN.
9. Thereafter, vide email dated July 20, 2020 additional material in relation to the Enquiry SCN was forwarded to the Noticee advising the Noticee to submit its reply by August 05, 2020. It is noted from the material available on record that the Noticee did not file reply to the said email.
10. 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:

“37. 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 Noticee i.e. Matalia Commodity should not be granted registration and its business as a commodity derivatives broker may be stopped.”

POST ENQUIRY PROCEEDINGS

Show Cause Notice, Reply and Personal Hearing

11. 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 should not be taken against it, as deemed fit, by the Competent Authority.
12. The Noticee, vide letter dated February 22, 2021, filed its reply and made the following submissions:
 - (i) The Enquiry Report provided to the Noticee was not in respect of Matalia Commodity and therefore, it was not possible for the Noticee to submit specific reply to the SCN;
 - (ii) The Noticee had submitted reply dated November 27, 2018 which was a detailed exhaustive and relevant to the subject;
 - (iii) The Noticee may be provided the correct Enquiry Report and the Noticee may file the submissions on merit thereafter;

(iv) The Noticee has already applied for surrender of its membership with MCX and the same may be accepted.

13. In view of above, vide letter dated February 26, 2021, a copy of the Enquiry Report in respect of Matalia Commodity was provided to the Noticee.
14. While the 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 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 its common order dated June 9, 2022 (hereinafter referred to as "**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....."

15. Subsequently, in August 2022, the present matter was allocated to me. 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 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. I note from the material available on record that no reply was submitted by the Noticee in response to the aforesaid SSCN dated October 12, 2022.

16. Thereafter, in compliance with the principles of natural justice, an opportunity of personal hearing was granted to the Noticee before me on December 14, 2022 through video conferencing and the Noticee vide its email dated December 13, 2022 confirmed its presence for the said scheduled hearing.
17. On the date of hearing, Mr. Chintan Matalia and Mr. Dipak Matalia, appeared on behalf of the Noticee and made oral submissions in the matter. As requested, three weeks' time was granted to the Noticee to make submissions to the supplementary SCN, if any. I note that in response to the SSCN dated October 12, 2022 and hearing held on December 14, 2022, the Noticee submitted its response post hearing vide its letter dated January 09, 2023. The Noticee, vide its letter dated January 09, 2023, reiterated its previous submissions dated November 27, 2018, February 22, 2021, oral submissions made during the course of personal hearing and made additional submissions in the matter. The submissions of the Noticee are summarized as under:
 - (i) The notice issued by the DA is silent on the aspect if the '*paired contracts*' were promoted by the Noticee;
 - (ii) Relevant documents have not been provided to the Noticee. The Noticee has not been provided with the trade log and in the absence of the same, it is not possible for the Noticee to provide a justification for the trades;
 - (iii) It is a legitimate expectation of a broker that a product introduced by the exchange would be legal and valid and a broker cannot be suspicious of the conduct of the exchange;
 - (iv) Reliance is placed upon decision of the Hon'ble Supreme Court in the matter of ***SEBI Vs. Rakhi Trading***¹ and ***Kasat Securities Private Limited Vs. SEBI***²

¹ 2018 SCC OnLine 101

² Appeal No. 27 of 2006 decided on June 29, 2006

to submit that a broker cannot be held liable for violation of SEBI Regulations merely because it has facilitated certain transactions;

- (v) The notice by DA has been issued for transactions/ contract from September 2009 to August 2013 done through the Noticee. At the said time, FMC was in existence but neither FMC nor any other authority initiated any action at the relevant time when FCRA was applicable. Pursuant to repeal of FCRA, unless expressly and specifically saved, all acts/ transactions/ contracts done under the FCRA on the floor of NSEL came to be abetted and became inoperative and therefore, no punitive/ disciplinary action can be taken against the Noticee. Thus, notice issued by the DA is without jurisdiction and authority;
- (vi) The SCN was issued by the DA in 2018 for the contracts done through the noticee for the period 2009-2013. As a general rule, the disciplinary action should be initiated within the prescribed time and if no time has been prescribed, then the same should be initiated within a reasonable time. In the present matter, the proceedings have been issued against the noticee after a long time and delinquency, on the part of the noticee, if any, shall lapse and no action shall be initiated against the noticee on this account only;
- (vii) SEBI does not have the jurisdiction to adjudicate the violation of the provisions of the 2007 Exemption Notification as the same falls within the domain of Central Government;
- (viii) While SEBI is not empowered to investigate/ inquire into the alleged violations of FCRA, it is paradoxical that SEBI has assumed power to declare the Noticee as not fit and proper on account of FIR filed by SEBI itself for alleged violations of FCRA;
- (ix) Vide letter dated November 20, 2015, Ministry of Finance had clearly stated that '*SEBI is not expected to deal with the matters which were not dealt with by erstwhile FMC. Further, it is clarified that since spot market /ready delivery contracts were not regulated by the FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets.*';
- (x) FIR is only the first instance of reporting of a complaint that is lodged with the police and is a preliminary document based on the one sided statements, without any adjudication of the same. Any adverse reliance on an FIR would be in gross violation of law. Thus, no reliance can be placed on an FIR, particularly an FIR which has been filed by SEBI itself;

- (xi) In terms of bye law 4.1 of the NSEL Bye-laws, NSEL was required to obtain prior permission from the FMC before commencement of any contract and failure to do so can be attributed to NSEL or FMC. As a broker, the Noticee acted on behalf of its clients and traded in the contracts being traded on the exchange. The Noticee was under the belief that NSEL/ FMC had complied with all the relevant bye-laws;
- (xii) Noticee was not required to check the legality of the contracts being offered by the exchange and thus it is unthinkable to allege today that the Noticee ought to have checked the legality of the contracts;
- (xiii) The present regulatory mechanism of SEBI for the cash, derivative and commodity derivative segments does not require the brokers to check the legality of the contract/ scrip;
- (xiv) Since the inception of trading on stock exchanges, the exchanges offer products and the brokers merely facilitate trading in the said products and a broker is not required to check the existence of the scrip/ company/ contract or legality of the contract;
- (xv) Paired contracts per se are not illegal and illegality was found with respect to contracts offered by NSEL which were in violation of permission given to NSEL. The Noticee neither designed nor approved the said paired contracts;
- (xvi) Amendment to the fit and proper person criteria came into effect on November 17, 2021, i.e., much after the initiation of the present proceedings and therefore the same cannot be applied retrospectively;

CONSIDERATION OF ISSUES AND FINDINGS

18. I have carefully perused the post enquiry SCN, SSCN along with all the documents attached therewith, the replies submitted by the Noticee, the oral submissions made by the Noticee during the course of personal hearing along with the material/information available on record. After considering the allegations made/ charges levelled against the Noticee in the instant case, I note that the only issue that arises for consideration in the present proceedings is whether the Noticee satisfies the '*fit and proper person*' criteria as laid down under Schedule II of the Intermediaries Regulations.

19. Before considering the issue on its merits, I note that the SCN dated 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 Intermediaries Regulations on January 21, 2021, regulation 27 which dealt with recommendations for actions which could be made by DA in case of default, has been substituted and regulation 28, which dealt with procedure for action on receipt of the recommendation from DA, has been omitted and these matters now stand governed by the Regulations 26 and 27, respectively. In the present case, I note that prior to the aforesaid amendment, procedure for conduct of enquiry proceedings before DA and Competent Authority (CA) was provided under regulations 25 to 28 of the Intermediaries Regulations wherein regulation 25 dealt with issue of SCN by the DA, regulation 26 dealt with reply of SCN by the Noticee, regulation 27 dealt with recommendation for actions which could be made by the DA and regulation 28 dealt with conduct of proceedings before the CA, like issue of SCN, hearing and passing of final order. After the aforesaid amendment, regulation 25, as substituted, deals with holding of enquiry proceedings before DA, regulation 26 deals with recommendation for actions which can be made by the DA and regulation 27 deals with conduct of enquiry proceedings before the CA and passing of order by the CA. Thus, the proceedings before CA which were earlier governed by the provisions of regulation 28 are now governed by the provisions of regulation 27 with certain modifications. Therefore, the new regulation 27 is regarded having force continuously (by virtue of pre-existing regulation 28) and the modification or changes are treated as amendment coming into force with effect from the date of enforcement of new regulation 27 i.e. January 21, 2021. Accordingly, I note that the present proceedings can be concluded under the amended provisions of the Intermediaries Regulations and for the violations committed by the Noticee, directions under regulation 27 of the Intermediaries Regulations can be issued.

20. Prior to moving forward with considering the said issue as stated at para 18 above, it is pertinent to refer to the common order dated June 09, 2022³ passed by the Hon'ble SAT as referred to, in paragraph 14 above. The Hon'ble SAT, while setting aside and remanding the earlier WTM Orders, 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*⁴ cannot be relied upon as the said judgement has been set aside in appeal⁵ 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*)⁶ cannot be relied upon, as in a subsequent Writ Petition⁷ moved by 63 Moons, a Division Bench of the Bombay High Court has allowed the prayer and held that NSEL is not a financial establishment and 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 the NSEL petition could not be relied upon as they were preliminary observations and such observation does not foreclose the issue about the applicability of the provisions of the MPID Act. I note that the Hon'ble Tribunal, was of the opinion that 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***⁸ and ***Mukesh Babu Securities vs. SEBI***⁹ 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

³ 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

⁴ Writ Petition No. 2743 of 2014

⁵ Civil Appeal No. 4467 of 2019

⁶ Writ Petition No. 1403 of 2015

⁷ Writ Petition No. 1181 of 2018

⁸ Appeal No. 26 of 2006 decided on September 06, 2006

⁹ Appeal No. 53 of 2007 decided on December 10, 2007

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 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) The 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."

21. As noted above, taking cognizance of the order passed by the Hon'ble SAT on June 09, 2022 (*supra*) in the NSEL matters, a SSCN dated October 12, 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 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).

22. Before considering the matter on merits and test the compliance of the Noticee with the '*fit and proper person*' criteria, on the basis of the material that has been brought on record, it would be appropriate to look at the background and understand the nature of the '*paired contracts*' that were offered on the NSEL – which ultimately is the cause / genesis of the current proceedings. While undertaking this exercise, I will not be independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings. I will, however, be relying on the observations made by other authorities including the Hon'ble Supreme Court in the matters of **63 Moons Technologies Ltd. vs. UOI**¹⁰ (hereinafter referred to as the "**merger petition**") and **The State of Maharashtra Vs. 63 Moons Technologies Ltd**¹¹ (hereinafter referred to as the "**MPID Matter**"), wherever appropriate.

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

23. 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.

¹⁰ Civil Appeal no. 4476 of 2019

¹¹ Civil Appeal No. 2748-49 of 2022

24. 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.
25. As mentioned at para 4 above, FMC, after analysing the trade data as received from NSEL, vide an order No. 4/5/2013-MKT/B dated December 17, 2013 ("FMC Order") 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".
26. Further, in the above mentioned Order, FMC, *inter alia*, held that the contracts traded on NSEL violated the following conditions stipulated in the 2007 Exemption Notification, that 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"*.
27. 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 Order that FMC had observed¹² 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

¹² Order No. 4/5/2013-MKT-1/B dated December 17, 2013

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, I note, 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.

28. Therefore, it is 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. 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 of 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 MPID matter, were for durations exceeding 11 days.
29. I note that the Hon'ble Supreme Court in the matters of NSEL (*supra*) 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 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)

30. 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.
31. 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 Supreme Court, the 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.

32. 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.

Objections raised by the Noticee:

33. Before coming to the merits of the case, it is relevant to deal with the preliminary contention of the noticee that the present proceedings are vitiated due to delay. In this regard, I deem it fit to place reliance on the decision of the Hon'ble SAT in the matter of **Mr. Rakesh Kathotia & Ors. vs SEBI**¹³, wherein the Hon'ble SAT had held as under:

"23. It is no doubt true that no period of limitation is prescribed in the Act or the Regulations for issuance of a show cause notice or for completion of the adjudication proceedings. The Supreme Court in Government of India vs, Citedal Fine Pharmaceuticals, Madras and Others, [AIR (1989) SC 1771] held that in the absence of any period of limitation, the authority is required to exercise its powers within a reasonable period. What would be the reasonable period would depend on the facts of each case and that no hard and fast rule can be laid down in this regard as the determination of this question would depend on the facts of each case. This proposition of law has been consistently reiterated by the Supreme Court in Bhavnagar University v. Palitana Sugar Mill (2004) Vol.12 SCC 670, State of Punjab vs. Bhatinda District Coop. Milk P. Union Ltd (2007) Vol.11 SCC

¹³ Appeal no. 7 of 2016, decided on May 27, 2019

363 and Joint Collector Ranga Reddy Dist. & Anr. vs. D. Narsing Rao & Ors. (2015) Vol. 3 SCC 695.” (emphasis supplied)

34. I further place reliance on the decision of the Hon'ble the Supreme Court in the matter of **SEBI Vs. Sunil Krishna Khaitan and Ors** (Decided on July 11, 2022) discussed its earlier decision in the matter of **SEBI Vs. Bhavesh Pabari**¹⁴ and held the following:

“81. This Court in the judgment authored by one of us (Sanjiv Khanna, J.) in Bhavesh Pabari (supra) had examined the question of delay and laches in initiating proceedings under Chapter VI-A of the Act and the principle of law that when no limitation period is prescribed proceedings should be initiated within a reasonable time and what would be reasonable time would depend upon facts and circumstances of each case. In this regard, it was held as under:

35. The Appellants have also contended that in the absence of any prescribed limitation period, SEBI should have issued show-cause notice within a reasonable time and there being a delay of about 8 years in issuance of show-cause notice in 2014, the proceedings should have been dropped. This contention was not raised before the adjudicating officer in the written submissions or the reply furnished. It is not clear whether this contention was argued before the Appellate Tribunal. There are judgments which hold that when the period of limitation is not prescribed, such power must be exercised within a reasonable time. What would be reasonable time, would depend upon the facts and circumstances of the case, nature of the default/statute, prejudice caused, whether the third-party rights had been created, etc. The show-cause notice in the present case had specifically referred to the respective dates of default and the date of compliance, which was made between 30-8-2011 to 29-11-2011 (delay was between 927 days to 1897 days). Only upon compliance being made that the defaults had come to notice. In the aforesaid background, and so noticing the quantum of fine/penalty imposed, we do not find good ground and reason to interfere.

¹⁴ (2019) 5 SCC 90

82. The directions given in the aforesaid quotation should not be understood as empowering the authorities/Board to initiate action at any time. In the absence of any period of time and limitation prescribed by the enactment, every authority is to exercise power within a reasonable period. What would be the reasonable period would depend upon facts of each case, such as whether the violation was hidden and camouflaged and thereby the Board or the authorities did not have any knowledge. Though, no hard and fast Rules can be laid down in this regard as determination of the question will depend on the facts of each case, the nature of the statute, the rights and liabilities thereunder and other consequences, including prejudice caused and whether third party rights have been created are relevant factors. Whenever a question with regard to inordinate delay in issuance of a show-cause notice is made, it is open to the noticee to contend that the show-cause notice is bad on the ground of delay and it is the duty of the authority/officer to consider the question objectively, fairly and in a rational manner. There is public interest involved in not taking up and spending time on stale matters and, therefore, exercise of power, even when no time is specified, should be done within reasonable time. This prevents miscarriage of justice, misuse and abuse of the power as well as ensures that the violation of the provisions are checked and penalised without delay, thereby effectuating the purpose behind the enactment.”

35. In view of the aforesaid decisions, it is clear that no specific limitation period has been prescribed in the SEBI Act. However, I also note that even though there is no limitation period in the SEBI Act, the proceedings have to be initiated in a timely manner by the regulator and there cannot be any undue/ unexplainable delay. In the present matter, although the trades were executed during the period 2011-2013, SEBI was granted the jurisdiction to regulate the commodities segment in 2015. Pursuant thereof, given the magnanimity of the NSEL scam, the SCN was appropriately issued to the noticee in the year 2018. It must also be noted that although the noticee has raised the plea of laches, it has not stated any kind of prejudice which has been caused to it, if any. Accordingly, I am of the view that the plea of laches raised by the noticee is not tenable.

36. The Noticee has submitted that it has not been provided with all the documents which have been relied upon while issuing the notice. In this regard, I note that the trade details of the Noticee were duly provided by the DA, to the Noticee, vide email dated July 20, 2020. Further, the Noticee has specifically argued that material such as the FMC order and the judgment of the Hon'ble Supreme Court in the merger petition has not been provided to the Noticee. In this regard, I note that such publicly available material has not been relied upon in the present matter to draw any adverse inference against the Noticee and has only been relied upon to explain the nature of the paired contracts which were being traded on the NSEL platform. I note that vide email dated July 20, 2020, SCN dated January 15, 2021 and SSCN dated October 12, 2022, the Noticee has been provided with the relevant and relied upon documents, including trade data in the matter. Accordingly, I am of the view that the principles of natural justice have been duly complied with in the matter and the Noticee's contention with regard to non-supply of relevant documents in the matter and is misplaced.
37. The Noticee has further submitted that SEBI does not have the jurisdiction to deal with the Spot Market in terms of letter dated November 20, 2015 of the Ministry of Finance. Since spot markets/ ready delivery contracts were not being regulated by the FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets. Accordingly, the merger of FMC with SEBI cannot empower SEBI to regulate the Spot Market. In this regard, without going into the merits of the contention that whether SEBI has the authority to regulate Spot Market or not, I note, that the issue under consideration in the present proceedings is limited to the determination of fit and proper status of the Noticee under the Intermediaries Regulations. It is a settled position of law that SEBI has statutory authority to adjudge the fit and proper status of the intermediaries registered with it or entities desirous of registering with SEBI. Since the Noticee has applied for registration with SEBI, as an intermediary, I am of the view that SEBI is within its jurisdiction to determine the fit and proper status of the Noticee. Similarly, the contention of the Noticee that SEBI does not have the jurisdiction to adjudicate the violations of the provisions of the Notification as the same falls within the domain of the Central Government (Department of Consumer Affairs) is also not tenable. As noted above, the present proceedings have been initiated to adjudge the '*fit and proper person*' status of the

Noticee and thus, the submissions of the Noticee as regards the jurisdiction of SEBI to continue the present proceedings are not tenable.

38. The Noticee has also contended that pursuant to repeal of FCRA, unless expressly and specifically saved, all acts/ transactions/ contracts done under the FCRA on the floor of NSEL came to be abetted and became inoperative and therefore, no punitive/ disciplinary action can be taken against the Noticee and accordingly, notice issued by the DA is without jurisdiction and authority. In this regard I deem it fit to refer to the repeal and savings provision of the FCRA which, *inter alia*, states as under:

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

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

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

A bare perusal of the aforesaid provision would reveal that it is an enabling provision which enables SEBI to initiate fresh proceedings within a period of three years from the date on which the FCRA is repealed. As stated above, SEBI has filed complaint, *inter alia*, against the Noticee within the stipulated period as specified in the FCRA. Accordingly, I note that SEBI has taken appropriate steps for the alleged violation of the provisions of the FCRA in terms of the aforesaid provision. Further, as stated above, the present proceedings pertain to examination of the ‘*fit and proper*’ person status of the Noticee under the Intermediaries Regulations and it is a settled position of law that as a statutory body, SEBI is well within its regulatory purview to examine the ‘*fit and proper*’ person status of the intermediaries registered with SEBI and desirous of being registered with SEBI. Accordingly, the submission of the Noticee as regard maintenance of the present proceedings under the Intermediaries Regulations is also without merit.

39. The Noticee has also relied upon the decision of the Hon'ble Supreme Court in the case of **SEBI Vs. Rakhi Trading Private Limited**¹⁵ and Hon'ble SAT in the matter of **Kasat Securities Private Limited Vs. SEBI**¹⁶ to submit that merely because the Noticee acted as a broker, it cannot be concluded that the Noticee knew about the nature of transactions or it was guilty of negligence or connivance. The said contention of the Noticee has to be seen in light of the fact that the '*paired contracts*' have been held to be in violation of the 2007 Exemption Notification by the Hon'ble Supreme Court (as noted above at para 29). Thus, as understood in light of the above observations of the Hon'ble Supreme Court, the nature of the transactions being carried out on the NSEL platform was simply "financing", whereby fixed returns (e.g. 16%) were being given by one party to the other. The same was apparent on a bare perusal of the "*paired contracts*" executed on the NSEL platform. Considering the above, I do not find any merit in the argument of the Noticee that it was not aware of the nature of transactions being carried out on the NSEL platform. Therefore, violations of 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 Noticee to be eligible to hold a certificate of registration, as a broker.

Fit and proper person criteria

40. Now, I would be proceeding to deal with the main 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:*

¹⁵ [2018] 207 CompCas 443 (SC)

¹⁶ Appeal No. 27 of 2006, Decided on June 29, 2006

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

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

Consideration of application for grant of registration.

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

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

Conditions of registration.

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

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

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

Liability for action under the 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.

41. I note that regulation 5(e) of the 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 Intermediaries Regulations, 2008 was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021 with effect from November 17, 2021.
42. From the records, I note that SEBI has filed a complaint with EOW Mumbai dated September 24, 2018, against brokers who had traded / facilitated access to '*paired contracts*' traded on NSEL, including the Noticee. On the basis of this complaint, an FIR dated September 28, 2018, was registered with the MIDC Police Station, Mumbai, against the Noticee. In the instant matter, I note that pursuant to the merger of FMC with SEBI, the Noticee is seeking registration from SEBI as a stock broker / trading member. In order to hold such Certificate of Registration from SEBI, the Noticee is also required to satisfy the conditions of eligibility, which, *inter alia*, includes, its status as a '*fit and proper person*'.
43. In this context, as per reply of the Noticee dated January 09, 2023, I note that the Noticee had traded on NSEL during the period 2011-12, 2012-13 and 2013-14. It is observed that during the said period, the Noticee executed trades in the '*paired contracts*' on behalf of its clients and also executed proprietary trades. Thus, it is clear from the admissions of the Noticee that it has indulged into trading in '*paired contracts*' on behalf of its clients and also executed proprietary trades. Further, on perusal of the Enquiry Report, it is noted that outstanding obligation against the Noticee, as per the EOW Report, was ₹13,17,75,044/-.
44. I note that the act of the Noticee in offering access to '*paired contracts*' by participating in and facilitating trading in such contracts, seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee. As recorded in the FMC order and the judgements of the Hon'ble Supreme Court (*supra*), these contracts were *ex facie* offered in violation of the

2007 Exemption Notification and were not spot contracts in commodities which were permitted to be traded on NSEL. The '*paired contracts*' were nothing but financing transactions masquerading as spot contracts in commodities. The execution of the trades in '*paired contracts*' were not permitted under the 2007 Exemption Notification and were purely financial contracts promising assured returns under the garb of spot trading in commodities, as observed by FMC in its Order and the Orders of the Hon'ble Supreme Court, referred supra. Therefore, the Noticee by its conduct and as a member of the NSEL has facilitated and dealt 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 such '*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 also executing proprietary trades 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.

45. I further note that Clause 3(b) of Schedule II of the amended Intermediaries Regulations lays down a list of disqualifications which *inter alia* 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;*

As discussed above, the Noticee has facilitated its clients to trade in '*paired contracts*' and also indulged in executing proprietary trades in the '*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 by MIDC Police Station, Mumbai and the same are validly 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. Therefore, the Noticee attracts the disqualification provided in clause 3(b)(i) of the Schedule II of the Intermediaries Regulations.

46. At this juncture, I deem it apposite to deal with the submission of the Noticee that SEBI cannot be permitted to use its own FIR as evidence in a proceeding and that since an FIR is a first instance of reporting of complaint, reliance on the same would be in gross violation of the principles of natural justice. As regard usage of FIR as evidence in the present matter, I note that being a '*fit and proper*' person is a continuing '*eligibility criteria*' statutory requirement, which must be satisfied by the Noticee including the amended criteria, at all times. I am of the considered view that the due presumption on the constitutional and legal validity of the said amended Schedule II of the Intermediaries Regulations holds the field which is binding upon SEBI, and arguments to the contrary are not maintainable. Accordingly, the Noticee's submission in this regard is not tenable.

47. The Noticee has also submitted that the fit and proper criteria was amended with effect from November 17, 2021, i.e., after initiation of the proceedings against the Noticee and thus cannot be applied retrospectively. In this regard, as noted above, the '*fit and proper*' person criteria, being a continuing requirement under the Intermediaries Regulations ought to be complied with at all times as long as an entity desires to remain associated with the securities market as a registered intermediary. The present proceedings intend to examine the '*fit and proper person*' status of the Noticee as per the Intermediaries Regulations. Therefore, I am of the view that the Noticee must satisfy the fit and proper person criteria as it exists on date and accordingly, I do not find any merit in the argument of the Noticee.

48. 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 provided a platform for its clients to access a product and also indulged in proprietary trading in the said product, which was not permitted to trade raised 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.

49. Furthermore, as mentioned in paragraph 45, 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 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 an 'eligibility criteria' which must be satisfied by the Noticee at the time of considering the application of the Noticee for grant of registration.

50. The Noticee has also submitted that it was under an expectation that the products launched by the Exchange are legal and valid and further, the paired contracts are *per se* illegal and illegality was only found in the contracts launched by NSEL and the Noticee had no role in designing or approving such contracts. The Noticee has further argued that brokers are merely required to facilitate the trading in the products launched by Exchanges and not required to check the legality of the same. 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 2007 Exemption Notification cannot be claimed. The 'paired contracts' were nothing but financing transactions which were portrayed as spot contracts in commodities. I note that even though the registration has not been granted by SEBI, the Noticee continues to operate as a Broker in the securities market by virtue of provisions of Section 131 of the Finance Act, 2015, till the disposal of the

application by the Noticee for registration with SEBI. Therefore, giving go-by to the terms of the 2007 Exemption Notification and attempting to camouflage the nature of the transactions brings into question appropriateness and suitability of the continuance of the Noticee as a broker by considering its application for grant of registration. 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 detrimental to the interest of the Securities Market and accordingly the Noticee can no longer be called a '*fit and proper person*', which is one of the conditions to be fulfilled while considering application of the noticee for grant of registration as specified in regulation 5(e) of the 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 an entity seeking to be registered with SEBI 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. I am also aware that SEBI has passed certain orders¹⁷ 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 similar to those 5 (five) cases wherein the entities had filed applications seeking certificate of registration. 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.

53. The noticee has also submitted that it has applied for surrender of its membership with MCX. In my opinion, such pendency of application for surrender of membership has no material relevance for the purposes of the present proceedings. The said application has not been accepted by MCX, on account of present proceedings. Accordingly, I do not deem it significant to take into account the factor of the pendency of the aforesaid application with MCX

54. 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 recorded in FMC order and Orders of the Hon'ble Supreme Court (*supra*), is 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 participated in or facilitated such '*paired contracts*' and

¹⁷ 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.

therefore continuing role of the Noticee in the Securities Market cannot be viewed as good and congenial for the interest of the investors or of the Securities Market.

55. Given the above discussions and deliberations, I am constrained to conclude that the act of the Noticee in providing access to its clients to participate in a product and also indulging in proprietary trades in the said product, which was not permitted to trade raises serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the said product. 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 under section 154 of Cr.PC registered with MIDC Police Station, Mumbai which is subsisting/pending as on date. Further, it is also not the case of the Noticee that said FIR filed by SEBI 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, granting registration to the Noticee as a broker will be detrimental to the interest of the Securities Market. Therefore, activities of the Noticee, as discussed in the preceding paragraphs, who is desirous to be registered as a trading member / stock broker cannot be condoned and deserve appropriate measure to prevent such wrong doings from recurring to the detriment of the interest of the Securities Market.

56. In view of the above, I concur with the recommendation of the DA that the Noticee should not be granted registration. However, I note that the DA has not specified the period for which the Noticee should be debarred from making fresh application seeking registration with SEBI. In this regard, in view of the above discussed facts of the matter, I am of the view that debarring the Noticee from making a fresh application seeking registration for a period of 03 (three) months from the date of this Order or till acquittal of the Noticee by a Court of competent jurisdiction, pursuant to the FIR registered by EOW in the NSEL matter, whichever is earlier, would be commensurate with the findings against the Noticee in this Order.

ORDER

57. I, therefore, in exercise of powers conferred under Section 19 of SEBI, Act, 1992, read with Regulation 27 of the Intermediaries Regulations reject the application filed by the Noticee seeking registration and also debar the Noticee from making a fresh application seeking registration, before SEBI, for a period of 03 (three) months from the date of this Order or till acquittal of the Noticee by a Court of competent jurisdiction, pursuant to the FIR registered by EOW in the NSEL matter, whichever is earlier.

58. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the aforesaid direction in paragraph 57 above.

59. Notwithstanding the direction at paragraph 57 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:

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

61. 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.

62. A copy of this order shall be served upon the noticee, the recognised Stock Exchanges and the Depositories for necessary compliance.

Sd/-

DATE: SEPTEMBER 12, 2023
PLACE: MUMBAI

S.V. MURALI DHAR RAO
EXECUTIVE DIRECTOR
SECURITIES AND EXCHANGE BOARD OF INDIA