

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

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

In respect of:

Name of the Noticee	SEBI Registration No.
AUM COMMODITY SERVICES PRIVATE LIMITED	INZ000050137

In the matter of National Spot Exchange Ltd. (“NSEL”)

BACKGROUND

1. The present proceedings originate from the Enquiry Report dated July 26, 2019 submitted in respect of AUM Commodity Services Private Ltd. (hereinafter referred to as “**Noticee**”), by the Designated Authority (hereinafter referred to as the “**DA**”) in terms of Regulation 27 of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as “**Intermediaries Regulations**”), as it stood prior to its amendment vide SEBI (Intermediaries) (Amendment) Regulations, 2021, w.e.f. January 21, 2021. The DA, based on factual findings and observations so recorded in the said Enquiry Report, has recommended that the Certificate of Registration of Noticee as a commodities derivatives broker may be cancelled.
2. After considering the Enquiry Report, a Post-Enquiry Show Cause Notice dated October 15, 2019 (hereinafter referred to as “**SCN**”) enclosing therewith the Enquiry Report of the DA was issued to the Noticee under Regulation 28(1) of the Intermediaries Regulations (as applicable at the relevant time) calling upon it to show cause as to why action of cancellation of Certificate of Registration as recommended by the DA or any other action, as deemed fit by the Competent Authority, under Regulation 28(2) of the Intermediaries Regulations (as applicable at the relevant time) should not be taken against

it. The SCN further required the Noticee to submit its reply, if any, within 21 days of receipt of the same. The SCN was duly served upon the Noticee.

3. While proceedings in the present matter were going on, SEBI passed five separate orders during February 2019 rejecting the applications filed by five broking entities for registration as commodities brokers. Aggrieved by the said SEBI orders, these five entities filed separate appeals before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "**Hon'ble SAT**"). The Hon'ble SAT vide a common order dated June 9, 2022, remanded the aforesaid orders to SEBI to decide these matters afresh within six months from the date of the said order. While remanding the aforesaid SEBI orders, the Hon'ble SAT *inter alia* held as under:

"42...The matters are remitted to the WTM to decide the matter afresh in the light of the observations made aforesaid in accordance with law after giving an opportunity of hearing to the brokers. All issues raised by the brokers for which a finality has not been reached remains open for them to be raised before the WTM. It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by the respondent should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice..."

4. In light of the aforesaid order of Hon'ble SAT and certain other subsequent orders passed by the Hon'ble SAT in similar set of cases from time to time, it was felt necessary to furnish certain additional documents/material to the Noticee before concluding the present proceedings. Accordingly, SEBI vide a Supplementary Show Cause Notice dated March 29, 2023 (hereinafter referred to as the "**SSCN**") (SCN and SSCN are collectively referred to as "**SCNs**") provided certain additional documents/ material to the Noticee and advised it to submit its reply/ comments/ clarifications, if any, within 15 days of receipt of the SSCN. The SSCN was served upon the Noticee. I note from the records that the Noticee vide letters dated November 6, 2019 and April 19, 2023 submitted its written replies on merits to the SCNs. Subsequently, in compliance with the principles of natural justice, a personal hearing was

scheduled on September 12, 2023, for which the Noticee sought adjournment. Accordingly, another opportunity of personal hearing was granted on September 25, 2023, for which the Noticee sought adjournment. Subsequently, another opportunity of personal hearing was granted on September 26, 2023, which was attended by Ms. Rishika Harish (Authorised Representative) on behalf of the Noticee and argued in the line with the aforementioned replies filed with SEBI.

5. The replies filed by the Noticee with SEBI /contentions raised during the personal hearing are summarized hereunder:
 - a) The appointment of DA in the present matter is bad in law and in violation of Regulation 24 (2) of Intermediaries Regulations in terms of which the DA is required to be appointed by the Executive Director and not by the Whole Time Member. In this regard, Noticee has referred to Section 3(1) of the SEBI (Delegation of {Powers) Order, 2015 to further buttress its arguments.
 - b) Noticee has not been provided with certain documents and materials. In the absence of relevant, vital and material information and documents, the Noticee is not in a position to present the facts of the case in a detailed and comprehensive manner.
 - c) SEBI Act and its regulations were not applicable to the Noticee for trading at the NSEL at the relevant time. Therefore, SEBI does not have power and jurisdiction to adjudicate the present proceedings. Further, SEBI has no jurisdiction over spot markets.
 - d) The reliance of DA on the observations of Hon'ble SAT in the matter of *Jermyn Capital LLC vs. SEBI* and *Mukesh Babu vs. SEBI* is completely wrong and without any basis.
 - e) Consequent upon the finding of Hon'ble Bombay High Court that the NSEL is not a 'Financial Establishment' and the paired contracts are not a financial transaction under MPID Act, the EOW case and SFIO Report, so far as they allege that the paired contracts were financial transactions have become redundant and infructuous.
 - f) Noticee had traded in / facilitated the paired contracts as a member of NSEL in accordance with the business rules and regulations of NSEL.

- g) The reliance of DA on the interim report of Economic Offence Wing (EOW) is erroneous as no specific charges made against the Noticee in the interim report.
 - h) Additional documents served vide SSCN cannot be considered by SEBI.
 - i) The paired contracts were introduced by NSEL with approval of its Board. NSEL had always presented to the public as well as to the brokers including the Noticee that paired contracts were legal and permissible contracts. Apart from acting as a mere broker, along with hundreds of other brokers, Noticee had no connection with NSEL. Further, no brochures / pamphlets / presentation of NSEL products were issued or provided to its clients by the Noticee.
6. It is pertinent to mention that Regulation 27 of the Intermediaries Regulations was amended with effect from January 21, 2021, pursuant to which the procedure for action on receipt of the recommendation of the DA (provided under Regulation 28 prior to the amendment) was incorporated in the amended Regulation 27. Thus, these proceedings are being considered under the amended Regulation 27 of the Intermediaries Regulations.

CONSIDERATION OF ISSUES AND FINDINGS

7. I note that the present matter in hand is different from the 5 cases remanded back to SEBI by the Hon'ble SAT vide its order dated June 09, 2022, as in the extant matter the Noticee is already holding a Certificate of Registration whereas in the remanded 5 cases, the entities had filed applications seeking Certificate of Registration, which were pending at the time of passing of those orders. The Noticee is a commodities derivatives broker registered with SEBI having Registration No. INZ000050137 with effect from December 17, 2015.
8. I have carefully considered the Enquiry Report and the SCNs issued to the Noticee, other materials/information available in the public domain and those made available to the Noticee. I note that the only question that arises for consideration in the present matter is whether the Noticee satisfies the 'fit and proper person' criteria as laid down under Schedule II of the Intermediaries Regulations and if not, then whether the Certificate of Registration granted to the Noticee should be cancelled, as recommended by the DA or any other action should be taken against the Noticee.

9. The Noticee has contended that SEBI does not have power and jurisdiction to adjudicate the present matter pertaining to trading in 'paired contracts'. It has also contended that SEBI does not have power to regulate the Spot Market. In this regard, without going into the merits of the contention that whether SEBI has the authority to regulate Spot Market or not, I note, that the issue under consideration in the present proceedings is limited to the determination of 'fit and proper' status of the Noticee under the Intermediaries Regulations. It is a settled position of law that SEBI has statutory authority to determine the 'fit and proper' status of intermediaries registered with it. Since the Noticee is an intermediary registered with SEBI, I am of the considered view that SEBI is within its jurisdiction to determine the 'fit and proper' status of the Noticee. I note that prior to the merger of FMC with SEBI on September 28, 2015, the Noticee was not required to be registered with either FMC or any other regulatory authority under the FCRA. The Parliament, noticing that the intermediaries dealing with commodities derivatives market were not required to be registered under FCRA and were not under control of any competent authority, rectified the same through the Finance Act, 2015, as notified on May 14, 2015, by bringing them under the regulatory supervision of SEBI. With regard to the aforesaid, the Hon'ble Bombay High Court while dealing with the Writ Petition Nos. 3262, 3266, 3294 and 3295 of 2018 in the matter of *Anand Rathi Commodities Ltd., Motilal Oswal Commodities Broker Private Ltd., Geofin Comtrade Ltd. and IIFL Commodities Ltd. vs. SEBI*, vide its Order dated October 04, 2018, observed the following:

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

10. I further note that the provisions in the Finance Act, 2015 effecting the merger of FMC with SEBI in September, 2015 do not, prima facie, confer any power on SEBI to take charge, deal, inquire and resolve NSEL settlement crisis that broke out in 2013. Pursuant to repeal of FCRA and dissolution of FMC in terms of Section 131 of Finance Act, 2015, all recognised associations under the FCRA became deemed recognised stock exchanges under the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as the “**SCRA**”). NSEL was not a recognised association under FCRA, therefore, a question regarding NSEL falling under the regulatory jurisdiction of SEBI does not arise.
11. I note that pursuant to the merger of FMC with SEBI, a commodity derivatives broker was mandatorily required to obtain a certificate of registration from SEBI in case it sought to remain associated with the securities market as a commodity derivatives broker. The Finance Act, 2015, *inter alia*, conferred the powers to SEBI to regulate commodity derivatives brokers, which included their registration as commodity derivatives broker with SEBI. In this regard, vide Section 131B of the Finance Act, 2015, a transitory period of 3 months was provided to all the intermediaries which were associated with the commodity derivatives market under the erstwhile FCRA to continue to deal in commodity derivatives as a commodity derivatives broker, provided it made an application of registration to SEBI within 3 months from September 28, 2015. Accordingly, the Noticee applied for a certificate of registration and was registered as a broker with effect from December 17, 2015 and since then it has been acting as a market intermediary registered with SEBI.
12. The power of SEBI to investigate/ inquire into the alleged violation of FCRA flows from the Finance Act, 2015, which amended the provisions of FCRA. Section 29A of FCRA, as inserted by the Finance Act, 2015 reads as under—
- “(1) *The Forward Contracts (Regulation) Act, 1952 is hereby repealed.*
- (2) *On and from the date of repeal of Forward Contracts Act—*
- (a)....
- (b)....
- (c)....
- (d)....

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

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

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

13. The present proceedings pertain to adjudging the ‘fit and proper person’ status specified in the Broker Regulations and the Intermediaries Regulations in light of the activities undertaken by the Noticee on the NSEL platform and consequent action taken by FMC and SEBI, i.e., filing of the criminal complaint to EOW under Section 154 of the Code of Criminal Procedure, 1973 (“CrPC”). I note that in terms of Regulation 5(e) of the Stock Brokers Regulations, every applicant/ stock broker at the time of seeking registration, and thereafter, throughout the time it holds a valid certificate of registration, has to satisfy the “fit and proper person” criteria specified in Schedule II of the Intermediaries Regulations. I note that the Enquiry Report proceeds on the basis that the past conduct of the Noticee in facilitating access to the “paired contracts” traded on NSEL calls into question the compliance of the Noticee with ‘fit and proper person’ criteria. Further, SEBI while examining the compliance of an applicant, or even a registered intermediary, with the ‘fit and proper person’ criteria can take into consideration not just contravention of the provisions of securities laws, but also the general conduct of the Noticee which may have a bearing on its functioning as a registered intermediary. The ‘fit and proper’ criteria including the amended criteria must be satisfied by the Noticee, at the time of making application of registration under the Stock Brokers Regulations as well as during the continuance of the registration once granted. The Noticee is required to satisfy the ‘fit and proper person’ criteria during the continuance of the registration, and thus, it is well within the jurisdiction and powers of SEBI to adjudge the said ‘fit and proper’ status of the market intermediaries in the interest of securities market.

14. The Noticee has further contended that the power to appoint a Designated Authority has been vested in the Executive Director while in the instant case the DA has been appointed by the Whole Time Member of SEBI thereby raising a concern about the irregularity in the Appointment of DA. In this regard, I note that the Section 3(2) of the Securities and Exchange Board of India (Delegation of Powers) Order, 2015 specifically provides that, "The powers and functions delegated to any member or officer of the Board or authority under the Order can be exercised by any officer or authority higher in grade or rank or position to him". Thus, in presence of a valid delegation conferred upon by the statute, I find that the Noticee's challenge to the appointment of DA by the Whole Time Member of SEBI (who is a higher authority over the Executive Director of SEBI) is just an afterthought to evade the outcome of this proceedings.
15. Noticee has also contended that had not been provided with necessary documents to give a comprehensive reply in respect of the allegations made. In this regard, I note from the records that the relied upon document have already been provided to the Noticee with SCN and SSCN. Therefore, I find that all the documents relied upon by SEBI and relevant for levelling charges against the Noticee have been provided. Thus, I find that there is no merit in the contention of the Noticee.
16. Before I proceed to examine the charges vis-à-vis the material available on record, it would be appropriate to refer to the relevant provisions of law, which are alleged to have been violated by the Noticee and/or are referred to in the present proceedings. The same are reproduced below for facility of reference:

SEBI ACT, 1992

Registration of stock brokers, sub-brokers, share transfer agents, etc.

12.(3) The Board may, by order, suspend or cancel a Certificate of Registration in such manner as may be determined by regulations:

Provided that no order under this sub-section shall be made unless the person concerned has been given a reasonable opportunity of being heard.

STOCK BROKERS REGULATIONS, 1992

Consideration of application for grant of registration.

5. The Board shall take into account for considering the grant of a certificate, all matters relating to trading, settling or dealing in securities and in particular the following, namely, whether the applicant,
(e) is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

Conditions of registration.

9. Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely, -
(b) he shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him;
(f) he shall at all times abide by the Code of Conduct as specified in Schedule II

Schedule II

Code of Conduct for Stock Brokers [Regulation 9]

A. General.

- (1) Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.
- (2) Exercise of due skill and care: A stock-broker shall act with due skill, care and diligence in the conduct of all his business.
- (5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.

Liability for action under the Enquiry Proceeding Regulations.

27. A stock broker shall be liable for any action as specified in Chapter V of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 including suspension or cancellation of his Certificate of Registration as a stock broker, if he —
(iv) has been found to be not a fit and proper person by the Board under these or any other regulations;

INTERMEDIARIES REGULATIONS, 2008

SCHEDULE II

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

(a) the competence and capability in terms of infrastructure and manpower requirements; and

(b) the financial soundness, which includes meeting the net worth requirements.

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

(a) the applicant or the intermediary;

(b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and

(c) the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:

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

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

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

(a) integrity, honesty, ethical behaviour, reputation, fairness and character of the person;

(b) the person not incurring any of the following disqualifications:

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

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

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

other person referred in clause (2), is also found to incur the same disqualification in the said matter:

Provided that if any person as referred in sub-clause (b) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall replace such person within thirty days from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against the intermediary:

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

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

Recommendation of action

26. (1) After considering the material available on record and the reply, if any, the designated authority may by way of a report, recommend the following measures, –

- (i) disposing of the proceedings without any adverse action;*
- (ii) cancellation of the Certificate of Registration;*
- (iii) suspension of the Certificate of Registration for a specified period;*
- (iv) prohibition of the noticee from taking up any new assignment or contract or launching a new scheme for such the period as may be specified;*
- (v) debarment of an officer of the noticee from being employed or associated with any registered intermediary or other person associated with the securities market for such period as may be specified;*
- (vi) debarment of a branch or an office of the noticee from carrying out activities for such period as may be specified;*
- (vii) issuance of a regulatory censure to the noticee:*

Provided that in respect of the same Certificate of Registration, not more than five regulatory censures under these regulations may be recommended to be issued, thereafter, the action as detailed in clause (ii) to (vi) of this sub-regulation may be considered.

Order.

27. (5) After considering the facts and circumstances of the case, material on record and the written submission, if any, the competent authority shall endeavor to pass an appropriate order within one hundred and twenty days from the date of receipt of submissions under sub-regulation (2) or the date of personal hearing, whichever is later.

17. Before moving forward to consider the matter on merits and decide whether the Noticee fulfilled the '*fit and proper person*' criteria, it would be appropriate to look at the background of NSEL and understand the nature of the '*paired contracts*' that were offered on NSEL, which ultimately is the genesis of the entire proceedings. While undertaking this exercise, without independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings, I have relied on the observations made by other authorities including the Hon'ble Supreme Court, wherever appropriate.

NSEL and the Nature of '*paired contracts*'

18. NSEL was incorporated in 2005 as an electronic platform for spot trading of commodities. On June 5, 2007, the Ministry of Consumer Affairs ("**MCA**"), Government of India, issued a Notification no. SO906(E) under Section 27 of the FCRA granting conditional exemption from the provisions of that Act for (i) forward contracts, and (ii) for sale and purchase of commodities, of one-day duration traded on NSEL. The conditions *inter alia* placed an absolute bar on short sales and stipulated that all outstanding positions at the end of the day must result in delivery. It was also stipulated that all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency. The spot exchange was envisaged as a platform for providing transparent and secure trading in commodities with a view to boost the agriculture sector in the country. NSEL commenced operations in October 2008.

19. In September 2009, NSEL introduced, on its platform, the concept of '*paired contracts*', which involved buying and selling the same commodity through two different contracts at two different prices wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In other words, the '*paired contract*' involved *two simultaneous transactions being undertaken at the same time with the same counterparty – one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at different prices on the platform of NSEL*. The transactions were structured in a manner that buyer of the short duration contract always ended up making profits.
20. On February 6, 2012, the Department of Consumer Affairs, Government of India, vide Gazette Notification S.O. 228(E) partially amended the Notification dated June 5, 2007, to the effect that "*all information or returns relating to the trade as and when asked for shall be provided to the Central Government or FMC*".
21. Thereafter, MCA on April 27, 2012 directed NSEL to show cause as to why action should not be initiated against it for the following alleged contraventions:
- a) Permitting short sale of commodities: NSEL had not made it mandatory for the seller to actually deposit goods in the warehouse before he took a short position through a member of the exchange. The exchange had no arrangement to verify the stock position in the warehouses. The exchange allowed trading on the exchange platform without verifying whether the seller member had the stocks with him or not.
 - b) Contracts made available by NSEL were for periods exceeding 11 days.
22. Subsequent to this, MCA vide its letter dated July 12, 2013, directed NSEL to give an undertaking that:
- a) No further/fresh contracts shall be launched by NSEL until further instructions from concerned authority; and
 - b) All the existing contracts will be settled on the due dates.
23. Thereafter, FMC vide an Order No.4/5/2013-MKT-1/B dated December 17, 2013 ("**FMC Order**"), observed that: "55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded

on NSEL were in violation of provisions of FCRA” and “the condition of ‘no short sale by members of the exchange shall be allowed’ was not being met by NSEL”.

24. Further, in the above mentioned Order, FMC *inter alia* held that the contracts traded on NSEL violated the following conditions stipulated in the aforesaid Notification no. SO906(E) dated June 5, 2007, that granted permission to NSEL to offer spot trading in commodities:

a) Short Sale

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

b) Contracts with Settlement Period going beyond 11 days

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

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

26. It is therefore noted that even though MCA had stipulated in the exemption Notification that only contracts of one-day duration were permitted to be offered on NSEL, FMC, in its Order, relying on the definition of “*forward contract*” under FCRA, had held that NSEL was allowed to trade only in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. Therefore, even going by the interpretation adopted by FMC, it becomes clear that the 55 contracts having duration longer than 11 days, which were permitted by NSEL, were *ex facie* in contravention of the exemption granted to NSEL. It is pertinent to note that all the 15 contracts that were publicized by NSEL, which are captured in the Hon’ble Supreme Court’s Judgement *in the matter of NSEL* and the extracts of which are quoted in the next paragraph, were for durations exceeding 11 days.
27. Now, while considering the additional material that has been brought on record, I note that the Hon’ble Supreme Court has extensively commented on the nature of the ‘*paired contracts*’ traded on NSEL in its two judgments. The said observations are captured below:
- a) The Two-Judge Bench of the Hon’ble Supreme Court in the course of determining the validity of the amalgamation order in the matter of 63 Moons had observed as under:
- “55. We have seen that neither FTIL nor NSEL has denied the fact that ‘paired contracts’ in commodities were going on, and by April to July, 2013, 99% (and excluding E-series contracts), at least 46% of the turnover of NSEL was made up of such ‘paired contracts’. **There is no doubt that such ‘paired contracts’ were, in fact, financing transactions which are distinct from the sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL and the FCRA.**” (emphasis supplied)*
- b) The Hon’ble Supreme Court in the MPID matter has drawn reference to the presentations made by NSEL in respect of the ‘*paired contracts*’ and has observed as under:
- “44. ... NSEL in the course of its brochures has held out representations about the trading and investment opportunities available for:*
- a) *corporate clients*

- b) *high net worth individuals; and*
- c) *retail investors*

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

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

The above representation specifies:

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

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

Opportunities

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

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

Features of Trading Opportunity:

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

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

Comparison

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

The above representation indicates that 'paired contracts' were designed as a unique trading opportunity by NSEL under which a trader would, for instance, purchase a T+2 contract (with a pay-in obligation on T+2) and would simultaneously sell a T+25 contract (with a pay-out of funds on T+25). The price differential between the two settlement dates was represented to offer an annualized return of about 16%. NSEL categorically represented that all trades were backed by collaterals in the form of stocks and its management activities included selection, accreditation, quality testing, fumigation and insurance. **Therefore, NSEL represented that on receiving money and commodities, the members would receive assured returns and a service.** Though NSEL has been receiving deposits, it has failed to provide services as promised against the deposits and has failed return the deposits on demand. Therefore, the State of Maharashtra was

justified in issuing the attachment notifications under Section 4 of the MPID Act." (emphasis supplied)

28. From the above, it is noted that the Hon'ble Supreme Court has already commented on the nature of the '*paired contracts*' offered on the NSEL platform. In the merger petition (**63 Moons Technologies Ltd. vs. UOI**), the Hon'ble Supreme Court has held that these contracts were in the nature of financing transactions. Further, in the MPID matter (**The State of Maharashtra vs. 63 Moons Technologies Ltd.**), it was held that such transactions come within the definition of '*deposits*' under the MPID Act.
29. I note that the Hon'ble Supreme Court, in the MPID matter, has extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. In this regard, from the data provided in the table reproduced under paragraph 27 (b) above, it can be seen that NSEL was publicizing a uniform return of 16% p.a. on the '*paired contracts*' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, return offered on a T+2 & T+25 paired contract in steel was same as the return offered on T+ 2 & T + 35 paired contract in castor oil. It is thus noted that the '*paired contracts*' were being projected as an alternative to fixed deposits.
30. I note that the FMC Order, the EOW compliant and the abovementioned two judgments of the Hon'ble Supreme Court have extensively dealt with the issue of NSEL permitting short sales, i.e. permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite quantity of commodity was available in the warehouse. It is further noted from the Hon'ble Supreme Court's Order in the MPID matter that an overwhelming majority of the sale leg of the '*paired contracts*' which were executed were short sales i.e. commodities to back such sales were not available at the designated warehouses of NSEL. However, I note that it was primarily the responsibility of NSEL, and not the brokers, to ensure that there was adequate collateral against sell orders posted on its platform. I am therefore not going to delve any deeper on this issue.
31. I shall now proceed to look into the issue of violation of the third condition mentioned in the exemption Notification i.e. the compulsory delivery of

outstanding position at the end of the day. In this regard, I take note of the observations made in this respect by various authorities. I note that the FMC Order records that “NSEL Board allowed launching of paired back-to-back contracts on its exchange platform comprising a short-term buy contract (T+2 settlement) and a long-term sell contract (T+25 settlement) with predetermined price and profit for the buyer and seller, **which violated the very concept of spot market of commodities and the transactions ultimately were in the nature of financial transactions.**” Further, it has already been stated in the preceding part of this Order that the Hon’ble Supreme Court has held ‘paired contracts’ to be in the nature of financing transactions. I thus note that the ‘paired contracts’ offered by NSEL, which were by design structured in a manner that resulted in no delivery of commodities, have already been found by authorities including the Hon’ble Supreme Court to be in blatant violation of the conditions prescribed in the exemption Notification issued by MCA.

32. Further, I note from the records that SEBI has filed a complaint dated September 24, 2018, against brokers who facilitated access to ‘paired contracts’ traded on NSEL, including the Noticee, with EOW. On the basis of this complaint, an FIR dated September 28, 2018 was filed against the Noticee with EOW.
33. The above observations essentially lead to the question as to whether the Noticee should have been aware that the ‘paired contracts’ offered by NSEL, rather than being spot contracts in commodities, were actually financing transactions which were far removed from commodity spot trading, as such ‘paired contracts’ did not result in compulsory delivery of commodities. As stated in the table reproduced under paragraph 27 (b) above, NSEL itself was publicizing such contracts as an alternate to fixed deposits and the return offered was 16% across all commodities irrespective of the nature of the contract or its duration.
34. It is an undisputed fact that there was a settlement default at NSEL and unsuspecting investors suffered losses of more than Rs. 5600 Crore. In this context, the question that needs to be considered is whether there were enough red flags to alert a reasonable person that what was being offered was not a spot contract in commodities but rather a financial product offering

fixed returns, which should have made him act in a circumspect manner when the “*paired contracts*” were first offered by NSEL. I note that during the period when “*paired contracts*” were offered by NSEL (2009 -2013), the policy repo rate ranged from 4.75 % to 8% whereas NSEL, in its own publicity material, was promising an ‘*assured return*’ of 16%. Contracts were structured in a manner where the buy side always made a profit. The return across commodities, as highlighted in the table under paragraph 27 (b) above, were the same irrespective of the duration of the contract. These are apart from the other *ex facie* deviations from the exemption notification that “*paired contracts*” suffered from.

35. I therefore find that the writings on the wall were quite visible and there were enough red flags for a reasonable person to come to conclude that what was being offered as paired contracts on NSEL were not spot contracts in commodities. However, there are sufficient evidences establishing that the Noticee had indulged in / facilitated paired contracts. In this context, I note that Noticee has admitted in its submissions that it had traded / facilitated trading in paired contracts. I also note that as per the EOW Report submitted vide letter dated April 4, 2015, the Noticee had an exposure of Rs. 214,75,81,528 in NSEL paired contracts. It is also noted that as per the forensic Audit Report of Grant Thornton dated September 21, 2023, there was a pay-out obligation Rs. 210,82,47,177 with respect to the Noticee as on September 19, 2013. Further, NSEL vide circular ref. no. NSEL/C&S/2013/073 dated August 27, 2013 provided the particulars of the special payout made to the Noticee amounting to Rs. 1,27,23,427 for making disbursement to its respective trading clients. Therefore, there is no dispute to the fact that Noticee had facilitated trading in ‘paired contracts’ on NSEL.
36. Having reviewed all the material on record, I am constrained to conclude that the Noticee, presumably driven by its desire to earn brokerage, acted as a facilitator for its clients to access a product which raised serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the product itself. The Noticee should have been more careful while offering such a product to its clients.

Fit and Proper Person’ Criteria

37. Regulation 5(e) of the SEBI (Stock Brokers) Regulations, 1992 (“Stock Brokers Regulations”) provides that for the purpose of grant of Certificate of Registration, the applicant has to be a fit and proper person in terms of Schedule II of the Intermediaries Regulations. I note that the *‘fit and proper person’* criteria, specified in Schedule II of the Intermediaries Regulations, was amended vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021, and the amended provision is quoted earlier in this Order.
38. I note that post the amendment carried out in 2021, the *‘fit and proper person’* criteria now has both a 'principle based criteria' and a 'rule based criteria', as opposed to the earlier criteria which was 'purely principle based'. I further note that *‘fit and proper person’* criteria is a requirement that has to be satisfied by an intermediary throughout the time it holds a valid Certificate of Registration with SEBI. Thus, even though the Noticee was granted a Certificate of Registration with effect from December 17, 2015, it was still required to comply with the revised criteria post the amendments carried out in 2021. I note that paragraph 3(b) of the amended criteria lays down a list of disqualifications which includes, under paragraph 3(b)(i) *“criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending.”*
39. As already stated above, a criminal complaint has been filed by SEBI before the EOW against the Noticee. Pursuant to the SEBI complaint, FIR No. Spl LAC No. 110/18 dated September 28, 2018 under section 154 of the CrPC at the MIDC Police Station, Mumbai, was registered against the trading members, including the Noticee, which were listed in the SEBI complaint to EOW. It is, therefore, noted that the Noticee attracts the disqualification provided in paragraph 3(b)(i). Further, the act of Noticee in offering access to *‘paired contracts’* also seriously calls into question the integrity, honesty and lack of ethical behavior on the part of the Noticee. These contracts, as stated earlier, were *ex facie* offered in violation of the exemption Notification issued by MCA and far removed from the spot contracts in commodities which were permitted to be traded on NSEL. The *‘paired contracts’* were nothing but financing transactions masked as spot contracts in commodities. It has

already been held above that there were enough red flags for a reasonable person to infer that what was being offered as “*paired contracts*” on NSEL were not spot contracts in commodities and that the Noticee, presumably driven by its desire to earn brokerage, provided a platform for its clients to access a product which raised serious questions on the Noticee’s ability to conduct proper and effective due diligence regarding the product itself.

40. In view of the above, I hold that the Noticee failed to comply with the ‘*fit and proper person*’ criteria specified in Schedule II of the Intermediaries Regulations on continuous basis.
41. I note that the DA has recommended for the cancellation of Certificate of Registration of the Noticee as a commodities derivatives broker. However, considering the role of the Noticee in the entire events surrounding the ‘*paired contracts*’, I am of the opinion that the suspension of Certificate of Registration for a period of 3 months from the date of this order or till the disposal of abovementioned FIR filed with EOW, whichever is later, would be commensurate with the findings made against the Noticee in this Order.

ORDER

42. In view of the foregoing discussions and deliberations, I, in exercise of powers conferred upon me under Section 12 (3) and Section 19 of the SEBI Act, 1992 read with Regulation 27 of the Intermediaries Regulations, hereby suspend the Certificate of Registration (bearing No. INZ000050137) of AUM Commodity Services Private Ltd., as a commodities derivatives broker, for a period of three (3) months from the date of this Order or till the disposal of FIR filed with EOW, whichever is later.
43. The Noticee shall, after receipt of this order, immediately inform its existing clients, if any, about the direction in paragraph 42 above.
44. Notwithstanding the direction at paragraph 42 above, the Noticee shall allow its existing clients, if any, to withdraw or transfer their securities or funds held in its custody, within 15 days from the date of this order.
45. The Order shall come into force with immediate effect.

46. A copy of this order shall be served upon the Noticee and the recognized Market Infrastructure Institutions for necessary compliance.

DATE: NOVEMBER 29, 2023

PLACE: MUMBAI

ASHWANI BHATIA

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA