

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 Securities and Exchange Board of India (Intermediaries) Regulations, 2008 in the matter of Geofin Comtrade Ltd. (previously known as Geojit Comtrade Ltd.)

NOTICEE	PAN
GEOFIN COMTRADE LIMITED	AADCG3019R

BACKGROUND

1. Geofin Comtrade Ltd., previously known as Geojit Comtrade Ltd., (“**GCL /Noticee**”) is a commodity derivatives broker and a member of the Multi Commodity Exchange of India Ltd. (“**MCX**”), the National Commodity & Derivatives Exchange Ltd. (“**NCDEX**”), and Ace Derivatives and Commodity Exchange Limited (“**ACE**”). The Noticee was earlier a member of the National Spot Exchange Ltd. (“**NSEL**”).
2. In the Union Budget for the FY 2015-16, it was announced that Forward Market Commission (“**FMC**”), the regulator of the commodity derivatives market, would be merged with the Securities and Exchange Board of India (“**SEBI**”). The Finance Act, 2015, provided that any person dealing in commodity derivatives prior to the aforesaid merger of FMC with SEBI might continue to do so provided they made an application for registration with SEBI within a period of three months from the date of such merger. The merger took effect on September 28, 2015, and the Noticee filed an application, received by SEBI on December 16, 2015, seeking registration as a commodity derivatives broker.
3. The registration application, submitted by the Noticee, was rejected by SEBI vide its Order dated February 25, 2019 (“**SEBI Order**”) on the grounds that the Noticee had failed to satisfy the ‘*fit and proper person*’ criteria specified under Schedule II of the SEBI (Intermediaries Regulations), 2008 (“**Intermediaries Regulations**”).

4. In arriving at the decision that the Noticee did not satisfy the '*fit and proper person*' criteria, SEBI Order relied on the following :
 - a) The '*paired contracts*' traded on the NSEL platform were observed to be in the nature of financing transactions by Courts and other authorities. These transactions in '*paired contracts*' were also held to be violative of the provisions of Forward Contracts (Regulation) Act, 1952 ("**FCRA**").
 - b) The role of the Noticee in facilitating access to its clients to take exposure in the '*paired contracts*' offered on the NSEL platform.
 - c) The close connection between the Noticee and NSEL and the observations made against the NSEL by various authorities and Courts.
5. The Noticee preferred an appeal against the SEBI Order before the Hon'ble Securities Appellate Tribunal ("**SAT**"). Vide an Order dated June 9, 2022 ("**SAT Order**"), SAT set aside the SEBI Order and remanded the matter back to SEBI for fresh consideration. In directing SEBI to decide the matter afresh, the SAT Order stated that SEBI would have the liberty to consider additional material which had come into existence after the passing of the initial SEBI Order.
6. A Designated Authority ("**DA**") was consequently appointed by SEBI who issued a Supplementary Show Cause Notice dated July 7, 2022 along with the corrigendum to the notice dated July 13, 2022 ("**Supplementary SCN**"). Subsequently, after providing an opportunity of hearing to the Noticee, the DA submitted his Report dated September 28, 2022 ("**DA Report**") recommending that the application for registration submitted by the Noticee be rejected. The DA Report also recommended that Noticee may be debarred from making a fresh application seeking registration for a period of three years from the date of conclusion of the present proceedings before SEBI or till complete acquittal of the Noticee by Courts pursuant to the charge sheet and FIR filed by/with Economic Offences Wing ("**EOW**"), whichever is earlier.
7. A copy of the DA Report was furnished to the Noticee vide show cause notice dated October 11, 2022, and the Noticee was advised to submit its reply to the recommendations/ findings contained in the Report. The Noticee was also provided with an opportunity of personal hearing on November 10, 2022. The opportunity of personal hearing was availed by the Noticee and Mr. Zerick Dastur, Advocate, entered appearance

on behalf of the Noticee. The Noticee has submitted its response to the show-cause notice dated October 11, 2022 by way of its reply dated November 10, 2022 along with a compilation of documents relied upon by them. Consequent to the hearing on November 10, 2022, the Noticee also submitted additional submissions vide letter dated November 14, 2022. A summary of the written and oral submissions made on behalf of the Noticee is given below:

- a. The present proceedings were barred by the principle of res judicata and SEBI was seeking to re-open issues which had attained finality by way of SEBI's Order dated February 25, 2019. The issues and allegations referred to in the Enquiry Report and the Supplementary SCN were exactly the same as the allegations contained in the October 2016 SCN and the December 2018 SCN issued by SEBI against the Noticee. While the SAT Order had remitted the matter to the WTM, the same would be subject to the settled principles of res judicata. So, the issues raised in the Supplementary SCN and the Enquiry Report against the Noticee were barred by the principle of res judicata.
- b. The SFIO report was a report under S. 173 of the CRPC, 1973 and could not be treated as evidence in law. A charge sheet is followed by a detailed trial and accordingly a finding of not fit and proper could not be attracted only on the basis of a charge sheet which was filed way back in 2018.
- c. The charge sheet sought to be relied upon was already available even at the time of passing of the WTM Order. No new or fresh cause for any adverse recommendation by the Ld. D A. was available.
- d. The application of the Intermediaries Regulations (as amended in 2021) was misplaced. The Hon'ble SAT in its Order considered the 'fit and proper person' criteria as provided in Schedule II of the Intermediaries Regulations prior to the amendment. The Noticee applied for registration as a commodity broker in December 2015 so the criteria considered by the Hon'ble SAT in its Order should be applied.
- e. The Noticee started offering brokerage services in paired contracts for the first time on NSEL only in October 2011, which was almost two years after NSEL introduced the concept of paired contracts on the exchange. During such time, NSEL had been permitted to operate in paired contracts on its Exchange. The Noticee simply acted in the ordinary/regular course of business and performed its functions as a commodities broker on NSEL, like it was doing on any other exchange.

- f. The FMC vide its circular dated September 13, 2011, announced that it was the Designated Agency for overseeing the spot exchanges including NSEL. It was only thereafter in October 2011 that the Noticee started participating as a broker for paired contracts on behalf of its clients on the NSEL platform, knowing that there was a Designated Agency overseeing the activities at NSEL.
- g. The Noticee was never aware of the Show Cause Notice dated April 27, 2012 issued by the Ministry of Consumer Affairs to NSEL for alleged violation of the conditions of exemption granted by the Central Government. The Noticee only became aware of the show cause notice issued by MCA and other correspondence upon such information being obtained under the Right To Information Act, 2005 after the NSEL scam was unearthed. Also, such documents had been marked as “private and confidential”.
- h. Even if the notice issued by the MCA to NSEL was publicised in the media, no further action was taken by the relevant authorities. Despite being aware of these alleged violations by NSEL, the said paired contracts initiated by NSEL were allowed to continue. It was only much later that the Ministry of Finance, vide Notification dated September 19, 2014 (in exercise of its powers under S. 27 of the Forward Contracts (Regulation) Act, 1952), withdrew the exemption granted to NSEL and rescinded the Exemption Notification with immediate effect.
- i. The Noticee had exercised utmost care and diligence towards its clients and acted in their interest. Also, there was nothing to show that from the year 2011 to 2013, the Noticee had failed to perform its obligations under the byelaws and circulars of NSEL and no complaint from NSEL alleging any such violations by the Noticee.
- j. The Noticee’s presentation was never used for public circulation or to solicit any business for the Noticee. The Noticee’s presentations were prepared and used for internal training purposes and were shared with the clients of the Noticee in very select few instances where the client requested for the same to understand the methodology of the transactions on NSEL. Also, the presentation did not assure any risk free returns to the investors. This had been stated in the report of the auditor, Mohan & Mohan.
- k. Every client of the Noticee had to sign the Know Your Client (KYC) form & associated member client agreement which had risk disclosures in detail, which clearly showed that the Noticee had put its clients to notice of the risks of dealing in the contracts of NSEL.

- l. Geojit Credits Pvt. Ltd. was not a related entity of the Noticee. SEBI's own forensic auditor M/s. Mohan & Mohan in their report mentioned the same. The clients were not lured to trade in paired contracts where they were obligated to enter into tripartite agreements with the Noticee and Geojit Credits Pvt. Ltd.
- m. The reliance in the Enquiry report on the Supreme Court's judgments in 63 Moons Technologies Ltd. v Union of India and State of Maharashtra v 63 Moons Technologies Ltd. was misplaced.
- n. The allegations in the SFIO complaint were not against the Noticee or its officials. Accordingly, the findings and observations in the SFIO complaint against NSEL and the other accused could not be attributed to the Noticee and could not become the basis of findings against the Noticee.
- o. The proceedings with respect to the FIR filed by SEBI before the EOW under section 154(3) of the CRPC and the charge sheet filed against the Noticee under the MPID act were *sub-judice*.
- p. The Exemption Notification was only applicable to NSEL and it was the duty of NSEL to adhere to the same. It was NSEL who issued circulars providing for trading period of T+25 and T+36, which were deemed to be permitted, owing to the fact that they continued to trade in a "market overt" without any action from the Government for any violation of the Exemption Notification.
- q. Reliance on the statements of clients in the DA report was misplaced. The said statements of the clients had not been provided to the Noticee and also the clients had not been produced for cross-examination.
- r. The Ld. DA's reliance on the aforesaid judgments of Jermyn Capital and Mukesh Babu was entirely misplaced.
- s. Mr. Krishnan's arrest in March 2015, would not impact the Noticee's reputation as of today. In any case, a detailed trial is yet to follow and accordingly a finding of not fit and proper status of the Noticee cannot be based on the FIR and Chargesheet filed before the EOW and the arrest of Mr. Krishnan which took place in 2015 after which Mr. Krishnan was also granted bail vide order dated March 23, 2015.
- t. The order of the Hon'ble Bombay High Court in the matter of Jignesh Shah vs. State of Maharashtra in the context of the Criminal Bail Application No. 1263 of 2014 of Jignesh Shah could not be relied.
- u. The Ld. DA had relied upon the order of SEBI dated December 20, 2020 in NSEL's case and the observations of the Hon'ble Supreme Court, FMC and SFIO in NSEL's

case to arrive at its finding that the Noticee was not ‘fit and proper’ person to be granted certificate of registration as its character was compromised. The findings and observations against NSEL in proceedings to which the Noticee was not even a party could not be the basis of any finding against the Noticee.

- v. The Noticee ceased to act as a broker on NSEL and deal in paired contracts 9 years ago (trading on NSEL platform was suspended in the year 2013). Moreover, it had already been 7 years since the Noticee’s Application under the Stock Brokers Regulations for registration as a commodities broker and a period of 5 years since SEBI issued the 1st SCN dated October 28, 2016.
 - w. As per the bye-laws of NSEL, the responsibility of setting-up, management and utilisation of the Settlement Guarantee Fund was with NSEL. Also, information regarding the quantum of the SGF was provided by NSEL on its website and was available in the public domain.
8. I have carefully considered the SEBI Order, the SAT Order, the DA Report, the arguments/submissions made on behalf of the Noticee and the additional material available on record. I note that the only question that arises for consideration in the present matter is whether the Noticee satisfies the ‘*fit and proper person*’ criteria laid down under Schedule II of the Intermediaries Regulations.

SCOPE OF THE PRESENT REMAND

9. I note that while considering the matter afresh, I will be bound by the findings and observations made by Hon’ble Tribunal in its Order setting aside the earlier SEBI Order. It would, thus, be appropriate to summarize and list the grounds on which the SEBI Order was set aside by SAT, and remanded back to SEBI :
- a. Observations of the Bombay High Court in the matter of **63 Moons vs. Union of India**¹ cannot be relied upon as the said judgement has been set aside in appeal² by Hon’ble Supreme Court vide judgment dated April 30, 2019.
 - b. Observation from the Order dismissing the Writ Petition filed by NSEL against the invocation of the Maharashtra Protection of Interest of Depositors (in Financial

¹ Writ Petition No. 2743 of 2014

² Civil Appeal No. 4467 of 2019

Establishments) Act, 1999 (“MPID Act”) (*NSEL vs. State of Maharashtra*³) cannot be relied upon, as in a subsequent Writ Petition⁴ moved by 63 Moons, a Division Bench of the Bombay High Court has allowed the prayer and held that NSEL is not a financial establishment and therefore the provisions of the MPID Act are not applicable. The Division Bench also observed that the *prima facie* observations made by the single bench while dismissing the NSEL petition could not be relied upon as they were preliminary observations and such observation does not foreclose the issue about the applicability of the provisions of the MPID Act. The Hon’ble Tribunal, I note, was of the opinion that *prima facie* observations cannot be utilized to judge the reputation, character or integrity of NSEL.

- c. Observations in the bail rejection order dated August 22, 2014, passed by the Hon’ble Bombay High Court in the matter of *Jignesh Prakash Shah vs. The State of Maharashtra*, cannot also be relied upon as the observations made in a bail order were limited to the fact as to whether the bail should be granted or not.
- d. Reliance on the SFIO Report, the Tribunal has held, was misplaced. The report only directs EOW/Police to initiate appropriate proceedings against NSEL and its directors/promoters. Based on the SFIO Report, the Special Session Judge took cognizance of the matter by an Order dated July 29, 2019. But this Order was challenged by NSEL and two other accused and has since been stayed by the Bombay HC. Also, no compliant yet has been filed against the Appellants pursuant to the SFIO Report
- e. Effect of SFIO Report under the Code of Criminal Procedure, 1973, not considered by SEBI.
- f. Reliance placed on decisions of the Hon’ble Tribunal in the matter of *Jermyn Capital vs. SEBI*⁵ and *Mukesh Babu Securities vs. SEBI*⁶ is misplaced as decisions in the said matters are distinguishable on facts. Jermyn Capital was held to be in relation to an Interim Order passed by SEBI, and the Tribunal was of the view that the criteria for passing an Ad Interim Order are based on a different criterion, namely *prima facie* case, the balance of convenience and irreparable injury which are distinct and different while considering an application for grant of Certificate of Registration. The decision in the matter of *Mukesh Babu Securities* was distinguished by the Hon’ble Tribunal

³ Writ Petition No. 1403 of 2015

⁴ Writ Petition No. 1181 of 2018

⁵ Appeal No. 26 of 2006 | Decided on September 6, 2006

⁶ Appeal No. 53 of 2007 | Decided on December 10, 2007

on the basis that in the matter a criminal complaint was filed against the Chairman of the Company. The Tribunal noted that there is no evidence to show that any proceedings have yet been initiated against the appellants in the matter under consideration.

- g. Reputation of the applicant cannot be lightly considered based on observations which are not directly related to the applicant.
 - h. Forensic report commissioned by SEBI does not find any close connection between the applicant and NSEL. This was overlooked by SEBI.
 - i. The SEBI Order does not state for how long the rejection of application will continue. The Hon'ble Tribunal was of the view that the rejection cannot continue indefinitely, and in such cases, a time period should be provided during which the applicant will become ineligible to seek fresh registration.
10. It is also noted from the SAT Order that the matter was remanded back to SEBI, taking into consideration the contention made by the counsel appearing on behalf of SEBI that there was additional material available, which had come into existence post the SEBI Order, based on which the findings in the said order could be sustained. The Hon'ble Tribunal, taking into consideration the submissions made, held that:

“It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice. It will also be open to SEBI if it considers necessary, to conduct an independent enquiry proceeding against the connected entities and persons associated with the brokers against whom evidence is available.”

ADDITIONAL MATERIAL BROUGHT ON RECORD

11. As stated above, once the matter was remanded back to SEBI, a DA was appointed to undertake a fresh enquiry. A Supplementary SCN was issued by the DA. Thereafter, the Report of the DA was forwarded to the Noticee vide SCN dated October 11, 2022. The additional material that has been brought on record subsequent to the SEBI Order through the SCN is as under:

- a. Order of the Hon'ble Supreme Court in the matter of ***63 Moons vs. Union of India*** (*refer to paragraph 9*).
- b. Order of the Hon'ble Supreme Court in the matter of ***The State of Maharashtra vs. 63 Moons Technologies Ltd.***⁷
- c. The complaints dated March 17, 2015, and March 24, 2015, filed by NSEL against brokers including the Noticee.
- d. EOW Report dated April 4, 2015.
- e. The charge sheet filed by the EOW against the Noticee.
- f. Copy of the complaint dated September 24, 2018, filed by SEBI with EOW, against brokers including the Noticee.
- g. Copy of the FIR dated September 28, 2018, filed by EOW, acting on the complaint filed by SEBI against the brokers, including the Noticee.
- h. The amendments made to 'fit and proper person' criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008, vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021.

PRELIMINARY OBJECTIONS

12. I propose to first take up the preliminary objections raised by the Noticee. It has been submitted by the Noticee that the issues, including the determination of the Noticee's conformity to the 'fit and proper' criteria have reached finality by way of the SEBI Order dated February 25, 2019, as the new material to be considered was all along in the possession of SEBI. Accordingly, it has been submitted by the Noticee that the present proceeding is barred by the principle of *Res Judicata*. It is emphasised that there is new material, brought out in the above paragraph, which had not been considered in the SEBI Order dated February 25, 2019. That being the case, the Hon'ble SAT has remanded the matter back to SEBI for adjudication of the issue of the Noticee's conformity to the 'fit and proper' criteria, in light of the new material. Had the issue of the Noticee's conformity to the 'fit and proper' criteria attained finality by way of the SEBI Order dated February 25, 2019, there would not have been any need for the Hon'ble SAT to remand the matter to SEBI. In view of the same, I do not find merit in the submissions of the Noticee that the present proceeding is barred by the principle of *Res Judicata*.

⁷ Civil Appeal No. 2748-49 of 2022

13. Before moving forward to consider the matter on merits and test the compliance of the Noticee with the '*fit and proper person*' criteria, on the basis of the additional material that has been brought on record post the SEBI Order (detailed at paragraph 11), it would be appropriate to look at the background of NSEL and understand the nature of the '*paired contracts*' that were offered on the exchange– which ultimately is the cause/ genesis of the current proceedings. While undertaking this exercise, I will not be independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings. I will, however, be relying on the observations made by other authorities including the Hon'ble Supreme Court wherever appropriate.

NSEL AND THE NATURE OF '*paired contracts*'.

14. NSEL was incorporated in 2005 as an electronic platform for spot trading of commodities. On June 5, 2007, the Ministry of Consumer Affairs ("**MCA**"), Government of India, issued a Notification bearing no. SO906(E) under Section 27 of the FCRA granting conditional exemption from the provisions of that Act for (i) forward contracts, (ii) for sale and purchase of commodities, of one-day duration traded on NSEL. The conditions *inter alia* placed an absolute bar on short sales and stipulated that all outstanding positions at the end of the day must result in delivery. It was also stipulated that all information or returns relating to the trades as and when asked for shall be provided to the Central Government or its designated agency. The spot exchanges were envisaged as a platform for providing transparent and secure trading in commodities with a view to boost the agriculture sector in the country. Thereafter, NSEL commenced operations in October 2008.
15. In September 2009, NSEL introduced, on its platform, the concept of '*paired contracts*', which involved buying and selling the same commodity through two different contracts at two different prices wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In other words, the '*paired contract*' involved *two simultaneous transactions being undertaken at the same time with the same counterparty – one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at different prices on the platform of NSEL*. The transactions were structured in a manner that buyer of the short duration contract always ended up making profits.

16. On February 6, 2012, the Department of Consumer Affairs, Government of India, vide Gazette Notification S.O. 228(E) partially amended the Notification dated June 5, 2007, to the effect that “*all information or returns relating to the trade as and when asked for shall be provided to the Central Government or FMC*”.
17. Thereafter, MCA on April 27, 2012 directed NSEL to show cause as to why action should not be initiated against it for the following alleged contraventions:
 - a. Permitting short sale of commodities. NSEL had not made it mandatory for the sellers to actually deposit goods in the warehouse before taking a short position through a member of the exchange, The Exchange had no facility to check stocks and the actual member level security position.
 - b. Contracts made available by NSEL were for periods exceeding 11 days.
18. Subsequent to this, MCA vide its letter dated July 12, 2013, directed NSEL to give an undertaking that: -
 - a. No further/fresh contracts shall be launched by NSEL until further instructions from concerned authority; and
 - b. All the existing contracts will be settled on the due dates.
19. Thereafter, FMC vide an Order No.4/5/2013-MKT-1/B dated December 17, 2013 (“**FMC Order**”), observed that: “55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA” and “the condition of ‘no short sale by members of the exchange shall be allowed’ was not being met by NSEL”.
20. Further, in the above mentioned Order, FMC *inter alia* held that the contracts traded on NSEL violated the following conditions stipulated in the aforesaid Notification SO906(E) dated June 5, 2007:

a. **Short Sale.**

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

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

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

21. It is therefore clear that NSEL was given permission to set up as a spot exchange for trading in commodities. It was essentially meant to only offer forward contracts having one-day duration as per the MCA Notification dated June 05, 2007. I note from the FMC Order that FMC had observed⁸ that 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA. I further note from the FMC Order that under the FCRA, a “*forward contract*” is defined as a “*contract for delivery of goods and which is not a ready delivery contract*”. A “*ready delivery contract*” is defined as “*a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days*”. Given the said definition contained in FCRA; FMC, I note, was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as *Non-Transferable Specific Delivery contracts*.

22. It is therefore noted that even though MCA had stipulated in the exemption Notification that only contracts of one-day duration is permitted to be offered on NSEL, FMC, in its Order, relying on the definition of “*forward contract*” under FCRA held that NSEL was allowed to only trade in one day forward contracts and was obliged to ensure delivery and settlement within 11 days. Therefore, even going by the interpretation adopted by FMC, what is not in doubt is that NSEL had permitted 55 contracts of various commodities having duration longer than 11 days and these contracts were *ex facie* in contravention of

⁸ Order No.4/5/2013-MKT-1/B dated December 17, 2013.

the exemption granted to NSEL. It is pertinent to note that all the 15 contracts that were advertised by NSEL, and which are captured in the Hon'ble Supreme Court's Judgement *in the matter of NSEL* (supra) and reproduced below, were for durations exceeding 11 days.

23. I am now moving on to consider the additional material that has been brought on record. I note that the Hon'ble Supreme Court has also extensively commented on the nature of the 'paired contracts' traded on NSEL. The said observations are captured below:

a. the Two-Judge Bench of the Hon'ble Supreme Court in the course of determining the validity of the amalgamation order in the matter of 63 Moons (supra) vide judgement dated April 30, 2019, had observed as under:

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

b. It is also noted that the Hon'ble Supreme Court in the MPID matter vide judgment dated April 22, 2022 has drawn reference to the presentations made by NSEL in respect of the 'paired contracts'. The relevant portion of the said judgment is reproduced below:

"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*

45. Under the head of "contract specifications", the following representation has been held out:

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

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 opportunity¹¹, 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)

24. I, therefore, note that the Hon'ble Supreme Court has already commented on the nature of the 'paired contracts' offered on the NSEL platform. In the merger petition (**63 Moons Technologies Ltd. vs. UOI**), it was held that these contracts were in the nature of

financing transactions in the MPID matter (*The State of Maharashtra vs. 63 Moons Technologies Ltd.*), the Hon'ble Supreme Court has held that such transactions come within the definition of 'deposits' under the MPID Act.

25. It is further noted that the Hon'ble Supreme Court in the MPID matter, had extensively referred to the claims made on the website of the NSEL and the contents of the advertising material and other investor resources. Of particular interest for the present matter is the data provided in the table reproduced at paragraph 23 (b) of this Order. It can be noted from the said table that NSEL was advertising a uniform return on 16% p.a. for the 'paired contracts' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, a T+2 & T+25 paired contract in steel had the same offered return as a T+ 2 & T + 35 paired contract in castor oil. The 'paired contracts', it is noted, were being projected as an alternative to fixed deposits.
26. I note that the FMC Order, the EOW compliant and both judgments of the Hon'ble Supreme Court have gone into great detail regarding NSEL permitting short sales i.e., permitting sellers to offer contract for sale of commodities on its platform without ensuring that the requisite amount of commodity was available in the warehouse. It is further noted from the Supreme Court's Order in the MPID matter that an overwhelming majority of the sale leg of the 'paired contracts' which were executed were short sales i.e., commodities to back such sales were not available at the designated warehouses of NSEL. I note that the Noticee in its reply has stated that it was the responsibility of NSEL and not the brokers to ensure that the sell orders were adequately collateralised. It was also submitted that brokers neither had an obligation nor the ability to check whether each sell order was backed by adequate collateral.
27. I note that it was primarily the responsibility of NSEL, and not the brokers, to ensure that there was adequate collateral against sell orders posted on its platform. But in the larger scheme of how these 'paired contracts' were structured, it was not inconceivable that sell orders would be short sales as they were designed to be reversed in all cases. Therefore, the question remains as to whether a reasonable person would expect the sellers to move the collateral to a warehouse in a situation where the transaction would be fully reversed.

However, as the responsibility was primarily of the exchange and not of the brokers facilitating these transactions, I am not going to delve any deeper on this issue.

28. I shall now proceed to look at the third condition mentioned in the exemption Notification i.e. the compulsory delivery of outstanding position at the end of the day and the observations made in this respect by various authorities. I note that the FMC Order records that the “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 stated in the preceding part of this Order that the Hon’ble Supreme Court held ‘paired contracts’ to be in the nature of financing transactions.
29. I note the fact that ‘paired contracts’, which were by design structured in a manner that resulted in no delivery of commodities, offered by NSEL, have now been found by authorities including the Hon’ble Supreme Court to be in violation of the conditions prescribed in the exemption Notification dated June 05, 2007, issued by MCA.
30. I also note that apart from the two judgments of the Hon’ble Supreme Court, certain additional material was brought out during the enquiry conducted by the DA. I note that DA Report also takes into consideration the contents of the SFIO Report. It is however noted that in the SAT Order it was held that reliance on the SFIO Report is misplaced as the Report only directs EOW/Police to initiate appropriate proceeding against NSEL and its directors/promoters. Further, the Hon’ble Tribunal noted that based on the SFIO Report, the Special Sessions Judge took cognizance by an Order dated July 29, 2019. But this Order was challenged by NSEL and two other accused and the Order has been stayed by the Hon’ble Bombay High Court. In view of the said finding, I do not propose to place any reliance on the material brought out in the SFIO Report.
31. It is noted that the DA Report also relies on the EOW Report and the charge sheet filed by EOW. Pursuant to settlement default, NSEL filed complaints dated March 17, 2015 and March 24, 2015, against the brokers including the Noticee. EOW, based on the initial investigation, prepared a Report dated April 4, 2015, *inter alia* alleging the following:

- a. that the Noticee gave false assurance to investors;
 - b. the Noticee indulged in market capturing practices by large scale UCC manipulations; and
 - c. the Noticee conducted short selling on the exchange.

32. Thereafter, EOW filed charge sheet dated December 25, 2018 in FIR No. 89/13. It has been noted in the charge sheet that the Noticee became a member of NSEL in 2011 and had around 1000 clients. The Noticee earned brokerage of INR 2.34 crore and collected INR 6.61 crore as clearing and forwarding charges. The total turnover with respect to the Noticee on the NSEL platform was INR 5542.21 crore. It has also been alleged that the Noticee participated in the financial scheme of illegal paired trade contracts launched by NSEL and induced the investors/clients through marketing material and power point presentation showing risk free assured returns. The other allegations in the charge sheet are summarized below:
 - a. Noticee carried out 715 unique client code (UCC) trade modifications valued at INR 163.30 Crore. Huge client code modifications are abnormal and not permitted under rules and regulation prescribed by NSEL.
 - b. Noticee failed to take any precautions to protect the interest of its clients.
 - c. Noticee was aware that it was entering into a contract from a specific seller and selling it back to them as per the contracts. Noticee was aware of risk involved however failed to take any precautions to protect the interest of the investors. In view thereof, it is alleged in the charge sheet that the Noticee participated in the financial scheme of illegal paired trade contracts launched by NSEL and its directors. Also that the Noticee was a financial establishment.
 - d. Noticee participated in the financial scheme of illegal 'paired contracts' launched by NSEL and induced the investors through marketing material and power point presentation showing risk free returns. Hence the Noticee had given false assurance to investors as regards NSEL with wrongful, misleading statements leading to enticement for investments in NSEL products.

33. I note from the records that SEBI filed a complaint with EOW Mumbai 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 the EOW.

34. This essentially leads to the question as whether the Noticee while facilitating such transactions was under the bona fide belief that the '*paired contracts*' were actually spot contracts in commodities. Or can it be said that the very fact that '*paired contracts*' were offered meant that NSEL was offering contracts which were not resulting in compulsory delivery and, therefore, the Noticee should have been aware that such a product was far removed from the spot trading which was permitted on NSEL. Further, as stated in the table reproduced at paragraph 23 (b) 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. Further, these contracts were structured in a manner which ensured that the buyer always made pre-determined profits.
35. What is also undisputed is that there was a settlement default at NSEL and unsuspecting clients of the Noticee suffered losses. The question that needs to be considered is whether there were enough red flags which should have alerted the Noticee when these products were started to be offered by NSEL. Was the material on record, especially that summarized at paragraph 25, sufficient to make a reasonable person act in a more circumspect manner and to conclude that what was being offered were not spot contracts in commodities but rather a financial product offering fixed returns, as the Hon'ble Supreme Court had held.
36. It has been contended on behalf of the Noticee that there is no finding recorded, yet, by any authority recording wrong doing on the part of the Noticee in respect of its role in the settlement default that happened at NSEL. It has also been argued by the Noticee that till the settlement default there were no signs that the '*paired contracts*' were offered in violation of the exemption granted by MCA. I cannot accept these contentions for the reason that the red flags identified above should have made the Noticee more vigilant. A broker finally has the responsibility to safeguard the interest of its clients. Further, in proceedings like the present one, where the compliance with the fit and proper person criteria of an applicant seeking registration is being undertaken, the decision which has to be made on the basis of the material available till that point on record. SEBI in such cases would not

be in a position to wait till the proceedings come to their logical conclusion and final determination is made by the respective authorities.

37. It was argued by the Noticee that it was just one among the 800 odd brokers who were facilitating such transactions at NSEL. It was even sought to be argued that such *'paired contracts'* were offered at the behest of the clients. I am tempted to quote Warren Buffett here in the context of the shenanigans that were being perpetuated. He has been famously quoted as saying that *'Only when the tide goes out do you discover who has been swimming naked'*. The music had to stop some day and the inevitable had to unfold. The music stopped shortly after MCA, vide its letter dated July 12, 2013, on the recommendation of FMC, asked NSEL to settle contracts on the due dates and to give an undertaking that no fresh contract shall be launched. When asked to settle /square off the paired contracts, NSEL was unable to do so. The exchange defaulted and collapsed like a pack of cards. It appears from the nature of contracts that NSEL was not functioning like a spot exchange for commodities but rather as a spot exchange for unsecured lending. As a result, investors lost money as all the underlying warehouse receipts were bogus and there was no underlying security. Had there been collateral, the exchange could have sold the same in a distress sale and recovered most of its dues and the balance, if any, could have been covered come from the Settlement Guarantee Fund of NSEL. As noted in the judgment of the Hon'ble Supreme Court in the MPID matter, the exchange publicised that it provided counter party guarantee risk. In reality, it failed to do so.

'Fit and Proper Person' CRITERIA

38. Regulation 5(e) of the SEBI (Stock Brokers) Regulations, 1992 ("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.

Stock Broker Regulations

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;”

39. I note that the ‘fit and proper person’ criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008, was amended vide SEBI(Intermediaries) (Third Amendment) Regulations, 2021. Schedule II, as amended, is reproduced below:

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

[See regulation 7]

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

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

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

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

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

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

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

- (a) integrity, honesty, ethical behaviour, reputation, fairness and character of the person;*
- (b) the person not incurring any of the following disqualifications:*

- (i) criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;*
 - (ii) charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences and is pending;*
 - (iii) an order of restraint, prohibition or debarment has been passed against such person by the Board or any other regulatory authority or enforcement agency in any matter concerning securities laws or financial markets and such order is in force;*
 - (iv) recovery proceedings have been initiated by the Board against such person and are pending;*
 - (v) an order of conviction has been passed against such person by a court for any offence involving moral turpitude;*
 - (vi) any winding up proceedings have been initiated or an order for winding up has been passed against such person;*
 - (vii) such person has been declared insolvent and not discharged;*
 - (viii) such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;*
 - (ix) such person has been categorized as a wilful defaulter;*
 - (x) such person has been declared a fugitive economic offender; or*
 - (xi) any other disqualification as may be specified by the Board from time to time.*
- (4) Where any person has been declared as not 'fit and proper person' by an order of the Board, such a person shall not be eligible to apply for any registration during the period provided in the said order or for a period of five years from the date of effect of the order, if no such period is specified in the order.*
- (5) At the time of filing of an application for registration as an intermediary, if any notice to show cause has been issued for proceedings under these regulations or under section 11(4) or section 11B of the Act against the applicant or any other person referred in clause (2), then such an application shall not be considered for grant of registration for a period of one year from the date of issuance of such notice or until the conclusion of the proceedings, whichever is earlier.*
- (6) Any disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub - clause (b) of clause (3), shall not have any bearing on the 'fit and proper person' criteria of the applicant or intermediary unless the applicant or intermediary or any other person referred in clause (2), is also found to incur the same disqualification in the said matter:*
- Provided that if any person as referred in sub-clause (b) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall replace such person within thirty days from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against the intermediary:*

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

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

40. I note that post the amendment carried out to Schedule II of the Intermediaries Regulations 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 Noticee has however contented that the revised criteria introduced in 2021 should not be made applicable to him as the present proceeding essentially pertains to the consideration of an application filed by the Noticee in 2015. I, however, find no merit in this argument. It is noted that 'fit and proper person' criteria is a requirement that has to be satisfied by the intermediary at the time of registration with SEBI and also through the time it holds a valid registration with SEBI. Therefore, even assuming for the sake of argument that the Noticee was granted a Certificate of Registration in 2015, such an intermediary would still be required to comply with the revised criteria post the amendments carried out in 2021. Further, as the application filed by the Noticee is being considered afresh, the criteria applicable as on date of such consideration needs to be applied.

41. It is noted that paragraph 3(b) of the amended criteria lays down a list of disqualifications which includes that following:

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

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

42. As already stated in paragraph 33, a criminal complaint has been filed by SEBI before the EOW against the Noticee. Further, the EOW has also filed a charge sheet against the Noticee. It is, therefore, noted that the Noticee attracts the disqualifications provided in

paragraph 3(b) (i) and (ii). Further, the act of the Noticee in offering access to *'paired contracts'*, as detailed in paragraph 25, also seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee. These contracts, as stated earlier, were *ex facie* offered in violation of the exemption Notification issued by 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.

43. The settlement default at NSEL led to investors suffering losses of more than INR 5600 Crore. This leads to the question whether the writing on the wall would have been visible if the Noticee acted with responsibility, care and diligence. This was the period (2009 - 2013), when the policy repo rate ranged from 4.75 % to 8% and NSEL, in its own advertising material, was promising an *'assured return'* of 16%. Contracts were structured in a manner where the buy side always made a profit. The return across commodities, as highlighted in the table at paragraph 23 (b), were the same irrespective of the duration of the contract. This is apart from the other *ex facie* deviations from the exemption notification that paired contracts suffered from. The lure of extra yield proved to be an irresistible bait. Brokers with vast experience like the Noticee should have been more careful while offering such a product to its clients.
44. I therefore note that there were enough red flags for a reasonable person to come to a conclusion that what was being offered as paired contracts on NSEL were not spot contracts in commodities. Given the above, I am constrained to conclude that the Noticee, presumably driven by its desire to earn brokerage, provided a platform for its clients to access a product which raised serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the product itself. In view of the above, I hold that the Noticee does not satisfy the *'fit and proper person'* criteria specified in Schedule II of the Intermediaries Regulations.
45. Now I move on to the question of the directions to be issued. I note that acts under question pertain to the period of 2011 to 2013. Further, the application that is being considered in these proceedings was submitted in 2015. There was even an attempt by the Noticee to withdraw the application, which was not permitted by SEBI. The decision was challenged by the Noticee before the Hon'ble Bombay High Court, which eventually held

that SEBI was justified in refusing the withdrawal as proceedings were pending. Thereafter, SEBI vide Order dated February 25, 2019 rejected the application filed by the Noticee. I cannot lose sight of these facts while arriving at the directions to be issued.

46. The DA in his Report recommended that the application submitted by the Noticee be rejected and the Noticee be debarred from making a fresh application seeking registration for a period of three years from the date of conclusion of the present proceedings before SEBI or till complete acquittal of the Noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier.
47. Given the facts that have been brought out in the preceding parts of this Order, I differ with the recommendation of the DA with regard to the period for which the Noticee should be debarred from making a fresh application seeking registration with SEBI, especially considering the timeline over which the events have played out. In view of the same, I am of the view that the Noticee be debarred from making a fresh application seeking registration for a period of 6 months from the date of this Order or till complete acquittal of the Noticee by Courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier, would be commensurate with the findings against the Noticee in this Order.

Order –

48. I, therefore, in exercise of powers conferred under Section 19 of the SEBI Act, 1992 read with Section 12 (3) of the SEBI Act and Regulation 27 of the Intermediaries Regulations, 2008, reject the application filed by the Noticee and also debar the Noticee from making a fresh application seeking registration, before SEBI, for a period of 6 months from the date of this Order or till acquittal of the Noticee by courts pursuant to the charge sheet and FIR filed by/with EOW, whichever is earlier.
49. This Order shall come into force with immediate effect.

Place: Mumbai
Date: November 29, 2022

ASHWANI BHATIA
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA