

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

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

In respect of:

Sr. No.	Name of the Noticee	SEBI Registration No.
1	M/s Alpha Commodity Pvt. Ltd.	INZ000033238

In the matter of National Spot Exchange Limited

BACKGROUND

1. The present proceeding is originating from the Enquiry Report dated May 29, 2020, submitted by the Enquiry Officer (hereinafter referred to as “**EO**”) in terms of regulation 27 of the SEBI (Intermediaries) Regulations, 2008 as it stood at the relevant point of time prior to its amendment vide SEBI (Intermediaries) (Amendment) Regulations, 2021, w.e.f. January 21, 2021, wherein the Designated Authority (hereinafter referred to as “**DA**”), based on various factual findings and observations so recorded in the said Enquiry Report, has recommended that the registration of M/s Alpha Commodity Pvt. Ltd. (hereinafter referred to as “**ACPL/ Noticee**”) as a commodity derivatives broker be cancelled.
2. The aforesaid Enquiry Report was submitted pursuant to an enquiry proceeding initiated against the *Noticee* by the Securities and Exchange Board of India (hereinafter referred to as “**SEBI**”) based on the findings that *ACPL*, as a Trading and Clearing Member of the National Spot Exchange Limited (hereinafter referred to as “**NSEL**”), has dealt/facilitated in the trading of the ‘paired contracts’ at the exchange platform of the NSEL during the period September 2009 to August 2013 (hereinafter referred to as “**relevant period**”) which were in violation of the applicable provisions of erstwhile Forward Contracts (Regulation) Act, 1952

(hereinafter referred to as “**FCRA**”) and the conditions prescribed in the Government of India Notification dated June 5, 2007 (hereinafter referred to as “**2007 Exemption Notification**”). Further, it was observed that the continuance of the registration of the *Noticee* as a commodity derivatives broker (having Registration No. INZ000033238) is detrimental to the interest of the securities market and that the *Noticee* is no longer a ‘fit and proper person’ for holding the certificate of registration (Registration No. INZ000033238) as commodity derivatives broker in the securities market which is one of the conditions for grant/holding/continuance of registration, in terms of regulations 5(e), 9(b) and 9(f) of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as “**Stock Brokers Regulations**”) read with Schedule II of the SEBI (Intermediaries) Regulations, 2008 (hereafter referred to as “**Intermediaries Regulations**”).

3. In view of the aforesaid finding of facts, a DA was appointed to enquire into and to submit a report pertaining to the aforesaid acts of the *Noticee* and into the possible violations of regulations 5(e), 9(b) and 9(f) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations, allegedly committed by the *Noticee*.
4. The DA issued a show cause notice dated September 25, 2018 (hereinafter referred to as “**SCN**”) to the *Noticee* under regulation 25(1) of the Intermediaries Regulations (as applicable at the relevant time) asking the *Noticee* to show cause as to why appropriate recommendation should not be made against it under regulation 27 (as applicable at that time) of the Intermediaries Regulations read with the provisions of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as “**SEBI Act**”). In response to the same, *Noticee* vide its letter dated October 22, 2018 requested for four weeks’ time to submit a reply to the SCN. The DA after considering the request of the *Noticee*, granted it time till November 15, 2018 to submit its response to the SCN. *Noticee* vide its letter dated November 14, 2018 submitted its reply. Subsequently, the DA vide letter dated July 26, 2019 provided certain documents (as specified in the said letter) to the *Noticee* asking it to file its written response within 14 days of the receipt of the

said letter. *Noticee* vide its letter dated August 23, 2019 made additional submissions in the extant matter. Subsequently, *Noticee* was provided with additional documents / data vide letter dated February 26, 2020 and was advised to make further submissions, if any, in the extant matter by March 15, 2020. In response to the aforesaid letter dated February 26, 2020, *Noticee* vide its email dated April 20, 2020 made further submissions in the extant matter.

5. The background facts necessary for the present proceedings are narrated in brief, hereunder:

- i. *Noticee*, M/s Alpha Commodity Pvt. Ltd., is a commodity derivatives broker registered with SEBI having Registration No. INZ000033238 and is a member of the Multi Commodity Exchange of India Ltd. and the NSEL.
- ii. NSEL was incorporated in May 2005 as a Spot Exchange *inter alia* with a purpose of developing an electronic Spot Exchange for trading in commodities. In exercise of powers conferred under Section 27 of the FCRA, the Central Government vide its 2007 Exemption Notification granted an exemption to all forward contracts of one-day duration for the sale and purchase of commodities traded on the NSEL from operations of the provisions of the FCRA subject to certain conditions, *inter alia* including “*no short sale by the members of the exchange shall be allowed*” and “*all outstanding positions of the trades at the end of the day shall result in delivery*”.
- iii. In October 2008, the 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 the NSEL had introduced the concept of ‘paired contracts’ in September 2009 which allowed buy and sell in same commodity through two different contracts at two different prices on the exchange platform wherein the investors could buy a short duration contract and sell a long duration contract and vice versa at the same time and at a pre-determined price. The trades for the buy contract (T+2 / T+3) and the sell contract (T+25/ T+36) used to happen on the NSEL on the same day at same time and at different prices, involving the same counterparties.

- iv. On February 6, 2012, the erstwhile Forward Markets Commission (hereinafter referred to as “**FMC**”) was appointed by the Department of Consumer Affairs, Government of India as the ‘designated agency’ as stipulated in one of the conditions prescribed under the said 2007 Exemption Notification, 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 called for the trade data from different Spot Exchanges, including the NSEL in the prescribed reporting formats. After analyzing the trade data received from the NSEL, the FMC passed an Order in the matter on December 17, 2013 (hereinafter referred to as “**FMC Order**”) observing *inter alia* that several contracts offered for trade on the NSEL platform were in violation of the relevant provisions of the FCRA and that the condition of ‘*no short sale by members of the exchange shall be allowed*’ was being not complied with by the NSEL and its members. The 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 violations of the conditions specified by the Government of India in its 2007 Exemption Notification, while granting exemptions to the one day forwards contract for sale and purchase of commodities traded on the NSEL, from the purview of the FCRA.
- v. As per the Finance Act 2015 (vide which the FMC was merged with the SEBI), an intermediary could continue to buy, sell or deal in commodity derivatives as a commodity broker, if it had made an application for such registration to the SEBI within a period of 3 months from the date of merger till the disposal of such application. Accordingly, ACPL was granted the aforesaid SEBI Registration Number on December 25, 2015 on the application made by the *Noticee* to SEBI for registration as a commodity derivatives broker in this regard.
6. On the basis of the aforesaid factual details, the DA, after considering the replies filed by the *Noticee*, has *inter alia* observed the following in the report:

“31. Thus, in the light of the admission of the Noticee at Para 7(d) above, that it had dealt in the paired contracts on behalf of its clients and also considering the

material brought on record during the instant proceedings viz. i) the trade details of the Noticee provided by the concerned department of SEBI; ii) the table showing amount of total special pay out made by NSEL to its members dealing in the paired contracts on behalf of their clients (publically disclosed through NSEL Circular dated March 10, 2015 bearing RefNo. NSEL/C&S/2015/003); iii) the list of brokers, identified by EOW, who were alleged to have indulged in 'paired contracts', iv) The report of Grant Thornton India LLP dated September 21, 2013, on NSEL which contained a list of 148 members of NSEL against whom NSEL had pay-out obligations as on September 19, 2013, the fact that the Noticee had participated in the trading on the NSEL platform during the period September 2009 to August 2013, which were in violation of the Notification issued under Section 27 of FCRA, is established..

...

33. In view of the aforesaid, it is evident that the Designated Authority is required to make an appropriate recommendation of suspension / cancellation /prohibition or debarment, whichever is applicable, under Regulation 27 of the Intermediaries Regulations against the Noticee, where the facts and evidences so warrant. Therefore, I am of the view that the material placed before me on record establishes the factum of Noticee's indulgence in the statutorily prohibited 'paired contracts' on the platform of the NSEL. Therefore, in the facts and circumstances of the instant case, I conclude that the Noticee has violated Regulation 9(b) and 9(f) read with Clause A(1), A(2) and A(5) of the Schedule II of the Broker Regulations and Regulation 5(e) of the Broker Regulations read with Schedule II of the Intermediaries Regulations."

7. After considering the Enquiry Report, a post Enquiry SCN dated July 10, 2020 enclosing therewith the Enquiry Report of the DA along with certain material/information as specified therein, was issued to the Noticee under regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) calling upon it to show cause as to why the aforesaid materials/information as brought out above along with Enquiry Report concerning the fit and proper

person criteria, should not be considered and as to why the action as recommended by the DA or any other direction/measure as may be deemed fit, should not be passed against /imposed on it by the Competent Authority. The post Enquiry SCN further advised the *Noticee* to submit its reply, if any within 21 days of receipt of the said SCN.

8. *Noticee* vide its letter dated December 14, 2020 denied the allegations levelled against it in the SCN and *inter alia* submitted as follows:

8.1. The *Noticee* has not been provided with documents which have been relied upon by SEBI till date. The enquiry report has been prepared based on irrelevant documents available in public domain and which have no bearing on the case of the *Noticee*. Hence, the principles of natural justice had not been adhered to while conducting the enquiry proceedings.

8.2. As per the finding of the DA, no irregularity was involved in appointment of DA by the Whole Time Member of SEBI instead of by the Executive Director of SEBI (as mandated by Intermediaries Regulations). The said finding is completely misconceived and legally untenable. The powers delegated to SEBI officers under the SEBI (Delegation of Powers) Order, 2015 cannot be in derogation of delegation of power which have been delegated under the SEBI Regulations. The delegation of powers under the SEBI Regulations will become redundant if it is interpreted that the SEBI (Delegation of Powers) Order, 2015 will supersede/ override all the delegation of powers given under the securities laws including SEBI Regulations.

8.3. The applicability of Intermediaries Regulations for the purpose of conducting the enquiry proceedings in the instant case is patently wrong and perverse. As per the SCN, the *Noticee* has allegedly participated in/ facilitated the execution of paired contracts at the trading platform of NSEL when it was governed by the rules, regulations, bye laws of NSEL and also by the provisions of FCRA and the provisions of the SEBI Act and its regulations were not applicable to the *Noticee* for trading at the NSEL at the relevant time.

- 8.4. It's a matter of record that FMC had not dealt with/ initiated any action against the brokers including the *Noticee* for trading in the paired contracts at NSEL. Hence, as per the mandate of the letter dated November 20, 2015 of the Ministry of Finance, SEBI is not supposed to deal with the matter in question pertaining to the members of NSEL which was not taken up by the erstwhile FMC. Further, as per the said letter SEBI is not expected to take upon itself any regulatory function with respect to spot markets/ ready delivery contracts. Clearly, the enquiry proceedings in question pertain to the activities of the *Noticee* at spot market (NSEL) and hence the same are also prohibited as per the said letter of Ministry of Finance.
- 8.5. The reliance placed by the DA in the matters of *Jermyn Capital LLC vs. SEBI* and *Mukesh Babu vs. SEBI* is completely wrong and without any basis. In the aforesaid cases, the Hon'ble SAT had found close associations between the entities/ persons considering their close business and personal relations. In the instant case no such facts are available.
- 8.6. The finding of the Hon'ble Bombay High Court in the matter of *63 Moons' Technologies Ltd vs. State of Maharashtra* dated August 22, 2019 that NSEL is not a "Financial Establishment" and the paired contracts are not a financial transaction under MPID Act, hence the EOW case and SFIO Report, so far as they allege that the paired contracts were financial transactions have become redundant and infructuous.
- 8.7. The reliance placed on the interim report of EOW is also erroneous and misplaced. It is pertinent to note that there are no specific charges made against the *Noticee* in the interim report. The *Noticee* had traded in/ facilitated the paired contracts as a member of NSEL in accordance with the business rules and regulations of NSEL and as on the date of closure of business of NSEL, there was no pay out obligation and the *Noticee* is not a defaulting member.
- 8.8. The DA has failed to appreciate that the paired contracts were introduced by NSEL with the approval of its Board. The *Noticee* as a member of NSEL had no

other option but to trade in such contracts by observing the business rules and regulations of NSEL. There is no allegation whatsoever that the *Noticee* has committed any breach of the business rules and regulations of NSEL as applicable to the trading in paired contracts.

9. In conformity with the principles of natural justice, an opportunity of personal hearing was provided to the *Noticee* on December 7, 2021. On the day of the scheduled personal hearing, the Authorised Representative of the *Noticee* appeared for the hearing and reiterated the submissions made by the *Noticee* in its written submissions and the submissions made by the *Noticee* before the Designated Authority. Subsequent to the personal hearing, *Notice* was granted additional time to make further submissions, if any in the extant matter.

10. *Noticee* vide its letter dated December 15, 2021 made additional submissions in the matter wherein it *inter alia* submitted as follows:

10.1. SEBI was granted the power to initiate proceedings under FCRA within a period of three years from the date on which FCRA was repealed. The said period expired on September 27, 2018. The first SCN was issued by SEBI on September 25, 2018 to the *Noticee* which was vague and could not be contemplated as a proper complete SCN and the subsequent notices issued were much later in time and after expiry of the limitation.

10.2. The observations of the Hon'ble Supreme Court of India in the matter of *63 Moons Technologies Ltd. (formerly known as Financial Technologies India Ltd.) & Ors. vs. Union of India & Others (Civil Appeal No. 4476 of 2019)* decided on April 30, 2019, do not hold precedential value as they do not form part of the *ratio decidendi* and they do not arise from the question which fell for consideration before the Hon'ble Supreme Court.

CONSIDERATION OF ISSUE AND FINDINGS

11. I have carefully perused the post Enquiry SCN including the Enquiry Report issued to the *Noticee* and other materials/information as made available to the *Noticee* vide letter dated July 26, 2019 or as available in the public domain. After

considering the allegations made/charges levelled against the *Noticee* in the instant matter as spelt out in the post Enquiry SCN, the issue which arises for my consideration in the present proceeding is as under:

Whether continuance of the Noticee as a market intermediary, in the light of its alleged involvement in trading / facilitation of trading in 'paired contracts' on the exchange platform of the NSEL if in violation of the conditions of the 2007 Exemption Notification and also of the applicable provisions of FCRA, is detrimental to the interest of the Securities Market and thus whether the Noticee is a 'fit and proper' person for holding the certificate of registration as a registered market intermediary in terms of regulations 5(e), 9(b), 9(f) read with regulation 27(iv) of the Stock Brokers Regulations.

12. Before dealing with the aforementioned issues and the replies/arguments of the *Noticee* on charges on merit, I deem it necessary to deal with the preliminary objections raised by the *Noticee*, in the subsequent paragraphs.
13. The *Noticee* has submitted that the enquiry report has been prepared based on irrelevant documents available in public domain and further, the *Noticee* has not been provided with the documents which have been relied upon by SEBI. The aforesaid submissions of the *Noticee* is completely devoid of any merit. I note that contrary to the *Noticee's* claim, it has been provided with the documents that have been relied upon while issuing the SCN vide letters dated July 26, 2019 and February 26, 2020. Such documents include copies of FMC order dated December 17, 2013, Grant Thornton Report, Report of the Economic Offences Wing, Gazette Notification No. SO 906(E) dated June 05, 2007, copy of Finance Act, 2015, data pertaining to *Noticee's* trades in the paired contract on NSEL etc. It is further noted that vide post Enquiry SCN dated July 10, 2020 additional material such as letter dated December 30, 2014 and Order dated August 22, 2014 of the Hon'ble High Court of Bombay in the criminal bail application of *Jignesh Prakash Shah vs. State of Maharashtra*, which were viewed relevant for the purpose of the present proceedings have also been provided to the *Noticee*. It has to be understood that the present proceedings as well as the proceedings before the DA, dealt with the

question of integrity, reputation or character of the *Noticee* and / or his association with any person who does not enjoy a good reputation, to arrive at a finding whether the *Noticee* as a registered intermediary satisfies the criteria of being held as *fit and proper* person. To that effect, documents which were in public domain which would shed light on the aforesaid issue as well documents / material collected by SEBI were relied upon by SEBI to issue the SCN and were duly provided to the *Noticee*. Moreover, I note that the *Noticee* has relied upon the documents provided by it to make its defense which emphasizes the relevance of the said documents in the extant matter. Therefore, I find that all the material documents considered for the purpose of establishing the allegations levelled against the *Noticee* have been duly furnished and made available to it in due compliance of the principles of natural justice during the enquiry proceedings as well as while conducting the instant proceedings before me.

14. It has been submitted by the *Noticee* that the present proceedings are barred by limitation as SEBI could have initiated proceedings under FCRA within a period of 3 years from the date of repeal of FCRA which has expired on September 27, 2018 and the first SCN was issued by SEBI on September 25, 2018 which cannot be considered as a proper SCN as it was vague. It is noted that the SCN was issued well within the limitation period and a bare perusal of the SCN would unequivocally show, that the material based on which allegation was made and the consequent violation have been duly mentioned therein. Thus, the SCN apprises the *Noticee* determinatively of the case, it has to meet. From the record, it is observed that not only the SCN was issued within the limitation period but at the same time, the allegations made in the SCN were also precise and unambiguous. In view of the above, the contention of the *Noticee* is not tenable, as the proceeding was initiated within the statutory period of 3 years and the instant proceeding under the Intermediaries Regulations is a stage towards completion of the proceeding and a not a *de novo* and independent proceeding. Additionally, it is noted that the present proceedings have been initiated under Intermediaries Regulations for which no limitation period has been prescribed under the relevant law, therefore the contention of the *Noticee* is not tenable.

15. *Noticee* has contended that the appointment of DA by Whole Time Member of SEBI instead of Executive Director leads to a situation where the SEBI (Delegation of Powers) Order, 2015 supersedes/ overrides the delegation of powers given under the securities laws including SEBI Regulations. In this regard, I note that Section 3(2) of the Securities and Exchange Board of India (Delegation of Powers) Order, 2015 specifically provides that, "*The powers and functions delegated to any member or officer of the Board or authority under the Order can be exercised by any officer or authority higher in grade or rank or position to him*". Further, regulation 24 (2) of Intermediaries Regulations provides for appointment of DA by the Executive Director. In the factual scenario before me, having regard to aforesaid provisions of law which have been enacted under SEBI Act, attempt has to be made to interpret them so as to give effect to both the provisions. It is well recognized that interpretation of a statutory enactment is not a mechanical task and statutory provision must be so construed, if possible, that absurdity and mischief may be avoided. In the given scenario, if the contention of the *Noticee* is to be accepted then it will lead to a situation where the aforesaid provisions would be in conflict with each other. However, both the provisions can be reconciled with each other, if it is interpreted that the appointed of DA has to be done by the Executive Director or authority higher in grade or rank or position to the Executive Director. Thus, giving effect to both the provisions of securities law, I am of the view that the contention of the *Noticee* that SEBI (Delegation of Powers) Order, 2015 overrides Intermediaries Regulations, is untenable.
16. It is the case of the *Noticee* that when it has allegedly facilitated the paired contracts, it was not governed by SEBI Rules and regulations, hence, Intermediaries Regulations is not applicable to the *Noticee* for the purpose of conducting enquiry proceedings in the instant case. In this regard, it is pertinent to note that the jurisdiction of SEBI upon the *Noticee* has been conferred upon by the enactment of the Finance Act, 2015. As the Finance Act, 2015 *inter alia* conferred the power of regulation of intermediaries dealing in commodity derivatives to SEBI, SEBI is well within its rights to determine whether the *Noticee* who was trading in the illegal 'paired contracts' on NSEL and then came to be

registered by SEBI is a *fit and proper* person to continue holding such registration, after its illegal trading activities on NSEL platform have come to light. It is highly inconceivable to accept the submission of the *Noticee* that merely for the reason that at the time of the alleged execution of illegal trades on NSEL platform, it was being administered by FMC and regulated by the provisions of FCRA, it would continue to be regulated by the same provisions and the provisions of the Finance Act, 2015, conferring power to SEBI including the specific power to initiate action within a period of 3 years should be ignored completely. It is also untenable to submit that provisions of the SEBI Act and rules and regulations made there under are not applicable to the *Noticee*, particularly when it is not disputed that under the FMC, the *Noticee* was not required registration of any nature, whereas under SEBI, it was granted a specific registration under the relevant provisions of the SEBI Act and regulations made thereunder.

17. *Noticee* has further submitted that as per the mandate of the letter dated November 20, 2015 of the Ministry of Finance, SEBI is not supposed to deal with the matter in question pertaining to the members of NSEL which was not taken up by the erstwhile FMC. In this respect, it is pertinent to note that the ambit of the present proceedings is to examine, as to whether pursuant to the grant of registration by SEBI, whether any evidence has come to light which would cast a doubt on the integrity, reputation and character of the *Noticee* and in the course of said examination, if certain matters which were earlier under the purview of NSEL, becomes material for the effective determination of status of *Noticee* as a *fit and proper* person, then there is no bar on SEBI to consider them. Thus, SEBI in effect is determining the violations of its Intermediaries Regulations and not of any regulations / bye laws of NSEL, over which the latter had the jurisdiction. Under these circumstances, the aforesaid contention of the *Noticee* is also not tenable, when the statute (Finance Act, 2015) itself empowers SEBI to take action and stipulates a period of 3 years for initiating action, if any. I note that provisions of the SEBI Act and rules and regulations made thereunder do not provide any period of limitation for initiating action. Considering the fact that FMC got merged with SEBI through the Finance Act, 2015 and the provision therein specifically

provided for a period of 3 years for initiating action, if any by SEBI, the instant proceedings which have been initiated within a period of 3 years, are valid under law in so far as it strives to scrutinize the status of the *Noticee* to continue as a registered broker of SEBI. Under the circumstances, no illegality can be fastened upon SEBI for initiating action for the alleged violation of provisions of FCRA and notification of 2007 by the *Noticee* as an erstwhile trader on the NSEL platform. I also see no reason to accept the submission that as per the mandate of the letter dated November 20, 2015, referred to by the *Noticee*, SEBI should not have initiated any action in the matter of NSEL, when I consider the above letter vis-a-vis with the mandate provided under the Finance Act, 2015. Therefore, the submission of the *Noticee* that SEBI has wrongfully taken upon itself the regulatory function of NSEL, is without merit.

18. It is further clarified that the letter dated November 20, 2015 was an administrative letter issued by Department of Economic Affairs at the time of merger of FMC with SEBI wherein administrative actions to be taken by SEBI with respect to NSEL issue was clarified. The aforesaid letter made it clear that SEBI is not expected to take any regulatory action with respect to spot markets / ready delivery contracts which were not being regulated by FMC. But the said letter did not preclude, SEBI from proceeding under the Intermediaries Regulations. It is observed that the issue involved in the extant matter is neither related to spot markets / ready delivery contracts, rather the issue under consideration is whether the *Noticee* who had participated in the execution of impugned trades on the trading platform of the NSEL in contraventions of the 2007 Exemption Notification and provisions of the FCRA, satisfies the criteria of 'fit and proper' person, as defined under Intermediaries Regulations. Having considered the same, I am of the view that the contention of the *Noticee* is not tenable and does not deserve any further consideration.
19. Now moving on to the charges against the *Noticee* vis-à-vis the evidence available on record, it would be appropriate at this stage to refer to the relevant provisions of the securities laws, which are alleged to have been violated by the *Noticee* and

referred to in the present proceedings. The same are reproduced below for ease of 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.

STOCK 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

SCHEDULE II

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

CODE OF CONDUCT FOR STOCK BROKERS [Regulation 9]

A. General.

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

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

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

Liability for action under the Enquiry Proceeding Regulations.

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

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

INTERMEDIARIES REGULATIONS

SCHEDULE II

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

Criteria for determining a 'fit and proper person'

For the purpose of determining as to whether an applicant or the intermediary is a 'fit and proper person' the Board may take account of any consideration as it deems fit, including but not limited to the following criteria in relation to the applicant or the intermediary, the principal officer, the director, the promoter and the key management persons by whatever name called –

(a) integrity, reputation and character;

(b) absence of convictions and restraint orders;

(c) competence including financial solvency and networth

(d) absence of categorization as a wilful defaulter.

Action in case of default.

27. After considering the representations, if any, of the noticee, the facts and circumstances of the case and applicable provisions of law or directions, instructions or circulars administered by the Board the designated authority shall submit a report, where the facts so warrant, recommending, –

(ii) cancellation of certificate of registration;

20. I note that prior to the merger of FMC with SEBI on September 28, 2015, the *Noticee* was required to be a member of a recognized commodity derivative exchanges and was not required to be registered with either FMC or any other regulatory authority under FCRA. Therefore, the Parliament, while noticing the mischief that the intermediaries dealing with commodities derivatives market were not required to be registered under FCRA and thus were not under control of any competent authority, rectified the same through the Finance Act, 2015 by bringing them under the regulatory supervision of SEBI. Recognizing the aforesaid step taken by the Parliament to remove the aforesaid mischief of regulatory gap, the Hon'ble Bombay High Court while dealing with the Writ Petition Nos. 3262, 3266, 3294 and 3295 of 2018 in the matter of *Anand Rathi Commodities Limited, Motilal Oswal Commodities Broker Private Limited, Geofin Comtrade Limited and IIFL Commodities Limited vs. SEBI* vide its Order dated October 4, 2018, held as under:

"It is not in dispute that prior to the coming into effect of the Finance Act, 2015, the intermediaries dealing with the commodity derivatives were not required to be registered under any of the provisions of law including the FCR Act. We find that the said mischief was noticed by the Parliament. As such, by virtue of the Finance Act, 2015, the said intermediaries dealing with commodity derivatives have been brought under the control of SEBI. We find that the reason as to why by Finance Act, 2015, the said intermediaries were brought under the control of SEBI appears to be that the Parliament found that the activities of intermediaries dealing in commodity derivatives should not remain uncontrolled and they should be brought under the control of competent authority".

21. Thus, it is an admitted position that prior to the date of merger of FMC with SEBI (i.e., September 28, 2015), the *Noticee* was not required to be registered under FCRA or any other regulation to operate as a commodity derivatives broker. However, after the merger of FMC with SEBI, a commodity derivatives broker is required mandatorily to have a certification of registration from SEBI in case it is desirous to remain associated with the securities market as a commodity derivatives broker. It is seen that the Finance Act, 2015 (as notified on May 14,

2015) conferred the power of regulation over intermediaries dealing in commodity derivatives to SEBI and also mandated regulation of commodity derivatives brokers by SEBI, which included their registration as commodity derivatives broker with SEBI. In this regard, vide Section 131B of the Finance Act, 2015, a transitory period of 3 months was provided to all the intermediaries which were associated with commodity derivatives market under the erstwhile FCRA, 1952 but did not require a registration certificate earlier, to continue to deal in commodity derivatives as a commodity derivatives broker, provided it made an application of registration to SEBI within 3 months from September 28, 2015. Accordingly, the *Noticee* was registered as a stock broker w.e.f. March 30, 2016 and since then it has been acting as a market intermediary registered with SEBI.

22. In order to continue to hold such certification of registration from SEBI, the *Noticee* is also required to satisfy the conditions of eligibility to continue with such registration, which *inter alia* included, continuance of its status as a 'fit and proper' person. The above condition to be a 'fit and proper' person is not an one time condition applicable only at the time of seeking registration. Rather, the provisions governing the eligibility 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 wishes to remain associated with the securities market as a registered intermediary.

23. It is relevant to note here that the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "**SAT/Tribunal**") in the matter of *Jermyn Capital LLC* vs. *SEBI* decided on September 6, 2006, while dealing with the nature and requirement of criteria of 'fit and proper' person under the SEBI (criteria for Fit and Proper Person) Regulations, 2004, *inter alia* held as under:

"Good reputation and character of the applicant is a very material consideration which must necessarily weigh in the mind of the Board in this regard. Reputation is what others perceive of you. In other words, it is the subjective opinion or impression of others about a person and that, according to the Regulations, has to be good. This

impression or opinion is generally formed on the basis of the association he has with others and/or on the basis of his past conduct. A person is known by the company he keeps. In the very nature of things, there cannot be any direct evidence in regard to the reputation of a person whether he be an individual or a body corporate. ... "

It is further held by the Hon'ble Tribunal that:

"...The Regulations apply across to all sets of regulations and all intermediaries of the securities market including those who associate themselves with the market and they all have to satisfy the criteria of 'fit and proper person' before they could be registered under any of the relevant regulations and this criteria they must continue to satisfy throughout the period of validity of their registration and throughout the period they associate with the market".

24. Therefore, it is clear that the criteria of 'fit and proper' person, is an ongoing requirement throughout the period during which the *Noticee* remains operational in the securities market as a registered intermediary. In case, pursuant to the grant of registration by SEBI, any evidence comes to the notice of SEBI that casts a doubt on the integrity, reputation and character of the registered intermediary, SEBI is well within the powers to examine the 'fit and proper' status of such entity based on various parameters including the following parameters provided under Schedule II of the Intermediaries Regulations:

- (a) integrity, reputation and character;
- (b) absence of convictions and restraint orders;
- (c) competence including financial solvency and network;
- (d) absence of categorization as a wilful defaulter.

25. The submission of the *Noticee* that the reliance placed by the DA in the matter of *Jermyn Capital LLC vs. SEBI* decided on September 6, 2006, is incorrect as the facts of that matter are completely different from the present matter, is untenable. The reliance placed by DA in the matter of *Jermyn Capital LLC vs. SEBI* was for the *ratio decidendi* laid down in the said matter holding that adherence to the criteria of 'fit and proper' person is not as one time requirement but is a continuous

requirement which has to be satisfied by the intermediary throughout the period it is associated with the securities market.

26. Further, while observing that SEBI was entitled to take a view that an entity was not a 'fit and proper' person even where there were charges of criminal conspiracy made against the Chairman of the company which were yet to be established in court of law, the Hon'ble SAT in the matter of *Mukesh Babu Securities Ltd. vs. SEBI* (Appeal No. 53 of 2007 decided on December 10, 2007) has held that:

"It is true that these are only allegations made in the charge-sheet and we are conscious that these are yet to be established in a court of law but from what is stated in the charge-sheet liaison between Shri Mukesh Babu and the chairman of the bank prima facie appears to be established. ... The charges leveled are indeed serious and if established, they involve moral turpitude. We are unable to agree with the learned counsel for the appellant that the criminal case pending against Shri. Mukesh Babu and others has no concern with the securities market. It is through the terminals of the company that the chairman of the Bank had traded and incurred losses through speculative trading which losses have been made up by overdrawing money from the Bank. In these circumstances, the Board was entitled to take the view that the company was not a fit and proper person. It could not be said that Shri. Mukesh Babu or the company enjoyed good reputation within the meaning of the Fit and Proper Person Regulations."

27. Noticee has contended that reliance placed by the DA on the matter of *Mukesh Babu Securities Ltd. vs. SEBI* (Appeal No. 53 of 2007 decided on December 10, 2007) is wrong as the SCN does not allege that the Chairman/ Whole Time Director/ Managing Director of the Noticee is involved in any criminal case which affects their reputation and thereby make the Noticee as not a *fit and proper person* for acting as intermediary. In this regard, I note that even though in the matter of *Mukesh Babu Securities Ltd. vs. SEBI*, the allegation levelled against the Chairman of the company was not proven, yet that allegation was still taken into account while considering as to whether the company with which Mukesh Babu was associated, satisfied the criteria of 'fit and proper' person and thus a *prima facie*

case was made out in the chargesheet which was held by Hon'ble SAT perfectly valid, legal and tenable to cancel the certificate of Registration. In the instant matter also, I note that the *Noticee* itself has been charged with engaging in acts of trading on NSEL alleged to be illegal in nature, which has not been disputed by the *Noticee*. In the instant matter, the DA has placed reliance in the matter of *Mukesh Babu Securities Ltd. vs. SEBI* since here also a *prima facie* case has been made out against the *Noticee*, though not proved / established, on the ground that the *Noticee* was associated with NSEL and in turn with Mr. Jignesh Shah (Vice Chairman of NSEL and member of Audit Committee of NSEL) and was a party to facilitate the trades in those illegal paired contracts at NSEL which was detrimental to the interest of the investors in the commodity derivatives market that is a part of the securities market. The said charge is serious in nature and involves questions of integrity and character.

28. Considering the aforesaid deliberations, I am of the view that the existence of any material on record that questions the integrity, reputation or character of the *Noticee*, or proves close association with any person who does not enjoy a good reputation, is a parameter good enough to determine that the person in question is not 'fit and proper'. Thus, good reputation and integrity are critical aspects of the 'fit and proper' criteria laid down in the Intermediaries Regulations. It has also been held by the courts that while determining as to whether an entity enjoys a good reputation, any adverse observations, even if *prima facie* made by the courts and other regulatory authorities, would be relevant. Further, the statutory requirements to obtain a certificate of registration as laid down under various provisions of the Intermediaries Regulations and the Stock Brokers Regulations are not only applicable to and required to be complied with by the *Noticee* at the time of making such application and obtaining such registration, but also has to be adhered to subsequently on a continuous basis after the registration is granted till the time the market intermediary is operating in the securities market.
29. Having discussed the scope, nature and requirement of the criteria of 'fit and proper' person, I will now proceed to deliberate on the allegations levelled against the *Noticee*. It is noted that the main allegation against the *Noticee* is that by

participating/facilitating in the trading in 'paired contracts' on the NSEL platform during the relevant period as a Trading Member/Clearing Member, the *Noticee* has, *prima facie*, violated the conditions stipulated in the 2007 Exemption Notification and consequently also the provisions of FCRA. Therefore, it is alleged in the post Enquiry SCN that the continuance of the registration of the *Noticee* as a commodity derivatives broker would be detrimental to the interest of the securities market as the *Noticee* is no longer a 'fit and proper' person for holding such certificate of registration as a commodity derivatives broker in the securities market, which is one of the conditions for continuance of registration as specified in regulation 5(e) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations and regulations 9(b) and 9(f) read with Clauses A(1), A(2) and A(5) of the Stock Brokers Regulations.

30. In this regard I note that NSEL was granted exemption from the provisions of the FCRA by the Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution, Government of India, vide Gazette Notification No. S0906(E) dated June 05, 2007, in exercise of the powers conferred under Section 27 of the FCRA, subject to certain conditions which, *inter alia*, included that '*no short sale by members of the NSEL shall be allowed*' and that all '*outstanding positions of the trade at the end of the day shall result in delivery*'.
31. From the 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 NSEL and its trading/clearing members (like the *Noticee* herein this proceedings) who traded in the paired contracts during the relevant period.

b. Contracts with Settlement Period going beyond 11 days

Although NSEL was supposed to allow trading in spot contracts which fall under the definition of ready delivery contracts under the FCRA, some of the contracts offered for trade on NSEL had settlement periods exceeding 11 days and therefore, such contracts were effectively “non-transferable specific delivery” contracts and not ready delivery contracts under FCRA. As per FCRA, the “ready delivery contracts” were required to be settled within 11 days of the trade and hence, the contracts traded on NSEL, which provided settlement schedule for a period exceeding 11 days were not allowed and were in violation of 2007 Exemption Notification.

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

“... It has also come to the knowledge of the Commission from the report of the forensic auditor that a large number of NSEL exchange trades were carried out with paired back-to-back contracts. Investors simultaneously entered into a “short term buy contract” (e.g. T+2 — i.e. 2 day settlement) and a “long term sell contract” (e.g. T + 25 i.e. 25 day settlement). The contracts were taken by the same parties at a pre-determined price and always registering a profit on the long-term positions. Thus, there existed a financing business where a fixed rate of return was guaranteed on investing in certain products on the NSEL...

NSEL conducted its business not in accordance with the conditions stipulated in the notification dated 05.06.2007 granting it exemption from the operation of FCRA, 1952, with regard to the one-day forward contracts to be traded on its exchange platform. As noted in the SCN, the condition of ‘no short-sell’ and ‘compulsory delivery of outstanding position at the end of the day’ stipulated in the notification were violated by NSEL. NSEL Board allowed launching of paired back-to-back contracts on its exchange platform comprising a short-term buy contract (T+2 settlement) and a long-term sell contract (T+25 settlement) with predetermined price and profit for the buyer and seller, which violated the very concept of spot

market of commodities and the transactions ultimately were in the nature of financial transactions” (emphasis supplied).

33. The Department of Economic Affairs, Ministry of Finance, while agreeing with the aforesaid observations of FMC, vide its letter dated December 30, 2014 observed as under:

“... This department is in agreement with FMC that NSEL has violated the first two conditions of exemption granted to it under section 27 of FCRA making it liable for appropriate action including penal action under section 21 of FCRA. Further, this department is also in agreement with the observations of Special Team of Secretaries that by offering contracts having settlement beyond 11 days, without obtaining recognition and/or registration, NSEL has also violated the provisions of sections 5, 6, r/w 14A also making it liable for appropriate action including penal action under section 21 of FCRA.”

34. The Hon’ble Bombay High Court, while deciding Writ Petition No. 2743 of 2014 dated December 4, 2017, in the matter of *63 Moons Technologies Limited vs. Union of India* had also observed as under:

“85] The very offer of T+18, T+25 or T+36 contracts by NSEL prima facie constituted breach of the condition that the exemption from applicability of FCRA was only in respect of contracts of one day’s duration. There is really no dispute, either in facts or in law on this aspect because even FTIL in its list of dates and events at entry 4 against date 05.06.2007, accepts this position...

86] Further, apart from the note against entry 8 (November 2011 onwards) in the list of dates and events of FTIL, there is ample material on record which establishes that NSEL offered ‘paired contracts’ at its exchange from 2009 itself. Further, the record indicates and it has not been disputed that by the year 2013 the volume of paired contracts constituted almost 99% of the turnover at the NSEL exchange. In monetary terms, this turn over from 2009 to 2013 was in the region of Rs. 1,34,000 crores. Therefore, to say that all this was without the involvement or even knowledge of FTIL and NSEL and to attempt to blame ‘certain trading clients, commodities sellers or brokers’ is just not prima facie acceptable.

...

88] The material on record, including in particular the presentations made by and on behalf of NSEL and the Grant Thornton Report establish that this *modus operandi* of paired contracts, was in reality, nothing but financing transactions. These contracts were invariably at predetermined prices and the long terms sell contract, was always at a profit, the difference effectively being the cost of lending. These paired contracts were obviously in breach of the conditions of the exemption notification and consequently the FCRA itself. Under the guise of offering spot delivery or ready delivery contracts, the NSEL Exchange indulged not just in forward trading but in financing unhindered by any regulatory checks which would, but for the exemption notification dated 5th June 2007 have applied to such operations.

89] The record indicates and it has not been disputed that by the year 2013, the volumes of paired contracts constituted almost 99% of the turnover of the NSEL Exchange. In monetary terms, this turnover of paired contracts was in the region of Rs. 1,34,000 crores between the years 2009 to 2013. This means that the entire operations at the NSEL Exchange, which was meant to be a commodities stock exchange, were entirely subverted in gross disregard of the conditions of the exemption notification dated 5th June 2007 and consequently, the FCRA itself.

90] The FTIL in its pleadings as well as the list of dates, is really in no position to factually dispute the manner in which the operations were held at the NSEL Exchange. The NSEL itself has not even instituted any petition to question the impugned order, which takes cognizance of such facts. The learned counsel for NSEL when requested to comment on the operations at NSEL Exchange simply chose to submit that since the impugned order is based only on one ground or reason, namely, facilitating NSEL in recovering dues from the defaulters, there is no point in offering any comments or explanations about the operations at the NSEL Exchange. Even otherwise, there is extensive material on record in the form of Grant Thornton Report etc. which establishes that the operations at the NSEL Exchange were inconsistent with the conditions of the exemption notification dated 5th June 2007 and consequently the FCRA itself."

35. The Economic Offences Wing, Mumbai, vide letter dated April 4, 2015, had forwarded an *interim* report to the SEBI in connection with the investigation being conducted by it to identify the role played by the broking houses in the NSEL Case (EOW C.R. No. 89/2013). The relevant extracts of the 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.”

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

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

37. It has been submitted by the *Noticee* that the aforesaid finding of Hon'ble Supreme Court of India does not have a precedent value as it does not form part of *ratio decidendi*. In this regard, I note that the core issue before the Hon'ble Supreme Court of India was the applicability and construction of Section 396 of the Companies Act, 1956, which deals with compulsory amalgamation of companies by a Central Government order, when the same becomes essential in the public interest. During the course of addressing the said issue, one of the material sub-issue which was addressed by the Hon'ble Apex Court was whether NSEL had flouted the conditions of exemption notification (of Department of Consumer Affairs) and had perpetrated a scam leading to an amalgamation order that had to be passed by the Central Government in “public interest”. Thus, a determination of the said sub-issue was crucial as the scam perpetrated by using paired contracts gave rise to an “emergency situation” (incapability of NSEL of effecting any substantial recovery from defaulting members) leading to an order of amalgamation of FTIL and NSEL by the Central Government. Therefore, the finding

with respect to the nature of paired contracts has to be considered as part of the reason for arriving at the final decision by the Hon'ble Apex Court.

38. I further find it apt to reproduce the observations of the Hon'ble Bombay High Court in its order dated August 22, 2014 in the matter of *Jignesh Prakash Shah vs. The State of Maharashtra (Criminal Bail Application No. 1263 of 2014)* wherein the Hon'ble High Court of Bombay *prima-facie* held as follows:

"16 There is great substance in the contentions advanced by the learned counsel for the applicant that the brokers through whom the so called trade transactions were entered into, do have their own legal team and a full knowledge of how the market operates. The legalities of the transactions were quite expected to be known to the brokers and the traders who do not hesitate to term themselves as 'investors', and they were expected to assess the legalities of the transactions. The brokers being quite experienced, and the investors being informed persons, it is apparent that the issue of illegality of the transactions raised by them is not out of their concern to adhere to legalities, but in order to project the applicant as the main offender, rather than the defaulting parties."

I find that, even eight years and several litigations later, the above observations of the Hon'ble Bombay High Court stand its grounds and haven't been overturned by any judicial forum.

39. The *Noticee* has contended that the finding of the Hon'ble Bombay High Court in the matter of *63 Moons' Technologies Ltd. vs. State of Maharashtra* decided on August 22, 2019 wherein it was held that NSEL is not a financial establishment and paired contracts are not a financial transaction under Maharashtra Protection of Interests of Depositors in Financial Establishments Act, 1999 (hereinafter referred to as "**MPID Act**") renders the EOW case and SFIO report infructuous. The aforesaid contention of the *Noticee* is without any merit. The main issue involved in that matter was whether NSEL is a financial establishment within the meaning of Section 2 (d) of MPID Act and the said issue was answered by establishing that NSEL was not accepting deposit as covered by Section 2 (c) of the MPID Act in any manner. The said matter never dealt with the issue as to whether or not paired

contracts were financial transactions as contended by the *Noticee*. It will be pertinent here to quote the finding of the Hon'ble Bombay High Court here with respect to exemption granted to NSEL from provisions of FCRA:

"...This leaves no doubt in our mind that the transaction was between two persons i.e. buyer and seller through medium of NSEL. No doubt something has gone wrong somewhere in these transactions and at the end, when a show cause notice came to be issued to the NSEL by the Central Government, it was on the basis that the squaring off did not take place on the same day and all outstanding positions of the trade at the end of the day did not result into delivery... (emphasis supplied)

... It is not in dispute that the NSEL was granted exemption from the operation of FCRA Act. It is also to be noted that the EOW, Mumbai has already registered a separate FIR under the FCRA against the NSEL brokers and others. However, the withdrawal of exemption on violation of certain conditions subject to which the exemption was granted would entail the consequences under the FCRA Act, 1952 and there are separate consequences which could then fall upon the NSEL. However, the present offence which has been registered against the NSEL is under the provisions of IPC and the provisions of MPID have been invoked and applied..."

Since the limited issue before the Hon'ble Bombay High Court was whether NSEL is a financial establishment that was accepting deposits as defined under MPID Act and the Hon'ble High Court was not addressing the issue of paired contracts being construed as financing transactions, the inference drawn by the *Noticee* is incorrect. In any event, the fact that the *Noticee* has engaged in execution of trades in the form of paired contracts which were being settled beyond the period prescribed for ready delivery contracts (spot contracts) that were permitted on NSEL for trading remains undisputed and for which no justification has been furnished by it, I see no merit in the above submission, more so when the Hon'ble Court has not made any favourable adjudication on the issue of paired contract undisputedly engaged in by the *Noticee*.

Without prejudice to the aforesaid, it may be noted that recently the Hon'ble Supreme Court of India in the matter of *The State of Maharashtra vs. 63 Moons*

Technologies Ltd. Civil Appeal Nos. 2748-49 of 2022 decided on April 22, 2022 while allowing the appeal filed by State of Maharashtra against the aforesaid order of High Court of Bombay, held that NSEL is a financial establishment within the meaning of Section 2 (d) of the MPID Act and was accepting 'deposit'. Further with respect to 'paired contracts', the Apex Court, held as follows:

"... 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."

In the above, the Hon'ble Supreme Court of India held that NSEL by transacting in 'paired contracts' has engaged in activities whereby assured returns can be earned.

40. In view of the aforesaid observations and findings of the various courts and authorities, I note that by engaging in trading in 'paired contracts', which was in reality nothing but a financing transaction wherein fixed rate of return was assured by the sellers (*Defaulters*) under the garb of offering 'paired contracts' to the buyers (investors), NSEL has acted in violation of the conditions of exemption mandated to it for compliance under the 2007 Exemption Notification issued under the FCRA and instead, has used its platform to provide such illicit services which were specifically barred under the FCRA. Further, as stated above, such 'paired contracts' constituted almost 99% of the turnover at the NSEL exchange

by FY 2013-14. I note that the *Noticee* was one of the commodity derivatives brokers that facilitated its clients to trade on the platform of the NSEL in 'paired contract' so as to earn assured returns under the garb of commodity spot trading, which have attracted serious adverse charges from several authorities and courts as discussed in detail above. Thus, I am of the view that the association of the *Noticee* with such illegal trading on the exchange platform of the NSEL would be crucial to determine the 'fit and proper' status of the *Noticee*.

41. In this regard, it is noted that the *Noticee* has admitted and not disputed that it has dealt in paired contracts contrary to the stipulation made in the 2007 Exemption Notification. I note that the *Noticee*, as a commodity derivatives broker, represented the face of NSEL for regular investors. The execution of the trades in 'paired contracts' by the *Noticee* is an evidence of the participation by the *Noticee* in a fraudulent scheme which promoted trading in 'paired contracts' that were not permitted under the 2007 Exemption Notification and were traded purely financial contracts promising assured returns under the garb of spot trading in commodities. Therefore, the *Noticee* by its conduct has acted as an instrument of NSEL in promoting 'paired contracts' which were in the nature of financing transaction as held by the Hon'ble Supreme Court of India as noted above. The *Noticee*, by providing a platform for taking exposure to 'paired contracts' has engaged itself in trades capable of exposing its clients to the risk involved in trading in a product that did not have regulatory approval thereby raising doubts on the competence of the *Noticee* to act as an honest and diligent registered securities market intermediary. Thus, I am of the view that the trading activities of the *Noticee* in 'paired contracts' on NSEL platform contain serious ingredients of fraud amounting to jeopardizing the reputation, belief in competence, fairness, honesty, integrity and character of the *Noticee* as an intermediary in the securities market.
42. Looking holistically at the alleged conduct of the *Noticee* which is a registered market intermediary, I find that by no standard, the aforesaid conduct of the *Noticee* can be said to be fair and honest and the said conduct overwhelmingly proves that the *Noticee* has not acted with due skill, care and diligence in the

conduct of its business as required under Schedule II of the Intermediaries Regulations and therefore the said conduct of the *Noticee* is detrimental to the securities market being not in conformity with the applicable code of conduct. It may also be noted that the scope of the instant proceeding is not to analyze the actual impact and consequences of the conduct of the *Noticee* but to examine as to whether or not, the *Noticee* has acted in a manner expected of a market intermediary to which the answer manifestly goes against the *Noticee*. In my considered view, it is immaterial if the *Noticee* has no outstanding investor obligation or has not taken any undue advantage of the fraudulent contracts by registering the investors on the NSEL and making / enabling them to trade. The fact that is undeniably clear before me is that the involvement of the *Noticee* in trading/facilitation of trading in 'paired contracts' on NSEL is certainly a conduct which was not permitted by the 2007 Exemption Notification and / or by any of the applicable provisions of the FCRA and therefore, such a conduct as has been displayed by the *Noticee* in its trading on the NSEL platform is detrimental to the interest of the securities market.

43. In view of the above observations and admission of the *Noticee* having traded in these 'paired contracts' on NSEL, I have no hesitation in holding that the *Noticee* has participated/facilitated in the trading in 'paired contracts' on NSEL platform during the relevant period as a Trading Member/Clearing Member and has violated the conditions of the 2007 Exemption Notification and also the provisions of FCRA. Therefore, the continuance of the registration of the *Noticee* as a commodity derivatives broker can prove to be detrimental to the interest of the securities market, as the *Noticee* can no longer be called a 'fit and proper person' for holding the certificate of registration as a commodity derivatives broker in the securities market, which is one of the conditions for continuance of registration as specified in regulations 5(e), 9(b) and 9(f) of the Stock Brokers Regulations read with the provisions of Schedule II of the Intermediaries Regulations.
44. Before summarizing my observations and discussions in the foregoing paragraphs, I must note here that an entity which is granted registration to

operate as a commodity derivatives broker is required to act in a manner and to comply with all applicable regulatory requirements which are in the best interests of the securities market and its investors, so as to uphold the integrity of the securities market. As the arena of securities market is fundamentally vast and complex, the Stock Brokers Regulations have prescribed broad checks and balances so as to keep the interest of the investors protected from any kind of wrong treatment in the hands of unscrupulous commodity derivatives brokers and also to uphold the integrity of the securities market. The Code of Conduct spells out the general duties of the commodity derivatives broker to exercise due skill, care and diligence in the conduct of its business so as to serve the best interest of the clients in a fiduciary manner and to keep intact the integrity of securities market.

45. In the context of securities market, I note that the role of a registered intermediary including a registered commodity derivatives broker is not only sensitive and predominantly fiduciary in nature but also demands from it honesty, transparency, fairness and integrity which are essentially the hallmarks of such market intermediaries. Given the fact that one of the avowed objects of 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 commodity derivatives brokers, which are not only required to act as an intermediary simplicitor i.e., a bridge or a connector between regulator 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. Thus, undisputedly a commodity derivatives 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.
46. However, contrary to the aforesaid the conduct displayed by the *Noticee* while performing its functions as a commodity derivatives broker, by indulging in

participation/ facilitation in the trading in 'paired contracts' on NSEL, with an aim to earn illegal profit by turning a blind eye to all the illegalities taking place on the exchange platform of NSEL, has seriously hampered the trust of the Regulator in the integrity of the *Noticee*, hence the continuation of the *Noticee* in securities market as an intermediary does not appear to be in the interest of investors and the securities market, since such misconduct has apparently amounted to serious violation of regulation 5(e) read with clauses A(1), (2) and A(5) of the Schedule II of the Stock Brokers Regulations and regulations 9(b) and 9(f) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations.

47. To reiterate, the limited scope of the present proceeding is to examine the conduct of the *Noticee* in the background of its active participation in the trading platform of the NSEL in contraventions of the 2007 Exemption Notification and provisions of the FCRA so as to decide its continuous association in the securities market. From the above, it is evident that NSEL through its members had indulged in running a scheme contrary to the legitimate trading activities as permitted to it by the Central Government and under the garb of 'paired contracts', had promoted trading in financing transactions, and such illegal activities as well as participation of the *Noticee* therein are certainly detrimental to the interest of the promotion and development of the securities market.
48. It is a trite law that when provisions of law prescribe certain acts to be done in a particular manner, the same is required to be honoured in letter and spirit. Law does not provide any exception to anyone to perform such acts as per his whims and fancies that is not permissible under an extant legal framework. Therefore, if an exemption is granted in respect of all forward contracts of one-day duration for the sale and purchase of commodities traded on the NSEL from operations of the provisions of the FCRA subject to compliance with certain conditions, then it is obligatory on the part of a market intermediary to execute forward contracts of one-day duration only subject to strict compliance with the said conditions.
49. It further needs appreciation that the issue under consideration is not to gauge the profit/loss incurred or likely to be incurred by an individual, but the limited

scope of the present proceedings is to see whether the indulgence, engagement and promotion of such activities could be held to be beneficial to the development of securities market or the same contain elements that are potentially dangerous and detrimental to the interest, integrity, safety and security of the securities market. In this respect, the undisputed facts that the scheme of paired contracts traded on the NSEL ultimately has put the investors to enormous risks and has caused loss to the market to the extent of Rs. 5,500 crore, itself cast serious aspersion on the conduct, integrity and reputation of the associate person like the *Noticee* who participated in such paired contracts and therefore, its continuous association with the securities market cannot be viewed as good and congenial for the interest of the investors.

50. As noted above, the adherence to the Code of Conduct is an ongoing requirement but the conduct displayed by the *Noticee* in performing functions of an commodity derivatives broker, including its act of indulging in participation/facilitating in the trading in 'paired contracts' on NSEL platform is certainly not in the interest of investors and the securities market and in my view such misconduct has amounted to serious violation of regulation 5(e) of the Stock Brokers Regulations read with Schedule II of the Intermediaries Regulations and regulations 9(b) and 9(f) read with Clauses A(1), (2) and A(5) of Schedule II of the Stock Brokers Regulations.
51. Under the circumstances, I am constrained to hold that the *Noticee* is not a 'fit and proper' person in terms of regulation 5(e) read with regulation 27(iv) of the Stock Brokers Regulations, further read with Schedule II of the Intermediaries Regulations and hence, the continuance of the *Noticee* as a commodity derivatives broker will be detrimental to the securities market. Therefore, such activities of the *Noticee* as a registered commodity derivatives broker cannot be condoned and deserve appropriate remedial measure to prevent such wrong doings from recurring to the detriment of the interest of the securities market.

ORDER

52. In view of the foregoing discussions and deliberations, in exercise of powers conferred upon me under Section 12 (3) and Section 19 of the SEBI Act, 1992 read with regulation 27 of the SEBI (Intermediaries) Regulations, 2008 and upon considering the gravity of the violations committed by *Noticee* viz. M/s Alpha Commodity Pvt. Ltd., I hereby cancel the registration of the *Noticee* viz. M/s Alpha Commodity Pvt. Ltd (SEBI Registration nos. INZ000033238).
53. The *Noticee* shall, after receipt of this order, immediately inform its existing clients about the aforesaid direction in paragraph 52 above.
54. Notwithstanding the direction at paragraph 52 above, the *Noticee* shall allow its existing clients to withdraw or transfer their securities or funds held in its custody, within 60 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 60 days, the *Noticee* shall transfer the funds and securities of such clients to another broker within a period of 30 days thereon, under advise to the said clients.
55. The Order shall come into force with the immediate effect.
56. It is clarified that in view of the amendment made w.e.f. January 21, 2021 in the Intermediaries Regulations, 2008, powers that were exercised under regulation 28 of the Intermediaries Regulations, 2008 are now being exercised under regulation 27 of the Intermediaries Regulations, 2008.
57. A copy of this order shall be served upon the *Noticee*, the recognised Stock Exchanges and the Depositories for necessary compliance.

DATE: April 29, 2022
PLACE: MUMBAI

S. K. MOHANTY
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA