

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER SECTION 12(3) 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:

CD Commosearch Pvt. Ltd.

SEBI Registration No: INZ000060233

In the matter of National Spot Exchange Limited (NSEL)

A. BACKGROUND

1. CD Commosearch Pvt. Ltd. ("**CCPL**"/"**Noticee**") was registered with Securities and Exchange Board of India ("**SEBI**") as a stock broker bearing SEBI registration no. INZ000060233. CCPL was earlier a member of National Spot Exchange Limited ("**NSEL**").
2. The present proceedings originate from the enquiry report dated October 18, 2019 ("**DA Report**"), submitted by the Designated Authority ("**DA**") in terms of regulation 27 of the SEBI (Intermediaries) Regulations, 2008 ("**Intermediaries Regulations**") as it stood at the relevant point of time prior to its amendment vide SEBI (Intermediaries) (Amendment) Regulations, 2021, w.e.f. January 21, 2021. The DA, based on findings recorded in the said DA Report, recommended that the registration of CCPL as a stock broker may be cancelled.

B. SHOW CAUSE NOTICE, REPLY AND HEARING

3. Pursuant to the DA Report, a post enquiry show cause notice dated January 03, 2020 ("**SCN**") was issued to the Noticee, alongwith copies of (i) the aforesaid DA

Report; (ii) Finance Ministry letter dated December 30, 2014 to Forwards Market Commission ("**FMC**"); (iii) Hon'ble Bombay HC's order in criminal bail application no. 1263 of 2014 in Jignesh Prakash Shah vs. State of Maharashtra dated August 22, 2014. In response to the SCN, the Noticee filed a reply dated March 23, 2020.

4. While the aforesaid proceedings were pending, SEBI passed five separate orders rejecting the applications filed by five other entities for registration as commodity brokers in NSEL matter during February 2019. Aggrieved by the said SEBI orders, the entities filed separate appeals before the Hon'ble Securities Appellate Tribunal ("**Hon'ble SAT**"). The Hon'ble SAT *vide* its common order in the matter of Geofin Comtrade Ltd. And Ors. vs. SEBI (Appeal no. 214 of 2019) dated June 09, 2022 ("**June 2022 SAT Order**"), remanded the aforesaid SEBI orders to decide these matters afresh within six months from the date of the said order. While remanding the aforesaid SEBI orders, the Hon'ble SAT *inter alia* held as under:

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

5. On July 15, 2022, Noticee submitted another reply. Further, a hearing opportunity was also granted to the Noticee. The Noticee appeared through video conferencing on July 19, 2022 and argued on similar lines as the reply submitted by it. Due to administrative reassignment, the present case was allocated to me for further proceedings. In light of the June 2022 SAT Order, it was felt necessary to furnish certain additional documents/material to the Noticee and grant an opportunity of

personal hearing, before concluding the present proceedings. Accordingly, a supplementary SCN dated February 27, 2023 (“**SSCN**”) was served on the Noticee along with the following documents:

- (i) Copy of SEBI complaint dated September 24, 2018 filed with Economic Offences Wing (“**EoW**”);
- (ii) Copy of FIR dated September 28, 2018 filed by SEBI under section 154 of Criminal Procedure Code, 1973 (“**CrPC**”);
- (iii) Amended Schedule II of Intermediaries Regulations; and
- (iv) Copy of chargesheet dated December 02, 2022.

6. *Vide* letter dated March 24, 2023, Noticee submitted a request for certain documents, which were provided by SEBI *vide* letter dated May 18, 2023. The Noticee submitted another reply *vide* letter dated May 23, 2023. Thereafter, a hearing opportunity was granted to the Noticee on June 22, 2023. On the said date, the authorized representatives (“**ARs**”) of the Noticee appeared before me in person and submitted another reply. The ARs reiterated submissions made in their replies and also stated that they have no additional submissions to make with respect to the Noticee.

7. The written submissions filed by the Noticee dated March 23, 2020, July 15, 2022, May 23, 2023 and June 22, 2023 and the oral submissions made during the course of personal hearing held on June 22, 2023 are summarized hereunder:

PRELIMINARY CONTENTIONS

7.1. Preliminary Contention 1: Proceedings should be disposed of owing to delay

7.1.1. Allegations in the DA Report refer to transactions executed during the years 2009 to 2013, *i.e.*, about 7 to 11 years old. DA SCN was dated September 24, 2018 *i.e.*, 5 to 9 years after the alleged violation but days before the period of 3 years saved *vide* the Finance Act, 2015 ended on September 28, 2018. Thereafter, *vide* letter dated

March 11, 2019, certain documents said to be relied upon by the DA in issuing DA SCN were provided. Thus, the allegations of DA preceded the documents said to be relied upon by the DA. Forwarding some relied upon documents in aforesaid manner after 6 months of issuing DA SCN and 3 months after receiving reply from the Noticee is an afterthought.

7.1.2. After 3 years of receipt of SCN and conclusion of hearing before WTM (SKM), SSCN has been sent. The documents sent along with the SSCN have the following defects: (i) FMC complaint dated January 16, 2015 is blurred and illegible; (ii) even numbered pages of Annexure H (chargesheet dated December 02, 2022) have not been received. Further, the documents have been provided in tranches.

7.1.3. Complaint was filed by SEBI on September 24, 2018 and FIR was filed on September 28, 2018. The documents were forwarded to Noticee on March 03, 2023, *i.e.*, 7 years after the Forward Contracts (Regulation) Act, 1952 ("**FCRA**") was repealed and 4 years after the last date *i.e.*, September 28, 2018, whereas the period for initiating proceedings under section 29A(2)(e) is 3 years by which SEBI could have initiated action. Thus, the proceedings are *void ab initio* and deserve to be disposed of without any action. The aforesaid documents refer to transactions during the years 2009 to 2013. Regarding delay, reliance is placed on the following decisions of Hon'ble SAT:

- (i) In the matter of Man Industries Ltd. and Ors. vs. SEBI (Appeal no. 64 of 2023), decided on January 19, 2023.
- (ii) In the matter of Parag Sarda and Ors. vs. SEBI (Appeal no. 279 of 2020), decided on November 12, 2020.
- (iii) In the matter of Ashlesh Gunvantbhai Shah and Ors. vs. SEBI (Appeal no. 169 of 2019), dated January 31, 2020.
- (iv) In the matter of Sanjay Jethalal Soni and Ors. vs. SEBI (Appeal no. 102 of 2019), decided on November 14, 2019.

7.1.4. The June 2022 SAT Order forwarded to Noticee as Annexure B of SSCN, states that Hon'ble SAT has granted 6 months' timeline to SEBI to decide the matter afresh. The said timeline is binding on the Competent Authority, and it has not been adhered to, hence, the proceedings deserve to be disposed of. The same direction was also given by Hon'ble SAT in subsequent orders dated July 20, 2022 and July 29, 2022, annexed as Annexure C and D to the SSCN. Forwarding the documents referred in the SSCN by relying on the aforesaid orders of Hon'ble SAT is not justified, as Noticee was not a party to those appeals before Hon'ble SAT. Since for issuing additional documents *vide* the SSCN, the Competent Authority has relied upon the order dated June 09, 2022, it is duty bound to follow the timeline stipulated therein. Reliance is placed on the decision of Hon'ble SAT in IFGL Refractories Ltd. vs. SEBI (Appeal no. 1044 of 2022) dated January 06, 2023 and Nirmal Kotecha vs. SEBI decision dated June 08, 2021.

7.1.5. The facts/circumstances and the timings of various communications from SEBI demonstrate an inordinate delay and a predetermined mind in this matter. Therefore, the proceedings should be disposed of without any adverse action.

7.2. Preliminary Contention 2: Observations in DA Report do not fall within the contours of Intermediaries Regulations

7.2.1 The appointment of DA under the Intermediaries Regulations is provided only for enquiring into matters falling within the purview of regulation 23 of Intermediaries Regulations *i.e*, either the entity fails to comply with the conditions subject to which registration certificate was granted or the entity has contravened any provisions of securities laws, directions *etc*. The Noticee was not a "stock broker" or an "intermediary" prior to July 11, 2016. NSEL was not a "stock exchange" and trades executed on NSEL were not in the nature of "securities". Further, provisions of regulations 23 and 24(1) of Intermediaries Regulations states that violations stated therein should have occurred on a date subsequent to the date the intermediary has been granted a registration certificate. The Noticee was registered with SEBI as

“stock broker” with effect from July 11, 2016, and the allegations mentioned in the SCN pertain to the period prior to August, 2013. During the period of its registration as a “stock broker”, the Noticee had not participated in/facilitated paired contract as alleged in the SCN. Therefore, the SCN is bad in law and *void ab initio*. Therefore, none of the observations in DA Report fall within the contours of Intermediaries Regulations.

7.2.2 In terms of regulation 2(1)(ga) of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (“**Brokers Regulations**”), a “stock exchange” means a stock exchange recognized by the Central Government or SEBI under section 4 of the Securities Contracts (Regulation) Act, 1956 (“**SCRA**”). Section 2(j) of SCRA prior to Finance Act, 2015 amendment stated that stock exchange means body of individuals constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. Further, FMC order dated December 17, 2013 states that NSEL is neither registered nor a recognized association/exchange under FCRA. Thus, NSEL was neither recognized as a “stock exchange” by CG or SEBI or the products traded/dealt on NSEL were in the nature of “securities”. The same was also admitted by FMC in its order. Provisions of Finance Act, 2015 came into effect from September 28, 2015. Section 133B of Finance Act, 2015 included “commodity derivatives” within the definition of “derivative” under section 2(ac) of SCRA, thereby, bringing commodity derivatives within the ambit of “securities” with effect from the aforesaid date. There is no stipulation that section 2(ac) of SCRA is retrospective. Therefore, trades executed by the Noticee on NSEL were not “securities” at the relevant time, due to which they do not fall within the ambit of SCRA, and hence SEBI.

7.2.3 As Noticee was not a “stock broker” or an “intermediary” before July 11, 2016, the question of violation of Brokers Regulations prior to the said date while acting as a member of NSEL which was neither recognized nor registered as a “stock exchange” does not arise.

7.2.4 Regulation 5(e) of Brokers Regulations states that for considering grant of certificate, SEBI shall take into account “fit and proper person” criteria set out in Schedule II of Intermediaries Regulations. Since the Noticee has not submitted any application for grant of registration certificate to SEBI, the said allegation about violation of regulation 5(e) is *void ab initio*. The DA Report does not specify which provision of securities law has been violated by the Noticee.

7.3. Preliminary Contention 3: SCN issued under the erstwhile Regulation 28(1) of Intermediaries Regulations is without any such law being in force on date

7.3.1 The SCN dated January 03, 2020 was issued under regulation 28(1) of Intermediaries Regulations. The SSCN states that the present proceedings are conducted under regulation 27 of Intermediaries Regulations. The SSCN is admittedly supplementary to the said SCN. Since SSCN is supplementary to SCN, the same is also in fact issued under the provisions of regulation 28(1) of Intermediaries Regulations, which has been omitted and not saved *vide* amendment regulations with effect from January 21, 2021. Thus, as on date, the aforesaid regulation does not exist.

7.3.2 In view of the above, any proceeding from January 21, 2021 under omitted provisions of regulation 28(1) of Intermediaries Regulations is wholly unsustainable. As on date, the SCN and SSCN do not survive for consideration of the Competent Authority. In this regard, reliance is placed on the decision of Hon’ble SC in Kolhapur Canesugar Works Ltd. vs. UOI, dated February 01, 2000.

7.3.3 If it is held that the present proceedings are under the provisions of regulation 27(1) of Intermediaries Regulations, the same are fresh proceedings and hence are time barred owing to section 29(A)(2)(e) of FCRA.

7.4. Preliminary Contention 4: The proceedings should be dropped without any action owing to Clause 4 to Schedule II to Intermediaries Regulations

- 7.4.1 Assuming without admitting that Noticee has committed any violation due to rendering service to investors on NSEL in alleged “paired contracts” which without delay would have led to an action by SEBI on or before 2015, then it would not have been able to apply for registration till 2020 (*i.e.*, the 5 year period stipulated under the said regulations would have ended by 2020). FMC was merged with SEBI with effect from September 28, 2015 *i.e.*, over 7 years ago. Thus, any delay on the part of SEBI should not be held against it.

7.5. Preliminary Contention 5: While forwarding documents *vide* SSCN, the Competent Authority has assumed the role of DA

- 7.5.1 The documents attached with the SSCN were available with SEBI at the time of issuing SCN. Thus, an attempt is being made to modify the initial allegations levelled *vide* the SCN. Any retrospective reliance on such documents would be gross violation of law and principles of natural justice.
- 7.5.2 The provisions of omitted regulation 28(1) or amended regulation 27(1) of Intermediaries Regulations do not provide for including any fresh observations/allegations by the Competent Authority which were not concluded by the DA after following the due process of Intermediaries Regulations. In terms of Regulation 28(1) of Intermediaries Regulations, the Designated Member is required to independently consider DA Report and not add certain observations of other authorities.
- 7.5.3 When law prescribes certain acts to be done in a particular manner, the same is to be done in the said manner. Reliance is placed on the decisions of Hon’ble SC in Asset Reconstruction Company Ltd. vs. S.P. Velayutham & Ors. dated May 04, 2022 and Chandra Kishore Jha vs. Mahavir Prasad.

7.5.4 Further, the fundamental principle of natural justice “*nemo judex in sua causa*” states that no person can judge a case in which he or she is a party or in which he/she has an interest. As per the SSCN, the Competent Authority would be judging the very same observations/allegations brought by itself. Reliance is placed on the order of Hon’ble SAT in Shruti Vora vs. SEBI dated February 12, 2020, wherein it *inter alia* held that AO is bound to follow the procedure prescribed under the act and rules. In view of the above, the proceedings *vide* the SSCN including complaint, FIR and chargesheet ought to be dropped.

7.6. Preliminary Contention 6: Proceedings should be dropped as FCRA has been repealed

7.6.1 FCRA was repealed with effect from September 29, 2015. Further, as per section 29A(2)(e), fresh proceedings related to an offence under FCRA may be initiated by SEBI within 3 years from the date of repeal (*i.e.* by September 29, 2018).

7.6.2 Since the complaint and FIR was forwarded to the Noticee on March 03, 2023, *i.e.* 7 years after the FCRA was repealed and 4 years after the last date by which SEBI could have initiated action against the Noticee, the proceedings initiated by SEBI are not maintainable and are liable to be dropped.

7.7. Preliminary Contention 7: Proceedings by SEBI are vitiated and are not maintainable since under the erstwhile FCRA, the power to investigate was with the police

7.7.1 NSEL was offering alleged paired contracts since 2009 and the Department of Consumer Affairs, Government of India (“**DCA**”)/FMC never objected to the same till the discontinuance of the contracts in July, 2013.

7.7.2 SEBI has lodged FIR with MIDC police station on September 28, 2018 alleging violation of section 20(d), (e), 21(b)(d)(f)(e) of FCRA by Noticee. The said FIR has

been filed against the entities named therein for violation of provisions of FCRA due to trading by such persons in paired contracts at the trading platform of NSEL. There is no other allegation against Noticee.

7.7.3 As per section 29(A)(2)(e) of FCRA, the present proceedings under Intermediaries Regulations for alleged violations of FCRA are not maintainable as such violation should have been brought to the notice of the concerned police authorities by SEBI through a complaint, which was done by SEBI on September 24, 2018 and September 28, 2018. SEBI is not empowered to investigate/inquire the allegations in the FIR.

7.7.4 With respect to powers of SEBI and NSEL matters, the Ministry of Finance *vide* letter dated November 20, 2015 had advised that SEBI is not expected to deal with matters which were not dealt by erstwhile FMC. Further, it was clarified that since spot markets/ready delivery contracts were not being regulated by FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets. Since FMC has not initiated any action against Noticee in the capacity of trading member of NSEL, SEBI is also prohibited from initiating.

MAIN CONTENTIONS

7.8. Main Contention 1: Initiation and continuation of proceedings against the Noticee are void ab initio as SEBI has accepted the surrender of registration certificate of the Noticee

7.8.1 The Noticee was granted registration certificate as a stockbroker by SEBI on July 11, 2016. On September 15, 2017, it submitted a duly completed application for surrendering the said registration to MCX, which was approved by it with effect from January 15, 2018. Further, from the said date, Noticee is also not registered with SEBI as a “stock broker” or “commodity derivatives broker”. Therefore, it was not a “stock broker” or “commodity derivative broker” or “intermediary” as defined under

regulation 2(1)(g) of Intermediaries Regulations on the date on which the action was approved or the DA was appointed or the SCN was issued by the DA or Competent Authority or SSCN was issued. Hence, nothing survives for cancellation by the Competent Authority as recommended by the DA.

7.8.2 It is evident that SCN and SSCN have been issued after the Noticee has ceased to be a member of a recognized stock exchange and has also ceased to be registered as commodity derivatives broker with SEBI. Complaint and FIR was lodged by SEBI on September 24, 2018 and September 28, 2018, respectively, much after January 15, 2018, the same being the date of approval of request for surrender of registration certificate by MCX and SEBI.

7.8.3 Reliance is placed on the order passed by ED, SEBI in respect of Camco Commodities Pvt. Ltd. in the matter of trading on NSEL dated February 27, 2023. In the said case, considering the fact that the noticee therein had surrendered its registration before issuance of SCN, no direction under regulation 27 of the Intermediaries Regulations was issued. Reliance is also placed on order passed by Competent Authority, SEBI in respect of Sharekhan Commodities Pvt. Ltd. in the matter of trading on NSEL dated June 16, 2023, wherein, in light of surrender of registration certificate by the noticee therein and its acceptance by SEBI, it was held that the determination of whether the noticee therein is 'fit and proper person' is infructuous. In the said case, no directions against the noticee were issued. Further, in Bharat Sanchar Nigam Ltd. & Anr. vs. UOI & Ors. dated March 02, 2006, the Hon'ble SC held that where the facts and law in a subsequent assessment year are the same, quasi-judicial or judicial authority cannot generally be permitted to take a different view.

7.9. **Main contention 2: DA Report or SSCN does not bring out any material to support that Noticee had knowledge of the illegality of the alleged paired contracts at the relevant time**

- 7.9.1 Reliance has been placed on decision of Hon'ble SC in Canara Bank & Ors. vs. Debasis Das & Ors., 2003 wherein it was held that principles of natural justice require that notice issued should apprise the party determinatively of the case he has to meet and it must be precise and unambiguous.
- 7.9.2 The observations contained in first 3 pages of DA Report (*i.e.*, observations by Department of Economic Affairs and Hon'ble Courts) are neither against the Noticee nor they contain any adverse conclusions against it. Such observations are not pursuant to any enquiry in accordance with Intermediaries Regulations. Therefore, such observations against third persons cannot be applied to the Noticee during the instant proceedings. Despite the absence of adverse observations by the said Department and Hon'ble Courts against the Noticee, adverse inferences have been drawn against the Noticee by the DA. SEBI is requested to furnish specific information/violations alleged against the Noticee by the Department of Economic Affairs/Hon'ble Courts referred in the DA Report along with the "basis of findings" and "material relied upon in those findings". The SCN does not bring out the details of "financing transactions" alleged to have been carried out by the Noticee, the names of entities with whom the Noticee has entered into "financing transactions" with, the amount financed and the dates of financing.
- 7.9.3 The FMC *vide* its order dated December 17, 2013 had declared the holding company of NSEL and its 3 ex-directors as not "fit and proper persons". Thus, the observations in the DA Report are not against the Noticee but against NSEL. Further, the DA has erred by relying on the findings of EoW Report as the said findings are interim in nature. The findings of EoW on 2 counts: (i) the EoW Report states that sellers had pledged their stocks in NSEL warehouses, whereas the Hon'ble SC in its decision dated April 30, 2019 has held that such stocks were missing; and (ii) the EoW report states that a scam of this magnitude could not have been carried out without large brokers. The scam has affected around 13,000 investors who have collectively lost Rs 5600 crores, *i.e.*, average each investor has lost Rs. 43 lakhs. An investor losing

Rs 43 lakhs cannot be called a novice investor who can misguided by trading cum clearing member.

- 7.9.4 Reliance on the case of Jignesh Prakash Shah vs. State of Maharashtra, dated August 22, 2014, wherein it was *inter alia* held that NSEL brokers have their own legal team and full knowledge of how the market operates is misplaced. The aforesaid is not a conclusion or finding of the said court but observations in connection with the bail application of the applicant in the matter and at the stage of his bail. In hearing the notice of motion in WP no. 337 of 2014, the Division Bench of Bombay High Court in its order dated November 17, 2014 did not rely on the aforesaid order. Further, against the said order, a special leave petition was filed before Hon'ble SC. The Hon'ble SC in its order dated November 17, 2014 directed that the observations made by Hon'ble HC shall not stand in the way in dealing in the trial by the trial court. In view of the above, the observation made in Hon'ble Bombay HC's order in *Jignesh Prakash Shah (supra)* cannot be relied upon.
- 7.9.5 Further, the Noticee was granted registration in 2016 only after SEBI had satisfied itself that it is a "fit and proper person" and that it has not violated any condition of registration. The SCN and SSCN does not demonstrate failure of Noticee to comply with any condition subject to which Noticee was granted registration certificate as a stock broker. Thus, the present proceedings do not fulfil the pre-requisites stipulated in regulation 23 of Intermediaries Regulations, and therefore, such proceedings not being in consonance with any provisions of securities laws are *void ab initio*.
- 7.9.6 Since the Noticee was registered with SEBI as a stock broker and intermediary, Noticee has not participated in or facilitated its clients in trading in any paired contracts or committed any default as alleged, therefore, the question of violation of Intermediaries Regulations does not arise. The Noticee was not an "intermediary" during the period of violation alleged in the SCN, or at the time of receipt of SCN from the DA. Therefore, initiation and continuation of proceedings under Chapter V is *void ab initio*.

- 7.9.7 DA has wrongly relied upon the case of Jermyn Capital LLC. In the said case, the WTM by order dated January 13, 2006, had established a close association of Jermyn Capital LLC by virtue of commonalities such as common directors, common shareholders, common names and common control by entities which had been already debarred by SEBI. In the present case, NSEL has/had no commonality or control over Noticee. Further, in contrast to the aforesaid matter, SEBI has not declared NSEL as not “fit and proper” or debarred it, hence, in view of the fact that NSEL continues to be “fit and proper” person, any adverse inference against the Noticee basis its alleged association with NSEL is bad in law.
- 7.9.8 The DA has erred in relying upon order of Hon’ble SAT in Mukesh Babu Securities Ltd. vs. SEBI. In the said case there were serious criminal charges against Mukesh Babu, the Chairman and MD of Mukesh Babu Securities. Mukesh Babu was a beneficiary in the matter. The CBI has alleged that there was a criminal conspiracy which resulted in wrongful loss to depositors and corresponding gains to Mukesh Babu. As opposed to the above, the SCN does not allege any criminal charge or financial irregularity by the Noticee.
- 7.9.9 In the June 2022 SAT Order, Hon’ble SAT had *inter alia* held that decisions in Jermyn Capital LLC and Mukesh Babu Securities Ltd. do not have precedent value.
- 7.9.10 Serious Fraud Investigation Office (“**SFIO**”) report cited in the DA Report is against NSEL, the same cannot be held against the Noticee.
- 7.9.11 DA has erred in holding that the Noticee had pay-out obligation of Rs. 92,26,59,167 to NSEL, rather the aforesaid amount is payable from NSEL to the Noticee as on September 19, 2013.

7.10. Main Contention 3: SEBI has violated principles of natural justice by relying on FIR and complaints filed by itself and by retrospectively applying amendment of Intermediaries Regulations with respect to the Noticee

- 7.10.1 SEBI has itself filed the complaints and the FIR, and now by way of the present proceedings, it is adjudging its own observations/allegations. Further, the criteria for “fit and proper person” laid out in Schedule II of Intermediaries Regulations took effect from November 17, 2021 which is after the initiation of present proceedings *vide* the SCN. An attempt is being made to modify the initial allegations levied *vide* the SCN. Therefore, any retrospective reliance on such documents and amendments that took place later would be in gross violation of principles of natural justice.
- 7.10.2 Criteria adopted by SEBI while levelling allegations in the present matter is not based on any material which would satisfy a rational mind and hence any exercise of power by competent authority which is based on such criteria is illegal. The orders passed by Hon’ble SAT dated June 09, 2022, July 20, 2022 and July 27, 2022 had emanated from similar material and in the same case. Therefore, proceedings *vide* the SSCN including the complaint, FIR and chargesheet are *void ab initio* and are liable to be dropped.
- 7.10.3 While events of years 2009-2013 are being considered *vide* the SCN and SSCN, the legal provisions which prevailed during the said years are being ignored. *Vide* the SSCN, SEBI complaint dated September 24, 2018, FIR dated September 28, 2018 and EoW chargesheet are being considered for adjudging, and the legal provisions which prevailed during 2018 are being ignored. However, amended Schedule II of Intermediaries Regulations which has come into effect later *i.e.*, from November 17, 2023, is being considered, which is contradictory.
- 7.10.4 The notification dated November 17, 2021 of the SEBI (Intermediaries) (Third Amendment) Regulations, 2021 states that the said regulation shall come into force

on the date of their publication in official gazette. For SEBI to consider any event which allegedly took place in 2009-2013, but which does not exist today for action *vide* these proceedings, would demonstrate that the said proceedings are contradictory, prejudiced, pre-determined and hence vitiated.

7.11. Main Contention 4: Notice has not carried out any financing transactions or paired trades on NSEL

- 7.11.1 During the time Noticee was registered with SEBI (from July 11, 2016 to January 15, 2018), it had not participated and/or facilitated clients in entering into paired contracts on NSEL platform. The period of alleged paired contracts on NSEL is from September 2009 to August 2013. Thus, the period of alleged paired trades mentioned in the SCN precedes the effective date of SEBI registration by 3 to 7 years. Despite Noticee's request to the DA, it has not been furnished information of trades and details of clients for whom it had allegedly participated and/or facilitated entering into paired contracts on NSEL from 2009 to 2013. Reliance is placed on decision of Hon'ble SC in State of Punjab vs. Chaman Lal Goyal (1995) and order of Hon'ble SAT in Tree House Education and Assn. Ltd. & Ors. vs. SEBI dated November 07, 2019.
- 7.11.2 Derivatives trading is akin to "financing transactions" alleged against the Noticee and day trading is akin to "paired contracts" alleged against the Noticee. Both derivative trading and day trading was not termed as illegal or in violation of any law by the stock exchanges or by SEBI but both these authorities facilitated/approved them. Further, the stock brokers who participated/facilitated derivative trades or day trading for their clients are neither alleged to be closely associated with the stock exchanges nor called into serious questions regarding their reputation/competence etc. Therefore, terming financing transaction and paired contracts in violation of law or alleging that the same establishes connection of Noticee with NSEL is self-contradictory. Hence, it is denied that during its registration, Noticee had carried out any financing transactions or paired trades on NSEL.

7.11.3 Hon'ble SC has also observed that the NSEL scam was due to missing stocks worth Rs. 6000 crores alone, leading to payment crisis, hence, the NSEL scam was irrespective of the alleged financing transactions, paired trades or alleged association taking place or not.

7.12. Main Contention 5: No evidence is furnished in support of alleged violation of section 20(d), (e), 21(b)(d)(e)(f) of FCRA mentioned in FIR

7.12.1 Paragraphs 2,3, 7 and 12 of the FIR lodged by SEBI contain allegations of violation of section 20(d)(e), 21(b),(d),(e), (f) of FCRA by 300 trading members of NSEL as set out in Annexure A to the complaint dated September 24, 2018.

7.12.2 Noticee's name is appearing in Annexure A of the said complaint, however, no evidence in support of the same has been forwarded to Noticee.

7.13. Main Contention 6: FIR lodged by SEBI is a preliminary document and it is factually incorrect

7.13.1 FIR is only the first instance of reporting a complaint lodged with police. It is a preliminary document based on one-sided statement of complainant without adjudication of the same. Any adverse reliance on FIR would be gross violation of law and cause irreversible damage to its reputation. No reliance can be placed on any such FIR/Complaint particularly when it has been filed by SEBI itself.

7.13.2 Noticee was registered with NSEL as a trading cum clearing member on March 28, 2011 till the time NSEL suspended trading in all alleged contracts (*i.e.* till July 27, 2013). However, SEBI has lodged FIR against Noticee alleging "occurrence of offence" during the period from 2008 to July 31, 2013. Since Noticee was not a member of NSEL during the entirety of the said period, SEBI has erred in this regard.

Further, since FIR is factually incorrect as stated above, the SCN and SSCN deserve to be disposed of without any action.

7.14. Main Contention 7: Ratio laid down by WTM, SEBI in order of Jermyn Capital LLC dated June 23, 2009 is applicable to the facts of the case and the DA has not properly considered the findings of Hon'ble SAT in Jermyn Capital LLC

- 7.14.1 *Vide* the aforesaid order, WTM has stated that persons/entities who had bad reputation and thereby contaminated the reputation of the applicant/intermediary, if no longer associated with the applicant/intermediary, the basis of the charge not being a “fit and proper person” does not survive, and therefore, the proceedings related to “fit and proper person” criteria becomes infructuous. Even after the person severs the association, there should be a moratorium period of 2 years. It is a matter of record that the alleged association of Noticee through the alleged paired contracts came to an end with effect from July 27, 2013. Thus, it is about 10 years since the cessation of those factors as against 2 years’ moratorium stipulated by WTM in the aforesaid order.
- 7.14.2 The notification exempting NSEL came into effect from June 05, 2007 (“**2007 Exemption Notification**”). The Noticee was admitted as a “trading cum clearance” member by NSEL on March 28, 2011 *i.e.*, 4 years after the said notification was issued. Therefore, the Noticee had no role in commencing or facilitating any activities by NSEL in violation if any of the conditions of the said exemption notification.
- 7.14.3 The DA has failed to consider that in decision of Hon'ble SAT in Jermyn Capital LLC dated September 06, 2006, it had also held that SEBI will have to show the material on the basis of which it concluded that the entity was not a “fit and proper person”. Further, the DA has failed to consider that the same was in the context of an intermediary seeking registration and no such application has been filed by the Noticee.

7.15. Main Contention 8: SEBI lodging complaint and FIR against the Noticee without taking similar action against NSEL is biased and bad in law

- 7.15.1 The FIR filed by SEBI dated September 28, 2018 states that NSEL was involved in organizing trading of illegal paired contracts of commodities. The Ministry of Finance *vide* letters dated June 19, 2014 and December 30, 2014 has advised FMC to take action against NSEL. Despite the above, SEBI has forwarded a copy of the FIR to the Noticee for taking action against it in the capacity of trading cum clearing member of NSL before pursuing and taking similar action against NSEL or any of the participants in the NSEL ecosystem (such as Financial Technologies India Ltd., national level clearing banks, depository participants, 6 state governments which had issued licenses to NSEL *etc*). NSEL had represented to the stakeholders about the trading and settlement mechanism at NSEL through its bye-laws, brochures, circulars *etc* and NSEL alone was designing and introducing contracts to be traded on NSEL. Thus, taking any action against the Noticee without first taking similar action against others who were part of NSEL ecosystem is biased and bad in law. Reliance is placed on decision of Hon'ble SAT in the matter of Vidhya Finvest Ltd., Kolkata and Ors. vs. SEBI dated September 30, 2013 and Networth Stock Broking Ltd. Vs. SEBI dated June 19, 2012.
- 7.15.2 Further, in orders dated December 17, 2013 (FMC Order), April 30, 2019 (63 Moons vs. UOI), and April 22, 2022 (State of Maharashtra vs. 63 Moons) in the NSEL matters, FMC or the Courts therein have held that NSEL scam was not due to any violation by members/brokers, but it was perpetrated by NSEL, its promoters and management due to missing stock. The said orders/decisions clearly demonstrate that members/brokers were victims of NSEL fraud and concealment. The said orders/decisions do not have any conclusions against members/brokers. Noticee and its clients are yet to receive crores from NSEL not because of any generally known risks associated with trading on the NSEL platform or due violation alleged to have been committed by Noticee but due to scam perpetrated by NSEL, its promoters and management. Therefore, merely undertaking trades on NSEL

platform in ordinary course of business as 'trading cum clearing member' cannot be considered as a ground for close association with NSEL and alleged paired contracts as alleged.

- 7.15.3 Attention is drawn to regulation 2(1)(b) of Intermediaries Regulations which defines the term "associate". Noticee was not associated with NSEL as per the aforesaid definition. Reliance is placed on June 2022 SAT Order wherein Hon'ble SAT had held that there is nothing on record to indicate close association of the said brokers with Jignesh Shah, and therefore, a presumption that the said brokers have close association with Jignesh Shah, due to which their reputation is eroded is not based on any cogent evidence.

C. BRIEF HISTORY OF NSEL SCAM

8. Before moving forward to consider the matter on merits, the background facts necessary for the present proceedings are narrated in brief as under:

- (i) NSEL was incorporated in May 2005 with the purpose of developing an electronic spot exchange for trading in commodities. In exercise of powers conferred under section 27 of the FCRA, the Central Government *vide* the 2007 Exemption Notification, granted an exemption to all forward contracts of one-day duration for the sale and purchase of commodities traded on NSEL from operations of the provisions of the FCRA subject to certain conditions. The said notification *inter alia* stated that "*no short sale by the members of the exchange shall be allowed*" and "*all outstanding positions of the trades at the end of the day shall result in delivery*". 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.
- (ii) In October 2008, NSEL commenced operations providing an electronic trading platform to its participants for spot trading of commodities, such as bullion, agricultural produce, metals, etc. It is observed that NSEL had

introduced the concept of 'paired contracts' in September 2009 which allowed buying and selling in same commodity through two different contracts at two different prices on the exchange platform wherein the investors could buy a short duration contract and sell a long duration contract and *vice versa* at the same time and at a pre-determined price. The trades for the buy contract (T+2 /T+3) and the sell contract (T+25/T+36) used to happen on NSEL on the same day at same time and at different prices, involving the same counterparties. The transactions were structured in a manner that buyer of the short duration contract always ended up making profits.

- (iii) On February 06, 2012, the erstwhile FMC was appointed by DCA as the 'designated agency' as stipulated in one of the conditions prescribed under the said 2007 Exemption Notification, authorizing it to collect the trade data from NSEL and to examine the same for taking appropriate measure, if needed, to protect investors' interest.
- (iv) DCA on April 27, 2012 directed NSEL to show cause as to why action should not be initiated against it for violation of the conditions mentioned in the 2007 Exemption Notification.
- (v) Subsequent to the above, NSEL filed a reply. Further, MCA sought comments of FMC on the said replies. MCA also sought certain information from NSEL pursuant to which *vide* its letter dated July 12, 2013, MCA directed NSEL to give an undertaking that:
 - a. No further/fresh contracts shall be launched by NSEL until further instructions from the concerned authority; and
 - b. All the existing contracts will be settled on the due dates

- (vi) NSEL issued a circular on July 31, 2013 suspending its spot exchange operations.
- (vii) On August 27, 2013, FMC directed a forensic audit of NSEL by Grant Thornton LLP. Further, the Union of India ordered an inspection of accounts of NSEL and 63 Moons Technologies Ltd. (*earlier FTIL*) under section 209A of the Companies Act. The EoW also registered cases against the directors and key management personnel of the NSEL and 63 Moons (*earlier FTIL*) and against trading members and brokers of NSEL under the provisions of the Indian Penal Code and Maharashtra Protection of Interest of Depositors Act, 1999 ("**MPID Act**").
- (viii) After analyzing the trade data received from NSEL and the forensic audit report submitted by Grant Thornton LLP, the FMC passed Order dated December 17, 2013 in the matter ("**FMC Order**") wherein it *inter alia* observed that Financial Technologies (India) Ltd. is not a fit and proper person to continue to be a shareholder of 2% or more of the paid-up equity capital of MCX. Further, from paragraph 8 of the FMC Order, I note that the DCA *vide* its letter dated April 27, 2012 directed NSEL to explain as to why action should not be initiated against NSEL for violation of the conditions of the 2007 Exemption Notification. In response to the same, NSEL submitted a reply *vide* their letter dated May 29, 2012. DCA, *vide* its letter dated May 31, 2012, sought comments of FMC on the NSEL reply. The FMC, *vide* its letter dated August 02, 2012 to the DCA provided its comments on the two main issues, which are relevant for consideration of the matter at hand, as paraphrased hereunder:
 - (a) Short sale by members of the exchange: NSEL did not insist upon ownership of goods before allowing its members to place the sale order. FMC was of the view that all the sale transactions which are not backed by the ownership of goods were in violation of the

condition of “*no short sale by the members of the Exchange shall be allowed*” as stated in the 2007 Exemption Notification.

- (b) Contracts in which settlement period goes beyond 11 days: In view of the definition of “forward contract” under FCRA, FMC was of the view that all the contracts traded on NSEL which provide settlement schedule for a period exceeding 11 days are “non-transferable specific delivery contracts”. Thus, even if the 2007 Exemption Notification does not specify the delivery period, NSEL had to settle the delivery for all open positions within a period of 11 days as NSEL was allowed to only trade in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days.
- (ix) On September 19, 2014, Ministry of Finance, Government of India, issued a notification withdrawing the exemption granted to NSEL *vide* the 2007 Exemption Notification.
- (x) From the above, it is clear that NSEL had permitted contracts of various commodities having duration longer than 11 days and these contracts were in contravention of the exemption granted to NSEL. Subsequently, certain entities who were primarily borrowing on the NSEL platform through the modus of trading in the aforesaid “paired contracts” defaulted in fulfilling their payment obligations leading to a huge settlement default of outstanding contracts to the tune of Rs. 5600 Crores.
- (xi) EoW, Mumbai, *vide* letter dated April 04, 2015, had forwarded an interim report in connection with the investigation conducted by them to identify the role played by the broking houses in the NSEL case. The relevant extracts of the said interim report are as follows:

“IV. Objectives of this investigation into the brokers’ role: A scam of this magnitude would be difficult to continuously occur for 3 years without some of the large brokers’ gross negligence or perhaps active participation.

The actual role of the brokers was:

- To bring in investors to invest in ‘pair trades’ promising them assured returns and the investors got about 13-16% p.a. for investing in the commodity*
- The sellers got finance at 18-20 or more % by pledging their commodity in NSEL warehouses*

They got brokerage from investors on the NSEL platform, and those brokers who had their NBFCs got additional revenue by financing investors for investing on NSEL.

Though the matter is still under investigation, brokers have also received back from exchange certain charges collected from investors such as transaction fees, delivery and warehousing charges, etc. It is suspected that these are indirect motivation incentives for brokers to generate huge volumes. It is also possible that brokers may have benefitted from or compensated by the sellers or defaulters.

The higher the trading turnover, the higher revenues for the exchange and the brokers. Therefore, both wanted to increase turnover at the exchange. In light of the foregoing, the objective of EOW in investigating brokers was to inquire whether they had been involved in any wrongdoing connected with trading on NSEL, specifically, to determine whether they participated in

a) Any activities which were detrimental to the investors, NSEL, or third parties. To determine whether they had made false and misleading representations, offered inducement, financing and deliberately made wrongful assertions purely to get brokerage and facilitate NSEL in generating higher volumes.

b) Whether they had any illegitimate personal enrichment, or, there has been knowing dereliction in their duties as clearing and forwarding agents towards the commodities and protect the investors.

c) It was also deemed necessary to ensure that their activities were within the framework of law.

- (xii) Vide the Finance Act, 2015, FMC was merged with SEBI on September 28, 2015 in pursuance thereof SEBI was entrusted with the powers to regulate the trading in commodities futures market. As per the said act, an existing intermediary could continue to buy, sell or deal in commodity derivatives as a commodity broker, if it would make an application for its registration as an intermediary to SEBI within a period of 3 months from the date of merger till the disposal of such application by SEBI. Accordingly, the Noticee on the basis of an application so made by it, was granted SEBI registration number to operate as a stock broker in the securities market. In terms of the said act, FCRA was also repealed with effect from the aforesaid date.
- (xiii) On September 24, 2018, SEBI filed a complaint with EoW to initiate appropriate action against brokers/members of NSEL and other persons in the NSEL matter under sections 20, 21 and other appropriate provisions of the FCRA.
- (xiv) On September 28, 2018, SEBI gave a statement to the police which resulted into a FIR under section 154 of CrPC.
- (xv) It is also pertinent to refer to the judgment of the Hon'ble Supreme Court decided on April 30, 2019, passed in the matter of 63 Moons Technologies Ltd. (formerly known as Financial Technologies India Ltd.) & Ors. vs. Union of India & Ors. (Civil Appeal No. 4476 of 2019) (2019)18 SCC 401 ("**Merger Petition**"), wherein it *inter alia* held that:

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

- (xvi) Further, in judgement dated April 22, 2022 passed by the Hon'ble Supreme Court in the matter of The State of Maharashtra vs. 63 Moons Technologies Ltd. (Civil Appeal No. 2748-49 of 2022), the Hon'ble Supreme Court while drawing reference to the presentations made by NSEL in respect of the “paired contracts” has *inter alia* held that:

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

- (xvii) In the background of the aforesaid discussion pertaining to “paired contracts” as captured in the preceding paragraphs, I now move on to examine whether the Noticee satisfies the “fit and proper person” criteria as laid down in Schedule II of the Intermediaries Regulations.

D. CONSIDERATION OF ISSUES AND FINDINGS

9. I find it appropriate to first deal with the preliminary contentions raised by the Noticee.

DELAY IN PROCEEDINGS

10. The Noticee has argued that there has been an inordinate delay in the present proceedings as:

- (i) The transactions referred to in the DA Report pertain to 7 to 11 years ago;
- (ii) SCN was issued by the DA 5 to 9 years after the alleged violation;
- (iii) FIR and complaint was filed by SEBI in 2018 and the said documents were forwarded to the Noticee in 2023 *i.e.*, 7 years after the FCRA was repealed and 3 years after which SEBI could have initiated action;
- (iv) The 6 months' timeline prescribed by Hon'ble SAT in June 2022 SAT Order has elapsed.

In support of the above, the Noticee has relied upon the cases of *Man Industries Ltd. (supra)*, *Parag Sarda and Ors. (supra)*, *Ashlesh Guvantbhai Shah and Ors. (supra)*, and *Sanjay Jethalal Soni and Ors. (supra)*.

11. In this regard, I note that the NSEL scam unfolded in 2013 after which several agencies such as EoW, SFIO, *etc.* conducted investigations into the activities of NSEL. Further, FMC, Hon'ble Bombay HC and Hon'ble SC made important pronouncements relating to different facets of the matter such as whether merger of NSEL with FTIL should be permitted and whether NSEL can be considered as a "financial establishment" under the MPID Act. A large number of brokers had allegedly participated in the illegal contracts at NSEL platform. After the merger of FMC with SEBI on September 28, 2015, some of these brokers applied for registration with SEBI. It is true that the trades and actions pertain to the period from 2009 to 2013. However, the jurisdiction was conferred on SEBI only on September 28, 2015. Thereafter assessing all the factual circumstances available before SEBI and considering the importance of fulfilling "fit and proper person" criteria by brokers,

action was duly initiated against the set of brokers who executed the alleged trades. Thus, in absence of any prejudice caused to the Noticee, merely because proceedings were initiated in 2018 by way of DA SCN, I find that the present proceedings do not stand vitiated. Further, I note that after issuance of DA SCN, June 2022 SAT Order was passed by Hon'ble SAT wherein it set aside the impugned orders of WTM concerning similar facts and evidence as the present case. I find it appropriate here to briefly delve into the grounds on which the impugned orders of SEBI were set aside by Hon'ble SAT leading to the issuance of SSCN. The grounds are as follows:

- (i) The observations of the Hon'ble Bombay High Court in the matter of 63 Moons vs. Union of India (Writ Petition No. 2743 of 2014 dated December 04, 2017) cannot be relied upon as the said judgement has been set aside in appeal by the Hon'ble Supreme Court in the Merger Petition judgment.
- (ii) The observation from the order dismissing the Writ Petition filed by NSEL against the invocation of the MPID Act in NSEL vs. State of Maharashtra and Ors. (Writ Petition No. 1403 of 2015 dated October 01, 2015), cannot be relied upon, as in a subsequent Writ Petition moved by 63 Moons Technologies Ltd., in Writ Petition No. 1181 of 2018, a Division Bench of the Hon'ble Bombay High Court observed that the *prima facie* observations made in its earlier order were not binding and the same was observed since further investigation was in process at the relevant stage.
- (iii) The observations in the bail rejection order dated August 22, 2014, passed by the Hon'ble Bombay High Court in the matter of Jignesh Prakash Shah vs. The State of Maharashtra, cannot also be relied upon as such observations were limited to the fact as to whether the bail should be granted or not.
- (iv) Reliance on the SFIO Report was misplaced. The report only directs EoW/Police to initiate appropriate proceedings against NSEL and its

directors/promoters. Based on the SFIO Report, the Special Sessions Judge took cognizance of the matter by an order dated July 29, 2019 which was challenged due to jurisdiction before Hon'ble Bombay High Court. The Hon'ble Bombay High Court by an order dated January 15, 2020 passed an interim order staying the effect and operation of the impugned order dated July 29, 2019.

- (v) Reliance placed on decisions of the Hon'ble Tribunal in the matter of Jermyn Capital vs. SEBI and Mukesh Babu Securities vs. SEBI 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 Hon'ble Tribunal was of the view that the criteria for passing an ad interim order are based on a different criterion, namely *prima facie* case, the balance of convenience and irreparable injury which are distinct and different while considering an application for grant of certificate of registration. The decision in the matter of Mukesh Babu Securities was distinguished by the Hon'ble Tribunal on the basis that in the said matter a criminal complaint was filed against the chairman of the company. The Hon'ble Tribunal noted that with respect to the appellants, there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.
- (vi) Regarding close association of the appellant with NSEL, forensic report which was made at the behest of SEBI has exonerated the appellant on this charge. This fact has not been considered by the WTM while holding the appellant to be closely connected with NSEL. There is no finding in the impugned cases indicating that the appellants have any control directly or indirectly over NSEL and, therefore, the question as to whether the appellant is a close associate of NSEL has not been considered in the right perspective.

- (vii) In the impugned cases, the application for grant of registration certificate has been rejected without specifying how long the rejection of application would continue. Such rejection cannot continue indefinitely and if an application is rejected, a period should be prescribed within which the broker cannot apply for grant of a fresh registration certificate but after the expiry of the period he could file such an application.

The SSCN issued pursuant to the June 2022 SAT Order takes into consideration additional material available on record. The issuance of SSCN, delivery of SSCN, examining the reply to the SSCN and hearing conducted thereafter, were essential steps in ensuring that principles of natural justice are being met at the cost of prolonging the conclusion of present proceedings. Therefore, I find that the events detailed above necessitated an extended period for concluding the proceedings.

12. The Noticee has further argued that there was delay in forwarding the FIR and complaint filed by SEBI to Noticee, as the same was received by the Noticee 7 years after the FCRA was repealed and 4 years after the last date SEBI could have initiated proceedings. I note that the complaint and the FIR filed basis the complaint was filed on September 24, 2018 and September 28, 2018 respectively, which was within the time period permitted under section 29A(2)(e) of FCRA. Section 29A(2)(e) of FCRA states that fresh proceeding relating to an offence under the FCRA may be initiated within 3 years from repeal of FCRA. In relation to forwarding the said complaint and FIR to the Noticee, as noted above, while the instant matter was under consideration, the Hon'ble SAT *vide* the June 2022 SAT Order remitted certain orders pertaining to some other brokers who had also participated in paired contracts on NSEL to SEBI to decide the matter afresh. The Hon'ble SAT left it open to SEBI to rely on other material like EOW charge sheet, complaint letters etc., after providing the same to the appellants therein. In line with the aforesaid order of the Hon'ble SAT, SSCN was issued to the Noticee along with the FIR and complaint. Therefore, present proceedings cannot be vitiated for supplying documents in compliance with the order of Hon'ble SAT which is also in adherence to principles of natural justice.

13. The Noticee has also argued that the 6 months' timeline prescribed by Hon'ble SAT in the June 2022 SAT Order has elapsed, therefore, the current proceedings should be disposed of. In support of the above, Noticee has relied on the decisions of Hon'ble SAT in *IFGL Refractories Ltd. (supra)* and *Nirmal Kotecha (supra)* to *inter alia* state that the WTM is bound by the order of Hon'ble SAT and that once an issue on the same facts between same parties has been determined, estoppel operates in subsequent proceedings also. I note that the timeline prescribed in the June 2022 SAT Order was with respect to the entities which had filed an appeal *i.e.*, 5 brokers namely, Geofin Comtrade Ltd., Philip Commodities India Pvt. Ltd., IIFL Commodities Ltd., Anand Rathi Commodities Ltd. and Motilal Oswal Commodities Broker Pvt. Ltd. The said timeline cannot be made applicable to Noticee's case as the direction rendered therein was with respect to the specific facts in appeal before Hon'ble SAT. Thus, I find that this argument is without merit.
14. Noticee has argued that if SEBI would have taken action in 2015 *i.e.*, at the time of its merger with FMC, the period contemplated under clause 4 of Schedule II of Intermediaries Regulations would have elapsed, and it would have been eligible for applying for registration as on date. In this regard, I note that the said clause states that where any person has been declared as not "fit and proper" by an order of SEBI, 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 5 years from the date of effect of the order, if no such period is specified in the order. As stated above, various factors have contributed in the additional time needed to conclude the present proceedings such as investigation by multiple authorities, impact of June 2022 SAT Order, filing of chargesheet in December, 2022 *etc* which were outside the control of SEBI. Thus, merely because of passage of time, I do not find that present proceedings should be dropped as argued by the Noticee.

JURISDICTION OF SEBI

15. The Noticee has argued that the observations in the DA Report do not fall within the ambit of Intermediaries Regulations as the DA has jurisdiction only with respect to

matters wherein the entity fails to comply with the conditions subject to which registration certificate was granted or the entity has contravened any provisions of securities laws, directions etc. The Noticee was not a “stock broker” or an “intermediary” prior to July 11, 2016 (*i.e.*, when the alleged illegal transactions took place). NSEL was not a “stock exchange” and trades executed on NSEL were not in the nature of “securities”. Noticee has also argued that since it has surrendered its registration certificate with effect from January 15, 2018, nothing survives for cancellation. In relation to the above, I note that:

- (i) Before merger of FMC with SEBI, the Noticee was not required to be registered with either FMC or any other regulatory authority under the FCRA for carrying out the alleged paired contracts on NSEL. The Finance Act, 2015, recognized the said fact and also that the commodity derivative brokers should be regulated by SEBI. Considering the same, it was made mandatory for all commodity derivative brokers, who wished to continue their activities, to apply for registration with SEBI within a period of 3 months’ from September 28, 2015. Thus, by virtue of the provisions of the Finance Act, 2015, all those entities, who were functioning as commodity derivatives brokers, after having made their application within 3 months from September 28, 2015, were under the supervision and control of SEBI like any other intermediary holding a certificate of registration.
- (ii) The Noticee had applied for a certificate of registration as a broker and was granted a certificate of registration by SEBI with effect from July 11, 2016. Therefore, the Noticee had become a SEBI registered intermediary from the said date and falls under the definitions of a “stock broker” and an “intermediary”. Being a SEBI regulated intermediary, SEBI has the jurisdiction to examine whether the activities of the Noticee in “paired contracts” for its clients on the NSEL platform affects its ability to be considered as a “fit and proper person”.

- (iii) While the surrender of registration certificate prohibits the Noticee from conducting business as a broker post acceptance of its surrender of registration certificate by SEBI, it does not cure any illegalities that were committed by the Noticee while it was conducting its business as an “intermediary”. Post the merger of FMC with SEBI and due to Finance Act, 2015, the liabilities of the Noticee with respect to all the omissions and commissions done earlier while dealing with commodity derivatives continued to be subject to the jurisdiction of SEBI.

ISSUANCE OF SSCN BY COMPETENT AUTHORITY

16. The Noticee has argued that while forwarding documents *vide* the SSCN, the Competent Authority has assumed the role of DA as regulation 28(1)/27(1) does not provide for including any fresh observations/allegations by the Competent Authority which were not concluded by the DA after following the due process of Intermediaries Regulations.
17. In this regard, as stated above, the SSCN was issued in light of the June 2022 SAT Order to provide all relevant material to the Noticee to defend itself.

OTHER PRELIMINARY CONTENTIONS

18. The Noticee has argued that if it is held that the present proceedings are under the provisions of regulation 27(1) of Intermediaries Regulations as stated in the SSCN, the same are fresh proceedings and hence are time barred owing to section 29(A)(2)(e) of FCRA. In this regard, I note that the Intermediaries Regulations was amended and in view of the amendment made w.e.f. January 21, 2021, powers that were exercised under regulation 28 of the Intermediaries Regulations are now being exercised under regulation 27 of the Intermediaries Regulations. I find that this technical change does not have any effect on the present proceedings.
19. The Noticee has argued that SEBI has lodged FIR with MIDC police station on September 28, 2018 alleging violation of section 20(d), (e), 21(b)(d)(f)(e) of FCRA by Noticee, and that SEBI is not empowered to investigate/inquire into the said

allegations. It is hereby clarified that the scope of the present proceedings is not to inquire into the allegations of the FIR but to ascertain whether the Noticee is a “fit and proper person” under the Intermediaries Regulations. It is well within SEBI’s jurisdiction and powers to adjudge the said fit and proper status of the market intermediaries in the interest of securities market. Therefore, this contention deserves dismissal.

20. Before moving forward to examine charges and the evidence available on record, it would be appropriate to take a look at the legal provisions of the SEBI Act, which are relevant in the present case. It is alleged that the Noticee has violated (i) regulation 5(e) of Brokers Regulations read with Schedule II of Intermediaries Regulations; and (ii) regulation 9(b), 9(f) read with clause A(1), A(2) and A(5) of Schedule II of Brokers Regulations. The same are reproduced below 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.

Brokers 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; and
Liability for action under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

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

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

SCHEDULE II

Code of Conduct for Stock Brokers

A. General.

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

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

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

Intermediaries Regulations

Schedule II

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-clauses (b) and (c) of clause (2) comply with the 'fit and proper person' criteria.

RETROSPECTIVE APPLICATION OF INTERMEDIARIES REGULATIONS

21. Noticee has argued that the criteria for “fit and proper person” laid out in Schedule II of Intermediaries Regulations took effect from November 17, 2021 which is after the initiation of present proceedings *vide* the SCN. Further, it has argued that the notification dated November 17, 2021 of the SEBI (Intermediaries) (Third Amendment) Regulations, 2021 states that the said regulation shall come into force on the date of their publication in official gazette. Thus, SEBI is trying to retrospectively apply Intermediaries Regulations with respect to the Noticee.
22. In this regard, in my view, the amendment of Schedule II of the Intermediaries Regulations merely encapsulates the criteria in the form of distinctly identifiable parameters, which existed even before the amendment. I note that the above condition to be a “fit and proper person” is not a onetime condition applicable only at the time of seeking registration. Rather, the provisions governing the criteria show

that this is a condition which each and every registered intermediary is required to fulfil on a continuous basis as long as the entity remains associated with the securities market.

23. Therefore, even if the Noticee was found to have fulfilled the 'fit and proper person' criteria while granting the certificate of registration, in 2016, such an intermediary can still be assessed on being fit and proper at a later date. Furthermore, as and when the 'fit and proper' criteria changes, the Noticee will be required to comply with the revised criteria, and in this instance criteria as revised *vide* the amendments in November, 2021. Thus, this argument of Noticee is not maintainable.

ALLEGATIONS/EVIDENCE EMANATING OUT OF DA REPORT AND SSCN

24. The Noticee has argued that the DA Report or SSCN does not bring out any material to support that Noticee had knowledge of the illegality of the alleged paired contracts at the relevant time. The Noticee has submitted that the evidence and cases referred to in the DA Report *viz.* (i) observations of FMC order dated December 17, 2013; (ii) observations of Hon'ble Bombay HC's order in Jignesh Prakash Shah vs. State of Maharashtra; (iii) observations in Hon'ble SC's order in 63 Moons Technologies vs. UOI and Ors., order dated April 30, 2019; (iv) observations in EoW interim report dated April 04, 2015; (v) observations made by Department of Economic Affairs *vide* letter dated December 30, 2014; (vi) Hon'ble SAT's order in Jermyn Capital LLC vs. SEBI and Mukesh Babu Securities Ltd vs. SEBI are irrelevant as the Noticee was neither a party to the said proceedings nor was any order passed against it in the said evidence/cases. Considering the findings of Hon'ble SAT with respect to the above in the June 2022 SAT Order, I find that the said documents are not relevant for consideration in the present matter.
25. The Noticee has argued that during the time Noticee was registered with SEBI (from July 11, 2016 to January 15, 2018), it had not participated and/or facilitated clients in entering into paired contracts on NSEL platform. I find the above technical argument does not help the Noticee as while determining "fit and proper person"

criteria under Intermediaries Regulations, SEBI can take into account acts committed prior to granting registration as well. Further, I find it relevant to refer to the finding of Hon'ble SC in Merger Petition, wherein it *inter alia* held that:

"We have seen that neither FTIL nor NSEL has denied the fact that paired contracts in commodities were going on, and by April to July, 2013, 99% (and excluding Eseries contracts), at least 46% of the turnover of NSEL was made up of such paired contracts....."

Thus, it is clear that on NSEL (other than E-series contracts) the proportion of paired contracts as a percentage of total trades amounted to 99% in 2013. It is not the Noticee's case that the transactions facilitated by it for its clients were E-series contracts. Accordingly, by inference, transactions on NSEL facilitated by the Noticee, could not have been anything but "paired contracts".

26. Noticee has also contended that "derivatives trading" and "day trading" are akin to "financing transactions" and "paired contracts" respectively. If "derivatives trading" and "day trading" are not held illegal, then holding financing transaction/paired contracts as illegal is contradictory. In this regard, I note that in both derivatives trading and day trading, physical delivery of the underlying asset typically does not take place. As opposed to that, in the 2007 Exemption Notification, it was explicitly mentioned that *"all outstanding positions of the trade at the end of the day shall result in delivery"*. Thus, this contention of Noticee is not maintainable.
27. It is a matter of record that SEBI has filed a complaint dated September 24, 2018 with EoW, seeking appropriate action under Sections 20 and 21 and other applicable provisions of FCRA against the brokers/members of NSEL, mentioned in the list attached thereto. I note that the Noticee is listed at serial no. 278 in the said list. Pursuant to the SEBI complaint, FIR No. Spl LAC No. 110/18 dated September 28, 2018 under section 154 of the CrPC at the MIDC Police Station, Mumbai was registered requesting it to take lawful action against the same trading members, which were listed in the SEBI complaint to EoW. I note that pursuant to the said FIR,

11 separate final report forms under section 173 of CrPC were filed in the Special Court under MPID Act, Sessions Court, Mumbai. The 11th final report form titled “Chargesheet No. 11 (Final)” dated January 19, 2023 at page no. 40 contains the name of the Noticee. Further, 2 directors of the Noticee, are also included in the said chargesheet. The said chargesheet was provided to the Noticee along with the SSCN. Thus, Noticee’s argument that FIR is a preliminary document based on one-sided statement of complainant without adjudication of the same is not sustainable in light of the chargesheets filed pursuant to the detailed investigation conducted by the police which includes the name of the Noticee.

28. Noticee has argued that SEBI has itself filed the complaints and the FIR, and now by way of the present proceedings, it is adjudging its own observations/allegations which is in violation of principles of natural justice. Further, Noticee has contended that paragraphs 2,3, 7 and 12 of the FIR lodged by SEBI contain allegations of violation of section 20(d)(e), 21(b),(d),(e), (f) of FCRA by 300 trading members of NSEL, however, no evidence in support of the same has been forwarded to the Noticee. In this regard, I note that pursuant to the complaints filed against the Noticee, chargesheets have been filed by the police after investigating the offence stated in the FIR. In accordance with clause 3(b)(i) of Schedule II of Intermediaries Regulations, the pendency of a chargesheet filed against a person by any enforcement agency in matters concerning economic offence is sufficient to disqualify a person from being considered as a “fit and proper person”.
29. The Noticee has contended that the 2007 Exemption Notification came into effect from June 05, 2007 and the Noticee was admitted as a “trading cum clearance” member by NSEL on March 28, 2011 *i.e*, 4 years after the said notification was issued. Therefore, the Noticee had no role in commencing or facilitating any activities by NSEL in violation of any of the conditions of the said exemption notification. It is noted that the long leg of the paired transaction involved contracts being settled on a T+25 or T+36 basis, whereas the exemption granted by the DCA permitted NSEL to only offer spot delivery contracts. The 2007 Exemption Notification was available

in the public domain and even basic due diligence would have shown that the paired contracts were *per se* in violation of the said notification. Therefore, I am of the view that while participating in such contracts, the Noticee failed to examine the basic nature of the product and also failed in understanding the source of powers relied upon by NSEL for selling such products which other exchanges were not offering. Thus, the Noticee failed to conduct proper and effective due diligence on these aspects of “paired contracts” which were not essentially spot contracts. Hence, the Noticee cannot evade its responsibility by citing that it was admitted as a member of NSEL after the decision to offer paired contracts was taken by NSEL.

30. The Noticee has pleaded that by lodging complaint and FIR against the Noticee without taking similar action against NSEL or any of the participants in the NSEL ecosystem is biased and bad in law. In this regard, the scope of the present proceedings before me is limited to determine whether the Noticee satisfies the criteria of “fit and proper person” under the Intermediaries Regulations. The actions taken/not taken against other entities which may be involved in NSEL scam does not fall within the purview of the instant proceedings, hence, I do not find it appropriate to comment on the same.
31. In view of the above, I note that the Noticee has traded in “paired contracts” on behalf of its clients on NSEL. The execution of such paired contracts shows participation of the Noticee in the said scam which raises questions regarding the integrity, honesty, ethical behavior, reputation, fairness and character of the Noticee. The Noticee has also attracted clause 3(b)(ii) of Schedule II to the Intermediaries Regulations which states that pendency of a chargesheet against a person is a ground that SEBI may take into consideration for determining whether any person is a “fit and proper person”. I have considered cases similar to the facts of the present case, namely, orders passed in respect of Dani Commodities Pvt. Ltd. decision dated December 20, 2022, Camco Commodities Pvt. Ltd. decision dated February 27, 2023 and Sharekhan Commodities Pvt. Ltd. decision dated June 16, 2023.

32. The facts and circumstances along with other material available on record clearly leads me to the conclusion that the Noticee has not satisfied the “fit and proper person” criteria specified in Schedule II to the Intermediaries Regulations. However, considering the fact that the Noticee had surrendered its registration, which was accepted by SEBI, before action was approved for enquiry proceedings or SCN was issued, an order cancelling the certificate of registration as recommended by the DA would be infructuous at this point. Further, for the same reason, I find that issuance of any direction, under regulation 27 of Intermediaries Regulations, against the Noticee at this stage would not be feasible.

E. ORDER

33. In view of the facts and circumstances of the case and the conclusions arrived at discussed above, I, in exercise of powers conferred upon me under section 12(3) read with Section 19 of the SEBI Act and regulation 27 of the Intermediaries Regulations, hereby dispose of the SCN and SSCN issued to CD Commosearch Pvt. Ltd without any directions, limiting my findings to hold that the Noticee is not a “fit and proper person” under the Intermediaries Regulations.
34. This 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.
35. A copy of this Order shall be served on the Noticee and upon all recognized stock exchanges and depositories.

DATE: July 31, 2023

PLACE: MUMBAI

ANANTH NARAYAN G.

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA