

SECURITIES AND EXCHANGE BOARD OF INDIA

MS. MADHABI PURI BUCH, WHOLE TIME MEMBER

Order

Under Regulation 28 of Securities and Exchange Board of India (Intermediaries) Regulations, 2008
read with regulation 7 of Securities and Exchange Board of India (Stock Brokers and Sub-brokers)
Regulations, 1992

In the matter of

Sl. No	NAME	PAN
1.	India Infoline Commodities Limited	AABCI2930D

In Re: Fit and Proper Criteria

BACKGROUND OF THE CASE:

1. India Infoline Commodities Limited (Now known as “IIFL Commodities Limited”) (hereinafter referred to as “IICL” / “Noticee”) was/ is a commodity derivatives broker / member of National Spot Exchange Limited (hereinafter referred to as “NSEL”), Multi Commodity Exchange of India Ltd (hereinafter referred to as “MCX”) and National Commodity & Derivatives Exchange Limited (hereinafter referred to as “NCDEX”).
2. NSEL was incorporated in May 2005 as a Spot Exchange for trading in commodities. In exercise of power conferred under Section 27 of the Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as “FCRA”), Central Government vide notification dated June 5, 2007, exempted all forward contracts of one day duration for the sale and purchase of commodities traded on NSEL from operations of the provisions of FCRA subject to certain conditions, inter alia including “no short sale by the members of the exchange shall be allowed” and “all outstanding positions of the trades at the end of the day shall result in delivery”. In October 2008, NSEL commenced its operations by providing an electronic trading platform to participants for spot trading of commodities such as bullion, agricultural produce, metals, etc.

3. It is observed that in September 2009, NSEL had introduced the concept of 'paired contracts'. Paired contracts means buying and selling the same commodity through two different contracts at two different prices on the Exchange platform and investors could buy a short duration settlement contract and sell a long duration settlement contract and vice versa at the same time viz. Trades for Buy (T+2 / T+3) and Sell (T+25/ T+36) used to happen on the exchange at the same time at different prices.
4. Pursuant to a settlement default at NSEL in 2012, Economic Offences Wing's (hereinafter referred to as **"EOW"**) initial investigations / arrests and complaints received from investors against the members / brokers of NSEL (including Noticee), NSEL vide complaint letters dated March 17, 2015 and March 24, 2015 and EOW via report dated April 04, 2015 had requested Securities and Exchange Board of India (hereinafter referred to as **"SEBI"**) to take appropriate/necessary action.
5. It is noted that vide Finance Act, 2015, Forward Market Commission (hereinafter referred to as **"FMC"**) got merged with SEBI on September 28, 2015. Further, it is noted that as per Finance Act 2015, an intermediary may continue to buy, sell or deal in commodity derivatives as a commodity broker, if it had made an application for such registration to SEBI within a period of 3 months from the date of merger till the disposal of such application. Pursuant to this merger, IICL on December 23, 2015, had made an application to SEBI for registration as a commodity derivatives broker.
6. Further, pursuant to the merger of FMC with SEBI, the regulation and supervision of the commodity derivatives brokers had been entrusted to SEBI. Therefore, in view of the abovementioned NSEL complaint letters and EOW report, SEBI had appointed Kirtane & Pandit LLP, Chartered Accountants (hereinafter referred to as **"Auditor"**) to carry out a performance audit/inspection of IICL.
7. Audit report along with Annexures were submitted by the Auditor to SEBI. Based on the findings of the Auditor and further analysis of the same by SEBI, it was decided by SEBI to initiate enquiry proceedings against IICL in terms of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as **"Intermediaries Regulations"**).

8. SEBI vide order dated October 06, 2016 had appointed a Bench of Designated Authorities (hereinafter referred to as “**DAs**”) to enquire into the alleged violations of various provisions of the SEBI (Stock Brokers & Sub Brokers) Regulations, 1992, (hereinafter referred to as the “**Brokers Regulations**”), SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (hereinafter referred to as “**PFUTP Regulations**”), Forward Contracts (Regulation) Act, 1952, (hereinafter referred to as “**FCRA**”), Prevention of Money Laundering Act, 2002 (hereinafter referred to as “**PMLA**”), Central Government Notifications and various Circulars / Code of Conduct, Guidelines, Bye Laws, Business Rules etc. of FMC / SEBI / NSEL / NCDEX / MCX.
9. In terms of Regulation 27 of the Intermediaries Regulations, the Designated Authorities had submitted the Enquiry Report dated April 11, 2017 in respect of IICL. Vide the said Enquiry Report, the Designated Authorities had stated that “*...in view of the seriousness of the matter, facts and circumstances of the case, the conduct of the Noticee in its functioning as a commodity broker is questionable and has certainly eroded its general reputation, record of fairness, honesty and integrity and has therefore affected its status as a ‘fit and proper person’ to be an intermediary in the securities market...*” and gave the following recommendations:
- (a) The application of IICL submitted for registration as a commodity broker may not be considered in the interest of securities market and the application of IICL may be rejected.
 - (b) SEBI may also consider initiating prosecution proceedings under the relevant provisions of Chapter V of FCRA for the irregularities committed by IICL including the violation of the Government of India Notification issued under section 27 of FCRA.

FIRST SHOW CAUSE NOTICE:

10. Pursuant to the submission of Enquiry Report dated April 11, 2017 in respect of IICL by the Designated Authorities, SEBI issued a Show Cause Notice dated April 24, 2017 enclosing a copy of Enquiry Report dated April 11, 2017 (hereinafter referred to as “**SCN**” / “**Enquiry**”

Report”) to IICL wherein IICL was advised to reply to the SCN within 21 days from the date of receipt of said notice. IICL vide letter dated May 12, 2017 had acknowledged the receipt of SCN. The allegations in brief as specified/mentioned/established/alleged in the Enquiry report were as under:

- 10.1. Noticee had violated the provision of the conditions prescribed vide Government Notification dated June 05, 2007 which in turn resulted in the violation of the provision of Section 27 of FCRA.
- 10.2. Noticee had made false representation in respect of assured / risk free return, arbitrage opportunity in spot market by way of pair contracts, making assurances that pair trades are backed by collateral in the form of stock / sufficiency of commodities in warehouses, making statements that goods in warehouse are backed by insurance cover; which are in violation of provisions of various circulars, rules and bye laws of NSEL and sections 21(g) of the FCRA.
- 10.3. Noticee had done client code modifications with manipulative artifice; Noticee had done trading in clients name without their permission; Noticee had allowed clients to execute trades despite debit balance in their accounts; which are in violation of provisions of various circulars, rules and bye laws of NSEL.
- 10.4. Noticee had failed to report suspicious transactions to Financial Intelligence Unit under PMLA thereby violated provision of NSEL Circulars.
- 10.5. Noticee had not segregated funds between clients account and its own account; Noticee had failed to do system audit of IBT system and CTCL System for the period under audit; Noticee had not obtained CCP certificate during the period under audit. Noticee had failed to resolve many investor’s complaints; which are in violation of provisions of various circulars of MCX and NCDEX.

It is alleged that the Noticee has not conducted its operations as a commodity broker at NSEL in a fair and transparent manner. The integrity, reputation and character of the Noticee is questionable from the conduct of its business at NSEL as a commodity broker. In view of the seriousness of the matter, facts and circumstances of the case, the conduct of the Noticee in its functioning as a commodity broker is questionable and has certainly eroded its general reputation, record of fairness, honesty and integrity and has therefore affected its status as a ‘fit and proper person’

ISSUE OF INSPECTION:

11. IICL vide various letters/emails dated May 12, 2017, June 08, 2017, July 10, 2017, September 15, 2017, September 19, 2017, September 22, 2017, October 06, 2017, October 27, 2017, November 21, 2017 and January 09, 2018 etc. had sought inspection of documents as well as copies of documents and submitted that SEBI has not provided complete inspection of all documents to them. However, SEBI submitted that it had granted inspection to IICL on June 19, 2017 and copies of all relied upon documents were also provided to IICL through various letters dated June 21, 2017, August 29, 2017, November 08, 2017 and January 05, 2018.
12. In view of the stand of SEBI that it has granted inspection of all relied upon documents and the stand of the Noticee that they are entitled to get additional documents and their request that a hearing on merits be fixed only after they file detailed reply based on all the requested documents, in order to overcome the impasse resulting from the conflicting stands, an opportunity of hearing on January 24, 2018 and February 07, 2018 was provided to the Noticee in respect of inspection of documents. Authorized Representatives of the Noticee appeared for hearing and made oral submissions with respect to the inspection of documents and matter was heard at length.
13. After consideration of submissions of the Noticee on the issue of inspection, a detailed order dated August 30, 2018 was passed on the issue of inspection and the proceedings related to inspection was closed. The said order dated August 30, 2018 was delivered to Noticee through email and speed post.

REPLY AND HEARING ON MERIT OF THE CASE:

14. Noticee submitted its reply dated June 15, 2018 on merits to the SCN. The reply of the Noticee in brief are as under:

Preliminary objections:

14.1. *Jurisdiction:*

- 14.1.1. That SEBI does not have jurisdiction to issue the SCN under Intermediaries Regulations [under regulation 28(1) read with regulation 7(2) of Intermediaries Regulations] as Noticee is not a registered intermediary under Intermediaries Regulations. Intermediaries Regulations is applicable only to persons who have been granted certificate of registration by SEBI under the Act or Regulations made thereunder. Noticee has made an application for registration as Commodity Derivative Broker under amended SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 on November 24, 2015 and application is still pending at SEBI. Therefore, Noticee has not received the certificate of registration from SEBI till date and so Noticee is not registered as an intermediary. Accordingly, Intermediaries Regulations is not applicable to the Noticee and therefore enquiry commenced thereunder is ultra-virus and void ab-initio.
- 14.1.2. Noticee submitted that the grant of certificate of registration under the Act or the regulations framed thereunder is a jurisdictional fact which confers jurisdiction on the Board to take action as provided under Chapter V, specifically Regulations 24, 25, 26 and 27.
- 14.1.3. Regulation 23 opens with the words “where any person who has been granted a certificate of registration under the Act or regulations made thereunder”. Regulation 23 can be invoked only if there is a non-compliance of any condition of certificate of registration or of the provisions of securities laws or directions, instructions or circulars issued thereunder. In the instant case, the question of non-compliance of any condition of certificate of registration does not arise as the Noticee has not yet been issued the certificate of registration by SEBI and its application for registration as a stock broker is still pending. No violation of securities laws has also been alleged. Securities laws means SEBI Act, Securities Contract (Regulations) Act, Depositories Act and rules & regulations made thereunder.
- 14.1.4. Regulation 24 (1) provides that where the designated member is satisfied that a person who has been granted certificate of registration under the Act or the regulations made thereunder has committed any default in complying with any condition of certificate of registration or securities laws or directions, circulars, instructions issued thereunder, then he may appoint a DAs to look into the default/violation. Thus, the Designated Member is empowered to appoint DAs only in a case where the aforesaid conditions are satisfied.
- 14.1.5. Regulation 25 (1) provides that the DAs may issue a notice to the concerned person to show cause as to why the certificate of registration granted to it should not be suspended or cancelled or why any other action provided therein should not be taken. It is submitted that if a certificate of registration is not granted under

the Act or the regulations, then there is no question of suspending or cancelling it. Further “any other action as provided herein” is also set out in Regulation 27 which provides for specific recommendation which can be made by the DA.

- 14.1.6. In the present case, the DAs has recommended that IICL not be granted certificate of registration as it is not a fit and proper person; and SEBI may consider initiation of prosecution against IICL for its alleged violation of the law. It is submitted that both the recommendations fall outside the purview of Regulation 27.
- 14.1.7. Assuming without admitting that DAs has the jurisdiction to commence enquiry and submit an Enquiry Report, the recommendations made by the DAs fall outside the purview of Regulations 27 of Intermediaries Regulations, therefore, the DAs has acted outside the jurisdiction conferred on it and the Enquiry Report, therefore, suffered from the vice of exercise of excessive jurisdiction which is not conferred by the statute on the Member and which in turn cannot be and in fact is not delegated on the DAs in the present case.
- 14.1.8. Since Noticee is not an intermediary for the purposes of the Intermediaries Regulations, therefore, Regulation 17 of Intermediaries Regulations which provides for inspection of books, accounts etc. is not applicable to them. Without paying any heed to the provisions of Regulation 17 as also the scheme of the Intermediaries Regulations, SEBI appointed M/s. Kirtane & Pandit, LLP, Chartered Accountants as the Inspecting Authority. IICL fully cooperated with the said Inspecting Authority despite having reservation on its legal status and authority.
- 14.1.9. That there is no provision for enquiry by DAs in case of Intermediaries who have applied for certificate of registration under Relevant Regulations.
- 14.1.10. That any violation of FCRA, NSEL Bye-laws, Business Rules of NSEL, Circulars of NSEL, Business Rules and Regulations of NCDEX or circulars issued under PMLA can neither be enquired into by DAs under the Intermediaries Regulations nor they can make any recommendation in that respect.
- 14.1.11. That the present procedure adopted by SEBI is not tenable at law and SEBI (after being vested with the powers of FMC) ought to have taken recourse to enquiry procedure as per section 12B of the FCRA pursuant to exercise of power u/s 29 (A)(2)(e) of the Amendment to FCRA as amended and notified under the Finance Act, 2015 dated May 14, 2015.
- 14.1.12. The Government Notification dated August 28, 2015 regarding merger of FMC with SEBI is prospective in nature. SEBI has no jurisdiction to issue the present SCN which is based on the alleged violations relating to the period prior to September 28, 2015.
- 14.1.13. All the alleged violations referred in the said Notice relate to the period prior to the notification dated August 28, 2015 i.e. merger of FMC with SEBI. SEBI has not been empowered to issue any notice to IICL as an intermediary for the alleged non-compliances/violations committed prior to the aforesaid notification dated

August 28, 2015. It is submitted that the Intermediaries Regulations referred in the notice cannot be made applicable to IICL with retrospective effect. Therefore, SEBI has no power to issue any notice under regulation 25(1) of SEBI (Intermediaries Regulations) 2008 for any alleged violations.

- 14.1.14. In terms of the amendment dated September 28, 2015 and further SEBI notification dated September 28, 2015, the provisions and/or the regulations under the Stock Brokers Regulations are applicable to the members of the Commodities Derivative Exchange post the effective date i.e., September 28, 2015. Thus, SEBI Regulations have become applicable to the commodities derivatives exchange members only from September 28, 2015. Therefore, any allegations of violating the regulations as stipulated under the Brokers Regulations read with the schedule II of the SEBI (Intermediaries) Regulations 2008, prior to the amendment coming into force (i.e. September 28, 2015), is incorrect, untenable and void ab initio as IICL was not a registered intermediary under the SEBI Regulations nor was it required to be registered with SEBI during the referred period of Inspection. Hence, the notice dated October 28, 2016, the report of DA and the current show cause notice dated April 24, 2017 are beyond the jurisdiction of the SEBI.
- 14.1.15. As per the provisions of Section 29A (2) (d) & (e) of the Amendment to the FCRA as notified under Finance Act 2015 dated May 14, 2015, any fresh proceeding relating to an alleged violation of the provisions of the Forward Contracts Act may be initiated by the Security Board (SEBI) under that Act i.e. FCRA within three years from the date on which that Act is repealed and proceeded with, as if that Act had not been repealed.
- 14.1.16. At the relevant time in question, the Noticee was governed by the provision of FCRA and not SEBI (Stock Broker & Sub-broker) Regulations which became applicable to Commodities Derivatives Exchange Members (including the IICL) after September 28, 2015. Since, the provisions relating to the SEBI (Stock Broker) Regulations were not applicable to IICL at the relevant time in question, any notice issued under these provisions are deemed to be beyond the jurisdiction of SEBI.
- 14.1.17. Considering Section 28A (1) of the Amendment to the FCRA as notified under Finance Act 2015 and the fact that IICL has not been registered with SEBI till date, SEBI Act and Regulations made thereunder are not applicable to IICL, particularly, in respect of actions which were governed by the FCRA, bye-laws, circulars or any like instrument made by the commodities exchanges, before merger of FMC with SEBI. So far as the transactions, carried on the trading platform of commodities exchanges, prior to the merger of FMC with SEBI are concerned, SEBI can only conduct enquiry u/s 12B of FCRA pursuant to exercise of power under section 29A(2)(e) of the Amendment to FCRA.

- 14.1.18. The DA has completely misunderstood and/or misinterpreted the provisions of aforesaid sections 131 and 132 of Finance Act 2015.
- 14.1.19. The Central Government vide Gazette notification dated June 05, 2007 granted an exemption under section 27 of FCRA to NSEL from complying with all the provisions of FCRA. Therefore, it is clear that NSEL, being a spot exchange for commodities was out of the regulatory purview of FCRA and FMC which was a regulatory authority for Commodities Derivatives Markets and Exchanges under FCRA. Even the commodity brokers were not regulated by FMC for their transactions executed on the trading platform of NSEL.
- 14.1.20. The Government vide its Notification dated August 06, 2013 empowered FMC for the purposes of settlement of all outstanding one day forward contract at NSEL. It is only after the merger of FMC with SEBI, SEBI has got all the powers of FMC. Even then, NSEL and its Brokers as well as the transactions carried out therein were out of regulatory purview of FMC upto August 6, 2013 and so it is SEBI's own admitted position that SEBI also has no expressive jurisdiction to regulate the transactions carried out on the platform of NSEL as it was a Spot Exchange for Commodities.
- 14.1.21. IICL was not registered as a stock broker with SEBI at the time of alleged trades on the platform of NSEL nor the functioning of NSEL were regulated by FMC or SEBI before September 28, 2015, hence, IICL cannot be held responsible for compliance with Brokers Regulations and consequently liable for any action. Consequently, IICL also cannot be held liable for committing breach of any provisions of Code of Conduct for Brokers as specified in Schedule II under Regulation 9 of Brokers Regulations for the period pertaining before September 28, 2015.
- 14.1.22. The Securities Contract Regulations Act, 1956 (hereinafter referred to as "SCRA") was amended on September 28, 2015 and the expression 'Commodity Derivatives' was included in the definition of 'Derivatives' which is inter alia covered under the definition of 'Securities'. Till September 28, 2015, the Commodities Derivative contracts were not considered as securities and therefore PFUTP Regulations were not applicable to the spot/alleged derivatives contracts on the platform of MCX, NCDEX and NSEL. The DAs has clearly accepted this view and dropped the allegation/charge of violation of the provisions of PFUTP Regulations by IICL.
- 14.1.23. The DAs has adopted contradictory position while rejecting the applicability of PFUTP Regulations but accepting the applicability of Intermediary Regulations to the Noticee which is not an Intermediary.
- 14.1.24. It is clear from above submissions that the provisions of SEBI Intermediaries Regulations and SEBI Stock Brokers Regulations are not applicable to IICL and SEBI has no jurisdiction to initiate the current proceedings under SEBI Intermediaries Regulations.

14.1.25. It is well settled that law cannot have retrospective application unless the statute so provides specifically. SEBI Act does not have any provision which authorizes SEBI to make regulations having retrospective application. Accordingly, the SEBI Regulations cannot be made applicable retrospectively particularly when the Intermediary Regulations were not applicable to IICL which is not registered as intermediary.

14.2. *Violation of Principles of Natural Justice by the Designated Authority:*

- 14.2.1. Without prejudice to the above and assuming without admitting that SEBI has the jurisdiction to issue the present SCN, it is submitted that the Designated Authority has relied upon various documents/information and data in its Enquiry Report while alleging various breaches by the Noticee. However, the said documents/data have not been provided to the Noticee along with the SCN.
- 14.2.2. The inspection report and/or findings in the inspection report were not provided to or shared with IICL.
- 14.2.3. That the DAs did not provide an opportunity for inspection of the documents to IICL.
- 14.2.4. It is well settled that non-disclosure of material relied upon against the noticee amounts to denial of a real and effective opportunity of hearing. It is also well settled that right to know the material on which the Authority is going to base its decision is an element of right to defend oneself. It is therefore, submitted that non-disclosure of the inspection report and documents amounts to denial of a fair opportunity of hearing to the Noticee. It is submitted that this amounts to violation of established principles of natural justice.
- 14.2.5. The DAs not only denied inspection of the relevant documents but also failed to grant a personal hearing despite a specific request made by IICL. It is submitted the denial of personal hearing by the DAs to IICL is in gross violation of principles of natural justice and discloses prejudice and bias against IICL.
- 14.2.6. That the Noticee was seriously prejudiced by denial of an inspection of documents and opportunity of personal hearing/oral hearing as the present SCN is issued only on the basis of findings and recommendations of the DAs. Had the DAs given an opportunity of hearing to IICL, IICL would not have to undergo the proceedings in relation to the present SCN.
- 14.2.7. That the above failure is a serious deficiency in following the principles of natural justice and the present SCN ought to be withdrawn and Enquiry Report / recommendations be ignored on this ground alone.

14.3. *Administrative discrimination*

- 14.3.1. Without prejudice to the above and assuming without admitting that SEBI has the jurisdiction to issue the present SCN and the SCN is not vitiated on account of the violation of the principles of natural justice, it is submitted that SEBI has

discriminated against IICL and handful of Intermediaries/brokers by initiating proceedings under the Intermediaries Regulations and the Criteria for Fit and Proper Person Regulations although several other intermediaries and brokers dealt with on behalf of their Clients at NSEL and undertook the same activities as the Noticee. However, such persons have been declared as fit and proper person under the Regulations and have been granted certificate under the Intermediaries Regulation.

- 14.3.2. That SEBI has exercised its power (to issue the notice and initiate proceedings under the Relevant Regulations) in a discriminatory/arbitrary manner by issuing the present SCN and by initiating the enquiry proceedings only against the Noticee (and a handful of other intermediaries/ brokers).
- 14.3.3. That the arbitrariness is the antithesis of rule of law and a denial of equality and equal protection of law guaranteed under Article 14 of the Constitution of India.
- 14.3.4. That there are no distinguishing features between the Noticee and the intermediaries who have been certified as fit and proper person to carry out activities as trading members of different Stock Exchanges.
- 14.3.5. That an unfettered discretion is a sworn enemy of the constitutional guarantee against discrimination. No Authority has any power to exercise the discretion vested in it unless the same is based on justifiable grounds supported by acceptable material and reason therefore. In the present instance no such justification is provided by SEBI.

14.4. *Defective show cause notice*

A show cause notice under regulation 28(1) for enquiry proceedings cannot be clubbed with the process for consideration of pending application for registration as an intermediary under regulation 7(2) & 7(3) of Intermediaries Regulations for the following reasons:

- 14.4.1. There was no mention of regulation 7(2) in the aforementioned show cause notice issued by the DA. Accordingly, the entire enquiry proceedings were restricted to ascertainment of commission of any violations alleged in the show cause notice.
- 14.4.2. The present SCN for the first time has referred to regulation 7(2) of Intermediaries Regulations without specifying any ground for rejection of the Noticee's pending application for registration as a stock broker. A separate procedure has been laid down under Chapter II of the Intermediaries Regulations for consideration of an application for registration of an entity as an intermediary, grant or rejection of the application as per the procedure laid down therein.
- 14.4.3. There is no bar for grant of certificate of registration when any proceeding is pending against the applicant. This position of law is clearly spelt out by the proviso to Regulation 8 (1) of SEBI (Intermediaries) Regulation 2008.

- 14.4.4. Designated authority after conducting enquiry is entitled to recommend any one or more of the actions mentioned under Regulations 27 of the SEBI (Intermediaries) Regulations 2008 against the delinquent entity.
- 14.4.5. In the instant case, DA has gone beyond the scope of Regulation 27 and recommended inter alia rejection of the Noticee's pending application for registration as a stock broker. Designated member has compounded the aforesaid error of DA by clubbing the show cause notice contemplated under regulation 7 (1) with the notice under Regulation 28(1).
- 14.4.6. The designated member has committed a gross error in clubbing the two proceedings which operate entirely in different situation. The regulations do not permit clubbing of such proceedings. The only situation where a common order can be passed by the designated member is covered by regulation 29 of SEBI (Intermediaries) Regulations 2008.
- 14.4.7. In the instant case, the subject matter under Regulation 7(2) / 7(3) of SEBI (Intermediaries) Regulations 2008 is substantially different from the subject matter to be enquired in to under Regulation 28(1).
- 14.4.8. In view of the aforementioned, it is patently wrong and unfair to club two different proceedings as the same tantamounts to denying the proper opportunity of representation against the SEBI's proposal for rejection of the Noticee's pending application for registration as a stock broker. No deficiencies have been pointed out and no opportunity is being given to make good such deficiencies, based on which the Noticee's pending application is proposed to be rejected. This is a gross violation of laid down process for consideration of application for registration by SEBI and so on this ground alone the show cause notice deserves to be withdrawn.

Response to the Specific Findings / allegations in the DAs Report / SCN:

14.5. The role of IICL as a commodity broker has been misconstrued by the DAs:

- 14.5.1. The role of IICL as Commodity Broker was in the normal course and not to assess the legality of the products introduced by the NSEL. IICL merely facilitated trading on NSEL by providing the required infrastructure and services to its clients. IICL was not involved in designing of any product introduced by NSEL. IICL role was limited to facilitate the investors to trade on the platform of NSEL. IICL was only a facilitator of trades and was placing the orders as per the instruction of the clients.
- 14.5.2. IICL was not the only broker who dealt on NSEL for facilitating client transactions but there were 160 other brokers in total who had similarly extended trading to the clients.
- 14.5.3. IICL never transacted for and on behalf of any of the borrowing clients on NSEL. It facilitated only the investor client on the NSEL.

- 14.5.4. Executing paired contracts where the settlement cycle “exceeds the prescribed limit of 11 days” is not mentioned in the Government Notification dated June 05, 2007.
- 14.5.5. In equity related exchanges, the broker is facilitating the investors to invest/trade in the products introduced by NSE/BSE and brokers are not involved in designing of the products/contracts.
- 14.5.6. In FMC order dated December 17, 2013, FMC had held NSEL responsible for the violation of Government Notification and not the IICL for the same.
- 14.5.7. NSEL defaulted in its payment obligations to the investors and the investigation are unnecessarily twisted against select few members including IICL who had only executed the trades as per the instruction of its clients on NSEL.
- 14.5.8. FTIL had a market cap of more than Rs. 2000 crores and had eminent luminaries on their board as Director/Chairman like Mr. Venkat Chary I.A.S. (Retd) (Ex-Secretary, Maharashtra State Electricity Board), Mr. A Nagarajan, I.A.S (Retd), Justice R. J. Kochar, former judge, Bombay High Court. FTIL and Mr. Jignesh Shah, the promoter had received Awards like Entrepreneur of the year Award, US – India Businessman of the year Award, FTIL stood at No. 89 in American Bankers FINTECH 100 Rankings 2012 etc. Considering this background, IICL was in belief that the regulators have recognitions and authorization for such important activities of exchanges and the products introduced by NSEL are in compliance with the rules, regulations and notifications.

14.6. *Nature of Transactions executed on NSEL:*

- 14.6.1. In FMC order dated December 17, 2013, FMC had held NSEL responsible for the violation of Government Notification and not the IICL for the same. The fraud was committed by NSEL, its Management and promoters.
- 14.6.2. As per the NSEL presentation and the products notes, the contracts were ‘spot contract’, as the buy and corresponding sell trades were executed on the same date. The positions were with varying settlement dates i.e. buy position on T+2/T+3 and sale position on T+25/T+36 as per the NSEL system. The same was neither objected by the Government nor by the FMC as a spot contract till July 16, 2013.
- 14.6.3. All contracts on NSEL platform were compulsorily deliverable contracts. The clients used to take delivery in buy transaction and the same was used to settle against its sell obligation. The client never intended to lift the delivery from the exchange accredited warehouse as it was always considered as early pay-in against its sell obligation. All the trades executed on NSEL platform were meant for compulsory delivery of commodities. Post the trades executed on NSEL platform, all the trades were settled through the delivery note and supported with allocation letter.

- 14.6.4. That there is no physical movement of goods under both MCX as well as NCDEX. The delivery under the client contract is backed by the warehouse receipt/allocation letter, which were followed by MCX/NCDEX as well. This practice is followed across the commodity exchanges.
- 14.6.5. IICL has no role whatsoever in inducing any of the investors as the whole product (as designed by NSEL) was explained to every investor and IICL had only acted as per the instructions of the investors in placing the orders in the NSEL system.
- 14.6.6. IICL was under genuine belief that the product introduced by NSEL was an arbitrage product.
- 14.6.7. It is not IICL who designed the paired contracts and it is therefore incorrect to allege that IICL was carrying out financial transactions under the garb of doing commodity transaction.

14.7. Power Point Presentation made by IICL.

- 14.7.1. The presentation and representations made by IICL to its clients were purely a replica of PPT and presentation made by NSEL from time to time. IICL had only tried to explain the product introduced by NSEL to the investors and never induced or forced any investors to trade on the NSEL platform. IICL had not made any statement in its own in this regard which was with a view to mislead the customers while marketing NSEL products as alleged in the notice. IICL has not received any extra monetary benefit or gains except the due brokerage from the clients.
- 14.7.2. IICL did not conduct any presentations/advertisement for specifically promoting NSEL products to its clients. IICL also denies that it had ever advertised any of the NSEL products.
- 14.7.3. That IICL had relied upon various product details of NSEL by way of circulars and presentations titled, “National Spot Exchange-Operations-its features & benefits, NSEL- Trading Opportunities, Investment Opportunities in NSEL, NSEL Investment Products, NSEL-Membership Drive, Press Release dated June 21, 2008 and NSEL Product Note”. (hereinafter referred as “NSEL Presentations”)
- 14.7.4. All communications / product documents / information from IICL to its customers with regard to the NSEL products and features contained only the extracts / information / examples as extracted from the above referred NSEL Presentations.
- 14.7.5. As a broker, IICL had only facilitated the transaction in the products designed by NSEL and IICL denies that it was mis-leading its clients/constituents by promising high returns / assured returns.
- 14.7.6. It was upto the clients to assess the opportunities of investments / transactions available in the market place and transact/invest accordingly.

14.8. Failure to redress investor complaints:

- 14.8.1. That all 16 complaints pertained to non-receipt of payouts on the clients positions due to default in July 2013 by NSEL. Pursuant to the default by NSEL, Government/FMC were working on various steps for making NSEL its management/ promoters for releasing the outstanding payouts to the clients and recoveries from borrower clients etc. and had provided timelines through FMC letters dated August 16, 2013 for the same. In view of this, the issue of payout can only be solved by NSEL/FMC and therefore IICL has promptly forwarded the complaints to NSEL with a copy to FMC. Accordingly, IICL had taken prompt action for resolution of complaints.
- 14.8.2. That IICL had proactively taken up the matter with the Exchange/FMC in order to have the complaints resolved in a timely manner. The DAs failed to appreciate the actions of IICL and its limitations in this regard.

14.9. Violation of provision of SEBI (PFUTP) Regulations, Violation of PMLA and Circular Trading:

- 14.9.1. In Enquiry report, IICL was not found guilty of violation of provisions of SEBI (PFUTP) Regulations, as the said regulations were not applicable to IICL at the relevant point of time i.e. before September 28, 2015.
- 14.9.2. Enquiry report rightly observed that IICL had not dealt on behalf of 22 defaulting clients of NSEL and so had not indulged in Circular Trading.
- 14.9.3. NSEL circular dated May 27, 2013 on applicability of PMLA was issued only two months prior to collapse of NSEL. During this period, IICL had not come across findings of any suspicious transactions by its clients.
- 14.9.4. Treating all paired contracts as illegal or fictitious transactions for the purpose of PMLA is not only legally incorrect but also unfair. Such transactions were carried out through the NSEL platform for a period of more than 3 years, neither FMC nor GOI or any other agency raised any objections or stopped the contracts until July 2013.

14.10. False Representations:

Reply in respect of making assured / risk free return, arbitrage opportunity in spot market by way of pair contracts, making assurances that pair trades are backed by collateral in the form of stock / sufficiency of commodities in warehouses and making statements that goods in warehouse are backed by insurance cover:

- 14.10.1. That the assumptions made by the DA in its SCN that IICL tried to influence the minds of the investors to trade in the commodity market and misguide the people through PPT presentation is incorrect, and without any substance and basis.
- 14.10.2. That it had not violated the code of conduct of NSEL. IICL denies that it had acted in any manner which is detrimental to the clients/Exchange. IICL reiterates that all the presentation and PPT were reproduction of the contents of presentation as circulated by the NSEL.
- 14.10.3. That the presentations of IICL were based on the factual contents provided by NSEL in its various presentations, website and also during various meetings of NSEL officials with IICL.
- 14.10.4. It is further clarified that none of the presentations and PPT were circulated to the public at large. The presentations and PPTs were provided to a few registered NSEL clients of IICL on their request.
- 14.10.5. IICL denies that it had acted in complicity with NSEL to market NSEL contracts. In this regard, DAs observation alleging IICL's complicity with NSEL to market NSEL contract and IICL cannot escape from the lapses on this count is against the principle of exchange v/s broker v/s clients functioning, wherein IICL's role was only as a broker and to facilitate execution of orders received from the clients on NSEL platform. Accordingly, the DAs observation is erroneous, incorrect and exaggeration. IICL reiterates that it had discharged its duties only as a broker and disseminated / forwarded / displayed the exchange notification/circulars etc. to its clients.
- 14.10.6. With regard to **arbitrage**, IICL submits that "arbitrage opportunities are the simultaneous purchase and sale of an asset to profit from a difference in the price" and are accordingly understood in the normal parlance in the market and the presentation depicted the same to its clients. IICL had no reason to disbelief or even suspect that NSEL was not authorized to offer such arbitrage to the traders. Hence, IICL denies any violation in this regard.
- 14.10.7. That NSEL vide email dated August 23, 2012 had forwarded the PPT on Investment products in commodities- E-series and Arbitrage, the presentation was received from Mr. Ashok Kawalsot, Manager, NSEL on August 23 2012. The said PPT contained details on Arbitrage and Arbitrage mechanism at NSEL.
- 14.10.8. IICL clarifies that the **misleading information** referred to herein and which was used by NSEL was regarding "FMC being the regulator". The observations of the DA is incorrect as NSEL continued to use the statement that FMC is the regulator, even in its subsequent communications to the General Public. Therefore, the allegations of the DA that despite NSEL removing the misleading information, IICL continued to use the information in its PPT/ presentations, is both incorrect and baseless.
- 14.10.9. With regard to the e-mail received from the MD of NSEL detailing about **SGF**, IICL believed the same to be true, correct and reliable, as the said mail was from

the top management of the Exchange and that too from the Managing Director of the Exchange. Hence, IICL had no reasons to suspect the contents of the mail and moreover, it did not find any reasons to call for additional and supportive documents from the Exchange and IICL relied on the email issued by the then Managing Director of NSEL. Even the Website of the Exchange carried the process of SGF and process for settling the client's payout in cases of default and the same was updated from time to time by the Exchange.

- 14.10.10. As a member of the exchange and in the absence of any suspicious circumstances, IICL is entitled to presume that the exchange was operating within the legal parameters and as per the “*doctrine of indoor management*” the member is entitled to proceed on the assumption of the existence of all regulatory approvals and the operations being within the legal frame work and also the correctness of emails received from their Management.
- 14.10.11. That each of the Product Notes issued by NSEL from time to time covers the details of the **insurance cover** and also about the fumigation charges. In one of the instances, IICL had proactively called for the details of the Insurance cover from NSEL. In response, Mr. Jay from NSEL had sought clarification from IICL as regards which specific product the insurance details were required. This very clearly implies the existence of Insurance cover in respect of various products at the Exchange level.
- 14.10.12. That SEBI's predecessor i.e. FMC in its order dated December 17, 2013 established findings and ordered that the NSEL/ its management and its promoter Mr. Jignesh Shah were solely responsible for the debacle/default by NSEL and borrowers (“defaulter clients”) which has brought the crisis.
- 14.10.13. In this context, the DAs allegations against the contents of NSEL Presentation, interest/assured returns, influencing the mind-set of the investors to trade on NSEL, misguiding/duping the investors, commodity spot arbitrage, financial transactions etc. are mere extrapolations without checking the facts, accuracy of the material on record as there were misdeeds of NSEL/ its management/ it promoters misdeed to IICL, without any basis or substance.

Reply in respect of NSEL acting as counterparty in both the trades and guaranteeing settlement, Noticee indulging in mis-selling in terms of risk suitability of the clients, Noticee's failure to make disclaimer for risk associated with the product, Noticee's failure to take documentary proof of income / failure to verify financial details of clients and failure to collect margins from its clients:

- 14.10.14. That the DAs in its findings, states that the NSEL is acting as a counter party in both the trades and guaranteed the settlement and accordingly IICL activities did not appear to be misleading as the same is supported by the bye laws of NSEL/FMC letter.

- 14.10.15. That the DAs in its findings had rightfully observed that IICL had published the disclaimer and risk associated with the NSEL products, in its presentation/booklet.
- 14.10.16. That the DAs has rightfully noted that there were no adverse remarks observed in the auditor's report on the allegations that no documentary proof of income taken by IICL from certain clients and no attempts were made by IICL to verify the financial details of the clients; risk suitability of the clients. The DA also noted that no such instances are available on the record to corroborate the observation in this regard and exonerated from these allegations.
- 14.10.17. With regard to the allegation of charging margin and collection thereof from the clients, the DA rightfully observed that there was no adverse findings in the auditor's report and so the allegation is not established against IICL.

14.11. *Client code modifications:*

- 14.11.1. That the total UCC modifications of 1246 trades constituted only 0.51% of total number of trades executed by IICL from 2011 to 2013, on NSEL platform and thus the client code modifications carried out were negligible.
- 14.11.2. That the process of client code modifications was notified by NSEL vide its circular no-NSEL/TRD/2011/122 dated July 08, 2011.
- 14.11.3. The earlier client code modification circular no-6/12/2010-MKT41 issued by FMC dated Sept 28, 2011 were not applicable to NSEL as NSEL was not regulated by FMC.
- 14.11.4. That even this negligible number of UCC modification carried out by IICL were in compliance with NSEL circular no-NSEL/TR.D/2011./122 dated July 8, 2011.
- 14.11.5. IICL clarifies that the 39 trades were Client's account dealing error trades which were transferred to IICL's dealing error account. As per the exchange systems all dealing errors are required to be transferred to the brokers dealing error account as the client do not bear such trades. These were not in the nature of proprietary trade executed by IICL, for its own benefit. These were basically error trade executed while punching or which client decline acceptance and so had to be transferred to the IICL, dealing error account "DEALGERR" mapped under IICL UCC account "10975026".
- 14.11.6. That the UCC data and the changes carried out were for genuine reasons. All these UCC modifications were genuine client code modifications and were incidental to IICL's business and constituted very negligible percentage of total trades.

14.12. Violation of PMLA and Suspicious Transactions:

- 14.12.1. IICL clarifies that 700 transactions have been identified in the forensic audit report based on the mismatch in the Order ID between IICL Trade File and NSEL trade file as received by them.
- 14.12.2. That these 700 transactions are not suspicious transactions, as alleged. These are genuine errors due to file constrain in excel sheet. These were genuine client transactions and were not suspicious transactions requiring reporting to FIU. Further, these were genuine commodity transactions executed on the exchange platform and the contract notes for the same had also been issued. Accordingly, these were not financing transactions.
- 14.12.3. IICL denies any violation of Section 12(1) of PMLA Act-2002, NSEL circular reference no. NSEL/COMP/2013/056 dated July 01, 2013 and NSEL circular reference no. NSEL/COMP/2013/042 dated May 27, 2013 relating to the provisions of Anti Money Laundering Act and Know Your Customer norms.

14.13. Trading in clients name without permissions:

- 14.13.1. The DAs failed to consider the proof of dispatch of the physical contract notes in hard copies, which were submitted by IICL in two box files alongwith its response to the earlier SCN. IICL reiterates and clarifies that while E-logs in respect of the ECN for the period 2010-2011 were not retrievable from the system, the PODs in respect of dispatch of physical contract notes to all such clients for the period 2010-2011 are available. IICL, denies any failure in sending ECN to clients.
- 14.13.2. It has retrieved PODs of all the clients and the same is submitted along with this reply in 8 box files.
- 14.13.3. With reference to the FMC circular no- FMC/COMP/VI/2009/04/06/114/5787 dated Sept 16, 2009, IICL states that the same is not applicable to IICL.
- 14.13.4. IICL denies any violation of the provision of Business Rules of NSEL and also the provision of code of conduct prescribed by NSEL

14.14. Funding of the clients through NBFC:

- 14.14.1. That the DAs had rightfully concluded that the allegations of directly transferring funds without the funds being routed through its client's account, funding of clients through NBFC, not carrying out income verification/risk profiling of the clients at the time of sanctioning of the loan amount do not stand established.
- 14.14.2. With regard to the procedural lapses, if any as mentioned by the DA in the notice, IICL states that IIFL has been appraising the appropriate authority i.e. RBI right from August 2013 through various communications as well as meetings and in turn specific inspections/scrutiny was conducted in 2016, IIFL

has submitted its replies and clarification to inspection report and show cause notice vide IIFL's letter dated April 26, 2017. Also, IIFL demonstrated and clarified on all the compliance / queries / observation to RBI. Further to the same, RBI vide its report concluded with a caution advise and concluded the matter against IIFL. A copy of the said RBI letter is enclosed.

14.15. *Allowing clients to execute trades despite debit balances in their account:*

- 14.15.1. With regard to 16 clients, IICL clarifies that from the trading pattern of these clients, it can be seen that these clients were regular trading clients and their positions varied from day to day basis. After payment of margins to IICL, these clients had delayed to arrange the balance funds, though IICL was following up with these 16 clients, regularly. These clients had cleared their debit balances with IICL by availing loan facility from NBFC, after its due sanction from NBFCs which had taken some, time. These happened in the normal course of broking business and there were nothing irregular in the same.
- 14.15.2. With regard to 10 clients who had delayed in making pay-in after paying the initial margins, IICL clarifies that during the intervening period the client's account were within IICL's risk management limits with adequate security cover as per the RMS policy of IICL. IICL, further states that the debit balances during the period were incidental to the IICL's business and such delays in payment towards the pay-in obligation should not be considered as funding by IICL. IICL further submits that such 10 instances were negligible as there were over 32,000 registered clients with IICL, for NSEL trading. Accordingly, IICL denies the violation of the provisions of- the code of conduct prescribed under clause 1.4 of NSEL Bye laws (clause 14.1).

14.16. *Non-segregations of funds between Spot Exchange and other Exchanges & running account authorization:*

- 14.16.1. The DAs had rightfully observed, that there were no violation in segregation of funds between exchanges at IICL.
- 14.16.2. The DAs while on the one hand correctly noted that IICL's transfer to the exchange settlement account immediately on the next day and on the other hand finding fault with the amount involved of Rs 2.01 Cr which was also rectified, is unreasonable and unjustified.
- 14.16.3. That the DAs had rightfully observed that there was no violation by IICL with regard to running account authorization.

14.17. *Failure to carry out system audit of IBT system and CTCL system:*

- 14.17.1. System Audit Reports for the year 2012 and 2013 was conducted by HCL Comnet and Kamlesh P. Mehta Associates. The copy of the same are submitted.

- 14.17.2. IICL had also undertaken System Audit of Algo Trading software during April 2012- March 2013. The copy of the same is also submitted.
- 14.18. *Not obtained CCP Certificate during the audit period:***
- 14.18.1. As per the records, there were four CCP certified officials/holders in IICL's Commodities Broking Business.
- 14.18.2. IICL was compliant with the referred circular under Para 114 of Enquiry Report. The details/copy of certificate as noted in respect of the audit for the period of F.Y. 2012- 13 and 2013-14 for NCDEX and MCX is submitted.
- 14.19. *Failed to resolve investor complaints at MCX and NCDEX:***
- 14.19.1. Actually there are 73 client complaints and not 74 client complaints as in the DA's report including duplication of complaints at both MCX and NCDEX. Out of these, there are 35 complaints which were repetitive i.e. the complaints which were reflecting in both exchanges i.e. MCX and NCDEX. Therefore, the actual number of complaints were only 35 direct complaints received by IICL and 3 complaints which were forwarded by the Exchange, totaling to 38 complaints in all. Out of the aforesaid 38 complaints, there were 13 client complaints and rest 25 cases were service related queries which were duly resolved.
- 14.19.2. Out of the aforesaid 38 complaints, 13 complaints and 16 service related queries were resolved after interactions with the clients within set timelines. As regards the remaining 9 service related queries, since clarification and reverts were awaited from the client's end, the same had taken additional time and ultimately, the same were resolved post the receipt of the clarifications and responses from the client. The DA failed to appreciate the factual position and resolution. IICL denies any violation of the provision of MCX circular No. MCX/012/2006 dated January 10, 2006.
- 14.20. *Other observations:***
- 14.20.1. Only in July 2013, IICL came to know that pursuant to the Govt. order which was disseminated by NSEL vide its circular dated July 16, 2013, NSEL notified that no fresh circular for launching new commodity, products or new centre shall be issued by the Exchange till further communications. Subsequently, NSEL started defaulting in releasing payout to the clients and only then IICL was aware of the problems at NSEL.
- 14.20.2. IICL who has been acting only as a broker and facilitated the client transaction on NSEL platform were not in a position to do anything other than following up with NSEL and its management for the settlement of the outstanding payouts to its clients.

- 14.20.3. IICL was not the only broker who dealt on NSEL for facilitating client transactions but there were 237 other brokers in total who had similarly extended trading to the clients.
- 14.20.4. IICL never transacted for and on behalf of any of the borrowing clients on NSEL platform. It facilitated only the investor client on the NSEL platform.
- 14.20.5. That the dues of Rs. 326.23 crores from NSEL to IICL clients were payout dues from NSEL and accordingly, it was a liability of NSEL. As IICL acted only as a broker wherein, NSEL the exchange had defaulted in releasing the payouts, it was clearly the liability of NSEL and not that of IICL.
- 14.20.6. IICL denies indulging in the illegal contract of NSEL and liable for the same.
- 14.20.7. That the communication between FMC / Ministry of Consumer Affairs with NSEL about its products were not disseminated through public or intermediaries till July 2013.
- 14.20.8. Accordingly, IICL was not aware of the alleged instructions / views / observations issued through various communications of FMC / Govt. / other authorities, till July 2013.
- 14.20.9. Accordingly, IICL, denies DAs observation that IICL was bound to be aware of the seriousness of the issue and refrain from taking part in such transaction as post facto and imaginative. IICL, as part of its commodity broking business had acted only as a broker on NSEL and accordingly, denies any undue benefit derived from these contracts.
- 14.20.10. The DAs was erroneous in observing that IICL was actually undertaking the business of lending and borrowing of funds and thus indulged in fund based activity akin to NBFC business.
- 14.20.11. IICL reiterate that it acted only as a broker of NSEL and had facilitated transaction only on behalf of investing client i.e. lending clients and had not transacted on behalf of borrowing clients on the NSEL platform. Further, the contracts executed on NSEL platform on behalf of the investing client were only commodity contract and not financing contract i.e. not as lending and borrowing of the funds. The contract notes issued for all these transactions clearly demonstrate the exact commodities bought or sold by the clients and prices at which it was contracted.
- 14.20.12. With regard to the arrest of IICL's official by EOW on March 3, 2015 in connection with NSEL, IICL would like to clarify that the arrest was made along with officials of two other brokers during investigation process and he has been released on March 23, 2015. The investigation is still pending at EOW and no charges have been framed/ filed against IICL or its officials till date. Accordingly, the DAs mentions of charges of EOW are factually incorrect.

14.21. Reply in respect of Fit & Proper Person:

- 14.21.1. That NSEL payout imbroglio and various findings of illegality, contract specific illegality, terms and conditions of the contracts provided by NSEL, bye laws, rules, regulations and system and process put in by NSEL etc. were the nefarious design/fault/fraudulent activity on the part of NSEL/its management and officials /its promoter Jignesh Shah and the borrowers.
- 14.21.2. It is established in the investigation /findings of FMC vide its order dated December 17, 2013 and FMC letter dated August 31, 2013 to NSEL that NSEL, its management and officials, its promoter) Jignesh Shah and borrowers, defaulting clients were responsible for the various violations and default by NSEL in releasing the payout to the clients.
- 14.21.3. FMC had also clearly observed no adverse findings against IICL, who acted only on behalf of investor clients (lending clients) on NSEL.
- 14.21.4. IICL is only a victim of NSEL and its management's/promoters fault and wrong doings.
- 14.21.5. It is a fact that it is not only IICL which had facilitated trades on behalf of investor clients on NSEL but there were over 160 other brokers who had similarly facilitated such transactions on NSEL during the period.
- 14.21.6. In view of the above, IICL had not violated any of the provisions of the law and had not contravened any of conditions laid down by the central Government / exchanges/other authority.
- 14.21.7. If the various alleged irregularities as brought out in the DAs report had been known to IICL during the period of facilitating client's transactions on NSEL the same would have been equally known to all the other brokers and the market as a whole.
- 14.21.8. The Ministry of Consumer Affairs which has given recognition to NSEL and was supervising the activity, Ministry of Finance, FMC and other regulators who were the custodian of common public and nations interest, would have been better aware of the irregularities but still allowed NSEL to function during the entire period from 2008 - July 2013.
- 14.21.9. Till date, the investigation into NSEL by various agencies had not effectively resulted in tracing the funds, commodities and assets and recovering the same and distribution to outstanding payout clients.
- 14.21.10. The charge sheet filed by EOW. Mumbai has accused NSEL, its management, officials and promoter Jignesh Shah and borrowing clients for the entire fraud and there are no charges against IICL, Further no charge sheets were filed by EOW against IICL, till date.
- 14.21.11. In above context and the various incorrect, erroneous and baseless findings of the DA explained in the earlier part of reply, the DAs questioning on the integrity, competence, compliance with the law and most importantly honesty and fairness, displayed in the conduct of its business by IICI is incorrect,

baseless and exaggeration without understanding the ground realities, actual position and without consideration of legal position.

- 14.21.12. Accordingly, the DA's questioning on the conduct of IICL on its fit and proper person is clearly exaggeration, and reflects biased mind set. Besides various serious deficiencies in the enquiry proceedings and the DA report reflects the same.
15. In the interest of natural justice, vide order dated August 30, 2018, Noticee was given an opportunity to appear for a personal hearing on merits on September 27, 2018 at SEBI, Head Office, Mumbai.
16. Meanwhile, IICL vide letter dated August 21, 2018 had filed an application with SEBI for withdrawal of the application for registration / surrender of deemed registration made by them vide applications dated December 19, 2015. SEBI vide letter dated September 04, 2018 had informed IICL that enquiry proceedings under Intermediaries Regulations against them are in progress, therefore, in view of pending enquiry proceedings, their request for withdrawal of the application for registration cannot be entertained.
17. Aggrieved by SEBI's letter dated September 04, 2018, IICL filed a writ petition no. 3295 of 2018 before Hon'ble High Court of Bombay challenging the said letter dated September 04, 2018 by which SEBI had not entertained the request of IICL for withdrawal of the application for registration. The said writ petition before Hon'ble High Court of Bombay was mentioned on September 24, 2018.
18. Alliance Law Advocates, on behalf of IICL vide letter dated September 26, 2018, stated the said Writ Petition before Hon'ble High Court of Bombay was scheduled to be listed before regular bench on October 01, 2018. Therefore, in view of this, IICL requested SEBI not to proceed with the hearing scheduled on September 27, 2018 and to defer the hearing till the disposal of said writ petition.
19. Considering the request of the Noticee and in the interest of Natural Justice, SEBI vide email dated September 26, 2018, has granted another opportunity of hearing to the Noticee to appear on October 09, 2018 at SEBI, Head Office, Mumbai.

20. It is noted that Hon'ble High Court of Bombay vide order dated October 04, 2018 rejected the Writ Petition no. 3295 of 2018 filed by the Noticee.

21. On October 09, 2018, Ms. Aparna Wagle, Principal Associate, Alliance Law Advocates, along with Mr. Mohan Radhakrishnan, Ms. Mamta Singh, Mr. Ravi Ramachandran and Mr. Chintan R. Modi from IICL, Authorized Representatives (“ARs”) of IICL appeared for the hearing. Following *inter alia* was noted during the hearing:

“

(a) *During the course of hearing, IICL stated that they had submitted their reply dated June 15, 2018 on merit. They requested to adjourn today's hearing due to the non-availability of Senior Counsel. They further requested to have a separate hearing from the other entities in similar matter.*

(b) *The undersigned expressed disinclination to accept the request of IICL to adjourn the hearing, since notice of the hearing had been given well in advance and repeated opportunities of hearing had already been granted to them. However, since other entities in similar matter were being granted hearing on October 12, 2018, IICL was also granted hearing on October 12, 2018.*

(c) *Decision Post Hearing*

Subsequently, considering the request of IICL to have a separate hearing and in the interest of disposal of case, the undersigned granted final opportunity of hearing on October 11, 2018 at 02.30 P.M. at Head Office, Mumbai.

.....”

22. On October 11, 2018, Mr. R. S. Loona, Managing Partner, Alliance Law, Ms. Aparna Wagle, Principal Associate, Alliance Law Advocates, along with Mr. Mohan Radhakrishnan, Ms. Mamta Singh, Mr. Ravi Ramachandran and Mr. Chintan R. Modi from IICL, **ARs** of IICL appeared for the hearing and made the oral submissions. The matter was heard at length and the following were *inter alia* noted during the hearing:

“

(a) *ARs reiterated and made the oral submissions in line with reply dated June 15, 2018.*

(b) *Following queries are raised to the ARs of the Noticee with regard to due diligence in respect of trading at NSEL by the Noticee:*

- (i) *Whether the Noticee had any internal process / product approval committee for assessment/determination of product that is to be traded on exchange/NSEL?*
- (ii) *Whether the product i.e. paired contract was approved by Noticee's product approval committee or not.*
- (iii) *Whether the Noticee has done independent assessment of the product.*
- (iv) *Whether the sales team of the Noticee has the direction to sell only approved products to their clients or sales team sell whichever product they would like to sell to their clients.*
- (v) *What due diligence Noticee done before / while trading in paired contracts at NSEL.*

ARs states that the reply to the aforesaid queries will be submitted alongwith additional written submissions.

- (c) *The matter is part heard and hearing in the matter is adjourned to October 24, 2018 at 10:00 A.M. at Head Office, Mumbai.*

.....”

23. On October 24, 2018, Mr. Mustafa Doctor, Senior Counsel, Mr. R. S. Loona, Managing Partner, Alliance Law, Ms. Aparna Wagle, Principal Associate, Alliance Law Advocates, along with Mr. Mohan Radhakrishnan, Ms. Mamta Singh, Mr. Ravi Ramachandran and Mr. Chintan R. Modi from IICL, **ARs** of IICL appeared for the hearing and made the oral submissions. The matter was heard at length and the following were *inter alia* noted during the hearing:

“.....

- (a) *ARs reiterated the oral submissions made during the hearing held on October 11, 2018 and made the oral submissions in line with reply dated June 15, 2018.*
- (b) *ARs granted time till November 06, 2018 to submit the replies of the queries asked during the hearing held on October 11, 2018 alongwith additional written submissions in the matter.*

.....”

24. Thereafter, the Noticee vide letter dated November 06, 2018 submitted its additional written submissions in the matter. The additional written submissions of the Noticee in brief are as under:

24.1. Objections on jurisdiction & defective Show Cause Notice:

- 24.1.1. Regulation 24 of the Intermediaries Regulations under which the DAs were appointed by the WTM vide Order dated October 06, 2016 to enquire into the matter is not applicable in the instant case as enquiry proceedings pursuant to the said Regulations can be undertaken only for breaches specified under Regulation 23 of the Intermediaries Regulations.
- 24.1.2. The alleged breaches of the FCRA and NSEL Bye-Laws, Business Rules, Circulars etc., Business Rules and Regulations of MCX, NCDEX and circulars issued under PMLA can neither be enquired into by the DAs under the Intermediaries Regulations nor can the DAs make any recommendations in that regard. Thus, the entire procedure including the appointment of DAs, issuance of pre- enquiry show cause notice, submission of the enquiry report and the present Show Cause Notice issued under Regulation 28 (1) are bad in law.
- 24.1.3. Regulation 23 under Chapter V of the Intermediary Regulations, provides that enquiry can be undertaken on any person who has been granted a Certificate of Registration under SEBI Act or regulations made thereunder in the event of following two situations only:
- (a) fails to comply with any conditions subject to which a certificate of registration has been granted to him;
 - (b) contravenes any of the provisions of the Securities laws or directions, instructions, circulars, issued thereunder.
- 24.1.4. That SEBI has wrongly invoked the above provisions as:
- (a) IICL is not holding Certificate of Registration issued by SEBI till date and hence the question of violation of any conditions of Certificate of Registration does not arise;
 - (b) The alleged violations are not in respect of SEBI Act and its Regulations but pertain to that of FCRA, the Bye-laws, Business Rules and Circulars of NSEL, MCX and NCDEX, Circulars of FMC and Government of India.
- 24.1.5. For conducting enquiry in respect of violations of FCRA, the appropriate provision was provided under Section 12B of FCRA and the same has not been followed by SEBI in this matter.
- 24.1.6. By virtue of insertion/amendments of Section 29A(2)(e) of FCRA through Finance Act 2015 empowers SEBI to initiate any fresh proceeding related to an offence only under that Act i.e. FCRA as if FCRA had not been repealed;
- 24.1.7. The present SCN dated April 24, 2017 has been issued under Regulation 28(1) read with Regulation 7(2) of Intermediaries Regulations; whereas in view of the amendments to the FCRA vide Finance Act, 2015, empowering SEBI to initiate proceedings relating to an offence under the FCRA, the same has not been followed by SEBI.

- 24.1.8. The SCN should have been issued under the provisions of section 29A(2)(e) of FCRA and the process as prescribed under Section 12B of FCRA should have been followed. Accordingly, the present enquiry proceedings including pre-enquiry SCN, Enquiry Report, post-enquiry SCN and the recommendations are defective and no action can be initiated thereon.
- 24.1.9. SEBI could not initiate the present proceedings under the Intermediaries Regulations for alleged violations of the provisions of FCRA, Bye-laws, regulations and circulars of NSEL, MCX, NCDEX.
- 24.1.10. SEBI can undoubtedly take action for violation of SEBI Regulations after September 28, 2015 and the SEBI Regulations will govern the activities of IICL after September 28, 2015. Till that date, IICL will continue to be governed by the Regulatory Regime under FCRA or the Government of India Notification giving exemption to NSEL from FCRA for conducting spot transactions and the Bye Laws, Business Rules and Circulars issued by respective commodities exchanges and NSEL and any such proceedings therein can be initiated only under FCRA as per Section 29A(2)(e) of FCRA.
- 24.1.11. With respect to the powers of SEBI, particularly with regard to NSEL matters, pursuant to the notification of the Finance Act, 2015 and the amendment of SEBI Act and FCRA as well as merger of FMC with SEBI with effect from September 28, 2015, the GOI, Ministry of Finance, Department of Economic Affairs vide its letter dated November 20, 2015 to SEBI had clearly advised:
“SEBI is not expected to deal with the matters which were not dealt with by erstwhile FMC. Further, it clarified that since spot market /ready delivery contracts were not regulated by the FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets”
- 24.1.12. Subsequently, SEBI in response to the complaint dated June 03, 2016 filed by Mr. Ranjith Sreekumar, one of the clients who traded on NSEL and forwarded by PMO office, clarified its role in NSEL related cases reiterating the above positions. It clarified that:
“since spot market/ready delivery contracts were not regulated by the erstwhile FMC, SEBI is not expected to take upon itself any regulatory function with regard to such markets”.
In view of the clarifications, SEBI informed the complainant-investor that the investor grievances pertaining to NSEL matters are beyond regulatory domain of SEBI.
- 24.1.13. That the recommendations of the DAs are premeditated and without full consideration of all the facts, circumstances and the legal position.
- 24.1.14. The proceedings under Regulation 7(2) for rejection of the application for registration of IICL i.e. Application for registration as a stock broker have been erroneously clubbed with that of the enquiry proceedings under Regulations 24

of Intermediaries Regulations. The Intermediary Regulations clearly lays down a separate procedure for action in case of default under Chapter V in respect of intermediaries who have been granted certificate of Registration by SEBI and a separate procedure under Regulation 7(2) for consideration and/or rejection of Application for registration of intermediaries.

24.1.15. The DAs made recommendations beyond the scope of Regulation 27 of Intermediaries Regulations. The said regulation does not authorise the DAs to recommend rejection of IICL's application for registration as a stock broker and consideration for launching of prosecution proceedings under the FCRA.

Additional response to the specific findings / allegations in the DA's report

24.2. Observation on the transaction executed at NSEL:

- 24.2.1. IICL had facilitated execution of trades only in Commodities Contracts and had not indulged in financing transactions or fund based business.
- 24.2.2. IICL as member of NSEL, facilitated execution of trades by its clients on the NSEL platform as per the NSEL, Bye-Laws, Rules, and Regulations, presentations, product notes and system & processes.
- 24.2.3. That the main charge against IICL is that it was in complicity with the fraud perpetrated by NSEL on the investors by facilitating illegal trading on the NSEL platform. IICL submitted that this charge is purely based on surmises and conjectures and reversal of burden of proof whereby burden is cast on IICL to disprove its alleged complicity with NSEL.
- 24.2.4. There is no charge that IICL designed the products available on NSEL, or that it forced investors to invest or trade on NSEL. There is no charge that IICL was the beneficiary of the fraud perpetrated by NSEL.
- 24.2.5. IICL did not have knowledge nor could it have had knowledge that the products available on NSEL were illegal or illegitimate.
- 24.2.6. IICL legitimately believed that the commodities were available in the warehouse to back the products launched by NSEL as NSEL was the counter party in all the transactions.
- 24.2.7. IICL genuinely believed that the products offered by NSEL were legal and legitimate, as NSEL was a legitimate exchange operating under the regulatory framework of the Central Government and supported by FMC.

24.3. Additional Due Diligence / Verification Carried out by IICL on trading at NSEL

IICL, during the course of facilitating trading, had carried out specific diligences/verification and pursuant to which sought various clarifications and confirmations from NSEL with regard to the product features and the presentations etc., through personal meetings/telephonic conversation Emails / client visits etc. Some of such diligences / verifications / communications and NSEL's clarification /

confirmation and assurances received are as under:

- 24.3.1. Pursuant to the tele-con of IICL with Mr. Anjani Sinha, MD, NSEL, vide email dated November 15, 2011 confirmed the availability of settlement guarantee fund of Rs. 255.86 crores by way of cash, bank guarantee and FDRs with NSEL.
- 24.3.2. NSEL, vide email dated June 17, 2011, confirmed that NSEL provides counter party guarantee of all the trades executed on NSEL platform.
- 24.3.3. Pursuant to the request of IICL to NSEL for arranging visit to NSEL warehouses, IICL representatives along with its clients had visited NSEL warehouses located at Delhi and Kakinada, Andhra Pradesh on May 07, 2012 and March 13, 2013 respectively.
- 24.3.4. Pursuant to the meetings of officials of IICL with NSEL on July 25, 2011, NSEL vide email dated July 26, 2011 provided the details of the warehouse for castor seed, cotton wash oil and castor oil arbitrage contracts.
- 24.3.5. On July 21, 2013, NSEL had confirmed the stock positions of Castor Seeds and denied the allegations of overstating of the stock.
- 24.3.6. Pursuant to the inquiry of IICL with NSEL as to the actual insurance coverage on the commodities lying in the warehouses of NSEL, NSEL vide email dated August 22, 2012, confirmed about the insurance coverage and provided the copy of insurance policy issued by New India Assurance Company Limited.
- 24.3.7. Pursuant to the IICL's e-mail dated June 07, 2012, requesting for information as to the regulatory body of NSEL, NSEL vide its e-mail dated June 11, 2012, clarified that "the FMC is nominated as the Designated Agency for providing oversight over all spot exchanges".
- 24.3.8. NSEL has confirmed on its website that as on September 17, 2012, the SGF maintained at the exchange was Rs. 544 crores and as on July 29, 2012, SGF was Rs. 839.53 Crores.
- 24.3.9. NSEL had always presented to the public as well as to the brokers including IICL that the paired contracts provided by the Exchange were legal and permissible contracts provided as per GOI Notification dated June 05, 2007 and based on the recognitions accorded thereon to NSEL as spot Exchange.
- 24.3.10. During the period of NSEL functioning, IICL and other intermediaries as well as the general public had come across various approvals accorded to FTIL group, the holding company of NSEL, by the Government and Regulators such as SEBI, FMC, etc., IICL as well as its clients believed that in the approvals, diligences & regulatory supervisions of SEBI/FMC etc., over the years whereby promoters of NSEL i.e. FTIL, Jignesh Shah and group entities as well as the Management had passed the SEBI/FMC's rigorous 'Fit & Proper' criteria / test.
- 24.3.11. IICL observed that whenever there were concerns about FTIL Group, they published prominent advertisements in leading newspapers reasserting their claims, which were like assuring investors and brokers with copy to the Regulators, Government, media and all concerned.

IICL's above diligences / verifications and the confirmation of NSEL from time to time did not raise any serious suspicion or alerts over the products, features, systems, process and risk control mechanism provided by NSEL.

24.4. Conditions set forth in the GOI Notification dated June 05, 2007 violation of which resulted in violation of section 27 of FCRA:

- 24.4.1. Paired contracts were devised by NSEL and introduced through their various circulars, presentations and provided through the NSEL platform and systems. IICL had no say in the matter as designing of the contract was entirely within the domain of NSEL.
- 24.4.2. The GOI, FMC and the government agencies had not brought out any warnings / findings of illegality over the NSEL contracts or its functioning nor acted upon NSEL until NSEL communication to the member/public about discontinuation of paired contracts in July 2013. Only post NSEL press release dated July 31, 2013, on discontinuation of paired contracts trading in NSEL, it had come to the knowledge of IICL and public that FMC informed DCA on April 10, 2012 about the alleged violation of exemption notification dated June 05, 2007 by NESL but DCA still took 15 months to give necessary final directives to NSEL on August 06, 2013.
- 24.4.3. As per the bye law no. 4.2 and 4.5 of NSEL, IICL or any other members of NSEL could not trade on commodities contract including alleged paired contracts unless the said contracts were specified by the Board of the Exchange for the purpose and the transactions in respect thereof were carried out in the manner approved by the exchange. Therefore, IICL had facilitated trading in commodities contracts for and on behalf of its clients as the said contracts were the contracts specified by the Board of NSEL for trading on the exchange.
- 24.4.4. It is very unfair to hold IICL responsible for facilitating the product which was introduced by NSEL as a spot commodities Exchange and which was granted recognition by the GOI through a Gazette notification dated June 05, 2007.

24.5. Violation of provisions of SEBI (PFUTP) Regulations:

- 24.5.1. In Enquiry report, IICL was not found guilty of violation of provisions of SEBI (PFUTP) Regulations, as the said regulations were not applicable to IICL at the relevant point of time i.e. before September 28, 2015.

24.6. Violation of PMLA and Circular Trading:

- 24.6.1. Enquiry report rightly observed that IICL had not dealt on behalf of 22 defaulting clients of NSEL and so had not indulged in Circular Trading.

- 24.6.2. NSEL circular dated May 27, 2013 on applicability of PMLA was issued only two months prior to collapse of NSEL. During this period, IICL had not come across findings of any suspicious transactions by its clients.
- 24.6.3. Treating all paired contracts as illegal or fictitious transactions for the purpose of PMLA is not only legally incorrect but also unfair. Such transactions were carried out through the NSEL platform for a period of more than 3 years, neither FMC nor GOI or any other agency raised any objections or stopped the contracts until July 2013.

24.7. *Failed to carry out system audit of IBT system and CTCL system:*

- 24.7.1. System Audit Reports for the year 2012 and 2013 was conducted by HCL Comnet and Kamlesh P. Mehta Associates. The copy of same are submitted.
- 24.7.2. IICL had also undertaken System Audit of Algo Trading software during April 2012- March 2013. The copy of same is submitted.

24.8. *False Representations:*

- 24.8.1. The spot commodity products were devised and provided by NSEL as a Government recognized Spot Exchange which had provided the product presentations / features / system etc., and the same were made available to the clients in IICL's usual business process. And the same should not be construed as false representation by IICL.
- 24.8.2. In case of any other products, other than the products offered by Exchanges, such as structured products, AIF etc., IICL internally discussed and based on the discussion, the products are recommended or made available to the clients.

24.9. *Complicity with NSEL:*

- 24.9.1. IICL has acted only as a member of NSEL as per the Bye-Laws, Rules, Regulations, Circulars, Systems / Processes, Presentations of NSEL from time to time and facilitated placement of the order to the clients on NSEL Platform as per the instruction received from the clients from time to time. Accordingly, IICL confirms that it had not acted in complicity with NSEL in any manner.

24.10. *Allegation of Fit & Proper:*

- 24.10.1. On the basis of IICL's reply on jurisdiction, principle of natural justice, administrative discrimination and defective show cause notice, the recommendation of DAs is beyond the powers of DA's as stipulated under regulation 27(2) of Intermediaries Regulations. Pursuant to these recommendations, present SCN issued under regulation 28(1) read with regulations 7(2) of Intermediaries Regulations does not meet the required following conditions:

- A. IICL has not been granted a certificate of registration by SEBI till date;
 - B. The recommendation of the DA's were beyond the stipulation as provided under Regulations 27 of Intermediaries Regulations on 'Action in case of defaults'.
 - C. The DAs observation on the integrity, competence, compliance with the law, honesty and fairness, displayed in the conduct of IICL business is grossly incorrect, baseless and exaggeration without understanding the ground realities, factual position and without consideration of legal positions.
- 24.10.2. Accordingly, the alleged findings of the DAs should not be construed as violative of "Fit & Proper" criteria by IICL.
- 24.10.3. No agency or regulator has presented any evidence or even alleged that IICL had gained even one rupee illegally from the operations of NSEL. All agencies concur and so does money trail reveals that the most likely truth is the proceeds of the Rs. 5,500 crores fraud have been misappropriated by promoters / management of NSEL in collusion with borrowers / mill owners. While authorities are not able to convict the real culprits, to make the regulated entities like IICL "a sacrificial lamb" would indeed be travesty of justice.
- 24.10.4. Notwithstanding the legal, jurisdictional infirmities on the SCN, assuming that if there are any violations by IICL, without its expressive admissions, the same were unintentional, non-grievous, trivial in nature and without any malicious intentions or for deriving any undue benefits. In this situation, the conclusion and recommended actions of DAs are harsh and unjustified.

SECOND SHOW CAUSE NOTICE, REPLY AND HEARING:

25. While the proceedings in the matter were in progress, Serious Fraud Investigation Office ("SFIO"), Ministry of Corporate Affairs ("MCA") vide letter dated November 01, 2018 had forwarded its detailed investigation report on "National Spot Exchange Limited and others" dated August 31, 2018 to SEBI.
26. Subsequent to the receipt of SFIO investigation report, SEBI issued a Second Show Cause Notice dated December 27, 2018 (hereinafter referred to as "**Second SCN**") to the Noticee. Vide the said Second SCN, Noticee was informed that reference to regulation 7(2) of SEBI (Intermediaries) Regulations, 2008 in body of the SCN dated April 24, 2017 shall be read as regulation 5(e) read with Regulation 7(1) of Brokers Regulations. Further, Noticee was also called upon to show cause as to why the information/materials as brought out in the Second SCN concerning the fit and proper person criteria, should not be considered while deciding

the Noticee's application for registration dated December 23, 2015, for rejection in accordance with the provisions of Regulation 5(e) read with regulation 7(1) of Brokers Regulations.

27. IICL was advised to reply to the Second SCN within 21 days from the date of receipt of said notice and to appear for a personal hearing on January 28, 2019 at 10:30 A.M., SEBI Head Office, Mumbai.

28. In response, the Noticee submitted its reply dated January 23, 2019 on merits to the Second SCN. The said reply of the Noticee in brief are as under:

28.1. That pursuant to the hearing held on October 11, 2018 and October 24, 2018, the matter was closed for orders by Ld. Whole Time Member subject to filing the Written Submissions by the Noticee on or before November 06, 2018. The same was filed on November 6, 2018. Thus, the Second SCN issued by SEBI after closing the matter for orders is arbitrary.

28.2. That there is no final determination or finality in terms of an order of a Competent Court in respect of the purported observations made in the SFIO report.

28.3. That the Investigation conducted by SFIO was under the Companies Act and not under the Securities Laws or Brokers Regulations. Any reliance on the said SFIO Report at this stage by SEBI without its own verifications and enquiries on the same, would be prejudicial to the Noticee and any adverse findings by SEBI based on such allegations or charges can cause irreparable damage/ loss to the Noticee particularly if the allegations / charges levied by SFIO are ultimately found to be without any basis by a court of law at any later stage.

28.4. That the SFIO investigation was conducted under the order dated October 28, 2016 of the DCA under section 210(1)(C) read with Section 212(1)(C) under the Companies Act, 2013, to investigate *"into the affairs of National Spot Exchange Limited, Financial Technologies (India) Limited (name changed to 63 moons Limited), their 18 subsidiaries and associate companies, the 20 defaulting members and their role and nexus with the Brokers who were responsible for the payment crisis"*. The SFIO report has also not been shared with the Noticee and the Noticee has had no opportunity to examine the purported observations made therein.

28.5. The allegations/ charges made by the EOW and referred to in the SFIO report are being strongly contested by the Noticee before the appropriate authorities and competent courts and the Noticee is strongly disputing the contents and observations made in the SFIO report as extracted in the Second SCN for reliance by SEBI.

28.6. That reliance on EOW charges (from the SFIO Report) in the Second SCN is misconceived and legally untenable. That these charges have not been proved and no

order has been passed by any Court against the Noticee till date. Therefore, the unsubstantiated allegations should not be relied upon and/or considered by SEBI for deciding the Noticee's Application for registration as a stock broker.

- 28.7. That no Charge sheet has been served on the Noticee till date and these charges are strongly disputed by the Noticee.
- 28.8. That without prejudice to the above preliminary objections and assuming without admitting that these observations can be considered, the Noticee is dealing with them on their own merits.
- 28.9. That SEBI has specifically referred to that part of SFIO Report where SFIO has taken note of the charges / allegations made by the EOW in 2015 at the time of Remand Application against the Noticee. It is submitted that the allegations/ charges of EOW are being strongly contested by the Noticee before the appropriate authorities and competent Court and Mr. Chintan Modi was released on the bail on March 23, 2015. Further, EOW, Mumbai is yet to serve the Charge sheet on the Noticee in the matter. The references to the observations of EOW, Mumbai are purely allegations raised in the year 2015 and the same have not been proved and no order has been passed by the Hon'ble Court against the Noticee till date and since the matter is *sub-judice* no reliance can be placed on the aforementioned allegations/ charges of EOW. The said charges/ allegations are more or less similar to the one which have been made by SEBI in its first SCN dated April 24, 2017. With regard to each charge/ allegation made by EOW, the Noticee submits that the same allegations were made by SEBI in its first SCN and the Noticee had dealt with it in its reply/ written submissions filed with SEBI. Additionally, Noticee's submission in brief are as under:
- 28.9.1. It is vehemently denied that the Noticee had ever made any wrong or misleading statements leading to enticement for investment in NSEL products.
- 28.9.2. It is incorrect that the Noticee was engaged in market capturing practices by large scale Unique Client Code (UCC) modifications. The Noticee's UCC modification constituted only 0.51% of the total trades of the Noticee on NSEL and these were on account of genuine error rectification as per the NSEL System in the normal course of business.
- 28.9.3. The Noticee reiterates that the allegation towards availing finance has been dropped by the DAs under para 97 in its Report dated April 11, 2017 after examining such allegation in detail.
- 28.9.4. The Noticee reiterates that the allegation of Circular trading has been clearly dropped by the DAs under Para 78-80 in its Report dated April 11, 2017 after examining such allegation in detail.
- 28.9.5. That all the transactions in IICL Arbitrage Accounts and Madhu Jain's account were genuine and the Noticee deny any irregularities in the same. It is clarified that there were two proprietary trading accounts of the Noticee assigned with the Unique Client Codes - 10975222 and 10975601 which were used for executing proprietary commodity transactions of the Noticee. The Noticee submits that no

client transactions were routed through these accounts. These were genuine proprietary transactions and settled through NSEL systems and through deployment of its own source of funds. Besides the above, there was a Dealing error account of IICL with Client Code- 10975026 used for rectification of error trades of the Clients as per NSEL system. The Noticee further submits that with regard to Madhu Jain's account, the account was opened with due KYC and broker client agreement as per IICL system. Only one purchase and sell trade was executed and duly settled through NSEL System.

- 28.10. That there is no record of any complaint by Vishvanidhi Dalmia against IICL before 2016 i.e., 3 years from the date of NSEL's default. This purported complaint was not served/ communicated to the Noticee. It is pertinent to note that at or around the same time when the complaint was purportedly made, Mr. Vishvanidhi Dalmia working as a Consultant with NSEL. Hence, the authenticity of this complaint and the veracity of the allegations made therein are entirely doubtful and therefore cannot be relied on for any reason whatsoever, in any event, the Noticee denies them in toto. Further, this complaint cannot be relied on or referred to, as the Client who was an HNI and was trading with the Noticee in NSEL from February 2011, has filed a civil suit against the Noticee before the Bombay High Court in May 06, 2016, the Suit is still pending and the matter is sub-judice.
- 28.11. That the presentations/brochures/pamphlets etc., as mentioned in Annexure-A to the Second SCN are concerned, the Noticee submits that NSEL had provided its presentations and brochures to the public and brokers through its website and emails from time to time. The referred Presentation of the Noticee were extracted from the larger presentations prepared and circulated by NSEL to the brokers and clients.
- 28.12. That Annexure A also contains SFIO analysis and observations based on the responses of 836 Clients of the Noticee received pursuant to the questionnaire in 2016. It is pertinent to note that the alleged questionnaire was circulated after three years of default by NSEL in releasing the payouts. The Noticee has not been provided with said Questionnaire and the actual responses given by the Clients to SFIO. Even the Client's alleged responses cannot be considered as the same were not cross verified or examined by the Noticee. SFIO has not questioned the clients as to why such complaints were submitted at such belated stage and not prior in time (in or around the year 2013) and whether such complaints are even maintainable considering the lapse of over five (5) years. The Noticee states that all these clients were trading till July 2013 and had never raised any deficiencies. The execution of trades by the Noticee was based on the client's instructions etc. It is only after the default by NSEL in releasing the payouts, the said allegations were raised by the Clients through these responses to SFIO. The purported responses of the Clients raising deficiencies against the Noticee that too after 3 years from the NSEL defaults raise serious doubts on the genuineness and their intentions. Neither this been cross verified nor investigated by

- SEBI/SFIO. The Noticee denies their allegations/adverse responses as opportunistic, malicious and without substance.
- 28.13. With regard to the arrangement with DCB, the Noticee submits that DCB entered into Referral Agreement with the Noticee on May 30, 2012 to refer its Clients who were interested in trading in the Commodity market. Accordingly, the Clients accounts referred by DCB were opened after proper KYC and due diligence. Hence, there is nothing unusual or illegal about the arrangement with DCB as it is a normal practice in the industry. This is the normal business practice being followed by all in the industry.
- 28.14. That out of the 10 observations brought out in SFIO report at page 625 & 626, eight observations were already forming part of SEBI SCN dated April 24, 2017 which were replied vide Noticee letters dated June 15, 2018, written submissions dated November 06, 2018 and also explained during the personal hearings held on October 11, 2018 and October 24, 2018 before SEBI. Without prejudice to it, the Noticee submits additional submissions as under:
- 28.14.1. All clients who dealt through the Noticee were duly registered clients with proper KYC, Member Client Agreement and other relevant documents signed and executed by the Client as per the system of NSEL.
- 28.14.2. All the trades were carried out as per NSEL system from time to time. The Contract notes were issued to the Clients as per the formats and the terms and conditions and bye-laws of NSEL.
- 28.14.3. Various brochures/pamphlets/presentations on NSEL Products were provided solely by NSEL through their systems, website and emails to the brokers and clients from time to time. The Noticee as a broker of NSEL forwarded the same to its Clients.
- 28.14.4. The Noticee is a subsidiary company of IIFL Holdings Limited which owns the brand name "IIFL" for financial services. Hence, the brand name of IIFL was used by all the subsidiaries and group companies of IIFL Holdings Limited and not just by the Noticee. Hence, the Noticee denies that it used the brand name "IIFL", for attracting the clients for particularly doing commodity trading.
- 28.14.5. With regard to allegation that the clients enrolled with the Noticee for NSEL trading were not commodity traders, the Noticee denies the same. Also, none of these Clients were borrowing clients. Out of total 12,235 Clients of the Noticee who were trading in NSEL, 55.5% Clients were registered on other Commodity exchanges and out of total 12,235 clients, 24.5% have traded in commodities on MCX and NCDEX platform through the Noticee. Trading volume of such clients for the year between 2010-2014 is 91,648 crores. The Noticee further submits that it is nowhere specified that a Client trading on NSEL must be a commodity trading client and hence the allegation is without any basis.
- 28.14.6. The Noticee denies that it had ever at any point in time assured any fixed returns to its Clients as alleged. It is submitted that NSEL had circulated and forwarded

to the brokers and public various presentations on NSEL products including the methodology of returns/calculations/other features etc. The same were only circulated by the Noticee to the Clients along with its disclaimers and risk disclosures.

28.14.7. NSEL was regulating under the Government Regulations and FMC was also entrusted with supervision in the year 2012 and accordingly, NSEL was functioning in complete public knowledge and permitted to carry out the activities and hence there was no reason to question the legality of the products by NSEL by the Noticee. The concept of paired contract was designed /introduced and operationalized by NSEL and the Noticee as a broker of NSEL provided the products to the clients as received from NSEL.

28.14.8. The Noticee denies that its clients had never taken physical delivery of commodities. Some of the clients of the Noticee at times had lifted physical delivery as per the system and process laid down by NSEL. The Warehouse Receipts were always in the custody of NSEL (as per their system) and based on the same, NSEL issued Allocation letters to the member brokers/Clients towards commodities delivery. Marking delivery through allocation letter was not a new terminology or process in commodity market as the same delivery mechanism was followed in national level commodities exchange such as MCX and the same process continuous till date.

28.14.9. The Noticee denies that it had carried out any fund based business. It acted only as a commodity broker of NSEL under its Byelaws/Rules/Regulations and dealt with registered clients for commodity contracts through NSEL Platform.

28.14.10. Therefore the Noticee denies all the aforesaid allegations/observations etc. of SFIO, EOW, other Courts as mentioned in the Second SCN. None of the referred allegations/ observations are made out against the Noticee or pronounced by any court against the Noticee and so the same cannot be relied upon by SEBI at this stage to decide on the registration of the Noticee as a stock broker.

28.15. That while SEBI has relied upon EOW's Remand Application for police custody in the year 2015, it has failed to consider the Order dated March 23, 2015 and the observations of the Hon'ble Court on the remand application, while granting bail to the Noticee's Director Mr. Chintan Modi in its Order dated March 23, 2015. A copy of the bail Order is submitted.

28.16. That the Hon'ble Bombay High Court's Order dated October 01, 2015 in Writ Petition No.1403 of 2015 pertains to the case of NSEL vs. State of Maharashtra. The Noticee was neither a party to the said proceedings nor the order passed was against the Noticee. Further, the observations, particularly made in Paragraph 10 of the Order of the Hon'ble Bombay High Court were about NSEL and its collusion with the Selling Trading Members, i.e. NSEL and the Defaulting Members. Admittedly, the Noticee

is a Non-Defaulting member and there are no observations whatsoever as against the Noticee in the said Order. The Noticee further submits that it had never dealt with any of the Defaulting Members/Selling Members and it had dealt only with the investing/purchasing clients on NSEL. Hence, the observations in this Order are of no relevance to the Noticee and reliance thereon is of no use. In any event and without prejudice to the above, it is submitted that the order dated October 01, 2015 itself records that the observations made therein are *prima facie* in nature and made for the limited purpose of considering the grant of relief of quashing the action under The Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 (hereinafter referred to as MPID Act). Thus, the same cannot be relied on for any purpose whatsoever much less for the purpose stated in the Second SCN.

- 28.17. With reference to paragraph 9 of the Second SCN, it is submitted that the observations are restricted to the failure/default of the Board and management of NSEL and there are no adverse observations as against the brokers in general or the Noticee in particular.
- 28.18. With reference to paragraph 10 of the Second SCN, it is submitted that it quotes a Government of India (GOI) letter dated December 30, 2014 addressed to the FMC, where it is stated that GOI agrees with the FMC that NSEL has violated the first two conditions of exemption granted to it under Section 27 of FCRA and FMC is advised to initiate appropriate action against NSEL under FCRA. No adverse finding or recommendation for action against the Noticee or brokers in general was made by the GOI in the said letter. Hence, this letter is of no consequence. The Noticee as a broker had only entered into the so-called paired contracts on behalf of its clients in accordance with the Bye-laws/ Business Rules of NSEL.
- 28.19. With reference to paragraph 11 of the Second SCN, it is submitted that observations by the Hon'ble Bombay High Court in Writ Petition No. 2743 of 2014 in the matter of 63 Moons Tech limited Vs. Union of India are clearly against FT1L and NSEL and their responsibility in offering paired contracts on its exchange platform from 2009 onwards. It is submitted that the Noticee is not even a party to this Writ Petition.
- 28.20. With reference to paragraph 12 of the Second SCN, it is submitted that the charge against the Noticee in the Second SCN has been summarized in this paragraph. It is submitted that Hon'ble Bombay High Court's Order on Criminal Bail Application No. 1236 of 2014 in the matter of Jignesh Prakash Shah Vs. The State of Maharashtra is in respect of Jignesh Shah's arrest by EOW in 2014. The Noticee was neither a party to the proceedings nor was any order passed against the Noticee. The observations in the said Order of the Hon'ble Bombay High Court with regard to the conduct of the brokers is just a passing remark in general about the Brokers and not a conclusive finding or an order against the Noticee and accordingly the same should not be given any weightage by SEBI.
- 28.21. That the observations are nothing but charges and allegations made by SFIO against the Noticee. The Noticee has had no opportunity to deal with these charges or to

answer them. The Noticee has not been given an opportunity to cross-examine the clients whose statements have been relied on in the SFIO report. These are nothing but purported evidences which have to be tested in a lawful trial against the Noticee. It is submitted that placing reliance on such observations against the Noticee at this stage is unfair and a violation of the fundamental principles of natural justice.

28.22. That the Noticee has filed its reply vide letter dated June 15, 2018 to the earlier show cause notice dated April 24, 2017 and also filed written submissions vide its letter dated November 06, 2018, along with all supporting documents with SEBI. The Noticee had also made its submissions during the personal hearings on October 11 as well as on October 24, 2018. The replies filed and the submissions/contentions made therein may also be considered for the present Second SCN as some of the observations/allegations raised in the present SCN are repetitive. Accordingly, the reply submitted hereunder is without prejudice to the earlier objections. SEBI may not place any reliance on the observations made in the SFIO Report, EOW's allegations/remand application and court orders as the allegations/ charges are unsubstantiated and court orders do not have any adverse findings with regard to the Noticee. Any reliance by SEBI at this stage on any of the documents/ Court Orders referred to in the Second SCN will cause irreparable loss and damage to the Noticee.

29. On January 28, 2019, Mr. Mustafa Doctor, Senior Counsel, Mr. R. S. Loona, Managing Partner, Alliance Law, Ms. Aparna Wagle, Principal Associate, Alliance Law Advocates, along with Mr. Mohan Radhakrishnan, Ms. Mamta Singh and Mr. Ravi Ramachandran from IICL, **ARs** of IICL appeared for the hearing and reiterated the earlier submissions and made the oral submissions in line with the reply dated January 23, 2019. ARs further stated that they have no further submissions to make in the matter.

FINDINGS AND CONSIDERATION

30. I have perused the SCN, Second SCN, submissions, and replies of the Noticee, oral and written submissions made by the Noticee and other materials available on the record. I record the issue for consideration and my findings as under:

ISSUE: Whether or not the Noticee is a fit and proper person for holding / being granted the certificate of registration as a commodity derivative broker?

31. Before moving forward it will be appropriate to refer to the relevant provisions of Finance Act, 2015, Intermediaries Regulations and Brokers Regulations which read as under:

Relevant Provisions:

31.1. **Finance Act, 2015**

Section 28A.

(1) All recognised associations under the Forward Contracts Regulation Act, shall be deemed to be recognised stock exchanges under the Securities Contracts (Regulation) Act, 1956 (herein referred to as the Securities Contracts Act):

“Provided that such deemed recognized stock exchanges shall not carry out any activity other than the activities of assisting, regulating or controlling the business of buying, selling or dealing in commodity derivatives till the said deemed recognized stock exchanges are specifically permitted by the Securities and Exchange Board of India:

Provided further that a person buying or selling or otherwise dealing in commodity derivatives as a commodity derivatives broker, or such other intermediary who may be associated with the commodity derivatives market, immediately before the transfer and vesting of rights and assets to the Securities and Exchange Board of India for which no registration certificate was necessary prior to such transfer, may continue to do so for a period of three months from such transfer or, if he has made an application for such registration within the said period of three months, till the disposal of such application.”.

- (4) All rules, directions, guidelines, instructions, circulars, or any like instruments, made by the Commission or the Central Government applicable to recognized associations under the Forward Contracts Act shall continue to remain in force for a period of one year from the date on which that Act is repealed, or till such time as notified by the Security Board, whichever is earlier, as if the Forward Contracts Act had not been repealed.
- (5) In addition to the powers under the Securities Contracts Regulation Act, the Security Board and the Central Government shall exercise all powers of the Commission and the Central Government with respect to recognised associations, respectively, on such deemed exchanges, for a period of one year as if the Forward Contracts Act had not been repealed.”.

Section 29A.

(1).....

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

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

31.2. **INTERMEDIARIES REGULATIONS:**

Cancellation or suspension of registration and other actions.

Regulation 23. Where any person who has been granted a certificate of registration under the Act or regulations made thereunder, –

(a) fails to comply with any conditions subject to which a certificate of registration has been granted to him;

(b) contravenes any of the provisions of the securities laws or directions, instructions or circulars issued thereunder;

the Board may, without prejudice to any action under the securities laws or directions, instructions or circulars issued thereunder, by order take such action in the manner provided under these regulations.

Action in case of default.

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

(i) Suspension of certificate of registration for a specified period;

(ii) Cancellation of certificate of registration;

(iii) Prohibiting the noticee to take up any new assignment or contract or launch a new scheme for the period specified in the order;

(iv) debarring a principal officer of the noticee from being employed or associated with any registered intermediary or other registered person for the period specified in the order;

(v) Debarring a branch or an office of the noticee from carrying out activities for the specified period;

(vi) Warning the noticee.

SCHEDULE II

Intermediaries Regulations

Criteria for determining a 'fit and proper person'

For the purpose of determining as to whether an applicant or the intermediary is a 'fit and proper person' the Board may take account of any consideration as it deems fit, including but not limited to the following criteria in relation to the applicant or the

intermediary, the principal officer the director, the promoter and the key management persons by whatever name called –

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

31.3. **BROKERS REGULATIONS:**

Consideration of application for grant of registration.

Regulation 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;

Procedure where registration is not granted.

Regulation 7. (1) Where an application under regulation 3, does not fulfill the requirements mentioned in regulation 5, the Board may reject the application after giving a reasonable opportunity of being heard.

Preliminary Objections:-

32. Further, before moving forward to the main issue in the matter, I first discuss the preliminary objections raised by the Noticee.

Jurisdiction and Applicability of Intermediaries Regulations:-

33. IICL stated that SEBI has taken a considered view in many proceedings before various fora/courts that it has no jurisdiction so far as the NSEL scam is concerned. With respect to the issue of jurisdiction, on the basis of documents available on record, it is observed that since the Noticee has applied to SEBI, for the purpose of granting registration to the Noticee to act as a commodity derivatives broker, SEBI has jurisdiction, *inter alia*, to determine whether the Noticee is a fit and proper person to act as a commodity broker. Further, the existence or absence of jurisdiction is determined by statute as the statute can vest or oust the jurisdiction and any representations or statements made by any party are not material to the arguments on jurisdiction. Thus, I find that by virtue of the application, and the control

and supervision of SEBI in respect of intermediaries dealing with commodity derivatives pursuant to Finance Act, 2015, among other grounds, SEBI has jurisdiction to determine whether the applicant is fit and proper.

34. As regards, the applicability of Intermediaries Regulations, the Noticee stated that SEBI does not have jurisdiction to issue the SCN under Intermediaries Regulations as the Noticee is not a registered intermediary under Intermediaries Regulations and Intermediaries Regulations is applicable only to persons who have been granted a certificate of registration by SEBI under the Act or Regulations made thereunder. With respect to the issue of applicability of Intermediaries Regulations, I note that the present matter is peculiar in nature. The ***Peculiar Facts and Circumstances*** of the present case are as under:

34.1. It is noted that the Finance Bill, 2015 was introduced in Parliament in the month of February 2015, *inter alia*, proposing the merger of Forward Market Commission (hereinafter referred to as “FMC”) with SEBI by making certain amendments in the Forward Contracts (Regulation) Act, 1952 and Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as “SCRA”). The said bill was passed and Finance Act, 2015 was notified on May 14, 2015. Central Government vide notifications dated August 28, 2015, appointed September 28, 2015 as the date on which the provisions of Part – I (excluding section 132 of Finance Act 2015) and Part – II of Chapter VIII of Finance Act, 2015 (i.e. the amendments made to FCRA and SCRA) would come into effect and appointed September 29, 2015 as the date on which the provisions of Section 132 of Finance Act, 2015 would come into effect (i.e. FCRA shall be repealed).

34.2. On September 28, 2015, FMC got merged with SEBI and provisions of Finance Act, 2015 as stated above came into effect from September 28, 2015 and September 29, 2015. Pursuant to the merger of FMC with SEBI, the regulation and supervision of the commodity derivatives brokers has been entrusted to SEBI.

34.3. It is noted that prior to coming into effect of Finance Act, 2015, the intermediaries dealing with the commodity derivatives were not required to be registered under FCRA. As per amendments / insertion of second proviso to Section 28A(1) of FCRA through Section 131B of Finance Act, 2015, “*an intermediary, who was associated with the commodity derivatives market, for which no registration certificate was*

necessary prior to merger, may continue to buy, sell or deal in commodity derivatives as a commodity broker for a period of three months from the date of merger or, if an intermediary has made an application for such registration within a period of 3 months from the date of merger, till the disposal of such application”.

34.4. It is also noted that Section 133B of Finance Act, 2015 has included “*commodity derivatives*” within the definition of *Derivative* under Section 2(ac) of SCRA, thereby, *commodity derivatives* falls under the definition of *Securities* with effect from September 28, 2015.

34.5. Thus, after the Finance Act, 2015 has come into effect, it has become necessary for every intermediary, who is dealing in commodity derivatives to get registered with SEBI. As a transitory measure, three months period had been given to them, so as to enable them to get themselves registered with SEBI. Also, if within three months such persons/intermediary move an application for registration, they are entitled to continue with their activities, till their application is finally decided / disposed by SEBI. Thus, by virtue of second proviso of Section 28A(1) of FCRA inserted through Section 131B of Finance Act, 2015 such intermediaries who were dealing with commodity derivatives and who had made an application within a period of three months have been brought under the control of SEBI.

34.6. **Hon’ble Bombay High Court** in Writ Petition Nos. 3262, 3266, 3294 and 3295 of 2018 in the matter of *Anand Rathi Commodities Limited, Motilal Oswal Commodities Broker Private Limited, Geofin Comtrade Limited and IIFL Commodities Limited Vs. SEBI* vide 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....”

- 34.7. Thus, from the above, it is summarized that, prior to September 28, 2015, IICL was functioning as a commodity derivatives broker and was recognized as such by the exchanges. Before merger of FMC with SEBI, IICL was required to be the member of recognized commodity derivative exchanges and was not required to be registered under FCRA with DCA or FMC or any other regulatory authority. The Finance Act, 2015, recognized the said fact and also that the commodity derivative brokers should now be regulated by SEBI. Considering the same, it was made mandatory for all commodity derivative brokers, who wished to continue their activities, to apply for registration with SEBI within a period of 3 months from September 28, 2015. Thus, all the commodity derivative brokers, who applied to SEBI and whose application was in process, were allowed to carry on their functions as commodity derivative brokers till the disposal of their respective application. Thus, by virtue of provisions of Finance Act, 2015 all those commodity derivatives brokers, who were functioning as commodity derivatives brokers, after having made their application to SEBI within 3 months from September 28, 2015, were under the supervision and control of SEBI like any other intermediary holding a certificate of registration.
- 34.8. It is noted that pursuant to merger of FMC with SEBI, IICL on December 23, 2015, had made an application to SEBI for registration as a commodity broker and by virtue of second proviso of Section 28A(1) of FCRA inserted through Section 131B of Finance Act 2015, IICL was permitted to continue to buy, sell or deal in a commodity derivatives as a commodity broker till the disposal of its application for registration.
- 34.9. It is pertinent to mention the normal circumstances in the securities market which are detailed as under:
- 34.9.1. Intermediaries Regulations is applicable when an intermediary is registered with SEBI and a certificate of registration is granted to them under SEBI Act and rules and regulations made thereunder, thereby operating and functioning in securities market as per the rules and regulations made under SEBI Act.
- 34.9.2. An entity that had applied for registration under regulation 3 read with regulation 5 of Brokers Regulations, would not normally be functioning or operating as stock broker till the disposal of application in his favor and consequent registration under regulation 7 of Brokers regulations.
- 34.10. However, in view of the facts and circumstances of the case discussed above i.e. prior to the merger of FMC with SEBI, an intermediary was not required to be registered

under FCRA, but operating / functioning in commodity derivatives market, and pursuant to the merger of FMC with SEBI, by virtue of the Finance Act, 2015, if an intermediary had made any application of registration within a period of three months from September 28, 2015, they were permitted to continue their activities and operate in the commodity derivatives market from September 28, 2015 till the disposal of their application of registration by SEBI even though technically they were not holding a certificate of registration. An entity cannot operate in a regulatory vacuum for the period when they operate as a commodity derivative broker till the disposal of their application of registration by SEBI. Thus, they were brought under the supervision and control of SEBI, by virtue of the Finance Acts, 2015, even as their application for registration was pending.

34.11. Thus, in view of the facts and circumstances of the case, the nature / status of the Noticee that it was operating and functioning in commodity derivatives market as commodity derivatives broker, prior and after the merger of FMC with SEBI, without technically holding a certificate of registration from SEBI but within the regulatory supervision and control of SEBI from September 28, 2015 and at the same time, the Noticee is an applicant for registration as a commodity derivatives brokers under Brokers Regulations.

35. Thus, IICL was and continues to be under the supervision and regulatory control of SEBI from September 28, 2015 onwards till the disposal of its application for registration. Therefore, in view of aforesaid facts and circumstances of the case, I am of the view that Chapter V and VI of the Intermediaries Regulations is applicable to the Noticee even though technically it does not hold a certificate of registration.

Administrative Discrimination:

36. IICL stated that the underlying basis for the present proceedings is the participation of IICL as a broker on NSEL. All the brokers trading in NSEL at the relevant time have undertaken the same activities as IICL. Despite this SEBI has granted registration to a majority of such brokers but has handpicked IICL and initiated proceedings against it. With respect to the issue of discrimination, on the basis of documents available on record, it is noted that the stand taken by SEBI in selection of the 5 brokers (including Noticee) for initiating proceedings against them is that the selection was on the basis of two documents i.e. EOW

report and NSEL complaints. It is also noted that, qua the NSEL matter, in the month of September 2018, SEBI has also initiated Enquiry Proceedings against approximately 300 brokers. The question of perceived discrimination in this context does not survive.

37. Having said that, I note the following observations of the Hon'ble Supreme Court in the context of argument of discrimination to claim negative equality in the matter of *Union of India and anr. vs. International Trading Co. and anr.* (AIR 2003 SC 3983) dated May 07, 2003, would be squarely applicable to the facts of this case.

“.....two wrongs do not make one right. A party cannot claim that since something wrong has been done in another case directions should be given for doing another wrong. It would not be setting a wrong right, but would be perpetuating another wrong. In such matters there is no discrimination involved. The concept of equal treatment on the logic of Article 14 of the Constitution of India, 1950 (in short ‘the Constitution’) cannot be pressed into service in such cases. What the concept of equal treatment presupposes is existence of similar legal foothold. It does not countenance, repetition of a wrong action to bring both wrongs on a par. Even if hypothetically it is accepted that a wrong has been committed in some other case by introducing a concept of negative equality the respondents cannot strengthen their case. They have to establish the strength of their case on some other basis and not by claiming negative equality.....”

38. While Hon'ble Supreme Court has clearly laid down the non-availability of the above ground of discrimination to establish the strength of one's case, even otherwise, when an argument of discrimination is advanced on the ground of violation of Article 14 of the Constitution of India, the same is in effect challenging the decision taken by SEBI in its administrative capacity to launch action against the Noticee. I consider that this quasi-judicial forum is not the right forum to test such a decision already taken by SEBI in its administrative capacity on this ground. Needless to say, Noticee has other appropriate fora for judicial review of administrative actions of SEBI on the ground of perceived discrimination.

Clubbing of Proceedings:

39. With respect to the ***clubbing of proceedings*** of regulation 23 of Intermediaries Regulations and regulation 7 read with regulation 5(e) of Brokers regulations, I am of the view that, in

view of the aforesaid facts and circumstances of the case as outlined in paragraph 34 and considering the fact that pursuant to Finance Act, 2015 the Noticee was already dealing in commodity derivatives, the proceedings under regulation 23 of Intermediaries Regulations and under regulation 7 read with regulation 5(e) of Brokers regulations are both applicable to the Noticee and can be clubbed together.

Whether SEBI had rightly initiated action against Noticee under regulation 23 of Intermediaries Regulation or not?

40. With respect to the applicability of Regulations 23 of Intermediaries Regulations, **Hon'ble Bombay High Court** in Writ Petition Nos. 3262, 3266, 3294 and 3295 of 2018 in the matter of *Anand Rathi Commodities Limited, Motilal Oswal Commodities Broker Private Limited, Geofin Comtrade Limited and IIFL Commodities Limited Vs. SEBI* vide Order dated October 04, 2018 observed the following:

“

- 15] Upon the plain reading of Regulations, at first blush, the arguments made on behalf the Petitioners appear to be attractive. Regulation 23, which deals with cancellation or suspension of registration and other actions, begins with the words "where any person who has been granted a certificate of registration under the Act or regulations." It could thus be seen that on a plain reading of Regulation 23, it would appear that for invoking provisions of Regulation 23 onwards, a person against whom action is sought to be taken must have been granted a certificate of registration under the Act or regulations made thereunder. Even the words used in Regulation 31 would also show that an application for surrendering the registration has to be made by a person who has been granted a certificate of registration.
- 16] However, in the present matter, while considering the regulation, we will have to consider as to what is the effect of Finance Act, 2015. No doubt that by virtue of Section 29A, FCR Act has been repealed. While repealing the said act, the Parliament has also saved the certain things. All offences committed or existing proceedings with respect to the offences, which may have been committed under the FCR Act are provided to be continued to be governed by the provisions of the said act, as if the said act has not been repealed. A fresh proceeding related to the offences under the FCR Act, is also permitted to be initiated by SEBI, within a period of three years from the date on which the earlier act is repealed and proceeded with, as if that Act had not been repealed. It is not in dispute that the criminal proceedings have already been filed within a period of three years. However, in the present case, we do not find it necessary to go into that aspect

of the matter, since the only question that falls for consideration before us is as to whether the Respondent - SEBI was bound to allow the application of the Petitioners for withdrawal of their application for registration and as to whether the continuation of the proceedings under the various regulations are permissible or not.

- 17] We find that the provisions of Section 28A of the Finance Act, 2015, would be the most relevant for determining the said issue. Undisputedly, prior to Finance Act, 2015, coming into effect, it was not necessary for intermediaries like the Petitioners, to have registration under the FCR Act. For the first time, by virtue of Finance Act, 2015, such a registration has become mandatory. By virtue of Section 28A, particularly sub section (1) thereof, all recognized associations under the FCR Act have been deemed to be recognized stock exchanges under the Securities Contracts (Regulation) Act, 1956. The first proviso thereof provides that such deemed recognized stock exchanges would not carry out any activities other than the activities of assisting, regulating or controlling the business of buying, selling or dealing in commodity derivatives till the said deemed recognized stock exchanges are specifically permitted by the SEBI.
- 18] The second proviso to Section 28A would be the most relevant one. It provides that a person buying or selling or otherwise dealing in commodity derivatives as a commodity derivatives broker, or such other intermediary who may be associated with the commodity derivatives market, immediately before the transfer and vesting of rights and assets to the SEBI for which no registration certificate was necessary prior to such transfer, may continue to do so for a period of three months from such transfer. It is further provided that if he has made an application for such registration within the said period of three months, then till the disposal of such application, he would be entitled to continue with his activities.
- 19] It could thus be seen that after the Finance Act, 2015 has come into effect, it has become necessary for every intermediary, who is dealing in commodity derivatives to get registered with SEBI. As a transitory measure, three months period has been given to them, so as to enable them to get themselves registered with SEBI. Even if within three months such persons move an application for registration, they are entitled to continue with their activities, till their application is finally decided by SEBI. It could thus be seen that by virtue of second proviso of Section 28A, such intermediaries who are dealing with commodity derivatives and who have made an application within a period of three months have been brought under the control of SEBI.
- 20] We find that in the present case, we will have to apply Heydon's rules of interpretation. It will be relevant to refer to the following observations of the Constitution Bench of the Hon'ble Apex Court in the case of Bengal Immunity Co. Ltd. Vs. State of Bihar and others (AIR 1995 SC 661):-

“22 It is a sound rule of construction of a statute firmly established in England as far back as 1584 when - Heydon's case, (1584) 3 Co. Rep. 7A (V) was decided that-

“..... for the sure and true interpretation of all Statutes in general (be they penal or beneficial, restrictive or enlarging of the common law) four things are to be discerned and considered:-

- 1st. What was the common law before the making of the Act,*
- 2nd. What was the mischief and defect for which the common law did not provide,*
- 3rd. What remedy the Parliament hath resolved and appointed to cure the disease of the Commonwealth and*
- 4th. The true reason of the remedy; and then the office of all the judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and ‘pro privato commodo’, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, pro bono public”.*

In -'In re Mayfair Property Co.', [1898] 2 Ch. 28, at p. 35 Lindley, M. R. in 1898 found the rule "as necessary now as it was when Lord Coke reported 'Heydon's case (V)'. In -'Eastman Photographic Material Co. v. Comptroller General of Patents, Designs and Trade Marks', 1898 AC 571 at p. 576 (X) Earl of Halsbury re-affirmed the rule as follows:

"My Lords, it appears to me that to construe the Statute in question, it is not only legitimate but highly convenient to refer both to the former Act and to the ascertained evils to which the former Act had given rise, and to the later Act which provided the remedy. These three being compared I cannot doubt the conclusion."

It appears to us that this rule is equally applicable to the construction of Art. 286 of our Constitution. In order to properly interpret the provisions of that Article it is, therefore, necessary to consider how the matter stood immediately before the Constitution came into force, what the mischief was for which the old law did not provide and the remedy which has been provided by the Constitution to cure that mischief."

- 21] 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.

.....”

41. I note that under normal circumstances as per regulation 23 of Intermediaries Regulations, SEBI can take action under Intermediaries Regulations against any person who has been granted a certificate of registration under the Act or regulations made thereunder either (a) fails to comply with any conditions subject to which a certificate of registration has been granted to him; or (b) contravenes any of the provisions of the securities laws or directions, instructions or circulars issued thereunder.
42. However, in view of the facts and circumstances of the case discussed above in paragraph 34, SEBI's Jurisdiction, observation of Hon'ble Bombay High Court in Order dated October 04, 2018, the fact that pursuant to Finance Act, 2015 the Noticee was already dealing in commodity derivatives and applicability of Intermediaries Regulations as already discussed in detail above, I am of the view that SEBI can take action against the Noticee under Intermediaries regulations if the Noticee has contravened any of the provisions of the securities laws or directions, instructions or circulars issued thereunder.
43. Now the question that arises is whether the Noticee has contravened any of the provisions of the securities laws or directions, instructions or circulars issued thereunder.
44. I note that SEBI was entrusted with regulatory supervision and control of commodity derivatives brokers from September 28, 2015 and Noticee had made an application to SEBI for registration as commodity derivative broker on December 23, 2015 under regulation 3 of Brokers Regulations. As per regulation 5(e) of Brokers Regulations, SEBI, while considering the application for grant of registration to the Noticee was required to take into account whether the Noticee is a fit and proper person based on the criteria specified in Schedule II of the Intermediaries Regulations. Further, I note that “*fit and proper person*” criteria specified in Schedule II of the Intermediaries Regulations forms the part of Securities Laws. Thus, I am of the view that from September 28, 2015, SEBI was entrusted to look into the status of “*Fit and Proper*” criteria, specified in Schedule II of the Intermediaries Regulations, of the intermediary/person who had made an application for registration. As laid down by

the Hon'ble Securities Appellate Tribunal in ***Jermyn Capital LLC vs. SEBI*** vide order dated September 06, 2006 “*The Regulations apply across to all sets of regulations and all intermediaries of the securities market including those who associate themselves with the market and they all have to satisfy the criteria of fit and proper person before they could be registered under any of the relevant regulations and this criteria they must continue to satisfy through out the period of validity of their registration and through out the period they associate with the market*” Hence, I am of the view that at the time of submitting the application for registration, Noticee is required to comply with the provisions of regulation 5(e) of Brokers Regulations read with “*Fit and Proper*” criteria specified in Schedule II of the Intermediaries Regulations. As the Noticee continued to act as commodity derivative broker pursuant to the Finance Act, 2015 and the requirement of being a fit and proper person being an ongoing requirement, in this case, Noticee is required to follow the same continuously.

45. In view of the above, I am of the view that issuance of the show cause notice against the Noticee, is sustained, since the same was issued on the allegation that it had contravened the ongoing requirement of fit and proper status, under the Brokers Regulations read with Intermediaries Regulations, which are part of Securities Laws, therefore, regulations 23 of Intermediaries Regulations is attracted and SEBI had rightly initiated action against Noticee under regulation 23 of Intermediaries Regulations.

Whether the recommendations made by Designated Authorities are in accordance with regulation 27 of Intermediaries Regulation or not?

46. I note that under normal circumstances, the Designated Authority, under regulation 25 of Intermediaries Regulations issues a notice to the concerned person requiring him to show cause as to why the certificate of registration granted to it, should not be suspended or cancelled or why any other action provided herein should not be taken. I also note that “*any other action provided herein*” is specified under regulation 27 of Intermediaries Regulations i.e. under regulation 27 of the Intermediaries Regulations, the designated authority shall submit a report, where the facts so warrant, *recommending*, – (i) suspension of certificate of registration for a specified period; (ii) cancellation of certificate of registration; (iii) prohibiting the Noticee to take up any new assignment or contract or launch a new scheme

for the period specified in the order; (iv) debarring a principal officer of the noticee from being employed or associated with any registered intermediary or other registered person for the period specified in the order; (v) debarring a branch or an office of the noticee from carrying out activities for the specified period; and (vi) warning the Noticee.

47. I note that in the present matter the Designated Authorities vide their report dated April 11, 2017 had stated that the conduct of the Noticee in its functioning as a commodity broker is questionable and its general reputation, record of fairness, honesty and integrity has eroded and therefore, the status of the Noticee as a 'fit and proper person' to be an intermediary in the securities market has affected and recommended that:

47.1. The application of IICL submitted for registration as a commodity broker may not be considered in the interest of securities market and the application of IICL may be rejected.

47.2. SEBI may also consider initiating prosecution proceedings under the relevant provisions of Chapter V of FCRA for the irregularities committed by IICL including the violation of the Government of India Notification issued under section 27 of FCRA.

48. I note that under normal circumstance, the Designated Authorities can only make the recommendations specified under regulation 27 of Intermediaries Regulation, but in the present matter the Designated Authorities had made the aforesaid two recommendations which are not specified under regulation 27 of Intermediaries Regulations. However, it is to be noted that in the facts and circumstances of the case discussed above in paragraph 34 and the fact that pursuant to Finance Act, 2015 the Noticee was already dealing in commodity derivatives, I am of the view that the recommendation of rejection of Noticee's application for registration is equivalent / similar to the recommendation of cancellation of certificate of registration that is envisaged under regulation 27 of Intermediaries Regulations.

49. With respect to the second recommendation of considering initiating prosecution proceedings by SEBI, I note that as per Section 29A(2)(e) of FCRA inserted through Section 132 of Finance Act 2015 a fresh proceeding related to an offence under the FCRA, may be initiated by SEBI under FCRA within a period of three years from the date on which FCRA is repealed and be proceeded with as if FCRA had not been repealed.

50. In the present matter, I note that the Designated Authorities had noted certain allegations / violations of FCRA committed by the Noticee. I note that by virtue of Finance Act, 2015 SEBI may initiate fresh proceeding related to an offence under FCRA within a period of 3 years from September 28, 2015 under FCRA. I also note that as per section 24 of FCRA, no court inferior to that of a presidency magistrate or a magistrate of the first class shall take cognizance of or try any offence punishable under FCRA.

51. Hence, in the interest of investors and responsibility entrusted by the parliament to SEBI of regulatory supervision and control of Commodity Derivatives Market, and considering the facts and circumstances of the case as detailed in paragraph 34 and considering the fact that pursuant to Finance Act, 2015 the Noticee was already dealing in commodity derivatives, I am of the view that the Designated Authorities have rightly made a recommendation for initiation of prosecution proceedings under the relevant provisions of Chapter V of FCRA although the said recommendation is not specified under regulation 27 of Intermediaries Regulations. Further, I also note that SEBI had filed the FIR dated September 28, 2018 against the Noticee.

52. **Initiation of Performance Audit / Inspection of books of accounts of the Noticee:**

With respect to the initiation of audit inspection of the Noticee by SEBI, I note that under Section 11(2)(i) of SEBI Act, 1992, persons associated with the securities market can be subjected to audit. Section 11(2) provides for various measures which SEBI can take for protection of investors. Regulatory requirement of “fit and proper” status of the intermediaries is one of the safeguards for investor protection. The reputation and belief in competence, fairness, honesty, integrity and character based on past conduct of the applicant for registration as intermediary is relevant for the purpose of determining the requirement of fit and proper status of the applicant. In a fit case, such assessment of reputation and belief in competence, fairness, honesty, integrity and character based on past conduct may be made by collection of materials through audit. As noted earlier, Section 133B of Finance Act, 2015 has included “*commodity derivatives*” within the definition of *Derivative* under Section 2(ac) of SCRA, thereby, *commodity derivatives* falls under the definition of *Securities* with effect from September 28, 2015. Since Noticee has been associated with commodity derivatives from September 28, 2015 onwards, SEBI has powers to cause audit of the Noticee

in terms of Section 11(2) (i) of SEBI Act, 1992. SEBI vide letter dated February 18, 2016 had assigned M/s Kirtane & Pandit to carry out performance audit / Inspection of books of accounts of the Noticee. Thus, the initiation of Performance Audit / Inspection of books of accounts of the Noticee was well within the powers and functions of SEBI.

53. **Hearing Opportunity before DA's:** With respect to the contention of the Noticee that an opportunity of hearing was not provided to the Noticee before the bench of Designated Authorities, it is noted that under Intermediaries Regulations, there is no requirement of providing opportunity of hearing before the bench of Designated Authorities. I also note that under regulation 28(2) of Intermediaries Regulations the requirement for providing opportunity of hearing is before Designated Member. Therefore, I note that before the undersigned i.e. Designated Member, Noticee was provided with and indeed availed, several opportunities of hearings on the issue of inspection as well as on merits. Hence, I am of the view that, in accordance with law, principal of natural justice has been duly followed in the present matter and the Noticee was not deprived of the same.

54. **Second Show cause notice.** Noticee argued that second show cause notice was issued after the completion of the hearing, therefore, the same is arbitrary and cannot be issued. This argument does not hold merit, because SEBI had received new materials such as the SFIO Report which were relevant to the matter. Further, the observations made in Hon'ble Bombay High Court in Writ Petition No. 2743 of 2014, in the matter of 63, *Moons Technologies Limited Vs. The Union of India* vide Order dated December 04, 2017, Hon'ble **Bombay High Court** in Writ Petition No. 1403 of 2015 in the matter of *National Spot Exchange Limited Vs. State of Maharashtra* vide Order dated October 01, 2015 and the letter dated December 30, 2014 issued by Ministry of Finance, Department of Economic Affairs ("DEA") are relevant to the matter. Therefore, in view of principles of natural justice, the said relevant materials were provided to the Noticee to submit its reply on them, if any, and subsequently an opportunity of hearing was also provided to the Noticee. Hence, the principles of natural justice have been followed in the matter. Therefore, I do not find any merit in the said argument of the Noticee.

Findings on Merits of the case:

ISSUE: Whether or not the Noticee is a fit and proper person for holding / being granted a certificate of registration as a commodity derivative broker

55. I note that the **Criteria for determining a ‘Fit and Proper person’** is defined under Schedule II of Intermediaries Regulation which states that *“For the purpose of determining as to whether an applicant or the intermediary is a ‘fit and proper person’ the Board may take account of any consideration as it deems fit, including but not limited to the following criteria in relation to the applicant or the intermediary, the principal officer, the director, the promoter and the key management persons by whatever name called (a) integrity, reputation and character; (b) absence of convictions and restraint orders; (c) competence including financial solvency and networth; (d) absence of categorization as a wilful defaulter.”*

56. I note that the concept of a fit and proper person has a very wide amplitude. The said Schedule confers wide discretion on the Board in respect of what considerations it has to take into account in view of its mandate to protect the interest of investors and integrity of the securities market. The said Schedule also provides for specific considerations such as integrity, reputation, competence and character.

57. While dealing with what considerations can be looked into as relevant for the purpose of determining whether an applicant can be considered as a fit and proper person, the following observation of Hon’ble Securities Appellate Tribunal in ***Jermyn Capital LLC vs. SEBI*** vide order dated September 06, 2006 is worth mentioning:

“.....

A reading of the aforesaid provisions of the Regulations makes it abundantly clear that the concept of a fit and proper person has a very wide amplitude as the name fit and proper person itself suggests. The Board can take into account any consideration as it deems fit for the purpose of determining whether an applicant or an intermediary seeking registration is a fit and proper person or not. The framers of the Regulations have consciously given such wide powers because of their concern to keep the market clean and free from undesirable elements. It can take into account the financial integrity of the applicant and its competence. Absence of convictions or civil liabilities would be another relevant consideration which could weigh with the Board. Good reputation and

character of the applicant is a very material consideration which must necessarily weigh in the mind of the Board in this regard. Reputation is what others perceive of you. In other words, it is the subjective opinion or impression of others about a person and that, according to the Regulations, has to be good. This impression or opinion is generally formed on the **basis of the association** he has with others and/or on the basis of his past conduct. A person is known by the company he keeps. In the very nature of things, there cannot be any direct evidence in regard to the reputation of a person whether he be an individual or a body corporate. In the case of a body corporate or a firm, the reputation of its whole time director(s) or managing partner(s) would come into focus. The Board as a regulator has been assigned a statutory duty to protect the integrity of the securities market and also interest of investors in securities apart from promoting the development of and regulating the market by such measures as it may think fit. It is in the discharge of this statutory obligation that the Board has framed the Regulations with a view to keep the market place safe for the investors to invest by keeping the undesirable elements out. The Regulations apply across to all sets of regulations and all intermediaries of the securities market including those who associate themselves with the market and they all have to satisfy the criteria of fit and proper person before they could be registered under any of the relevant regulations and this criteria they must continue to satisfy through out the period of validity of their registration and through out the period they associate with the market. The purpose of the Regulations is to achieve the aforesaid objects and make the securities market a safe place to invest. One bad element can, not only pollute the market but can play havoc with it which could be detrimental to the interests of the innocent investors. In this background, the Board may, in a given case, be justified in keeping a doubtful character or an undesirable element out from the market rather than running the risk of allowing the market to be polluted. We may hasten to add here that when the Board decides to debar an entity from accessing the capital market on the ground that he/it is not a fit and proper person it must have some reasonable basis for saying so. The Board cannot give the entity a bad name and debar it. When such an action of the Board is brought to challenge, it (the Board) will have to show the material on the basis of which it concluded that the entity concerned was not a fit and proper person or that it did not enjoy a good reputation in the securities market. The basis of the action will have to be judged from the point of view of a reasonable and prudent man. In other words, the test would be what a prudent man concerned with the securities market thinks of the entity. In the instant case we are satisfied that the Board was justified in debarring the appellant as a temporary measure pending final investigations and keeping it out of the market by not allowing it to access the same because of its close association with Dharmesh Doshi and

Ketan Parekh who, in the perception of the Board and in our view rightly, do not enjoy good reputation in the context of the securities market. This association, in the circumstances of the case, would be enough to hold that the appellant is not a fit and proper person.

.....”

58. Reliance is also placed on the following observations of Hon’ble SAT in **Mukesh Babu Securities Limited vs. SEBI & others** made vide order dated December 10, 2007:

“.....

*It is true that these are only allegations made in the charge-sheet and we are conscious that these are **yet to be established in a court of law** but from what is stated in the charge-sheet liaison between Shri. Mukesh Babu and the chairman of the Bank prima facie appears to be established. The CBI has alleged that there was criminal conspiracy among all the accused and that they have committed illegal acts which have resulted in wrongful loss to the depositors of the Bank and corresponding gain to the accused. The charges levelled are indeed serious and if established, they involve moral turpitude. We are unable to agree with the learned counsel for the appellant that the criminal case pending against Shri. Mukesh Babu and others has no concern with the securities market.....In these circumstances, the Board was entitled to take the view that the company was not a fit and proper person. It could not be said that Shri. Mukesh Babu or the company enjoyed good reputation within the meaning of the Fit and Proper Person Regulations.*

.....

We are of the opinion that in the facts and circumstances of the case, the Board has taken a possible view which cannot be said to be perverse. It is not contrary to the material on record and nothing relevant has been ignored nor any irrelevant material taken into consideration. Thus, neither the decision nor the process followed by the Board suffers from any legal infirmity. In our opinion, the Board was justified in keeping the company out of the market as a risk containment measure in order to maintain its integrity and in the interests of investors. In view of the aforesaid, we answer the question posed in the earlier part of the order in the negative and hold that the Board has not erred in holding that the company is not a ‘fit and proper person’.....”

59. **The Hon’ble Supreme Court** vide its order dated April 7, 2008, **confirmed** the Hon’ble SAT order dated December 10, 2007 in matter of *Mukesh Babu Securities Limited vs. SEBI & others*, by dismissing the appeal filed against the said SAT order dated December 10,

2007. Similarly, the appeal filed against the Hon'ble SAT order dated September 06, 2006 in matter of *Jermyn Capital LLC vs. SEBI* was disposed by Hon'ble Supreme Court without interfering on the law laid down by the Hon'ble SAT.

60. From the above two judgments of Hon'ble SAT, I note the following:

60.1. An applicant or an intermediary seeking registration, requires to be a fit and proper person. Equally, an entity who has received a certificate of registration or is acting as a commodity derivative broker, as in this case, by virtue of the provisions of Finance Act, 2015 should continue to be a fit and proper person. SEBI can take into account any consideration as it deems fit for the purpose of determining the fit and proper status of the above said persons. Good Reputation, competence, integrity and character of the applicant are material parameters which are to be considered by the Board in this regard. Reputation is what others perceive of the applicant. It is the subjective opinion or impression or belief of others about a person and that, according to the Regulations, has to be good. In other words, the test would be what a concerned prudent man thinks of the entity. This impression or opinion or belief is generally formed on the basis of the association he has with others and/or on the basis of his past conduct. There cannot be any direct evidence in regard to the reputation of a person whether it be an individual or a body corporate. It is to be gathered from all the attendant circumstances of the case.

60.2. The Board as a regulator has been assigned a statutory duty to protect the integrity of the securities market and also the interest of investors in securities apart from promoting the development of and regulating the market by such measures as it may think fit. The purpose of the Regulations is to achieve the said objects and make the securities market a safe place to invest. In this background, the Board may, in a given case, be justified in keeping a person of doubtful reputation out from the market rather than running the risk of allowing the market to be affected.

60.3. Thus, in the present case and in keeping in mind the case law quoted above, the following two parameters would be enough for the Board to ascertain the reputation of the Noticee in order to determine the Fit and Proper status of the Noticee:

60.3.1. The existence of material, if any, adversely impacting the reputation of the Noticee or its close associates, even if such material is prima facie in nature.

60.3.2. The existence of a close association or even prima facie evidence of a close association, if any, of the Noticee with a person who does not enjoy a good reputation.

Allegations:

61. I note that, in the present matter, two show cause notices were issued, the allegations mentioned in the SCNs are as under:

61.1. **First SCN dated April 24, 2017:** The Enquiry Report dated April 11, 2017 finds that the integrity, reputation, character, competence, compliance with law and most importantly honesty and fairness displayed by the Noticee in the conduct of its business are questionable based on the conduct of its business at NSEL as a commodity broker. The said conclusions in the enquiry report have been arrived, inter alia, on the basis that the Noticee had violated various provision of laws which are serious in nature, including trading in contravention of the conditions laid down in Central Government Notification dated June 05, 2007, defeating the very purpose of spot trading on the NSEL, indulging in financial transactions, indulging in forward contract transactions, short selling in violation of Government of India (GOI) Notification dated June 5, 2007, inducing directly/indirectly the clients to transact in paired contracts, making misrepresentations/mis-selling relating to transactions on NSEL, trading in client's account without authorization, misleading presentations, assuring fixed returns, giving unverified / false information regarding trades backed by collateral in the form of stock, assuring investors regarding arbitrage opportunity, UCC modification, suspicious transactions, non-forwarding of contract notes/ ECNs to clients, funding the clients by way of allowing them to trade despite debit balance, failure in system audit of IBT/CCTL and not obtaining CCP certificate for its terminal users etc. The enquiry report dated April 11, 2017 has found the above conduct of the Noticee in violation of various provisions of laws such as FCRA, GOI Notifications, NSEL Circulars, Rules and Bye-laws, MCX and NCDEX Circulars. In view of the above findings of the Enquiry Report dated April 11, 2017, allegations to that extent have been levelled in the SCN dated April 24, 2017.

61.2. **Second SCN dated December 27, 2018:** The second SCN was in furtherance to the first SCN dated April 24, 2017. The second show cause notice highlights certain information/materials to the Noticee in the form of observations by various Courts/Authorities regarding paired contracts transacted on NSEL which the Noticee as a broker had participated in/facilitated. Under these observations, these paired contracts which were alleged to be designed to be in the nature of lending and borrowing transactions rather than trading in commodities. The SCN levels an allegation that in view of this observations as detailed in the said SCN, the reputation/competence/ character/integrity of the Noticee is seriously in question and thus has bearing on its Fit and Proper status.

62. Thus, the allegation against the Noticee that it is not a *fit and proper person*, rests on **twin basis**. *First* on the basis of alleged violations of various provisions of law/circulars by the Noticee mentioned in SCN dated April 24, 2017. *Second* on the basis of existence of various adverse observations by various Courts / Authorities regarding the transactions in paired contracts on NSEL and the association of the Noticee with such transactions and with NSEL. Both sets of allegation lead to serious questions about the reputation, integrity, character and competence of the Noticee.

63. In order to appreciate the allegations with the proper perspective, **certain context setting narrations** are noted hereunder.

64. I note that NSEL was incorporated in May 2005 as a Spot Exchange for trading in commodities and in exercise of power conferred under Section 27 of the Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as “FCRA”), Central Government vide notification dated June 5, 2007, exempted all forward contracts of one day duration for the sale and purchase of commodities traded on NSEL from operations of the provisions of FCRA subject to certain conditions, namely:

- (i) *No short sale by members of the Exchange shall be allowed;*
- (ii) *All outstanding position of the trade at the end of the day shall result in the delivery;*
- (iii) *The National Spot Exchange shall organize spot trading subject to regulation by the authorities regulating spot trade in the areas where such trading takes place;*

- (iv) *All information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agencies;*
- (v) *The Central Government reserves the right to impose additional conditions from time to time as it may deem necessary; and*
- (vi) *In case of exigencies, the exemption will be withdrawn without assigning any reason in public interest.*

65. It is noted that in October 2008, NSEL commenced operations providing an electronic trading platform to participants for spot trading of commodities, such as bullion, agricultural produce, metals, etc. and in September 2009, NSEL had introduced the concept of ‘paired contracts’.

66. With regard to the transactions in paired contracts on NSEL, Hon’ble Bombay High Court in Writ Petition No. 2743 of 2014 in the matter of 63, *Moons Technologies Limited Vs. The Union of India* vide Order dated December 04, 2017 had *inter alia* noted the practice followed at NSEL Exchanges:

“

- i. *Certain Trading Clients and Commodity Sellers entered into what are called “paired contracts” – meaning thereby 2 simultaneous transactions would be entered into on the same date (i.e. 'T' day) where a Trading Client purchased commodities from a Commodity Seller under a T+2 contract, and then sold the same commodities to the same Commodity Seller under a T+25 contract at a higher price;*
- ii. *Though both T+2 and T+25 contracts were independent contracts offered by NSEL through separate circulars, it seems that the Commodity Sellers, Commodity Seller's Brokers, Trading Clients and Trading Client's Brokers, paired the contracts, so that:*
 - a) *both the T+2 and the T+25 contracts were entered into at the same time, on the same day, between the same Trading Client and Commodity Seller;*
 - b) *upon settlement of the T+2 Contract, the Trading Client received a Delivery Allocation Report from NSEL, indicating that the commodities were deposited in the warehouse (under a Warehouse Receipt), and the Commodity Seller received the purchase consideration;*

c) the T+25 Contract (i.e. where the Commodity Seller bought back the commodities earlier purchased by the Trading Client), was thereafter settled by the Trading Client delivering the Delivery Allocation Report to NSEL so that the Warehouse Receipt representing the underlying commodities, could be handed over to the Commodity Seller, and the Commodity Seller paid the T+25 purchase consideration for the commodities purchased.
.....”

67. From the Enquiry report dated April 11, 2017, following is noted:

“.....

We have observed that the Noticee had carried out back-to-back pair contracts at NSEL for and on behalf of its constituents. The Noticee on behalf of its constituents simultaneously entered into a ‘short term buy contract’ (eg, T+2 i.e 2 day settlement) and a ‘long term sell contract’ (eg, T+25 or T + 36 i.e settlement in 25 days or 36 days) with pre-determined price and profit for the buyer and seller, which itself violated the very concept of spot market for trading in commodities. The contracts were executed by the Noticee in such a manner that it was always ensured that these contracts were registering a profit on the long term positions. Thus, there existed a financing business where a fixed rate of return/ assured returns were guaranteed to the investors of the Noticee who had invested in these pair contracts. These paired contracts generated an assured return of 13% to 18% per annum, and therefore, in actuality, financial transactions were taking place through these pair contracts under the garb of doing commodities trading in spot market. Apparently, every transaction of buy and sell was paired with one leg of the transaction (i.e the contracts with long duration T+25 /T + 36) were settled beyond the prescribed settlement schedule. As already mentioned in the pre-paragraph, NSEL contracts that were settled within 11 days were defined as ‘spot’ and were considered as legal, but, the Noticee through the paired contracts was carrying forward the transactions beyond the prescribed time frame, with the second leg of the pair transactions extending to T + 25/T+36 days. As a result, the buyers of such contracts (who lend the funds) benefited from an increase in the value of their positions and they book profit by selling at a higher price within the T+25/T+36 cycle period and the difference in the price of the two contracts is in actuality the interest paid to defer the payment and was the return for the financier. The ‘borrowers’ of the funds

who participated in the long term contracts also benefitted as the funds were easily available to them without going through the rigorous procedures, which they may have to undergo in case funds are borrowed from banks/NBFC....”

68. With respect to the role of members / brokers at NSEL, **Hon’ble Bombay High Court** in Criminal Bail Application No. 1263 of 2014, in the matter of *Jignesh Prakash Shah Vs. The State of Maharashtra* vide order dated August 22, 2014 observed the following:

“

10. Indeed, it appears that the NSEL deviated from its business model. It also appears there had been no actual physical delivery of commodities, and bogus warehouse receipts were issued. NSEL was actually supposed to trade in commodities, but instead of doing that, it permitted bogus transactions of trading to be introduced and resultantly, in effect, permitted financial transactions of lending and borrowing.

.....

15. What, however, is significant is that though these illegalities or this ‘fictitious trading’ is sought to be highlighted as material against the applicant, the real grievance of the First Informant – and even of the other investors – is not with respect to the fact that such fictitious trading was taking place. Their grievance is that their money has been lost. A big uproar has been created by them, and for showing the magnitude of the alleged offences, it is termed as a ‘scam of about Rs. 5600 crores’. In this connection, certain basic aspects of the matter cannot be lost sight of. The persons whose monies are lost, including the First Informant, are apparently, not the genuine trades for whom NSEL was supposed to provide a platform. The very fact that these persons are, as also the Investigation Agency is, freely using the terms as the ‘investors’, ‘borrowers’, indicates that the transaction in question were not genuine transactions of sale or purchase was well known to the so-called buyers also, who now choose to describe themselves as ‘investors’. It is clear that from their point of view, it was only an investment yielding high returns for their money. These investors are not middle class or lower class people, but are themselves businessmen. The transactions in question were being entered through brokers who had knowledge of the commercial market. Going by the broad probabilities of the case, it cannot be accepted that the persons who are now crying foul, were not aware of the fact that their transactions were not genuine. They were looking at these transactions clearly as an investment of their monies yielding safe returns. Their

estimate or belief about the safety of the transactions has been proved to be wrong, and that is the reason for the uproar which is now being made by pointing out the illegalities in the transactions undertaken by NSEL. Undoubtedly, these wrongs appear to have taken place, and undoubtedly, it cannot be suggested that those who permitted such fictitious trading have not committed serious offences, still, the fact remains that the persons who are raising the grievance about such fictitious tradings were themselves not genuine traders, and had entered into the transactions purely as financial investments. There is every reason to believe that a sizable number of so-called 'investors' whose transactions were being entered into through brokers actually did not bother about the fictitious trades, and knowingly participated in such illegal activities, without raising any issue of illegality thereof.

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

.....

18. Though the case has been projected as a 'scam of Rs. 5600 crores', it needs to be kept in mind that these amounts have not been received by NSEL. As already observed, it is difficult to accept that the brokers and / or their clients for whom they were working were 'deceived' by the NSEL inasmuch as in all probability, the brokers and the investors were well aware that they were not entering into a genuine sale and purchase contract. When there is a clear and obvious possibility that these persons knew about the transactions, the 'deception' if any, caused to them cannot be said to have been caused by the nature of the transactions and, at the most, they can be said to have been misled by a propaganda that 'investing' money in those transactions, was safe. The money invested has not come to NSEL, but has gone to the borrowers i.e. bogus sellers. It is the borrowers who have been befitted by the transactions and the money of 'investors' has

gone to them. The names of 25 different companies who are the defaulters have been mentioned in the FIR itself. Thus, though projected a 'scam of Rs. 5600', the ill-gotten amount has not gone to the applicant, or for that matter, to NSEL. In fact, it is not the case of anyone.

19. The picture that emerges is as follows. Indeed, illegal and bogus transactions of sale and purchase were shown as having taken place. This has been possible because the NSEL did not stick to its business model. Instead of providing a platform for genuine buyers and trader, this platform was permitted to be used – and actually used by businessmen who wanted safe investments for their money. These investments were made through brokers who were well experienced with the working of the market. To show bogus sales, bogus documents were created by the bogus sellers/brokers, and this has been possible with the connivance of the officers and directors of NSEL. Though the applicants contention that the was not aware of the illegalities, or that he being a Non-Executed Director of NSEL was not concerned with the illegal activities, cannot be accepted, it is also clear that, that the transactions were not genuine, was in all probability, known to the 'investors' at least to a great number of them – and in any case, certainly known to the brokers who were entering into the contracts for their customers -investors. This fact is obvious to the investigating Agency also, inasmuch the buyers and sellers are freely described as 'investors' and 'borrowers'. The NSEL, by its improper and wrong working, did provide an opportunity for the unscrupulous 'borrowers' to have huge funds for themselves. However, in the zeal of opposing the applicant's application for bail, it is, perhaps, conveniently ignored that the funds had not come to NSEL, but had gone to such borrowers. Though a number of contentions showing his complicity in the whole matter are raised, on a careful consideration and scrutiny of the matter, the only real allegation against the applicant is that he allowed NSEL to violate the rules and regulations, and its own business model which enabled the 'borrowers' to dupe the 'investors'.

.....”

Observations by various courts/authorities regarding NSEL and paired contracts and findings related to them are as under:

69. In continuation of the above, the observations made by FMC in its order No. 4/5/2013-MKT-I/B dated December 17, 2013 (hereinafter referred to as “**FMC Order**”) are *inter alia* as under:

“

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

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

70. The observations made by the Ministry of Finance, Department of Economic Affairs (“**DEA**”) vide letter dated December 30, 2014 (hereinafter referred to as “**DEA letter**”) are as under:

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

making it liable for appropriate action including penal action under section 21 of FCRA.....”

71. The observations of **Hon’ble Bombay High Court** in Writ Petition No. 2743 of 2014 in the matter of 63, *Moons Technologies Limited Vs. The Union of India* vide Order dated December 04, 2017(hereinafter referred to as “Writ Petition No. 2743 of 2014”) are *inter alia* as under:

“

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

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

.....

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

any regulatory checks which would, but for the exemption notification dated 5th June 2007 have applied to such operations.

.....

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

.....”

72. The observations made by SFIO in its investigation report, while discussing the “Concept of Paired Contract” (hereinafter referred to as “**SFIO Report**”) are *inter alia* as under:

“....In allowing such a mechanism, the BoD and Management of NSEL knew that the scheme put in place was patently illegal and would result in violation of the terms and conditions under which it was allowed to trade, that these paired contracts were not in the nature of spot trades and that the two essential conditions in the exemption condition not allowing short sales and delivery against all open conditions at the end of the day would be violated....”

73. I now proceed to examine whether the aforesaid observations in FMC order, DEA letter, Writ Petition No. 2743 of 2014 and SFIO Report are relevant considerations against the Noticee to determine its fitness for acting as a commodity derivative broker.

74. I find that various Courts / Competent Authorities have made adverse observations that there was trading in paired contracts on the NSEL exchange, which were in reality nothing but financing transactions and such contracts were in breach of the exemption conditions of the

GOI notification dated June 05, 2007 and consequently the FCRA itself. As discussed earlier, on the basis of SAT orders which were confirmed by Hon'ble Supreme Court, given the serious nature of observations, even though the adverse observations have not reached finality, SEBI is fully justified in taking into consideration the same in determining Fit and Proper status of the Noticee and would be sufficient for the same, if found relevant. These observations are adverse in nature since they indicate that NSEL which was required to perform its operations within the conditions of exemption has failed to do so. Instead these observations state that NSEL has indulged in financing transactions. Since NSEL is observed to have misused the exchange platform for purposes other than for which permission was granted, these observations are seriously adverse in nature. In view of the gravity of the adverse nature of the observations, the same would be sufficient to determine the fit and proper status of the Noticee.

75. From the submissions of the Noticee, I note that the Noticee had not disputed the existence of such adverse observations made by various Courts / Authorities qua NSEL and paired contracts. Thus, I am of the view that the aforesaid adverse observations qua NSEL and paired contracts exist. Thus, such adverse observations made by various Courts / Competent Authorities had seriously impacted the reputation and belief in competence, fairness, honesty, integrity of NSEL and paired contracts.

76. In view of the parameters already mentioned in previous paragraph 60.3 I now proceed to examine whether there exists any close association or even prima facie evidence of a close association of the Noticee with NSEL and paired contracts whose reputation has been seriously eroded.

77. As per the Noticee, it, as a broker had only entered into the so-called paired contracts on behalf of its clients in accordance with the Bye laws/ Business Rules of NSEL. Noticee contented it had not no role in launching of such contracts.

78. From the submissions of the Noticee, I note that Noticee admitted that it had facilitated trading on NSEL by providing the required infrastructure and services to its clients, the role of the Noticee was limited to facilitate the investors to trade on the platform of NSEL and

Noticee was only a facilitator of trades and was placing the orders on NSEL as per the instruction of the clients. I note that for the clients, the face of the NSEL and the paired contracts was the Noticee itself and the paired contracts could not have been executed in such large volumes, across the large number of clients without the actions and facilitation of the broker. In my view this facilitation is sufficient to establish the close association of the Noticee with NSEL and paired contracts. Hence, I am of the view that Noticee is closely associated with NSEL and paired contracts.

79. As already established, the reputation of the NSEL and paired contracts has been seriously impacted by the adverse observations of various Courts and Authorities. Thus, by virtue of the close association of the Noticee with NSEL and paired contracts, I find that, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has, in turn, been seriously eroded.

80. Even though, facilitation as broker itself would be sufficient for sustaining a finding on erosion of reputation, I note that, Noticee has also admitted the following:

80.1. That it has made presentations and representations to its clients by way of replicas of PPTs and presentations made by NSEL.

80.2. That various brochures/pamphlets/presentations on NSEL Products were provided by NSEL through their systems, website and emails to the brokers and clients from time to time and Noticee as a broker of NSEL had forwarded the same to its Clients.

80.3. That it tried to explain the product introduced by NSEL to the investors.

80.4. That NSEL had circulated and forwarded to the brokers and public, various presentations on NSEL products including the methodology of returns / calculations / other features etc., which in turn were circulated by the Noticee to its Clients along with its disclaimers and risk disclosures.

All the above, clearly demonstrate an association of the Noticee with NSEL and the paired contracts that goes well beyond transacting on behalf of brokers on behalf of its clients. In essence, Noticee allowed itself to **become the channel or instrument of NSEL** in promotion of paired contracts amongst its clients. Hence, I am of the view that the Noticee is even more closely associated with NSEL and paired contracts.

81. However, the Noticee has contested that these observations are not against the Noticee. In response to the DEA letter, the Noticee stated that in the DEA letter, GOI has not made any adverse finding or recommendation for action against the Noticee or brokers in general. In respect of the FMC order, Noticee contented that FMC order only established findings and ordered that the NSEL / its management and its promoter Mr. Jignesh Shah and borrower, defaulting clients were responsible for the various violation and default by NSEL in releasing the payout to the clients for the debacle / default by NSEL and borrowers (“defaulter clients”) which has brought the crisis. In respect of observations in Writ Petition No. 2743 of 2014, Noticee contented that the observations are clearly against FTIL and NSEL and their responsibility in offering paired contracts on its exchange platform and there is no adverse observations against it. The Noticee also submitted that it is not even a party to this Writ Petition. In respect of SFIO observation regarding ‘Concept of Paired Contract’, Noticee contented that the observations are restricted to the failure/default of the Board and management of NSEL and there are no adverse observations as against the brokers in general or the Noticee in particular.

82. Even though it is already established that the Noticee was closely associated with NSEL and paired contracts, in view of the submissions of the Noticee that the observations made by courts/ competent authorities are not against them, I proceed to examine whether the observations made by the Courts / Competent Authorities are relatable to or against the Noticee. I find from the observations of the FMC order, that “....investors simultaneously entered into a ‘short term buy contract’ (e.g. $T + 2$ – i.e. 2 day settlement) and a ‘long term sell contract’ (e.g. $T + 25$ – i.e. 25 day settlement). The contracts were taken by the same parties at a pre-determined price and always registering a profit on the long-term positions. Thus, there existed a financing business where a fixed rate of return was guaranteed on investing in certain products on the NSEL...”. It goes without saying, the adverse observations of the FMC capture both sides of the transactions; one side which is attracted to the fixed returns for their investment and the other side which receives such investments. Therefore, it is incorrect to state that the observations of FMC are not in respect of brokers such as Noticee who are on the side of the contract to invest for fixed returns. Further, FMC observations are in respect of ‘short term buy contract’ and ‘long term sell contract’ as captioned by FMC. Similarly, the observations of the DEA are in respect of the same

contracts when it observed that the conditions of the exemption have been violated by NSEL. Similar is the case with the observations of SFIO on paired contracts when it observed that paired contracts were not in the nature of spot trades and were violative of exemption conditions. It is not the case of the Noticee that it has not entered into such contracts on behalf of its clients at all. It has always been the position of the Noticee that he has been a broker to such kinds of contracts. The observation of FMC is that such contracts *violated the very concept of spot market of commodities and the transactions ultimately were in the nature of financial transactions*. Hon'ble Bombay High Court in Writ Petition No. 2743 of 2014 has also made observations that *"The very offer of T+18, T+25 or T+36 contracts by NSEL prima facie constituted breach of the condition that the exemption from applicability of FCRA was only in respect of contracts of one day's duration"*. These observations are directly relatable to paired contracts and the Noticee is directly related to paired contracts, thus, the observations are **factually relatable to the Noticee**.

83. Further, such observations relating to paired contracts by the Courts / Competent Authorities are similar to declarative statements in nature, as the observations in effect declare that the paired contracts constituted breach of the exemption conditions of GOI Notification from applicability of FCRA and violated the very concept of spot market of commodities. Such observations are **in the nature of "in rem" observations**. In this regard the observations made by Hon'ble Madras High court in *C.L. Pasupathy v. Engineer in Chief (WRO) (2009) 2 MLJ 491*, explaining the distinction between *judgment-in-rem* and *judgment-in-persona* are of relevance.

"27. Historically the term judgement "in rem" was used in Roman law in connection with actio but not in connection with "jus actio in personam". The effect of "actio in rem" was to conclude against all mankind, but the effect of "actio in personam" was to conclude with regard to the individual only. After the Roman forms of procedure had passed away, the term "in rem" survived to express the effect of an action "in rem" and gradually, it came to import "generally".

28. The judgements "in rem" signified as judgements which are good against all mankind and "judgements in personam" signified the judgements which are good

only against the individuals who are parties to them and their privies. The point adjudicated upon in a "judgement in rem" is always as to the status of the "res" and is conclusive against the world as to that status, whereas in a judgement "in personam", the point whatever it may be, which is adjudicated upon, not being as to the status of the "res" is conclusive only between the parties or privies. Reference can be made to Firm of Radhakrishnan Vs. Gangabai, 1928 S 121, Ballantyne vs. Mackinson 1896 2 QB 455.

29. Courts have held that, "Judgement in rem", operates on a thing or status rather than against the person and binds all persons to the extent of their interest in the thing, whether or not they were parties to the proceedings. The judgement "in rem", as distinguished from judgement "in personam" is an adjudication of some particular thing or subject matter, which is the subject of controversy, by a competent Tribunal, and having the binding effect of all persons having interests, whether or not joined as parties to the proceedings, in so far as their interests in the "res" are concerned. In determining whether a judgement is "in rem", the effect of the judgement is to be considered and it is tested by matters of substance, rather than by measure of any particular draft or form.

.....Thus with respect to the "res or status", a "judgement in rem" has to be conclusive and binding upon "all the world" that is, on all the persons, who may have or claim any right or interest in the subject matter of litigation, whether or not, they were parties to or participants in the action, atleast to the extent, that it adjudicates or establishes a status, title or res, constituting the subject matter of the action..”

84. This would assume significance, whether any of the adverse observations are in respect of any “res” in Writ Petition No. 2743 of 2014 or in the FMC order. One of the subject matters of controversy, being “res” in those proceedings, either on prima facie or on final basis, was whether the paired contracts are in violation of exemption conditions of Government Notification dated June 05, 2007. It is my considered view that such observations in FMC order and in Writ Petition No. 2743 of 2014 on the status of the “res” is binding on non-parities as well. The observation that the paired contracts are in violation of exemption conditions of Government Notification dated June 05, 2007 are binding on the Noticee who has an interest in the subject matter i.e., paired contracts, in this case, as broker for the same.

It is also admitted by the Noticee that it has facilitated transactions in such paired contracts. Therefore, the contention that the Noticee was not a party in those proceedings and hence such observations do not bind it, has no merit. The fact that the Noticee did not play a role in launching such contracts also has no relevance to this proceedings as what is material is the interest in such contracts, of the Noticee by virtue of its role as a broker. Since the observations are in the nature of “in rem” observations, they are binding on the Noticee also.

85. In respect of the SFIO Report, the Noticee contented that the contents of the SFIO report are strongly contested by it before the appropriate authorities and competent courts. Noticee also disputed the contents and observations made in the SFIO Reports as extracted in the second SCN. Noticee has contended that charges are not yet proved and no final determination by the competent court is rendered in respect of the observations of the SFIO Report and unsubstantiated SFIO observations cannot be relied upon by SEBI without verification of the same by SEBI. It further contented till date no charge sheet in this regard is received by the Noticee.

86. Regarding the contention of the Noticee in respect of SFIO Report, I note that the basis of contention of the Noticee is that they strongly contest the observations made in SFIO report and that these are only prima facie in nature and since no competent court has determined on the charges, no finality has been attained on the findings. In this regard, as the point of law already noted in *Jermyn Capital LLC vs. SEBI* and *Mukesh Babu Securities Limited vs. SEBI & others*, as confirmed by the Hon’ble Supreme Court, is that prima facie findings in this regard would be legally valid for the purpose of consideration of fit and proper criteria of the Noticee. The enquiry by SEBI is in respect of whether the Investigation Report of SFIO renders serious findings affecting the reputation of the Noticee or not. The fact that the observations of the SFIO Report are subject to final determination before a competent authority is not material to these proceedings of assessment of reputation and therefore, fitness of the Noticee.

87. In this context, I note that the Noticee has sought the cross-examination of SFIO investigating officer and the clients of the Noticee referred in the SFIO investigation report. The SFIO also

has recorded the statement of the some clients of the Noticee during the course of the Investigation. The contents of the complaints are denied by the Noticee. It may be noted that what is relevant in the current proceedings is the fact that SFIO has conducted investigation and rendered its findings/observations. The findings of SFIO investigation would be established in the competent courts. The fact that such findings are yet to be established does not come in the way of SEBI exercising its responsibility. SEBI has been conferred the responsibility of determining whether in view of the existence of SFIO report and its adverse observations on paired contracts reproduced in paragraph 72, the Noticee has become a unfit person to be commodity derivative broker. As determined in previous paragraphs, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has been seriously eroded and thus, the fit and proper status of the Noticee, is affected by virtue of adverse observation by SFIO on the paired contracts with which the Noticee is closely associated. As noted earlier, the fact that the contested allegations are yet to be determined by the Competent Court is not a relevant consideration for assessing the fit and proper criteria of the Noticee. Cross examination is meant for assisting the courts in final determination of facts which are yet to be established. Since such determination is not relevant for assessment of fit and proper criteria, the question of cross examination does not arise. In any event the contents of the complaints/survey as such are not relied upon in the present proceedings. In view of the aforesaid discussion, the request for cross examination is accordingly disposed off.

Observations regarding MPID violations and findings related to them:

88. Over and above, the determination made so far, I proceed to determine whether the observations made by Hon'ble Bombay High Court in Writ Petition No. 1403 of 2015 in the matter of *National Spot Exchange Limited Vs. State of Maharashtra* vide Order dated October 01, 2015(hereinafter referred to as Writ Petition No. 1403 of 2015) in respect of invocation of MPID Act by the Investigating Agency is independently relevant and sufficient for consideration of whether or not the Noticee is a fit and proper person. The observations made by the Hon'ble High Court are *inter alia* as under:

“

10. The material collected by the EoW during the course of the investigation reveals that the Petitioner did not carry out its operations as per the bye-laws and permission granted to it by the Government of India. From the statements recorded by the Investigating Agency, copies of which were placed before us for our perusal, it would prima facie reveal that the Petitioner represented to the Traders / Suppliers of the goods that they would be provided security free loan. The Petitioner had assured its clients fixed returns @ 14% to 16% pa. A copy of the brochure published by the Petitioner -Exchange gives an assurance to its clients that if they enter into contract of T+2 and T+25, they would get returns in the range of 14% to 16% pa. The record indicates that the Petitioner convinced its clients that since the actual possession of the commodities will be kept in the accredited warehouses under its control, this will enable its members to trade on its platform without there being actual physical stock. The statements of various investors recorded during the investigation shows that the Petitioner had assured them a fixed returns of 14% to 16% on their investments. The statements recorded by the Agency prima facie also indicates that the Petitioner represented to them that it would provide security free loan. The record placed before us further reveals that transaction of the Petitioner and the traders / suppliers of the goods are not fully supported by the actual delivery of goods. In many cases, the accounts of the Petitioner and the suppliers of the goods are not tallying with each other due to bogus entries. The physical delivery of the commodities has not been verified and there has been no control over the stock lying in the ware-houses. The record further indicates that there are many accommodation entries which resulted into financial mishap due to collusion between the Petitioner and its selling trading members.

11. Section 3 of the MPID Act defines the offence, identifies the person liable and prescribes the penalty. Section imposes a penalty for fraudulent non-payment of the deposit along with benefit by the financial establishment. Section 2(d) defines the term "financial establishment" means any person accepting any deposit under any scheme or arrangement or in any other manner. Section 2(c) defines the terms "deposit". The definition is inclusive. The inclusive definition when used enlarges the meaning of the expression defined so as to comprehend not only such things as they signify according to their natural merit but also those things which the interpretation clause declares

that they shall include. The terms "deposit" defined under clause (c) of section 2 includes any receipt of money or acceptance of any valuable commodity by any financial establishment to be returned after specified period of otherwise, either in cash or kind or in the form of specified services with or without any benefit in the form of interest, bonus, profit or any other form. In the present case, **the provisions of MPID Act are invoked as the Petitioner assured its clients** if they invest in T+2 and T+25 schemes they would get assured returns of 14 to 16% pa. Hence the said receipt of money, in our *prima facie* view fall within the definition of "deposit"....."

89. As before, in respect of the observations of the Hon'ble Bombay High Court also, the Noticee contended that the Noticee was neither a party to the said proceedings nor the order passed was against the Noticee. Further, the observations, particularly made in Paragraph 10 of the Order of the Hon'ble Bombay High Court are about NSEL and its collusion with the Selling Trading Members, i.e. NSEL and the Defaulting Members. It was contended that the Noticee is a Non-Defaulting member and there are no observations whatsoever against the Noticee in this Order. Therefore, the observations in this Order are of no relevance to the Noticee. In any event these observations as recorded by the Hon'ble Court itself are *prima facie* in nature.

90. I have already observed the relevance of *prima facie* findings for the consideration of the fit and proper criteria in line with the judgments rendered in *Jermyn Capital LLC vs. SEBI* and *Mukesh Babu Securities Limited vs. SEBI & others* as confirmed by the Hon'ble Supreme Court. On perusal of paragraph 10 of the judgment of the Hon'ble Bombay High Court, I note that the observations made are equally applicable to the clients, (and therefore their brokers) who were given assurance of fixed returns @ 14% to 16% pa. At paragraph 11 of the judgment it is further observed that the MPID Act is invoked as there is an assurance to the clients that if they invest in T+2 and T+25 Scheme, they would get assured returns. It goes without saying, the observations of the Hon'ble High Court capture both sides of the transactions; one side which is attracted with the fixed returns for their investment and the other side which receives such investment. Therefore, it is incorrect to state that the observations of the Hon'ble High Court are not in respect of the Noticee as these observations are factually relatable to the Noticee as already discussed in paragraph 82 of this order. The fact that a serious charge of MPID Act violation has been levelled against NSEL in respect

of the paired contracts seriously erodes the reputation and belief in competence, fairness, honesty and integrity of the NSEL and paired contracts. In view of the close association of the Noticee with NSEL and paired contracts as outlined earlier, and the factual relatability of the Hon'ble High Court's observations to the Noticee, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has been seriously eroded on this basis as well.

91. As brought out in preceding paragraphs, the adverse observations of Courts and Competent Authorities, even if some of them are *prima facie* qua NSEL and paired contracts, combined with the close association of the Noticee with NSEL and the said paired contracts, seriously affects, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee and are thus sufficient for determining that the Noticee is not a fit and proper person. Therefore, the question of determination of other allegations of violations of various provisions of law, does not arise in this case to determine the fit and proper status of the Noticee.

Summary:

92. In summary, I note the following :

- 92.1. Various Courts and Authorities in the country have made serious adverse observations against NSEL and Paired Contracts, observing the transactions to be violative of the FCRA and to be in the nature of financing transactions that were violative of MPID Act.
- 92.2. Even though these observations are yet to be established in a court of law, SEBI is justified in considering them when assessing the reputation of the parties concerned for the purpose of determining their fit and proper status since it is mandated with investor protection and in that context, it is justified in keeping a person with doubtful reputation out from the market rather than running the risk of allowing the market to be affected. The SAT order laying down this position of law, in the matter of *Mukesh Babu vs. Sebi* was confirmed by the Honorable Supreme Court in second appeal.
- 92.3. The Noticee, by virtue of being a broker, and by its own admission, has facilitated transactions in the said Paired Contracts for its clients on the NSEL platform. This in itself establishes a close association between the Noticee on the one hand and Paired Contracts and NSEL on the other. Over and above this, the Noticee, by its

own admission, allowed itself to become a channel and instrument for NSEL to promote Paired Contracts amongst its clients.

- 92.4. Given the close association of the Noticee to NSEL and the Paired Contracts, and the relatability of the same to the Noticee, the serious adverse observations of the various Courts and Authorities have, in turn, seriously eroded the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee. The SAT order laying down this position of law as to reputation being linked to close associations in the matter of *Jermyn vs Sebi* was confirmed by the Honorable Supreme Court in second appeal.
- 92.5. Reputation is an important factor for consideration of Fit and Proper Criteria and the reputation of the Noticee has been seriously eroded. Thus, I find that the Noticee is not a fit and proper person to be granted registration/ to operate as a commodity derivatives broker.

ORDER:

93. Thus, I, in exercise of the powers conferred upon me under Regulation 28 of Securities and Exchange Board of India (Intermediaries) Regulations, 2008 read with regulation 7(1) of Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992, in the interest of investors and to protect the integrity of the securities market, declare that the Noticee is not a fit and proper person to hold, directly or indirectly, the certificate of registration as commodity derivatives broker, and hereby, reject the application dated December 23, 2015 filed by India Infoline Commodities Limited for registration as commodity derivatives broker. The Noticee shall cease to act, directly or indirectly, as a commodity derivatives broker.
94. In case of any existing clients of the Noticee as Commodity Derivatives Broker, the Noticee shall allow such clients to withdraw or transfer their securities or funds held in its custody or withdraw any assignment given to it, without any additional cost to such clients within 45 days from the date of this order. In case of failure of any clients to withdraw or transfer their securities or funds within 45 days from the date of this order, the Noticee shall transfer its balance clients with their corresponding securities and funds to another person, holding a valid certificate of registration to carry on such activity, within a further period of 30 days. Such person should not be directly or indirectly related to the Noticee.

95. The order shall come into force with immediate effect.

96. A copy of this order shall be served on the Noticee and upon all recognized Stock Exchanges and Depositories.

-Sd-

Date: FEBRUARY 22, 2019

MADHABI PURI BUCH

Place: MUMBAI

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA