

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.	Phillip Commodities India Pvt. Ltd. (Formerly known as “MF Global SIFY Securities India Ltd.”)	AACCR6675H

In Re: Fit and Proper Criteria

BACKGROUND OF THE CASE:

1. Phillip Commodities India Pvt. Ltd. (Formerly known as “MF Global SIFY Securities India Ltd.”) (hereinafter referred to as “PC IPL” / “Phillip” / “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”), National Commodity & Derivatives Exchange Limited (hereinafter referred to as “NCDEX”), Indian Energy Exchange Limited (hereinafter referred to as “IEX”) and NCDEX e-Markets Limited (formerly known as NCDEX Spot Exchange-NSPOT) (hereinafter referred to as “NeML”).
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, PCIPL had made an application to SEBI for registration as a commodity derivatives broker received on December 16, 2015.
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 J. Singh & Associates, Chartered Accountant (hereinafter referred to as “**Auditor**”) to carry out a performance audit/inspection of PCIPL.

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 PCIPL 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 PCIPL. 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 PCIPL submitted for registration as a commodity broker may not be considered in the interest of securities market and the application of PCIPL 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 PCIPL including the violation of the Government of India (GOI) 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 PCIPL 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 PCIPL wherein PCIPL was advised to reply to the SCN within 21 days from the date of receipt of said notice. PCIPL vide letter dated May 11, 2017 had acknowledged the receipt of SCN. The allegations *inter alia* as specified / mentioned 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 / misleading representation in respect of assured / risk free return, arbitrage opportunity in spot market by way of pair contracts 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 repeatedly failed to collect margins across exchanges which is in violation of MCX, NCDEX circulars.

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. The Noticee vide various letters/emails dated May 11, 2017, June 23, 2017, September 15, 2017, September 18, 2017, November 20, 2017, January 07, 2018 and January 22, 2018 etc. had sought inspection of documents as well as copies of documents and submitted that SEBI

has not provided complete inspection of all relevant documents to them. However, SEBI submitted that it had granted inspection to the Noticee on June 20, 2017 and copies of all relied upon documents were also provided to PCIPL by SEBI through various letters dated August 28, 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 February 06, 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 June 06, 2018 was passed on the issue of inspection and the proceedings related to inspection was closed. The said order dated June 06, 2018 was delivered to Noticee through email and speed post.

REPLY AND HEARING ON MERIT OF THE CASE:

14. In the interest of natural justice, vide order dated June 06, 2018, Noticee was given an opportunity to appear for a personal hearing on merits on July 12, 2018 at SEBI, Head Office, Mumbai.
15. PCIPL vide letter dated June 27, 2018 had filed an application with SEBI for withdrawal of the application for registration made by them vide applications received by SEBI on December 16, 2015. SEBI vide letter dated July 09, 2018 had informed PCIPL 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.

16. Aggrieved by SEBI's letter dated July 09, 2018, PCIPL filed an appeal before Hon'ble Securities Appellate Tribunal (hereinafter referred to as "SAT") challenging the said letter dated July 09, 2018.
17. In the interest of natural justice, and in view of the SEBI's letter dated July 09, 2018, SEBI vide email dated July 12, 2018 had re-scheduled the hearing on merits to July 18, 2018 at SEBI, Head Office, Mumbai
18. Hon'ble SAT vide order dated July 17, 2018 stated *inter alia* that "*..Accordingly, in that proceeding WTM of SEBI is scheduled to hear the appellant on July 18, 2018. Since the enquiry proceedings have been initiated under SEBI (Intermediaries) Regulations, 2008 and the scheduled date of hearing is imminent I find no reason to interfere with those proceedings at this stage. However, the WTM of SEBI shall also consider the fact that the appellant has surrendered its membership of MCX and NCDEX and also sought to withdraw its application for registration with SEBI...*"
19. On July 18, 2018, Mr. Pesi Modi, Senior Counsel and Mr. Neville Lashkari, Advocate along with Mr. Sandeep Gupta, Mr. Rajendra Bhambhani and Mr. Nikunj Modi from PCIPL, Authorized Representatives (hereinafter referred to as "ARs") of PCIPL appeared for the hearing. Following *inter alia* was noted during the hearing:
- ".....
- 3) The ARs *inter alia*, submitted the following:
- (i) SEBI passed an Order dated June 06, 2018 in respect of inspection of documents sought by the Noticee.
 - (ii) The Noticee is a part of multinational group which has spread across 17 countries viz., U.S.A., U.K., Japan, China, Hong Kong, U.A.E., etc.
 - (iii) In case of an order against us in respect of fit and proper person, it will have worldwide impact. Considering the observations in the order against the Noticee regarding inspection of documents, a considered view has been taken to shut down its business and filed applications for surrender of its memberships with the MCX, NCDEX etc. Further, the Noticee also filed withdrawal of application for registration before SEBI.
 - (iv) In response, SEBI vide letter dated July 09, 2018 replied that since these quasi-judicial proceedings are pending, the request for withdrawal of application for

registration cannot be entertained at this stage. Being aggrieved, the Noticee filed an appeal before the Hon'ble SAT. The Hon'ble SAT held that the application for withdrawal shall be considered by the WTM.

- 4) The Noticee made its submissions at length against the said rejection. The undersigned explained to the ARs of PCIPL that the consideration of withdrawal of application for registration is within the purview of administrative Member of SEBI and that is independent of the present quasi-judicial proceedings. Hence, the Noticee is advised to pursue the same before the Administrative WTM.*
- 5) The undersigned noted the Hon'ble SAT direction to consider the fact of withdrawal application, and the same is noted. Accordingly, the quasi-judicial proceedings will continue.*
- 6) Since the withdrawal is not entertained, the Noticee sought two to three weeks' time to file reply on merits and the same is granted.*
- 7) The matter is adjourned for hearing on merits on **August 02, 2018** at 10.30 am.*
.....”

20. Noticee vide email dated July 30, 2018 had requested for adjournment of personal hearing scheduled on August 02, 2018. In the interest of Natural Justice and acceding to the request of the Noticee, SEBI vide email August 01, 2018 had re-scheduled the hearing on August 09, 2018 at SEBI, Head office, Mumbai.

21. Noticee submitted its detailed reply dated August 01, 2018 on merits to the SCN.

22. On August 09, 2018, Mr. Pesi Modi, Senior Counsel and Mr. Neville Lashkari, Advocate along with Mr. Sandeep Gupta, Mr. Rajendra Bhambhani and Mr. Nikunj Modi from PCIPL, **ARs** of PCIPL 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 reiterate and made the oral submissions in line with reply dated August 01, 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.

..... ”

23. In the interest of natural justice, SEBI vide email dated October 01, 2018, had scheduled another hearing on merits to October 11, 2018 at SEBI, Head Office, Mumbai

24. On October 11, 2018, Mr. Pesi Modi, Senior Counsel and Mr. Neville Lashkari, Advocate along with Mr. Sandeep Gupta, Mr. Rajendra Bhambhani and Mr. Nikunj Modi from PCIPL, **ARs** of PCIPL 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 reiterate the oral submissions made during the hearing held on August 09, 2018 and further reiterate and made the oral submissions in line with reply dated August 01, 2018.

*(b) The matter is part heard and another hearing in the matter is scheduled on **October 30, 2018** at 10:30 A.M. at Head Office, Mumbai.*

..... ”

25. On October 30, 2018, Mr. Pesi Modi, Senior Counsel and Mr. Neville Lashkari, Advocate along with Mr. Sandeep Gupta, Mr. Rajendra Bhambhani and Mr. Nikunj Modi from PCIPL, **ARs** of PCIPL 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:

“

(c) ARs reiterate the oral submissions made during the hearing held on August 09, 2018 and October 11, 2018 and further reiterate and made the oral submissions in line with reply dated August 01, 2018.

(d) ARs granted time till 1st week of December 2018 to submit the replies of the queries asked during the hearing held on August 09, 2018 alongwith additional written submissions in the matter, if any.

.....”

26. During the course of hearing dated October 30, 2018, Noticee offered to submit a summarized version of its detailed reply dated August 01, 2018. Therefore, the Noticee vide letter dated December 12, 2018 had submitted its short written submission which summarized their submissions / arguments. The summarized written submissions of the Noticee in brief are as under:

26.1. Jurisdiction:

26.1.1. Noticee’s application to withdraw its application for SEBI registration was rejected by SEBI. Aggrieved by the same, the Noticee filed an appeal before the Hon’ble SAT, and by an Order dated 17.7.2018, the Hon’ble SAT inter alia held that :-

“...the WTM of SEBI shall also consider the fact that the appellant has surrendered its membership of MCX and NCDEX and also sought to withdraw its application for registration with SEBI.”.

26.1.2. Therefore, it is submitted that considering “the fact” that the Noticee has withdrawn the application for SEBI registration, the entire question of deciding whether the Noticee is “fit and proper” to grant registration becomes totally irrelevant and an exercise in futility.

26.1.3. The entire commencement of the present proceedings was misconceived and faulty. The Order commencing the present proceedings stated therein that SEBI had appointed Auditors to investigate and make a Report because the Noticee was named in the EOW Report. Even at a meeting with the Ministry of Finance on 19.7.2016, SEBI stated that it had conducted an inspection of 5 brokers only on the basis that their names were in the EOW Report. From a perusal of the EOW Report, it now turns out that the Noticee name is not even mentioned in the EOW report and there is not a single allegation against the Noticee therein. Therefore, the alleged reasons and justification for even commencing the proceedings against the Noticee were false, baseless and fictional.

26.1.4. On 11.2.2016, at a Review Meeting of the Special Team Of Secretaries which was set up to examine violations by NSEL, SEBI was directed to take action against defaulting brokers. However, as far as the Noticee is aware, no action has

been taken by SEBI against the defaulter brokers and no money has been recovered from them by SEBI. Instead, the present proceedings are being relentlessly pursued against the Noticee, even though admittedly the Noticee is not a defaulter, no client of the Noticee is a defaulter, and as recorded in the EOW Report and in SEBI's Forensic Auditors Report.

26.1.5. NSEL's purported complaint (NSEL letter dated 24.3.2015, alleges that there was a complaint by one of the Noticee's clients i.e. Mr. Ketan Shah) about an investor alleged complaint against the Noticee could never have justified commencing the present proceedings. Further, despite this stand of SEBI that it will not even deal with NSEL investor grievances, the Enquiry Report makes extensive allegations about this one investor's purported complaints against the Noticee, that too despite the fact that the SEBI appointed Forensic Auditor has expressly held that they are all baseless.

26.2. **Discrimination:**

26.2.1. The present proceedings were initiated only against 5 brokers, even though the exact same allegations applied to more than 500 brokers all of whom traded on the NSEL in pair contracts and over 11 day contracts. Yet, SEBI has granted registration to approximately 300 such brokers, thus holding them to be fit and proper for the grant of registration. Thus, other brokers with larger turnovers and outstanding's have been granted registration. While SEBI has now issued about 300 SCN's to such other brokers, they are still continuing to act as registered commodities brokers, whereas the Noticee have applied to withdraw their application, yet, SEBI insists on continuing the present proceedings against the Noticee.

26.2.2. There were more than 800 brokers who were registered members with NSEL. There is discrimination against the Noticee since show cause notices have not been sent to all other member brokers who had even once traded on the NSEL in pair contracts (irrespective of whether they had applied to SEBI for registration as a commodities broker or not).

26.3. **Due Diligence by Noticee on NSEL & its Regulations**

26.3.1. There is no specific SEBI regulation, Bye-laws of NSEL / NSEL circular where broker has to do due diligence on an Exchange or on the contracts that are launched by an Exchange. As a matter of prudence and acting with due skill and care, the Noticee had carried out its normal due diligence and have tendered a detailed note thereon at the hearing.

26.3.2. Neither the FMC nor SEBI nor anyone else has ever alleged that NSEL violated Bye law 4.1. Even the FMC's own detailed Order dated 17.12.2013 makes no allegation that Bye law 4.1 was not complied with. Therefore, the concurrence of the FMC must have been obtained by NSEL, before NSEL permitted the

commencement of trading in any contracts on the NSEL platform. Therefore, all the allegations in the Enquiry Report in this regard, are not at all tenable.

26.3.3. It is pertinent to note that the Hon'ble Bombay High Court in its Order dated 4.12.2017 in Writ Petition No. 2743 of 2014, expressly held that brokers cannot be blamed for trading in pair contracts.

26.3.4. The DCA – GOI, by its letter dated 5.8.2011 to the FMC, informed the FMC that it was nominated as the “Designated Agency” in respect of NSEL for providing oversight and safeguarding the interests of investors, and that FMC had to ensure that the GOI Exemption conditions were being complied with and to take action if there was any breach thereof. Even the Enquiry Report holds that NSEL was under the Regulatory ambit of the GOI and the FMC. It is therefore indisputable that the FMC itself:

- had recommended the exemption conditions;
- used to monitor NSEL's trading;
- carry out stress testing of the risk management framework of NSEL;
- ensure that the conditions stipulated for grant of exemption were complied with; and
- was empowered to take action in case of any breach of the said conditions.

Thus, FMC was acting as the regulator and was aware of trades settled without actual physical delivery. Yet, it never cautioned member brokers or clients about the alleged violation of GOI Notification dated 5.6.2007. It is only because FMC was also not aware of the fraud being committed by NSEL that no orders were passed by FMC until as late as 17.12.2013. Therefore, it is untenable to now allege that the Noticee were aware of the same contemporaneously.

26.4. **GOI Gazette Notification Dated 5.6.2007**

26.4.1. In the ordinary course of business, Exchanges launch various contracts / products. It is not the duty of each broker to independently investigate and assess the legality of the contracts launched. Even if it is now to be held that there was any such violation of the said exemption conditions, only NSEL and its officers can be held liable and not every broker, client, clearing bank, auditor, etc.

26.4.2. Even NCDEX Spot Exchange offered contracts with settlement periods exceeding 11 days. There is discrimination against the Noticee since show cause notices have not been sent to NCDEX spot exchange or any broker of NCDEX Spot Exchange with respect to trades on NCDEX Spot Exchange.

26.4.3. During the relevant period, no Authority, Regulator, or Government cautioned the brokers /clients/ public, that such pair contracts or contracts exceeding 11 days

violated the Exemption conditions. All allegations in the Enquiry Report that any trades were “illegal” are totally untenable.

- An “illegal” trade is void and has to be annulled. Yet, to date, no one has annulled any trades;
- To date, the FMC, the GOI, the Courts and all authorities have taken the stand that all the trades have to be settled and paid, and have not contended that the same are “illegal” or void.
- Neither the Statutory Auditors nor Clearing Banks ever alleged that the trades are “illegal”.

26.4.4. FMC did Inspections of NSEL brokers & data of all trades was regularly furnished by NSEL to FMC on a fortnightly basis. No allegation of any illegality or violation of exemption conditions was raised at the relevant time. It is therefore hardly tenable for SEBI to now contend that it was so obvious that all such trades were “illegal” that all brokers and clients must have been aware of the same.

26.4.5. As regards the allegations of short sale and contracts not backed by delivery, it is submitted that the first leg for all the Noticee’s pair trades was always a “purchase”. Therefore, there is no question of any “short sale”. The Noticee always gave early pay-in against the sale position. In any event, there was no short sale, and title to the goods was transferred. There is no allegation that the Noticee failed to fulfill any of its delivery obligations against any of its contracts.

26.4.6. As regards the allegation of inadequacy of the stocks in the warehouses, it is submitted that allegation does not relate to the Noticee at all. No one has ever alleged that the Noticee failed to deliver any goods. The Noticee is not a defaulter. No auction claim was ever made against the Noticee. Admittedly the Noticee has to recover approx. Rs. 130 crore and no one has disputed the same.

26.4.7. As regards the allegation that the exemption stood automatically withdrawn and the FCRA would apply automatically on breach of Exemption Conditions, it is submitted that the same is not correct since if there was to be any such “automatic” applicability of FCRA, then the NSEL ought to have been automatically shut down 2 years before the Noticee even became a member of the NSEL. No such condition was stipulated in the Exemption Notification dated 5.6.2007 or even in Section 27 of the FCRA.

26.4.8. In fact, since the trading was always open, transparent and to the knowledge of the FMC / DCA and since they permitted the same to go on without any objection or warning for years, the same amounts to a waiver of the alleged breach, if any. In fact, the same also amounts to estoppels as to the correct interpretation of the GoI exemption notification dated 5.6.2007. It is also well settled law that where two interpretations can be given to a statute, the court must lean towards that construction which exempts the subject from a penalty.

- 26.4.9. As stated in FMC order dated 17.12.2013, the fact is that 500 brokers, numerous Clearing Banks were defrauded by NSEL by keeping them in dark about the fraudulent activities of NSEL about rolling over the positions of defaulting brokers and allowing defaulting brokers to take positions without having sufficient commodities in warehouses which was discovered after NSEL default.
- 26.4.10. The Enquiry Report alleges that despite the Government of India's letter dated 12.7.2013, the Noticee continued to trade. Noticee submits that the said letter dated 12.7.2013 was addressed to the NSEL, and was not in the public domain. The same does not contain reference to any paired trades.
- 26.4.11. On 16.7.2013, the NSEL issued a Circular stating that "... *In respect of existing contracts traded on the Exchange, members and their constituents are allowed to participate in trading, subject to other requirement....*". No objection was raised by the GOI or anyone. Consequently, all brokers believed that trading was permitted to continue, and even Government companies such as MMTC and PEC who were NSEL members, continued trading.
- 26.4.12. Even the Hon'ble Bombay High Court by its Order dated 4.12.2017 has confirmed that there was no need for NSEL to suspend its trading as late as on 31.7.2013.
- 26.4.13. As regards to the allegation in the Enquiry Report that Pair trades were "financial transactions, it is submitted that trading on the NSEL was an anonymous blind trading system. The same prices were available to all traders, and there was no "pre -determined price and profit". The Noticee would execute pair trades only if both the short buy and long sell were available on screen at favourable prices. By way of abundant and excessive caution and as part of its due, skill and care, the Noticee had sought clarification from the NSEL as to whether such pair trades would amount to "financial transactions". It can never at this stage be alleged to mean that they were aware that pair trades were financial transactions. FMC got regular Reports from the NSEL but FMC never alleged that pair trades were "financial transactions" at the relevant time while NSEL was still functioning.
- 26.4.14. The allegation that NSEL cannot act as legal counter party to pair trades since the same are allegedly "financial transactions" is also belied and contradicted by the fact that the GOI, FMC, the Courts and all other authorities have held that it is NSEL's obligation to conclude the settlement obligations, that it has to make pay out as per the settlement obligations of all pair trades, and all authorities have been pursuing the same.
- 26.4.15. As regards to the allegation that the Noticee ought to have stopped trading after the DCA SCN dated 27.4.2012 to NSEL was reported in media, it is submitted that the Noticee has submitted a detailed note demonstrating the steps taken for due diligence as prudent brokers after reading the article.
- 26.4.16. No allegation was made against any broker in that article. In any event, on same date i.e. on 3.10.2012, the NSEL on its website, (in the public domain) stated that they had filed a reply to the SCN; that there was no violation; that the NSEL was

in full compliance and that neither the GoI nor the FMC had directed the NSEL to discontinue trading. It may also be noted that at a FSDC Meeting held on 5.11.2012 did not conclude that all brokers had to shut down trading due to the issue of the said SCN or the news article.

26.4.17. Therefore, the allegation and insinuation that the Noticee ought to have stopped trading after the DCA SCN dated 27.4.2012 to NSEL was reported in media and that the failure to do so shows that the Noticee is not “fit and proper” is untenable.

26.5. Submission with reference to 3 PPTs on record.

26.5.1. None of the 3 PPTs on record are of the Noticee. Further, there was no presentation (PPT) shared with Mr. Ketan Shah before the NSEL default. Moreover, email dated 13.12.2012 was relating to advertisement approval sought from NSEL and there was no PPT attached to that email.

26.5.2. As regards, allegation of misleading advertisements by the Noticee, it is submitted that the allegation is based on purported complaints of just one client / investor - Mr. Ketan Shah. Till the default by NSEL on 31.7.2013, even Ketan Shah had no complaints. The Noticee did not allow Mr. Ketan Shah to trade in NSEL after the ET article was published. Even, the SEBI appointed Forensic Auditor has recorded that Mr. Ketan Shah’s complaints are incorrect, baseless, lack credibility and have no substance.

26.5.3. It is not correct to insinuate that sending one SMS to one client (Mr. Ketan Shah) amounts to an “advertisement” or “in the nature of tempting the public at large”.

26.5.4. As regards to forwarding a “Calculation sheet” vide email dated 30.5.2012, it is submitted that the SEBI appointed Forensic Auditors Report correctly held that the calculation sheets were prepared by NSEL and that the Noticee forwarded it in normal course of business and no fault can be attributed to the Noticee. There was a disclaimer in the email sent by Noticee.

26.5.5. As regards, the allegation that the Noticee gave / forwarded links of NSEL website to its clients, it is submitted that only forwarding links to the NSEL website to the clients amounts to only telling clients that there is a website of NSEL in the public domain, and can never amount to any wrong doing. In fact, the Noticee was mandated to comply with the Bye laws of the NSEL, 14.1.3 and 14.1.5 which requires Noticee to inform its clients about all relevant information. Moreover, the allegation that there was false information on the NSEL website is vague, bald and in any event cannot amount to any wrong doing by the Noticee.

26.5.6. The Enquiry Report alleges that by an email of 23.7.2013, the Noticee forwarded to Mr. Ketan Shah the NSEL’s clarification on media reports, and that the same amounted to the Noticee acting as an accomplice of NSEL. It is submitted that SEBI appointed Forensic Auditor’s report expressly exonerates the Noticee. Further, the Noticee was mandated under the Bye Laws to do the same and there

was instruction from NSEL to all the brokers on 22.7.2013 to forward the advertisement to all the clients.

- 26.5.7. With respect to seminars being conducted by the Noticee at which NSEL made presentations, it is submitted that seminars were conducted for the benefit and knowledge of the clients. The same is a common market practice and in fact has been encouraged by the regulators.
- 26.5.8. As regards, the allegation based on FMC order that the information on the website of NSEL was false, yet the Noticee provided links to the public. It is submitted that, FMC merely objected to the representation on NSEL's website that NSEL was regulated by FMC. No objection was raised by the FMC to any other representation on the website. Further, on 5.8.2011, the FMC was nominated as the "Designated Agency" and was required to check compliance of the said GoI Exemption Conditions and take action in the event of any breach.

26.6. **Jignesh Shah's Bail Application**

- 26.6.1. With respect to the reliance placed on the Hon'ble Bombay High Court Order in the matter of Jignesh Shah's Bail Application it is submitted that the only issue in the said High Court proceedings was as to whether bail should be granted to Mr. Jignesh Shah. All other observations therefore are mere obiter. Most pertinently, the said Order of the High Court was challenged before the Hon'ble Supreme Court, which by its Order dated 17.11.2014, inter alia directed that:-
"..the observations made by the High Court shall not stand in the way in dealing with the trial by the Trial Court at any point of time."
- 26.6.2. Even the Division Bench of the Bombay High Court in its said Order dated 17.11.2014 in FTIL's Notice of Motion (L) No. 564 of 2014 in Writ Petition No. 337 of 2014 held that :-
"The reliance upon the order of the learned single judge of this court granting the petitioner's officers bail is not well founded..."
(The Observations therein) "... are prima facie, made in an application for bail preferred by the petitioners directors..."

26.7. **PMLA**

- 26.7.1. SEBI appointed Forensic Auditors and FMC order have not stated that the Noticee's transactions were "suspicious". All the Noticee transactions were with the prior concurrence of the Commission as per the Bye-Law 4.1 of the NSEL.
- 26.7.2. The 6.8.2013 Gazette Notification directing NSEL to stop trading and 19.9.2014 Gazette Notification of the GOI made no such allegation that the trades in pair contracts were "suspicious" transactions under PMLA

26.8. **Margin Shortfalls**

- 26.8.1. Margins other than initial margins have also been considered which should be excluded while calculating the margin shortfall amount. Further, the Auditor did not consider the payments received upto T+2. The Margin shortfall also reduces, if one considers the commodities lying in the Depository account of the concerned client.
- 26.8.2. Most pertinently, during the said Inspection period of FY 2012-13 and FY 2013-14, FMC was the regulator which has levied penalties for margin shortfalls. The same were duly paid.
- 26.8.3. The Noticee never defaulted on their trading and settlement obligations.

26.9. **Noticee is different from other Brokers**

- 26.9.1. Noticee is one of the non-defaulting brokers and is different from other Brokers on the following grounds:
- Noticee started trading 3 years after these pair contracts were continuously & successfully trading on NSEL on a nationwide basis.
 - No funding to clients through group companies / NBFC
 - No collective buying / No client code modifications.
 - Not a single adverse finding by SEBI appointed forensic auditor about Noticee on NSEL.
 - No trading in NSEL pair contracts before FMC being designated by Government of India for NSEL.
 - Not acted as Clearing & Forwarding (C&F) agent on NSEL.
 - No print and media advertisements unlike some other brokers.
 - Noticee did not have any defaulters as its clients on NSEL.
 - No confirmation letter for stock in NSEL warehouses.
 - No PMS activity on NSEL.
 - No unauthorised trading.
- 26.10. That Regulation 27 of the Intermediaries Regulations have no application to the facts of the present case, because Noticee have not been granted a certificate of registration.
- 26.11. That Noticee had requested the Designated Authorities to give them a personal hearing in the matter prior to the preparation of Enquiry Report. However, the Noticee has not received any reply to said requests, nor was any opportunity of a personal hearing was provided to them before the Designated Authorities.
- 26.12. Noticee stated that Paired contracts were being traded openly and transparently on the NSEL since about September 2009 and Noticee had started trading in these paired contracts only since about May 2012, after having observed the prolonged, open,

- transparent and successful trading in such contracts which had gone on for almost 3 years as aforesaid
- 26.13. That Noticee are one of the non-defaulting brokers on NSEL and have duly complied with and fulfilled all its obligations in respect of all its trades. Noticee have to recover and receive about Rs. 130 crores from the NSEL on behalf of its clients
- 26.14. Noticee stated that out of abundant caution, its Compliance officer had expressly raised the issue with the NSEL and had sought clarification from the NSEL as to whether such pair trades would amount to financial transactions. In reply, NSEL vide email dated 19.6.2012 had expressly recorded that the pair contracts would not amount to financial or structured transactions. This proves that Noticee acted with excessive due diligence, integrity and prudence.
- 26.15. That as per Bye Laws of NSEL, it is an obligation of Noticee to keep its clients informed about all relevant information pertaining to the Exchange including its circulars, orders, instructions etc. In any event, as per normal course of business, Noticee forwarded links of notices, circulars, etc of other Exchanges where they are members like MCX, NCDEX to its clients in the same manner as done by them qua its NSEL clients. The same can never be alleged to amounting to any “false representations” being made by them as incorrectly alleged in the Enquiry Report.
- 26.16. That merely forwarding links to the NSEL website does not amount to any representation as to the sufficiency of the SGF and it can never be held that Noticee thereby made any false representation or induced any clients to trade in the pair contracts.

SECOND SHOW CAUSE NOTICE, REPLY AND HEARING:

27. 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.
28. 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 received by SEBI on December 16, 2015, for rejection in accordance with the provisions of Regulation 5(e) read with regulation 7(1) of Brokers Regulations.

29. PCIPL 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 31, 2019 at 10:30 A.M., SEBI Head Office, Mumbai.

30. Noticee vide email dated January 11, 2019 had requested for adjournment of personal hearing due to non-availability of senior counsel on January 31, 2019. In the interest of Natural Justice and acceding to the request of the Noticee, SEBI vide email January 18, 2019 had re-scheduled the hearing on February 06, 2019 at SEBI, Head office, Mumbai.

31. In response to the Second SCN, the Noticee submitted its reply dated February 04, 2019 on merits to the Second SCN. The said reply of the Noticee in brief are as under:

31.1. That Noticee have not been given a reasonable period of time to peruse the massive quantities of data which have been furnished by SEBI of which only soft copies were furnished to us. In fact, Noticee have not been given an opportunity to inspect any of the original documents that SEBI now seeks to rely upon in support of the said SCN. The same is obviously a complete failure of the principles of natural justice.

31.2. Brokers Regulations do not at all apply to us since we have already withdrawn our application for registration there under.

31.3. The present SCN completely bypasses the procedure under the SEBI (Intermediaries) Regulations, 2008, which envisages a two stage process. It is submitted that the Intermediaries Regulations do not contemplate any such additional or supplementary SCN's being issued, and the present SCN is in violation of the provisions of the Intermediaries Regulations.

31.4. Government of India had assigned an investigation to SFIO under Section 210(1)(c) read with Section 212 (1) (c) of the Companies Act, 2013 vide its order dated 28.10.2016. The said order specifically mentions the list of companies which were to be investigated by SFIO. It is however most pertinent to note that in spite of our name not being there in the said list of companies, SFIO has made comments about us.

31.5. In any event, it is pertinent to note that at the highest it can only be alleged that SFIO has recommended that SEBI take action against the non-defaulting brokers also. SEBI

is already doing so. Therefore, the present SCN is irrelevant, meaningless and ought to be withdrawn.

- 31.6. There are factual errors in the SFIO Report vis-à-vis EOW Report with respect to the number of brokers whose clients are entitled to receive payments from NSEL. Further, the SFIO Report has not explained how it has chosen 9 brokers out of so many brokers involved in the matter.
- 31.7. The finding of the SFIO with respect to the status of availability of commodities in warehouses is that at the time of the execution of the trades on the platform of the NSEL, the requisite stocks were in the warehouses but were subsequently removed and siphoned off after the default at the NSEL in July 2013. The aforesaid is without prejudice to our previous detailed submissions including that to date no authority has even alleged that the commodities relating to our transactions were not available in the warehouses.
- 31.8. All the specific allegations and findings in the SFIO order in respect of collusion, relate to the collusion between the NSEL, its management and the defaulter brokers. Further, no investigation was done by SFIO on the banks with whom Settlement Bank accounts were opened. Thus, this is a clear case of discrimination against us. Moreover, one Director of FTIL had traded on NSEL. However, no forensic audit of the brokers was done by SEBI through whom the Director traded. This is clear discrimination.
- 31.9. As regards the alleged summary of Mr. Bhambhani's statement, it is submitted that the complaints filed by Agarwal family / group and by M/s Responsive Industries Ltd., have been withdrawn / rejected. Consequently, the only remaining complaints were the purported complaints of Mr. Ketan Shah and M/s. Khemsati Exims Pvt. Ltd., for which we have already made detailed submissions in our earlier reply. It is submitted that merely because some clients make some purported complaints is no ground to allege that a person is not "fit and proper". The question is the legitimacy of such complaints.
- 31.10. SFIO had sent some questionnaire to some of our clients and claim that they got responses from some of them on the basis of which the allegations are made at the said Pg. 634. However, so far we have not been able to find any of them from the said DVD and pen drive given to us by SEBI. SEBI is hereby requested to identify and / or furnish to us these so called client responses so that we can seek to verify whether the said allegations in the SFIO Report are at all factually correct or are misconceived.
- 31.11. However, without prejudice to the aforesaid, it is pertinent to note that the SFIO Report only states that 78 of our clients stated that they were "informed about opportunities on NSEL platform by their broker". Many of our clients were registered with multiple brokers. Therefore, the allegation is meaningless. Further, it is in fact the duty and obligation of every broker to inform their clients about the opportunities and risk of trading on any Exchange Platform and we had always done so.
- 31.12. In respect of the allegation of not disclosing the risk of trading in the NSEL, it is submitted that we had entered into written member client agreements ("MCA") with all our clients. The agreements had specific clauses pertaining to "risks" involved in

trading in the NSEL and from time to time the same were even improved and augmented based on experience and circumstances.

- 31.13. After the ET Article dated 3.10.2012, out of abundant caution, we decided to request our clients that if they wish to continue trading through us on NSEL, they would be required to acknowledge that they had gone through the said ET article and had understood the risk of trading on NSEL. Even the MCA was modified accordingly. The Hon'ble Bombay High Court relied upon the Risk Disclosure clauses in the MCA and based thereon dismissed the petition filed by M/s. Responsive Industries Ltd.
- 31.14. It is completely incorrect to say that we have assured any clients of any "fixed returns. This was also the findings of the forensic auditor. Without prejudice to anything else herein stated, it is also stated that in fact the rate of return on pair trades was obviously known as soon as the transactions of buy and sell were executed.
- 31.15. It is submitted that far from making any assurances of paying the clients for their sell trades, we had expressly informed the clients that we would be in a position to make payment only if the payment was received by us from the NSEL, and the risk factors in this regard was already incorporated into the MCA, the contract Notes, and in the separate express letters after the ET Article dated 3.10.2012.
- 31.16. It is completely false and denied that we had made any unlawful gains. The losses suffered by our clients are because of the default by NSEL and the defaulting brokers, and the failure of the concerned authorities to recover and pay our client dues. It is reiterated that we and our clients have been victims of the fraud and mischief by NSEL.
- 31.17. The complaint dated 20.12.2014 of Mr. Ketan Shah has been withdrawn. Further, SEBI appointed Forensic Auditor expressly reported that the said complaints are baseless and untenable.
- 31.18. The present SCN merely states that the said order dated 1.10.2015 of Hon'ble Bombay High Court "made various observations about the scheme by NSEL". However, it does not disclose which specific observations are sought to be relied upon by SEBI, if any. As far as Noticee can make out there is not a single observation against them or any other non-defaulting broker. All observations in the said order are in fact only against the wrongdoings of the NSEL and its selling trading members, i.e. the defaulting entities.
- 31.19. SEBI can never rely on the observations of the said order in the collateral proceedings against us, when the said order directs that the observations therein cannot be relied upon in subsequent proceedings under the MPID Act itself between the parties thereto themselves.
- 31.20. FMC's order dated 17.12.2013 inter alia concluded that the "unpermitted financing scheme" was that the NSEL and its management secretly allowed the defaulting members to roll over their positions year after year despite defaulting. It is also clearly the finding of the FMC that market participants like us and our clients were unaware of the same and were completely in the dark and were defrauded by Mr. Jignesh Shah,

NSEL and its management. Therefore, it can never be alleged that any fault can be attributed to us.

- 31.21. SFIO correctly holds that we are a non- defaulting broker. Thus, as we were a non-defaulting broker and were completely unaware about the fraud that was being perpetuated by the NSEL, no question arises of SEBI taking any action against us.
- 31.22. NSEL had reputed Auditors yet, their Annual Reports and particularly the Auditors Reports did not contain any qualification or adverse remarks in respect of the legitimacy, validity or bona fides of in respect of any of the contracts being traded on the NSEL platform, nor was there any reservation or insinuation that any of the contracts could be in violation of the conditions in the said Exemption Notification dated 5.6.2007. Even our statutory Auditor did not highlight any illegality in their audit reports.
- 31.23. Even after the FMC order issued on 17.12.2013, it took the DEA, MOF more than a year to examine and conclude that NSEL had violated the exemption conditions of the GoI Notification dated 5.6.2007 and therefore it is most unjust and unfair to expect that we as a mere market participant should have known about the purported illegality of the NSEL contracts at the relevant time, and should not have traded in such NSEL contracts. Further, MOF had advised FMC to initiate appropriate actions only against NSEL, and not against any non-defaulting brokers, like us.
- 31.24. Writ Petition No.2743 of 2014 was filed by 63 Moons Technologies Limited to challenge a merger order passed by the Government of India dated 12.2.2016 ordering the amalgamation of NSEL with FTIL in public interest so as to ensure recovery of funds to pay the outstanding dues of all the clients in respect of pair contracts. It is reiterated that if the pair trades were illegal no question could arise of payment or settlement against such illegal contracts. Even the extract relied upon the para 86 of the said order clearly states that the clients and broker cannot be blamed. Further, as per the Order, Exchange had to ensure compliance with the conditions of the GOI Exemption Notification.

32. On February 04, 2019, Mr. Pesi Modi, Senior Counsel and Mr. Neville Lashkari, Advocate along with Mr. Sandeep Gupta, Mr. Rajendra Bhambhani and Mr. Nikunj Modi from PCIPL, **ARs** of PCIPL appeared for the hearing and reiterated the earlier submissions and made the oral submissions in line with the reply dated February 04, 2019. ARs were granted time till February 14, 2019 to make additional written submissions in the matter.

33. Pursuant to the hearing, the Noticee submitted its additional written submission dated February 14, 2019. In order to avoid repetition, below are the additional submissions in brief which are not mentioned in the reply dated February 04, 2019:

- 33.1. It was *bona fide* belief at the relevant time that FMC was the regulator. The same is now re-confirmed by SEBI as well as SFIO. We did not believe that any illegal contracts could be traded on a national level exchange which is regulated by FMC as well as the Central Government and trading continuously / daily for 3 years before we started trading for our clients in these pair contracts.
- 33.2. No Government Authority, except SEBI is finding fault with non - defaulting brokers like us for violation of conditions of GOI Notification dated 5.6.2007 and that these government authorities have found fault only with NSEL, its Promoters, Management and Directors as they were required to ensure compliance with the conditions of GOI Notification 5.6.2007.

FINDINGS AND CONSIDERATION

34. I have perused the SCN, Second SCN, 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?

35. 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:

35.1. 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;

35.2. 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.

35.3. 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:

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

Jurisdiction, withdrawal application and Applicability of Intermediaries Regulations:-

37. With respect to the issue of jurisdiction as contented by the Noticee in its various replies, I, on the basis of documents available on record, observe 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.

38. Noticee submitted that considering the fact that the Noticee has withdrawn the application for SEBI registration, the entire question of deciding whether the Noticee is “fit and proper” to grant registration becomes totally irrelevant and an exercise in futility. In this regard, it is noted that SEBI vide its letter dated July 9, 2018 had informed Noticee that enquiry proceedings under Intermediaries Regulations against it are in progress; therefore, in view of pending enquiry proceedings, its request for withdrawal of the application for registration cannot be entertained. It is noted that Hon’ble High Court of Bombay vide its order dated October 04, 2018 rejected the Writ Petitions filed by other brokers, upholding the stand of

SEBI. Thus, in view of the said High Court order, the submission of the Noticee does not hold any merit.

39. Further, I note that the present matter is peculiar in nature. The ***Peculiar Facts and Circumstances*** of the present case are as under:

- 39.1. 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).
- 39.2. 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.
- 39.3. 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*”.
- 39.4. 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.

39.5. 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.

39.6. **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....”

39.7. Thus, from the above, it is summarized that, prior to September 28, 2015, PCIPL was functioning as a commodity derivatives broker and was recognized as such by the exchanges. Before merger of FMC with SEBI, PCIPL 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.

39.8. It is noted that pursuant to merger of FMC with SEBI, PCIPL had made an application to SEBI for registration as a commodity broker received on December 16, 2015 and by virtue of second proviso of Section 28A(1) of FCRA inserted through Section 131B of Finance Act 2015, PCIPL 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.

39.9. It is pertinent to mention the normal circumstances in the securities market which are detailed as under:

39.9.1. 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.

39.9.2. 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.

39.10. 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.

39.11. 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.

40. Thus, PCIPL 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 are applicable to the Noticee even though technically it does not hold a certificate of registration.

Administrative Discrimination:

41. PCIPL stated that the present proceedings were initiated only against 5 brokers, even though the exact same allegations applied to more than 500 brokers all of whom traded on the NSEL in pair contracts and over 11 day contracts. Yet, SEBI has granted registration to approximately 300 such brokers, thus holding them to be fit and proper for the grant of registration. 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.

42. 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.....”

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:

43. I note that the Second SCN has been issued under regulation 28(1) of the Intermediaries Regulations and read with regulations 5(e) and 7(1) of Brokers Regulations. In other words, the proceedings under regulation 23 of Intermediaries Regulations and regulation 7 read with regulation 5(e) of Brokers Regulations have been clubbed together. In view of the

aforesaid facts and circumstances outlined in paragraph 39 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 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?

44. 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.

.....”

45. 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.
46. However, in view of the facts and circumstances of the case discussed above in paragraph 39, 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.
47. 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.
48. 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 received on December 16, 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.

49. In view of the above, I am of the view that issuance of the show cause notice against the Noticee, is sustained. The Noticee had allegedly 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?

50. 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.

51. 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:

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

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

52. 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 39 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 cancelation of certificate of registration that is envisaged under regulation 27 of Intermediaries Regulations.

53. 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.

54. 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.
55. 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 39 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.
56. **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.

Issuance of Second SCN:

57. Noticee submitted that the Second SCN completely bypasses the procedure under Intermediaries Regulations, 2008, which envisages a two stage process. Noticee further submitted that the Intermediaries Regulations do not contemplate any such additional or supplementary SCN's being issued, and the present SCN is in violation of the provisions of the Intermediaries Regulations.

57.1. I am of the view that, in case of quasi-judicial enquiry proceedings, the proceedings subsequent to the issuance of post enquiry show cause notice comes to a logical end only on passing of the order on merits. In the present matter, I note that during the pendency of proceedings, 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 submission 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

58. 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.”

59. 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.

60. 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.

.....”

61. 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'"

62. **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.

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

63.1. 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.

63.2. 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.

63.3. 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:

63.3.1. 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.

63.3.2. 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:

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

64.1. **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, misleading presentations, assuring fixed returns, unverified / false information regarding Exchange providing counterparty guarantee risk, assuring investors via email that media reports regarding exchange are false and it is safe to continue investing in the pair contracts offered by NSEL 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.

64.2. **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.

65. 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.

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

67. 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.*

68. 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’.

69. 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.*

.....”

70. 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.... ”

71. 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 as 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’.

..... ”

In view of above context narration, I proceed to examine the Observations by various courts/authorities regarding NSEL and paired contracts.

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

72. In view of the above context, 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.....”

73. 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.....”

74. 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.

..... ”

75. 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....”

76. 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.

77. 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.

78. 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.

79. In view of the parameters already mentioned in previous paragraph 63.3 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.

80. From the submissions of the Noticee, I note that Noticee stated that paired contracts were being traded openly and transparently on the NSEL since about September 2009 and it had started trading in these paired contracts on behalf of its clients since about May 2012, after having observed the prolonged, open, transparent and successful trading in such contracts which had gone on for almost 3 years. Noticee admitted that it, as a broker, had entered into the so-called paired contracts on behalf of its clients in accordance with the Bye laws/ Business Rules of NSEL. Noticee also stated that as per normal course of business, it forward links of notices, circulars, etc. of NSEL to its clients. Thus, I note that Noticee was a facilitator of trades and was placing the orders on NSEL on behalf of its 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.

81. 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.

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

82.1. That the “calculation sheets” were prepared by NSEL and the Noticee forwarded the same to its clients in normal course of business.

82.2. That forwarding links to the NSEL website to the clients amounts to telling clients that there is a website of NSEL in the public domain.

82.3. That seminars were conducted for the benefit and knowledge of the clients. Noticee used to invite clients to these seminars and also used to invite NSEL officials for giving presentation to their clients.

All the above, clearly demonstrate an association of the Noticee with NSEL and the paired contracts that goes beyond transacting as a broker 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.

83. Further, following submissions of the Noticee are noted:

83.1. *“As a matter of abundant caution and excessive due diligence, our Compliance officer had therefore expressly raised this issue with the NSEL and had sought clarification from the NSEL as to whether such pair trades would amount to financial transactions. By their email dated 19.6.2012 in reply, the NSEL had expressly recorded that the pair*

contracts would not amount to financial or structured transactions. This proves that we acted with the highest level of due diligence, integrity and prudence”

83.2. That after the ET Article dated 3.10.2012, out of abundant caution, Noticee decided to request its clients that if they wish to continue trading through us on NSEL, they would be required to acknowledge that they had gone through the said ET article and had understood the risk of trading on NSEL. It stated that even the Member Client Agreement was modified accordingly.

83.3. That Noticee had taken necessary due diligence and clients were notified of the risks of trading through the Noticee in NSEL.

I note that the basis of the present findings is the existence of adverse observations by the competent authorities/courts and that in view of such observations, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has been affected. In this regard, even if for a moment, I accept the contention of the Noticee that they had exercised due diligence and notified their clients of the risks, the question would still be, whether, despite this, the existence of adverse observations by the competent authorities still affects the reputation of the Noticee. As noted in the SAT judgment quoted earlier, reputation is what others perceive of the Noticee. In other words, it is the 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. A person is known by the company he keeps. There cannot be any direct evidence in regard to the reputation of a person whether he be an individual or a body corporate. Therefore, the close association of the Noticee with NSEL and paired contracts that did not enjoy good reputation as discussed above would be enough to impact the reputation of the Noticee. Thus, in view of the existence of adverse observations by the competent authorities/courts and the close association of the Noticee with NSEL and paired contracts, I hold that the said contention of the Noticee does not hold merit.

84. The Noticee has contested that Courts / Competent Authorities observations are not against the Noticee. In response to SFIO observation regarding ‘Concept of Paired Contract’, the Noticee stated that the said SFIO observation does not contain any allegations against any non-defaulting brokers (Noticee is a non-defaulting broker). All the allegations made therein

are only against NSEL, its Directors and management. In response to the DEA letter, Noticee stated that the Ministry of Finance had advised FMC to initiate appropriate actions only against NSEL, and not against any non-defaulting brokers (like Noticee) as FMC knew that Noticee was not responsible for either violation of the exemption conditions or for the NSEL fraud and losses caused to investors. In respect of observations in Writ Petition No. 2743 of 2014 of Hon'ble High Court, Noticee stated that the paragraph 86 of the said order states that the clients and broker cannot be blamed and there are no observations or findings against Noticee or any other non-defaulting broker. Noticee further state that they were not even party to the said proceedings and were not given any hearing. In response to the observation in FMC order regarding 'paired contracts', Noticee stated that findings are against NSEL. Noticee was not party to the proceedings before the FMC. The FMC has not passed any order whatsoever against Noticee, nor does its order dated 17.12.2013 even refer to Noticee or its trades. The said FMC order nowhere holds or even suggests that Noticee had any role to play in, or were aware of, or ever violated any of the exemption conditions stipulated in the said GOI Exemption Notification dated 5.6.2007. Further, the FMC had found fault only with the NSEL and no allegations were made against Noticee.

85. 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**.

86. 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..”

87. 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.

88. I also note that SFIO report has not attained finality i.e. that the observations therein are only prima facie in nature and the violations covered in SFIO have to be established in the Court of competent jurisdiction . 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.

89. In respect of the SFIO Report, the Noticee submitted that there are factual errors in the SFIO Report vis-à-vis EOW Report with respect to the number of brokers whose clients are entitled to receive payments from NSEL. Further, the SFIO Report has not explained how it has chosen 9 brokers out of so many brokers involved in the matter. The Noticee further submitted that the alleged SFIO report at inter-alia page number 603 and 796 states that there were approximately 148 commodity brokers whose clients were entitled to receive payments from the NSEL. The same according to the Noticee appears to be factually incorrect. In fact, as far Noticee is aware, there are 237 such brokers, inter-alia since the EOW Report as relied upon by SEBI itself and furnished in inspection by SEBI to the Noticee gives a list of 237 such brokers including the Noticee.

89.1. I note that the fact as to whether Noticee is a defaulting broker or not, is not relevant for this proceedings. Since the basis of the present order is existence of the adverse observations affecting the reputation of NSEL and paired contracts and by association, the reputation of the Noticee as discussed earlier. Therefore, whether the Noticee was a non-defaulting broker or not will not affect adverse nature of the observations qua NSEL and paired contracts. Therefore, any argument on that basis has no relevance in the present proceedings.

90. Noticee submitted that it has not been given an opportunity to inspect original documents (i.e. SFIO Report) that SEBI relied upon in support of second SCN. Hence, the same is a failure of principles of natural justice. In this regard, I note that the present proceedings being quasi-judicial in nature strict rules of Indian Evidence Act is not applicable herein. Further, I note that the Noticee was provided with a copy of the SFIO Report to show that there are adverse observations against it, findings of which have been arrived at by an investigating agency and as such has a bearing in the extant proceedings. In other words, SEBI has provided the Noticee with a document (SFIO Report) which shows the existence of adverse observations with respect to the Noticee. Further, this is not the correct forum to contest the veracity of the observations of SFIO Report and therefore the request of the Noticee for inspection of original documents cannot be entertained. Moreover, SEBI is not in possession of the original SFIO Report, so the issue of inspection of original SFIO Report does not arise.

91. Noticee vide reply dated February 04, 2019 had requested SEBI to furnish Noticee's clients responses mentioned in the SFIO report and inspection thereof; Noticee has also sought the cross-examination of these clients of the Noticee referred in the SFIO investigation report. I note that the SFIO has recorded the statement of the some clients of the Noticee during the course of the Investigation. 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 competent Courts have the power to determine the contested findings of SFIO investigation. 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 preceding paragraphs, the Noticee has become an unfit person to be a commodity derivatives 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 Competent authorities / Courts on NSEL and the paired contracts with which the Noticee is closely associated. As noted earlier, the fact that the 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 contested facts. 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/responses of Noticee's clients as such are not relied upon in the present proceedings. In view of the aforesaid discussion, the request for cross examination and inspection is accordingly disposed of.

92. Further, it is also noted that the Noticee has raised certain issues with respect to SFIO Report like the Government of India order dated 28.10.2016 specifically mentions the list of companies which were to be investigated by SFIO and despite Noticee's name was not there in the said list of companies, SFIO has made comments about them i.e. SFIO has enlarged its scope of investigation. In this regard, I note that this forum is not the appropriate forum to contest the scope and findings of the SFIO Report and the same are not relevant in the extant proceedings.

93. I note that Noticee vide reply dated February 04, 2019 had requested the inspection and copy of letter dated June 19, 2014 referred in Ministry of Finance, Department of Economic Affairs letter dated December 30, 2014. I am of the view that, for the purpose of this order, letter dated June 19, 2014 has not been relied upon, hence, no prejudice would be caused to Noticee if its request for inspection of such documents are denied.

Observations regarding MPID violations and findings related to them:

94. 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:

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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". "*

95. In respect of the observations of the Hon'ble Bombay High Court in order dated October 01, 2015, the Noticee submitted that the second SCN merely states that the said order dated October 01, 2015 made various observations about the scheme by NSEL and Second SCN does not disclose which specific observations are sought to be relied upon by SEBI, if any. Noticee further stated that in the said order there is not a single observation against Noticee or any other non-defaulting broker. Noticee was not party to the said proceedings and was not heard by the Hon'ble Bombay High Court and therefore, none of the said observations in the said order dated October 01, 2015 are binding upon Noticee. All observations in the said order are in fact only against the wrongdoings of the NSEL and its selling trading members, i.e. the defaulting entities, and not against Noticee. SEBI can never rely on the said observations of the said order in the collateral proceedings against Noticee, when the said order directs that the observations therein cannot be relied upon in subsequent proceedings under the MPID Act itself between the parties thereto themselves.

I have perused the observation of the Hon'ble High court, which states *"that observations made hereinabove are prima facie in nature and made for the limited purpose to consider the grant of relief of quashing the action of invocation/application of provisions of the MPID Act. Needless to state that if the Petitioner files an application for discharge, the same shall be decided independently on its own merits without being influenced by any of the observations made herein."* I note that the said observations were made in the context of petitioner filing a discharge application before the competent court and in such scenario the said application will be decided independently on its own merits. Further, there is a difference

between relying upon the observation of the Hon'ble High Court for arriving at a finding that Noticee has committed the violation under MPID Act and relying upon the existence of the observation for arriving at the finding that in view of such observation the reputation of the Noticee has been affected. Therefore, there is no substance in the argument that the observations of the Hon'ble High Court cannot be relied for the purpose of assessing the reputation of the Noticee.

96. Further, 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, the observations of the Hon'ble High Court are in respect of the Noticee as these observations are factually relatable to the Noticee as already discussed in paragraph 85 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.

97. 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:

98. In summary, I note the following :

- 98.1. 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.
- 98.2. 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.
- 98.3. The Noticee, by virtue of being a broker, 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.
- 98.4. 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.

- 98.5. 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:

99. 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 filed by Phillip Commodities India Pvt. Ltd. and received by SEBI on December 16, 2015, for registration as commodity derivatives broker. The Noticee shall cease to act, directly or indirectly, as a commodity derivatives broker.

100. 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.

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

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

-Sd-

Date: FEBRUARY 27, 2019

MADHABI PURI BUCH

Place: MUMBAI

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA