

BEFORE THE 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:

Name of the Noticee	SEBI Registration No.
Ratnakar Commodities Private Limited	INZ000024138

In the matter of National Spot Exchange Limited

Background –

1. Ratnakar Commodities Pvt. Limited is registered with SEBI as a stockbroker in the commodity derivative segment bearing registration no. INZ000024138, with effect from December 18, 2015 (the “**Noticee**”).
2. The Noticee was a member of National Spot Exchange Limited (“**NSEL**”), which was incorporated in May 2005 as a spot exchange for trading in commodities. NSEL organised trading in commodities after it was granted exemption from the provisions of the Forward Contracts (Regulation) Act, 1952 (“**FCRA**”) by the Department of Consumer Affairs, Ministry of Consumer Affairs, Food and Public Distribution, Government of India, vide Gazette Notification No. SO 906(E) dated June 05, 2007, in exercise of powers conferred by Section 27 of FCRA (“**Exemption Notification**”). The said exemption was subject to certain conditions, which *inter alia* required that no short sale by members of NSEL be allowed; all outstanding positions at the end of trading-day should result in

delivery and all information or returns relating to trading as and when asked for should be provided by NSEL to the Central Government or its designated agency.

3. 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. NSEL introduced the concept of 'paired contracts' in September 2009, which allowed simultaneous sale and purchase of the 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 the buyer of the short duration contract always ended up making profits.
4. On February 06, 2012, the Forward Markets Commission, Mumbai ("**FMC**") was appointed by the Department of Consumer Affairs, Government of India as the 'designated agency', in accordance with the conditions prescribed under the Exemption Notification, authorising it to collect trading data from NSEL and to examine the same for taking appropriate measures, if needed, to protect investors' interest. The FMC accordingly called for trading data from different spot exchanges, including NSEL in the prescribed reporting formats. After analysing the trading data received from NSEL, the FMC passed an Order bearing no. 4/5/2013-MKT-1/B dated December 17, 2013 in the matter ("**FMC Order**"), wherein it was, *inter alia*, observed that fifty five (55) contracts offered for trading on the NSEL platform were in violation of the relevant provisions of the FCRA and that the condition of 'no short sale by members of the exchange shall be allowed' was not being complied with by NSEL and its members. The FMC further observed that 'paired contracts' offered for trading on the NSEL platform were in violation of the provisions of the FCRA and the conditions specified by the Government of India in the Exemption Notification, while

granting exemptions to contracts traded on NSEL, from the purview of the FCRA.

5. Additionally, in respect of 'paired contracts', The FMC Order observed the following:

- 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*" had not been met by NSEL and its trading/clearing members who had traded in 'paired contracts' during the relevant period.

- b. Contracts with Settlement Period going beyond 11 days

Some of the contracts offered for trade on the NSEL had settlement periods exceeding 11 days and therefore, such contracts were "non-transferable specific delivery" contracts under the FCRA. As per the provisions of FCRA, the "ready delivery contracts" were required to be settled within 11 days of the trade being effected 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 the Exemption Notification.

6. Subsequently, in 2015, the FMC was merged with SEBI. Pursuant to the merger of the FMC with SEBI, commodity derivatives brokers were mandatorily required to obtain a certification of registration from SEBI in case they sought to remain associated with the securities market as commodity derivatives brokers. The Finance Act, 2015, *inter alia*, conferred powers on SEBI to regulate commodity derivatives brokers, 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 three (3) months was provided to all the intermediaries which were associated with the commodity derivatives market under the erstwhile FCRA to continue to deal in commodity derivatives as commodity derivatives brokers, provided it made an application of registration to SEBI within 3 months from September 28, 2015. Accordingly, the Noticee applied for a certificate of registration and was registered as a

broker with effect from December 18, 2015, and since then it has been acting as a market intermediary registered with SEBI.

7. Further, consequent to the merger of the FMC with SEBI, the FCRA was repealed. However, by way of a savings clause contained in Section 29 A of the FCRA, SEBI was empowered to initiate fresh proceedings with respect to offences under the FCRA within a period of three years from the date of repeal of the FCRA.
8. In the following years, subsequent to the merger, the scale and impact of the violations in respect of NSEL came to be realised.

Enquiry Proceedings against Ratnakar Commodities Private Limited –

9. Considering the above, Enquiry Proceedings were initiated against the Noticee, a registered intermediary, in terms of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 ("**Intermediaries Regulations**") and Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Regulations, 1992 ("**Stock Brokers Regulations**") by appointing a Designated Authority ("**DA**") in the matter.
10. Pursuant to the said appointment, the DA issued a Show-cause Notice dated September 25, 2018 bearing number A&E/EAD-8/KS/VB/26901/2018 to enquire as to whether the Noticee was fit and proper to continue to hold the certificate of registration as a registered Stock Broker ("**SCN**").
11. In this regard, the SCN *inter alia* alleged that the paired contracts were in contravention of the provisions of FCRA and the Exemption Notification, and the Noticee had participated and/or facilitated its clients in such paired contracts during the period September 2009 to August 2013. In view of the same, it was alleged in the SCN that the Noticee by carrying out broking on NSEL had violated Regulation 9(b) and (f) of the Stock Brokers Regulations read with Clause A(1), A(2) and A(5) of Schedule II of the Stock Brokers Regulations, and was, as such, not a 'fit and proper person' for holding a certificate of registration

in terms of Regulation 5 (e) read with Regulation 27 (iv) of the Stock Brokers Regulations and Schedule II of the Intermediaries Regulations.

12. Accordingly, the SCN called upon the Noticee to show cause as to why suitable recommendation for action under Regulation 27 of the Intermediaries Regulations read with Section 12(3) of the SEBI Act, 1992 ("**SEBI Act**") should not be made against him.

13. It is noted that the SCN was duly served on the Noticee. Consequent to the issuance of the SCN, by way of communication dated October 16, 2019 the Noticee was informed that the following documents relied upon by SEBI had been provided to it:

" i) Copy of the relevant FMC Order with Annexures.

ii) Copy of the Grant Thornton Report with Annexures (Annexure 6 is relevant to the proceedings which details the list of members to whom the exchange has pay-out obligations).

iii) Copy of the Notification issued by the Ministry of Consumer Affairs dated June 05, 2007.

iv) Documents explaining specifications of paired contracts (which forms part of the Grant Thornton Report).

v) List of Trading Members/ Fund name & Clearing Member name and the amount mentioned against their name in the EOW Interim Report dated April 04, 2015, who have applied/registered with SEBI (the amount indicates default amount of clients (investors) who traded through the said brokers).

vi) Copies (total 11) of fortnightly reports submitted by NSEL to the erstwhile FMC.

vii) List of 148 members against whom NSEL has pay-out obligations as on September 19, 2013 as mentioned in the Grant Thornton Report (as per Annexure 6 of the Grant Thornton Report) dated September 21, 2013.

viii) Data containing registration documents and Annual Return documents."

14. It is noted that the Noticee submitted its reply to the SCN on November 13, 2019. Consequently, the DA enquired into the above-mentioned violations, and in his report dated November 29, 2019 (“**Enquiry Report**”), found that the Noticee had contravened the provisions as alleged in the SCN. In view of the same, the DA in terms of Regulation 27 of the Intermediaries Regulations recommended that the Certificate of Registration of the Noticee be cancelled.

Post - enquiry SCN dated January 28, 2020, Personal Hearing and Reply –

15. After considering the Enquiry Report, a Post-enquiry Show-cause Notice dated January 28, 2020 (“**Post-enquiry SCN**”) enclosing therewith the Enquiry Report of the DA was issued to the Noticee under Regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) calling upon the Noticee to show cause as to why the action of cancellation of Certificate of Registration as recommended by the DA or any other action, as deemed fit by the Competent Authority, under regulation 28(2) of the Intermediaries Regulations (as applicable at the relevant time) should not be taken against it.
16. It is stated that while proceedings in the present matter were ongoing, SEBI passed five separate orders during February 2019 rejecting the applications submitted by five entities for registration as commodity brokers. Aggrieved by the said SEBI orders, the entities filed appeals before the Hon’ble Securities Appellate Tribunal (“**SAT**”). The Hon’ble SAT vide its common order dated June 09, 2022 (“**SAT Order**”), remanded the matters back to SEBI to examine them 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...

17. In light of the aforesaid order of the Hon'ble SAT and certain other subsequent orders passed by the Hon'ble SAT in similar matters, it was felt necessary to furnish certain additional documents/material to the Noticee before concluding the present proceedings. Accordingly, SEBI issued a Supplementary SCN dated February 13, 2023 to the Noticee, enclosing a copy of the SAT Order along with the SEBI complaint dated September 24, 2018 filed with Economic Offences Wing, Mumbai Police ("**EOW**"), First Information Report dated September 28, 2018 ("**FIR**") instituted pursuant to the above-mentioned complaint, and amended Schedule II of the Intermediaries Regulations ("**SSCN**"), advising it to submit its reply/ comments/ clarifications, if any, in addition to its earlier replies, within fifteen (15) days of receipt of the SSCN.
18. The Post-enquiry SCN (enclosing the Enquiry Report therewith) and the SSCN were duly served on the Noticee. It is noted from the record that the Noticee has filed replies dated February 27, 2020; March 29, 2023; April 17, 2023; April 25, 2023; June 06, 2023 in response to the Post-enquiry SCN and SSCN. In addition to the written replies, oral submissions were made by the Noticee at the personal hearing on June 08, 2023 in response to the findings in the Enquiry Report. I also note that the Noticee had submitted a reply dated November 13, 2019 before the DA. The submissions made by the Noticee through his written replies as well as oral submissions are summarised in the following paragraphs :-
 - a. The issuance of SCN to the Noticee was an afterthought and was belatedly issued, for which no reasons had been cited in the SCN.
 - b. At the relevant time when the matter in respect of NSEL arose, SEBI was not the regulator of the Noticee; it only happened subsequently.

So, no action could have been initiated against the Noticee under the Intermediaries Regulations.

- c. By way of letter dated April 17, 2023, the Noticee had inter alia requested for inspection of documents, as mentioned in the said letter. However, during the course of inspection, only a few limited documents were provided and the request to provide inspection of relevant documents had not been complied with. In the absence of relevant, vital and material information and documents, the Noticee was not in a position to present the facts of the case in a detailed and comprehensive manner.
- d. The Noticee should have been granted an opportunity of personal hearing before the finalisation of the Enquiry Report. Regulation 25 (6) of the Intermediaries Regulations (w.e.f. January 21, 2021) required the DA to grant opportunity of hearing.
- e. The FIR against the Noticee was registered on September 28, 2018, which was prior to the amendment of Schedule II of the Intermediaries Regulations, which came into effect from November 17, 2021. In view of that, the said provision was not applicable to the Noticee. Also, the retrospective application of the amended Schedule II of the Intermediaries Regulations was a gross violation of the principles of natural justice.
- f. Further, the transactions in respect of NSEL were carried out during the period, 2009 to 2013. The Noticee was granted registration by SEBI much after the date of alleged transactions. So, the Noticee had already fulfilled the condition of fit and proper at the time of grant of registration by SEBI in February 2016.

- g. The Noticee's exposure to 'paired contracts' was limited in comparison to trading on other commodity exchanges. The details of the total turnover of the Noticee on various commodity exchanges during the relevant time:

Particulars	MCX	NCDEX	NSEL		Total	% of Turnover of Alleged Paired Contract to Total Turnover
			E-Series	Alleged Paired Contracts		
2009-10	1609.75	1.58	0.00	0.00	1611.34	0%
2010-11	2116.89	4.71	0.00	0.00	2121.59	0%
2011-12	2294.30	8.87	0.39	0.00	2303.56	0%
2012-13	1205.81	3.02	1.80	162.90	1373.53	11.86%
2013-14	917.77	0.00	0.08	71.49	989.34	7.23%

- h. The paired contracts were not traded in the Proprietary Trading Account, but were executed only on behalf of the clients. Those transactions were entered on the instructions of the respective clients and the Noticee had no role to play except executing the transactions as per instructions of clients. Also, certain clients had filed affidavits that they had on their own volition invested in 'paired contracts' without any inducement.
- i. Further, no Court or authority had ever held or even alleged that any contracts were launched by the NSEL without the prior concurrence of the FMC as stipulated in Bye-Laws 4.1 of the NSEL's Bye-Laws. In fact, at the relevant time, based on the information available in the public domain, it could not have been considered that the paired contracts, which were so widely traded on a national level government approved Exchange and regulated by the FMC, could ever be illegal or at all in violation of any conditions of the Exemption Notification.

- j. The doctrine of proportionality and Wednesbury rules required that relevant and material facts were required to be considered for a decision. The punishment proposed would do irreparable harm, and accordingly the punishment should be reasonable and fit the breach of law.
- k. The Noticee was in compliance of Regulation 9 (b) and 9(f) of the Stock Brokers Regulations and also Clause A(1), (2) and (5) of the Code of Conduct for Brokers.

Consideration of Issues and Findings –

- 19. Upon examination of the allegations made against the Noticee in the instant matter and the Enquiry Report, the limited issue which arises for consideration in the present proceeding are whether the Noticee has been in continuous satisfaction of the 'fit and proper person' criteria as laid down under Schedule II of the Intermediaries Regulations. If the answer to the above is in the negative, then whether the Certificate of Registration granted to the Noticee should be cancelled, as recommended by the DA or any other action, as deemed fit, should be taken against the Noticee.
- 20. However, before moving to the consideration of the principal issue, it shall be relevant to examine certain preliminary issues raised by the Noticee challenging the initiation of the present proceeding.

An opportunity of personal hearing had not been provided by the DA before the finalisation of the Enquiry Report.

- 21. It is acknowledged that the records do not reflect that a hearing was provided by the DA to the Noticee prior to the finalisation of the Enquiry Report. However, it is stated that pursuant to the receipt of the SCN, ample opportunities were provided to the Noticee to make submissions in respect of

the allegations made in the SCN. It is evident from the record that the Noticee filed written submissions dated November 13, 2019. It is only pursuant to that the Enquiry Report containing the findings of the DA and recommendation was finalised on November 29, 2019 after consideration of the written submissions. In view of the same, it is stated that it cannot be claimed that the lack of a personal hearing before the DA had greatly prejudiced the Noticee and was in violation of the principals of natural justice. Additionally, it is stated that Regulation 25 of the Intermediaries Regulations, as it existed on November 29, 2019, did not mandatorily require the DA to provide an opportunity of personal hearing. Further, post the finalisation of the Enquiry Report, the Noticee had been provided opportunities for making written submissions as well as oral submissions through a personal hearing. Accordingly, it cannot be said that the lack of personal hearing before the DA has in any manner detrimental in the Noticee presenting its case in the present proceeding.

The SCN was not proper as it was issued under the SEBI Act.

AND

The transactions on which the SCN was based on had taken place during the period, 2009 – 2013, and the Certificate of Registration was granted on February, 2016. So, the Noticee had already satisfied the 'fit and proper' criteria.

22. The above-mentioned objections to the initiation of proceedings against the Noticee, even though, separately made are interconnected, and, as such, they are being dealt with together.
23. It is noted that prior to the merger of FMC with SEBI on September 28, 2015, the Noticee was required to be a member of an association recognised by the Central Government under Section 6 of the FCRA, and was not required to be registered with either FMC or any other regulatory authority under the FCRA. Consequently, by way of the Finance Act, 2015, the intermediaries dealing in the commodity derivatives market were brought under the regulatory purview of SEBI. With regard to the aforesaid, 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 Rath Commodities Limited, Motilal Oswal Commodities Broker Private Limited, Geofin Comtrade Limited and IIFL Commodities Limited vs. SEBI* vide its Order dated October 04, 2018, observed the following:

“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”.

24. It is noted that Section 29A of the FCRA, as inserted by the Finance Act, 2015, *inter alia*, provided:

“(1) The Forward Contracts (Regulation) Act, 1952 is hereby repealed.

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

(a)....

(b)....

(c)....

(d)....

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

(f) no court shall take cognizance of any offence under the Forward Contracts Act from the date on which that Act is repealed, except as provided in clause (d) and (e);

(g) clause (d), (e), (f) shall not be held to or affect the general application of section 6 of the General Clauses Act, 1897 with regard to the effect of repeal to matters not covered under these sub-sections.”

25. It is noted that the aforesaid provision empowered SEBI to initiate fresh proceedings with respect to offences under the FCRA within a period of three years from the date of repeal of the FCRA. Thus, pursuant to the merger of FMC with SEBI, SEBI stepped into the shoes of FMC to initiate proceedings under Chapter V of FCRA. In exercise thereof, SEBI filed a criminal complaint dated September 24, 2018 with the EOW. It is noted from the said complaint that EOW was requested to take appropriate action under Sections 20 and 21 and other provisions of the FCRA against the brokers/ members of NSEL, and other persons mentioned in the complaint.
26. It is stated that the aforesaid proceedings are different from the present proceedings. The present proceedings pertain to adjudging the ‘fit and proper person’ status specified in the Stock Broker Regulations and the Intermediaries Regulations in light of the activities undertaken by the Noticee on the NSEL platform. This is an examination to consider the status of the Noticee since it is an intermediary.
27. The above account clearly brings out the distinct actions initiated by SEBI under the FCRA on one hand and under the SEBI Act/provisions of securities laws on the other. Accordingly, the claim of the Noticee that since the NSEL matter took place before SEBI had become the regulator, the SCN could not have been issued under the SEBI Act/Intermediaries Regulations was not sustainable.
28. It has been contended by the Noticee that since the transactions happened between 2009 and 2013, and the Certificate of Registration was granted in February 2016, the ‘fit and proper’ condition had already been satisfied by the Noticee.
29. It needs no reiteration that FMC merged with SEBI only in 2015. The facts in the matter were emerging while SEBI was carrying out the process of giving registration to various erstwhile commodity derivatives brokers as stock brokers in commodity derivatives segment under the Stock Brokers Regulations. That being the case, it would not be appropriate to assume that a sort of estoppel

had come into effect as regards the NSEL case, just because the transactions pertained to the period, 2009 – 2013, and the Certificate of Registration was granted in February 2016 with effect from December 18, 2015. The Noticee is obligated to maintain the fit and proper person criteria on a continuous basis, and it is well within SEBI's jurisdiction and powers to adjudge the said fit and proper status of the market intermediaries in the interest of securities market.

The amended provisions of the Intermediaries Regulations, as annexed to the SSCN, would not be applicable to the Noticee.

30. As already brought out, the 'fit and proper' criteria, must be met by a Stock Broker at all times. This includes the amended criteria as finding mention in Schedule II of the Intermediaries Regulations. It is stated that no finding has been arrived at by any competent court, as yet, repudiating the legal validity of the said amendment. That being the case, it shall be presumed that the said provision was valid, and arguments in respect to its inapplicability were without merit.

31. It is reiterated that the 'fit and proper' criteria is not a condition that has to be met by a registered Stock Broker only at the time of registration, but rather something which remains a persisting obligation, so long as the Stock Broker continues to remain a registered intermediary on the rolls of SEBI.

All documents had not been provided by SEBI to the Noticee.

32. The Noticee has additionally claimed that it had not been provided with necessary documents to give a comprehensive reply in respect of the allegations made. In this regard, reference is made to the letter dated October 16, 2019 addressed by SEBI to the Noticee whereby documents that had been relied upon by SEBI were provided to the Noticee. The documents provided by way of the said letter has already been detailed in paragraph 13 of this Order, and, as such, the same is not being reiterated here. It is noted that pursuant to said documents being provided, the Noticee filed its reply dated November 13,

2019. Further, after the finalisation of Enquiry Report and issuance of Post-enquiry SCN, the Noticee was granted an opportunity for inspection of documents as requested. It is noted from the record of proceedings of inspection of documents held on April 24, 2023 that “...as requested copies of EOW Report; FMC letter dated 16.01.2015; SEBI complaint dated 09.07.2018; SEBI Complaint dated 24.09.2018 along with annexure; SIT email dated 31.08.2018 and NSEL letter dated 17.03.2015 and 24.03.2015 is provided to the AR (Authorised Representative).” Additionally, upon the issuance of the SSCN, the following documents had been provided to the Noticee: SEBI Complaint dated September 24, 2018; FIR dated September 28, 2018 and amended Schedule II of the Intermediaries Regulations. So, it is evident that SEBI has all along endeavoured to provide all the relied/relevant documents to the Noticee. Therefore, the claim of the Noticee that it did not have the necessary documents to give a comprehensive and detailed reply is not sustainable.

33. The preliminary objections/submissions having been dealt with, it would be relevant to consider the primary issue in the matter.
34. It has already been stated that NSEL was given permission to setup a spot exchange for trading in commodities. NSEL was, therefore, meant to offer forward contracts having one-day duration as per the Exemption Notification. In its order, the FMC had observed that the fifty five (55) contracts offered for trading on NSEL were with settlement periods exceeding 11 days, and, as such, all such contracts traded on NSEL were in violation of the provisions of the FCRA. It is noted from the FMC Order that under the FCRA, a “forward contract” was defined as a “*contract for delivery of goods and which is not a ready delivery contract*”. A ‘ready delivery contract’ was defined as “*a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days*”. In view of the said definitions contained in the FCRA, the FMC Order observed that all the contracts traded on NSEL which provided a settlement schedule exceeding eleven (11) days were treated as Non-Transferable Specific Delivery contracts. It is, therefore, seen that even though MCA had stipulated in the Exemption

Notification that only contracts of one-day duration were permitted to be offered on NSEL, the FMC, in its Order, relying on the definition of “forward contract” under the FCRA held that NSEL was allowed to only trade in one-day forward contracts and was obliged to ensure delivery and settlement within eleven (11) days. It is not in doubt that NSEL had permitted fifty five (55) contracts of various commodities where the settlement schedule was longer than eleven (11) days, and such contracts were in contravention of the exemption granted to NSEL.

35. At this stage, it is instructive to refer to the judgement 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) (“**Merger Petition**”), wherein it was, *inter alia*, held,

“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”. (emphasis supplied)

36. It is also relevant to refer to the judgment 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)* (“**MPID matter**”), the Hon'ble Supreme Court while drawing reference to the representations made by NSEL in respect of paired contracts, *inter alia*, observed as under:

“44. ... NSEL in the course of its brochures has held out representations about the trading and investment opportunities available for:

- a) corporate clients
- b) high net worth individuals; and
- c) retail investors

Commodity	Duration	Investment (lacs.)	Yield
Castor Seed	T+3 & T+36	7.5 -9	16%
Castor Oil	T+5 & T+30	7-9	16%
Cotton Wash Oil	T+2 & T+25	10	16%
Paddy	T+2 & T+25	3.5-4.5	16%
Steel	T+2 & T+25	4.5-5	16%
Raw Wool	T+2 & T+25	3.5-4	16%
Wool Top	T+2 & T+25	1.8-2	16%
Crude Soybean Oil	T+2 & T+25	3.3.-3.5	16%
Soya DOC	T+2 & T+25	1.7-2.0	16%
Refined Mustard Oil	T+2 & T+25	6.5	16%
Refined Soybean Oil	T+2 & T+25	6.5	16%
Refined Sunflower Oil	T+2 & T+25	6.5	16%
RBD Palmolein Oil	T+2 & T+25	6.5	16%
Sugar	T+2 & T+25	3.0	16%
Maize	T+2 & T+25	3.0	16%

The above representation specifies:

- (i) Commodities;*
- (ii) Duration of trades;*
- (iii) Investment; and*
- (iv) Yield.*

For example, in the case of castor seeds, NSEL held out a buy contract (T+3) and sale contract (T+36), in which the yield is stated to be 16%. Moreover, NSEL represented that:

Opportunities

- *Traders can trade and lock their return*
- *Trader has to buy in near settlement contract and sell in far settlement contract simultaneously*
- *Price for both settlements available*
- *Exchange provides counterparty guarantee risk*
- *No basis risk, No link with future contracts*

While describing the features of —trading opportunity to traders, NSEL represented that:

Features of Trading Opportunity:

- *T+2 and T+25 contract offers unique trading opportunity to traders*
- *Trader purchases T+2 contract and simultaneously sells T+25 contract*
- *Pay-in obligation is on T+2 while Pay-out of the funds will be on T+25. Entire settlement cycle is of 35-37 days*
- *Price differential between the two settlement dates i.e premium if annualized offers interest rate of about 16%*
- *Income arising out of such trades are treated as Business Income*

While comparing the investment opportunities of bank fixed deposits with trading opportunities at NSEL, NSEL represented that:

Comparison

- *Bank FD 9.25% for 390 days; NSEL Trading Opportunity 16%;*
- *Bank FD minimum duration 390 days; NSEL Trade duration 35-55 days, depending on the contract*
- *Traders have an option of rolling over their position as per their convenience*

The above representation indicates that 'paired contracts' were designed as a unique trading opportunity by NSEL under which a trader would, for instance,

purchase a T+2 contract (with a pay-in obligation on T+2) and would simultaneously sell a T+25 contract (with a pay-out of funds on T+25). The price differential between the two settlement dates was represented to offer an annualized return of about 16%. NSEL categorically represented that all trades were backed by collaterals in the form of stocks and its management activities included selection, accreditation, quality testing, fumigation and insurance. Therefore, NSEL represented that on receiving money and commodities, the members would receive assured returns and a service. Though NSEL has been receiving deposits, it has failed to provide services as promised against the deposits and has failed return the deposits on demand. Therefore, the State of Maharashtra was justified in issuing the attachment notifications under Section 4 of the MPID Act.” (emphasis supplied)

37. It is, therefore, noted that the Hon’ble Supreme Court has already commented on the nature of the ‘paired contracts’ offered on the NSEL platform. In the Merger Petition (63 Moons Technologies Ltd. vs. UOI), it was held that such contracts were in the nature of financing transactions. In the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon’ble Supreme Court has held that such transactions came within the definition of ‘deposits’ under the MPID Act. So, the claim of the Noticee that no court was had made any finding in respect of ‘paired contract’ was ill-founded.
38. It is further noted that the Hon’ble Supreme Court in the MPID matter, had extensively referred to the claims made on the website of NSEL and the contents of the publicity material and other investor resources. In this regard, it can be noted that NSEL was advertising a uniform return of 16% p.a. for the ‘paired contracts’ traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, paired contracts of T+2 & T+25 durations in steel had the same offered return as paired contracts of T+ 2 & T+ 35 durations in castor oil. It requires no special knowledge to make the assessment that the return on steel and castor oil would be different, since they were very distinct commodities. The ‘paired contracts’, it is noted, were being marketed as an alternative to fixed deposits. It was also noted by the Hon’ble Supreme Court

in its judgement in the MPID matter that an overwhelming majority of the sale leg of the 'paired contracts' comprised of short sales i.e., commodities to back such sales were not available at the designated warehouses of NSEL.

39. Further, as stated above, NSEL itself was advertising such contracts as an alternative to fixed deposits and the return offered was 16% across all commodities irrespective of the nature of the contract or the duration. Also, those contracts were structured in a manner which ensured that the buyer always made pre-determined profits.

40. Now, it would be relevant to look into the issue of violation of the third condition mentioned in the Exemption Notification i.e. the compulsory delivery of outstanding position at the end of the day. In this regard, the observations made in this respect by various authorities are taken note of. Specific note is taken of the FMC Order, wherein it has been stated that *"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."* Further, it has already been elaborated in the preceding part of this Order that the Hon'ble Supreme Court has held 'paired contracts' to be in the nature of financing transactions. I thus note that the 'paired contracts' offered by NSEL, which were by design structured in a manner that resulted in no delivery of commodities, have already been found by authorities including the Hon'ble Supreme Court to be in blatant violation of the conditions prescribed in the Exemption Notification issued by MCA.

41. Further, I note from the records that SEBI has filed a complaint dated September 24, 2018, against brokers who facilitated access to 'paired contracts' traded on NSEL, including the Noticee, with EOW. On the basis of this complaint, an FIR dated September 28, 2018 was filed against the Noticee with EOW. Further, it is a matter of record that the Noticee had indulged in / facilitated paired contracts. This is also demonstrated from the submission of

the Noticee wherein the Noticee has given details of its exposure to 'paired contracts'.

42. It is an undisputed fact that there was a settlement default at NSEL and unsuspecting investors suffered losses of more than Rs. 5600 Crore. In this context, the question that arises for consideration is whether there were enough red flags to alert a reasonable person that what was being offered was not spot contract in commodities but rather a financial product offering fixed returns. It is noted that during the period when "*paired contracts*" were offered by NSEL (2009 -2013), the policy repo rate ranged from 4.75 % to 8% whereas NSEL, in its own publicity material, was promising an '*assured return*' of 16%. Contracts were structured in a manner where the party on the buy-side always made a profit. The return across commodities, as highlighted before, were the same irrespective of the duration of the contract. These are apart from the other *ex facie* deviations from the Exemption Notification that 'paired contracts' suffered from.

43. I therefore find that the anomalies were clear as daylight and there were enough red flags for a reasonable person to conclude that the contracts being offered as paired contracts on NSEL were clearly not spot contracts in commodities. Even after the evident red flags, the Noticee had indulged in / facilitated the purchase and sale of paired contracts. It is relevant to note that the Noticee, in its replies, has acknowledged that it did not carry out any proprietary trades in 'paired contracts', but it did act as a broker for the clients. Having reviewed all the material on record, I am constrained to conclude that the Noticee, presumably driven by its desire to earn brokerage, provided a platform for its clients to access a product whose fundamental economic logic and legal sanctity was tenuous and shaky. The lure of extra yield proved to be an irresistible bait. The Noticee should have been more careful while offering such a product to its clients. This raises serious questions on the ability of the Noticee to conduct proper and effective due diligence and carry out its activities as a Stock Broker.

44. In the background of the discussion on 'paired contracts' in the preceding paragraphs, I now proceed to examine whether the Noticee satisfies the 'fit and proper' person criteria, as laid down under Schedule II of the Intermediaries Regulations.
45. Regulation 5(e) of the Stock Brokers Regulations provides that for the purpose of grant of certificate of registration, the applicant has to be a fit and proper person in terms of Schedule II of the Intermediaries Regulations. I note that the '*fit and proper person*' criteria, specified in Schedule II of the Intermediaries Regulations, was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021.
46. I note that post the amendment carried out in 2021, the '*fit and proper person*' criteria now has both a 'principle based' criteria and a 'rule based' criteria, as opposed to the earlier criteria which was purely 'principle based'. The reasoning as to the applicability of the amended Schedule II to the Noticee has already been elaborated in the preceding paragraphs. Thus, even though the Noticee was granted a certificate of registration with effect from December 18, 2015, it was still required to comply with the revised criteria post the amendments carried out in 2021. I note that paragraph 3(b) of the amended criteria lays down a list of disqualifications which includes, under paragraph 3(b)(i) a circumstance where a "*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.*"
47. As already stated above, a criminal complaint has been filed by SEBI before the EOW against the Noticee. 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 against the trading members, including the Noticee, which were listed in the SEBI complaint to EOW. It is, therefore, noted that the Noticee attracts the disqualification provided in paragraph 3(b)(i). Further, the acts of the Noticee in offering access to 'paired contracts' also seriously calls into question the integrity, honesty and lack of ethical behavior on the part of the Noticee. These contracts, as stated earlier,

were *ex facie* offered in violation of the Exemption Notification issued by the MCA and far removed from the spot contracts in commodities, which were permitted to be traded on NSEL. The 'paired contracts' were nothing but financing transactions masquerading as spot contracts in commodities. It has already been detailed above that there were enough red flags for a reasonable person to infer that the contracts being offered as 'paired contracts' on NSEL were not spot contracts in commodities, and that the Noticee, presumably driven by its desire to earn brokerage, provided a platform for its clients to access a product which was clearly in violation of the Exemption Notification.

48. In view of the above, I hold that the Noticee failed to comply with the 'fit and proper person' criteria specified in Schedule II of the Intermediaries Regulations on a continuous basis.

49. I note that the DA has recommended the cancellation of the certificate of registration of the Noticee as a commodities derivatives broker. However, considering the role of the Noticee in the entire events surrounding the paired contracts, I am of the opinion that the suspension of certificate of registration for a period of three (3) months from the date of this Order or till the disposal of abovementioned FIR filed with EOW, whichever is later, would be commensurate with the findings made against the Noticee in this Order.

Order –

50. In view of the foregoing discussions and deliberations, I, 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 Intermediaries Regulations, hereby suspend the certificate of registration (bearing No. INZ000024138) of Ratnakar Commodities Pvt. Ltd., as a commodities derivatives broker, for a period of three (3) months from the date of this Order or till the disposal of FIR filed with EOW, whichever is later.

51. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the direction in paragraph 50 above.

52. Notwithstanding the direction at paragraph 50 above, the Noticee shall allow its existing clients, if any, to withdraw or transfer their securities or funds held in its custody, within fifteen (15) days from the date of this Order.

53. The Order shall come into force with immediate effect.

54. A copy of this Order shall be served upon the Noticee and the recognised Market Infrastructure Institutions for necessary compliance.

Place: Mumbai

ASHWANI BHATIA

Date: November 29, 2023

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA