

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.	Geofin Comtrade Limited (Formerly known as “Geojit Comtrade Limited”)	AADCG3019R

In Re: Fit and Proper Criteria

BACKGROUND OF THE CASE:

1. Geofin Comtrade Limited (Formerly known as “Geojit Comtrade Limited”) (hereinafter referred to as “GCL” / “Geofin” / “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”) National Multi Commodity Exchange of India Limited (hereinafter referred to as “NMCE”) and Ace Derivatives and Commodity Exchange Limited (hereinafter referred to as “ACE”).
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, GCL 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 Mohan & Mohan Associates, Chartered Accountants (hereinafter referred to as **“Auditor”**) to carry out a performance audit/inspection of GCL.
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 GCL 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 GCL. 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 GCL submitted for registration as a commodity broker may not be considered in the interest of securities market and the application of GCL 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 GCL 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 GCL 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 GCL wherein GCL was advised to reply to the SCN within 21 days from the date of receipt of said notice. GCL vide letter dated May 15, 2017 had acknowledged the receipt of SCN. The allegations in brief 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, making assurances that pair trades are backed by collateral in the form of stock / sufficiency of commodities in warehouses, making statements that goods in warehouse are backed by insurance cover; which are in violation of provisions of various circulars, rules and bye laws of NSEL and sections 21(g) of the FCRA.
- 10.3. Noticee had done client code modifications with manipulative artifice which are in violation of provisions of various circulars, rules and bye laws of NSEL.
- 10.4. Noticee had failed to report suspicious transactions to Financial Intelligence Unit under PMLA thereby violated provision of NSEL Circulars.
- 10.5. Noticee had failed to exercise proper skill and diligence in making necessary / timely disclosures relating to change in shareholding pattern; Noticee had not maintained separate margin books for each exchange; Noticee had failed to obtain KYC forms / discrepancies in KYC procedure; Noticee had failed to collect margins from clients across exchanges; Noticee had failed to adhere to the guidelines related to pre-funded instruments; Noticee had not settled the accounts of its clients; Noticee had delayed in making payment of service tax; Noticee had failed to report violations of audit annual confidential report; which are in violation of MCX, NCDEX, NMCE 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. GCL vide various letters/emails dated June 05, 2017, July 11, 2017, August 09, 2017, September 15, 2017, September 19, 2017, September 21, 2017, October 04, 2017, October 18, 2017, November 20, 2017, January 05, 2018 and January 18, 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 GCL on July 06, 2017 and copies of all relied upon documents were also provided to GCL through various letters dated August 29, 2017, November 08, 2017 and January 05, 2018.
12. In view of the stand of SEBI that it has granted inspection of all relied upon documents and the stand of the Noticee that they are entitled to get additional documents and their request that a hearing on merits be fixed only after they file detailed reply based on all the requested documents, in order to overcome the impasse resulting from the conflicting stands, an opportunity of hearing on February 20, 2018 was provided to the Noticee in respect of inspection of documents. Authorized Representatives of the Noticee appeared for hearing and made oral submissions with respect to the inspection of documents and matter was heard at length.
13. After consideration of submissions of the Noticee on the issue of inspection, a detailed order dated August 30, 2018 was passed on the issue of inspection and the proceedings related to inspection was closed. The said order dated August 30, 2018 was delivered to Noticee through email and speed post.

14. Noticee had filed an appeal before Hon'ble Securities Appellate Tribunal (SAT) against the Order dated August 30, 2018 passed by SEBI Whole Time Member. However, it is noted that vide Hon'ble SAT order dated December 12, 2018, Noticee had withdrawn the said appeal.

REPLY AND HEARING ON MERIT OF THE CASE:

15. In the interest of natural justice, vide order dated August 30, 2018, Noticee was given an opportunity to appear for a personal hearing on merits on September 27, 2018 at SEBI, Head Office, Mumbai.

16. GCL vide letter dated June 22, 2018 had filed an application with SEBI for withdrawal of the application for registration made by them vide applications received on December 16, 2015. SEBI vide letter dated July 09, 2018 had informed GCL that enquiry proceedings under Intermediaries Regulations against them are in progress, therefore, in view of pending enquiry proceedings, their request for withdrawal of the application for registration cannot be entertained.

17. Aggrieved by SEBI's letter dated July 09, 2018, GCL filed a writ petition no. 3294 of 2018 before Hon'ble High Court of Bombay challenging the said letter dated July 09, 2018 by which SEBI had not entertained the request of GCL for withdrawal of the application for registration. The said writ petition before Hon'ble High Court of Bombay was mentioned on September 24, 2018.

18. I.V. Merchant & Co. Advocates & Solicitors, on behalf of GCL vide email dated September 26, 2018, stated the said Writ Petition before Hon'ble High Court of Bombay was scheduled to be listed before regular bench on October 01, 2018. Therefore, in view of this, GCL requested SEBI not to proceed with the hearing scheduled on September 27, 2018 and to defer the hearing till the disposal of said writ petition.

19. Considering the request of the Noticee and in the interest of Natural Justice, SEBI vide email dated September 26, 2018, has granted another opportunity of hearing to the Noticee to appear on October 09, 2018 at SEBI, Head Office, Mumbai.
20. It is noted that Hon'ble High Court of Bombay vide order dated October 04, 2018 rejected the Writ Petition no. 3294 of 2018 filed by the Noticee.
21. On October 09, 2018, Mr. Dipan Merchant, Senior Counsel, Mr. Digant Bhatt, Advocate, Ms. Juhi Shah along with Mr. Simon Mathews, from GCL, Authorized Representatives (hereinafter referred to as "ARs") of GCL appeared for the hearing. Following *inter alia* was noted during the hearing:

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- 2) *During the course of hearing, GCL submitted that in the present matter they had filed petition before the Hon'ble High Court of Bombay. The Hon'ble High Court of Bombay has disposed of the said petition on October 04, 2018 and formal order from the Hon'ble High Court of Bombay is yet to come. They further stated that they are unaware about the content of the order and are yet to decide on the future course of action on the said High Court order. Therefore, in view of non-receipt of High Court order in the matter, GCL sought an adjournment of today's hearing. The undersigned noted that it is understood that the Hon'ble High Court of Bombay has pronounced as dismissed the writ petition and no evidence of stay of the enquiry proceedings in respect of GCL is brought to notice. Thus, the undersigned is of the view that, the enquiry proceedings in respect of GCL is to continue.*
- 3) *During the course of hearing, GCL submitted that today morning they have filed an application before Hon'ble Securities Appellate Tribunal and the matter will be mentioned before Hon'ble Securities Appellate Tribunal later today afternoon after the conclusion of today's hearing before Hon'ble Whole Time Member, SEBI. The undersigned noted the said submission of GCL, however, the undersigned is of the view that, there is no bar on SEBI to proceed further in the enquiry proceedings.*
- 4) *During the course of hearing, ARs of GCL stated that SEBI had not provided the copy of documents as directed by Hon'ble Whole Time Member in order dated August 30, 2018. Thus, it is submitted that SEBI is in non-compliance of Hon'ble Whole Time Member order dated August 30, 2018. ARs requested to provide those documents and the legible copies of the documents. In view of this, ARs requested to adjourn today's hearing.*

The undersigned directed SEBI to state whether the copy of documents required to be provided by SEBI as per the order dated August 30, 2018 has been granted to GCL and that any required reconciliation of this is to be concluded today itself.

*On the basis of this representation, the undersigned granted final opportunity of hearing on **October 12, 2018** at 03.00 P.M. at Head Office, Mumbai and the same was informed at the time of hearing.*

Decision Post hearing

- 5) *After the conclusion of today's hearing, SEBI stated that the copy of documents required to be provided by SEBI as per the order dated August 30, 2018 has been granted to GCL at the time of inspection held on February 21, 2018 and the same has been mentioned at paragraph 21 of the order dated August 30, 2018. ARs of GCL who were on reconciliation have conceded that nothing is pending.*
- 6) *SEBI stated that it has provided the best possible legible copy of documents mentioned at Sr. No. 19 of Table No.1 of Order dated August 30, 2018 at the time of inspection held on February 21, 2018.*
- 7) *In view of position mentioned at paragraph 5 and 6 above, the undersigned notes that the request of adjournment sought by GCL is on the basis of incorrect representation made during course of today's hearing.*
.....”

22. On October 12, 2018, Mr. Dipan Merchant, Senior Counsel, Mr. Digant Bhatt, Advocate, Ms. Anisha Agarwal, Advocate, Ms. Juhi Shah and Mr. Simon Mathews, Chief Manager from GCL, **ARs** of GCL 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:

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- (a) ARs submit the reply dated October 12, 2018 and made the oral submissions in line with reply dated October 12, 2018.*
- (b) Following queries are raised to the ARs of the Noticee with regard to due diligence in respect of trading at NSEL by the Noticee:*
 - (i) Whether the Noticee had any internal process / product approval committee for assessment/determination of product that is to be traded on exchange/NSEL?*
 - (ii) Whether the product i.e. paired contract was approved by Noticee's product approval committee or not.*
 - (iii) Whether the Noticee has done independent assessment of the product.*

(iv) *Whether the sales team of the Noticee has the direction to sell only approved products to their clients or sales team sell whichever product they would like to sell to their clients.*

(v) *What due diligence Noticee done before / while trading in paired contracts at NSEL.*

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

*(c) The matter is part heard and hearing in the matter is adjourned to **October 31, 2018** at 10:30 A.M. at Head Office, Mumbai.*

..... ”

23. Noticee submitted its reply dated October 12, 2018 on merits to the SCN. The reply of the Noticee in brief are as under:

- 23.1. That the notification dated 5th June, 2007 which was Gazetted did not cast upon any independent responsibility on the members of NSEL but on the contrary it saddled NSEL with the responsibility of seeing that no transaction of short sales took place and that all outstanding positions of trade at the end of the day would result into delivery.
- 23.2. That NSEL started its membership drive in June 2008. It had a set of bye- laws and rules like other commodity exchanges i.e. MCX, NCDEX, NMCE, etc. and had bunks offering the clearing services. The membership was granted subject to NSEL bye-laws. The NSEL bye-laws came into effect from June 2008. Reading the byelaws of NSEL would clearly show that NSEL had adopted all the necessary requirements in its byelaws for it being said to be an exchange dealing in commodities. This aspect aspired confidence on the part of various persona who later on started trading on the exchange. It must not be out of place to mention here that though the membership drive was started in 2008, Geofin became member of NSEL in the year 2010 and started trading on the exchange in or about October, 2011 in respect to the commodities.
- 23.3. Since NSEL had various brokers on their membership lists at the time of Geofin becoming a member, therefore, there was no need for Geofin to doubt the credentials of NSEL.
- 23.4. That after becoming a member, Geofin only informed their respective clients about their becoming a member of NSEL on their website and nothing else about the working of NSEL. Geofin did not do a presentation of its business to solicit work contrary to the byelaws. It is also to be noted that the said presentation was not circulated to the outside world at large.

- 23.5. That it was NSEL who was in charge of approving the contracts and it was only after the approval by NSEL that the transaction could materialize.
- 23.6. The very fact that none of the transactions are disapproved/objected by NSEL, it presupposes that all transactions were within the parameters of the byelaws, enactments and regulations and therefore cannot be opened up as a subject matter of the SCN or the Report. That admittedly there is no complaint against Geofin by NSEL in respect of the transaction carried out by Geofin on NSEL nor has NSEL informed Geofin of any of its clients complaining about the performance of Geofin on the NSEL to NSEL exchange.
- 23.7. That it was NSEL on the basis of whose representation / acceptance of the transaction, Geofin would be able to give a guaranteeing service. That a foolproof mechanism was provided for in the NSEL Regulations. Various companies/brokers had become members of NSEL prior to Geofin trading on NSEL, on behalf of their clients. Therefore, in 2010-11 when Geofin entered the NSEL Exchange various other brokers were already enrolled on the NSEL panel and were already carrying on business, Geofin merely followed the Regulations and carried on business on the Exchange like other brokers already registered with the exchange.
- 23.8. That Geofin have in fact not breached the condition of completing a transaction within period of 11 days. There is no provision in the Bye-Laws for Geofin or its clients to take direct delivery of goods.
- 23.9. That NSEL was following delivery and settlement beyond 11 days from September, 2009 when Geofin was not even its member and the Board of Directors of exchange ratified the above in the board meeting of 16th November, 2009. The exchange also in its board meeting dated 19th December, 2009 ratified trading of T+25 contracts and subsequently thereto such contracts were introduced. Therefore, it is to be noted that T+25 contract were permitted by the board of NSEL since 2009 before Geofin became its member. The Designated Agency namely FMC was appointed in or about September, 2011 and even they did not object to or prohibit the T+25 contract. Geofin's first trade on the paired contract was in or around October, 2011 (after the appointment of FMC as Designated Agency).
- 23.10. That the Hon'ble High Court in W.P. No.2743 of 2014 had stated that turnover of paired contract between 2009-2013 was not a negligible figure but was to the tune of Rs. 1,34,000 Crores. This proves that paired contracts were in existence in NSEL since 2009 as stated above. Geofin crave leave to refer to and rely upon the Order of the Hon'ble Bombay High Court dated 4th December, 2017 passed in W.P. No.2743 of 2014.
- 23.11. That till date there is no adjudication in relation to the allegations made against NSEL. There is no findings of any court of competent jurisdiction that the function of NSEL was contrary to any law for time being in force and therefore the proceedings against Geofin about declaration of it not being fit and proper person is premature till the time the stand taken by NSEL about the transaction of T+25 and T+35 are not adjudicated

upon the question of any authority deciding on a fit and proper person so far as Geofin are concerned is in violation of principle of natural justice and fair play. Adjudication proceedings on the above issue are pending before the Hon'ble High Court of Bombay and various other investigating agencies. The burden of proof that the transaction of T+25 or T+35 is and was on NSEL till that issue is decided, Geofin cannot be considered guilty of any offence.

- 23.12. That Geofin have been members of MCX, NCDEX and NMCE since December, 2008 and none of these exchanges have lodged any disciplinary action/complaint against Geofin. Therefore, there is no reason for Geofin being considered not being a fit and proper person.
- 23.13. That none of the clients of Geofin have complained about any false assurances or any misleading statements given to them by Geofin.
- 23.14. That as an intermediary Geofin was on one hand connected with their respective client and on the other hand with NSEL. With the byelaws of NSEL regulating each and every transaction, the question of Geofin misleading or soliciting work from the respective client did not arise. The KYC form and Member Client Agreement and the Risk Disclosure document which Geofin have obtained from their respective clients contained the clause about the risk in dealing on NSEL. Therefore, the clients of Geofin were put to notice of the risks associated with the transactions/dealing on the NSEL.
- 23.15. That till 2011, when FMC was appointed to regulate NSEL, there was no regulatory authority/designated agency controlling NSEL, therefore what was decided and done by NSEL was at their discretion and binding on all members.
- 23.16. FMC vide its letter dated 12th February, 2013 stated that they are not designated regulator for NSEL, nor the department of Consumer Affairs, Food & Public distribution has recognized NSEL. Neither FMC nor any regulatory authority took any steps to direct NSEL to stop the contracts and till 12th February, 2013, NSEL was directed to remove misleading information from its website but no specific direction to NSEL to stop the paired contracts.
- 23.17. That Geofin believed bonafide as to what was stated on the website of NSEL to be correct since the contents of the website was there much prior to Geofin becoming members of NSEL. Therefore, there was no question of Geofin doubting the same and not following what was mentioned on the Exchange/NSEL's website.
- 23.18. That NSEL were in complete control of all the transactions between to 2007 to 2011, NSEL did not take any objection to the paired contracts and did not inform the members not to deal in the paired contracts. In 2011 when Geofin started trading, Geofin proceeded on the basis of what was being traded on the exchange since 2009. Further, NSEL guarantee the fulfillment of the contracts, therefore if all the contracts were covered under the settlement guarantee mechanism and a Settlement Guarantee Fund (SGF) was also in place, it presupposes that all the contracts in the exchange were covered under the same and accorded guarantee for fulfillment of such a contract.

I Hence, irrespective of the member's obligation towards its own clients, in view of the guarantee given by the exchange under its SGF, member cannot be held responsible for any settlement default other than its own.

- 23.19. That the charges of Circular trading, suspicious trading, trading in clients name without their permission, funding the client through NBFC were exonerated against Geofin by the DAs in their enquiry report.
- 23.20. That the NSEL circular dated 8th July, 2011 bearing no. NSEL/TRD/2011/122 states that Client Code Modification was permitted but it had to be within the time frame provided for in the circular. Geofin state that, the Client Code Modification had taken place within the time period given in the above referred circular and Geofin are ready and willing to produce such documentary evidence as and when called upon to prove the above position.
- 23.21. With respect to the allegation of violation of failure to report change in the shareholding pattern and failure to obtain necessary permission/approval, Geofin states that when Geofin was informed about the same by MCX exchange through their auditors, Geofin was penalized on the payment of fees which Geofin had paid. Therefore, so far as Geofin is concerned the issue doesn't survive now.
- 23.22. Geofin deny that it did not exercise proper skill and diligence in the matter of making necessary / timely disclosure relating to its shareholding pattern hence deny that they have violated MCX circular dated 4th May 2012, 10th January 2006 and other circulars and regulation referred in paragraph 88 to 91 of the report.
- 23.23. With respect to the allegation regarding non-maintenance of separate margin deposit book, Geofin state that, it was pointed out to the auditors of NSEL as stated therein the Margin Deposit Book was in a soft copy form. But the allegation is that it was not maintained exchange wise. Geofin states that it is in position to show the bifurcation as and when called upon.
- 23.24. That not giving an opportunity of personal hearing before the Designated Authorities as particularly sought by Geofin is violation of principles of Natural Justice.
- 23.25. That for determining a person to be 'fit and proper person', financial integrity, competence and good reputation character, efficiency and honesty are some of the criteria's. From the perusal of the enquiry report, it can be seen that neither any remarks have been attributed to financial integrity, competence, good reputation character nor of efficiency and honesty therefore as far as the enquiry report is concerned for declaring Geofin as not fit and proper person by recommending the same. Therefore, the finding of the report is contrary to regulation 3.1 and 3.2 of the Securities Exchange Board of India (Criteria for Fit and Proper person) Regulations 2004. Further, there is no conviction by any competent court nor any civil liabilities attributed to Geofin by any court of competent jurisdiction. Thus, the findings of the report are contrary to the facts, the statute and the Regulations.

- 23.26. So far as preliminary objection raised in Geofin letter dated 6th December, 2016, Geofin still contend that SEBI does not have jurisdiction to issue an inquiry under the said Regulations.
- 23.27. That in the entire enquiry report the allegations made against Geofin are general in nature and without any documentary evidence. Even the show cause notice which was given, proceeded on the basis of general allegation without any specific reference to any fact or any specific allegation with documentary evidence. Therefore the enquiry report as well as the SCN on which the Report is based is devoid of particulars. The circulars of which breach is alleged were addressed to the exchange and not specifically to Geofin nor in the report or the SCN it is shown by way of documentary evidence that Geofin was privy to such circulars.
- 23.28. That NSEL did not make it mandatory for the seller to actually deposit goods in the warehouse before he takes a sell position through a member of NSEL. NSEL system had no stock check facility that validated the stock position in the accredited warehouses. NSEL allowed trading on the exchange platform without verifying the seller member has the stock with him or not. In this manner it is NSEL itself which violated the condition no (i) in the 5th June, 2007 Gazette that no short sale were permitted.
- 23.29. That when the entire transaction was through the medium of NSEL, the NSEL exchange failed in its duty of not verifying the stock in its go downs. The brokers like Geofin who are members of NSEL were duty bound to only trade through the medium of NSEL. Upholding, rejecting, altering the transactions was within the parameters of NSEL only, if NSEL would have kept proper noting of actual deliveries, stock availability and accordingly allowed or disallowed the transaction, the question of short sale would not have arisen.
- 23.30. That on 7th February, 2012, NSEL issued a circular giving guidelines for advertisements and usage of NSEL logo by the Members. It is not the case of NSEL that Geofin have violated any provision of this circular. Again a circular was issued on 6th August, 2012 regarding advertisements and Do's and Don'ts by the Members. Geofin have followed this circular and there is no letter or complaint from NSEL or even from SEBI pointing out non-compliance of this circular by Geofin. Geofin had neither used NSEL logo nor advertised or issued any brochures, pamphlets, catalogs in newspaper magazine, radio, television or periodicals. Geofin had only white labelled the PPT of the exchange which was on the website of the Exchange.
- 23.31. That it is settled position that as a member of the Exchange one is bound to follow the circulars issued by NSEL and if there is no breach on the part of the member in following the circular, no member can be held liable for an act which is in consonance with the circular of NSEL.
- 23.32. That the Bye-Laws of NSEL provides that the Board of Directors or the committee may from time to time prescribe the business rules and regulations for the function of NSEL members, participants on various issues mentioned in the Bye- laws and the

members, participants would be bound by such business rules or amended bye-laws. Therefore in light of the above the above circulars issued by NSEL from time to time by way of business rules and regulations were binding on the members like Geofin. Clause 3.14 of the Bye-laws clearly provide *“any delay or failure to observe or comply with any requirement, either in full or in part under these Bye-Laws or the Business Rules and Regulations of the Exchange, may be dealt with by the Exchange as a violation of the Bye-Laws, Business Rules or Regulations of the Exchange”*. There is no complaint on record from NSEL till date that Geofin has failed to observe or comply in full or in part Regulations, Bye-Laws or Business Rules of the Exchange from the Exchange.

- 23.33. In view of the Bye-Laws it is clear that it was the exchange who had complete control of the transaction including the contracts, terms of the contracts and days for buy and sale of commodities. Whenever there would be a failure: on the part of the member to meet its settlement obligation Bye-laws 12.7 r/w Bye-Laws 12.1 and 12.2 would apply. In view of Bye-law 12.7, the constituent was fully protected. It is no one's case that NSEL had to take shelter of Bye-Law 12.7 due to any settlement failure on the part of our client.
- 23.34. That there is nothing on record to show that Geofin was defaulter. There is nothing on record to show from year 2010 till 2013 when the alleged fraud at NSEL was being probed, that Geofin had not performed their obligations under rules and Bye-Laws of NSEL.
- 23.35. Geofin states that the transactions with its client which are subject matter of default of pay-out by NSEL of Rs.323 Cr., none of its clients have filed any suits in any court of India for recovery of the same nor have they complained to any forum or invoked the arbitration for the amount. This clearly shows that Geofin client have not found any fault with regards to any dealings or orders with Geofin. The clients have complained against NSEL.
- 23.36. That the obligation of the pay-out was on NSEL and Geofin was not connected with the pay-out obligation.
- 23.37. That under regulation 24(1) of Intermediaries Regulations the designated member had to first come to a conclusion that any person has committed it default under Regulation 23 of Intermediaries Regulations and then only power to appoint designated authority will come into play.
- 23.38. That SEBI does not have any jurisdiction to issue SCN as it was not in consonance with SEBI (Intermediaries) Regulations 2008 nor in consonance with SEBI (Stock-Brokers and Sub-Brokers) Regulations 1992.
- 23.39. That since there is no breach on the part of Geofin of SEBI (Intermediaries) Regulations 2008 or with SEBI (Stock-Brokers and Sub-Brokers) Regulations 1992. Therefore, the appointment of designated authority is itself bad.
- 23.40. That the application for registration which was required to be made under Section 131 of Finance act, 2015 was made by Geofin and is pending. In view of this, regulation 7

of Intermediaries Regulations would come into operation. Therefore, before rejecting an application the applicant (in this case Geofin) ought to have been given the opportunity in writing to make good the deficiencies within the time specified by the board. Admittedly no such opportunity in writing has been given to our clients to make good the deficiencies. In fact no letter has been addressed by SEBI pointing out deficiency in the application. In view of the above if there is a non-compliance of regulation 7 then under Intermediaries Regulations there is no provision for not allowing, or rejecting the application. The Designated Authorities who made the inquiry report are not the concerned authorities under regulation 7 of Intermediaries Regulations 2008 and therefore they could not cancel or recommend cancellation of the application. Regulation 7 of Intermediaries Regulation does not permit SEBI to rely upon or to call for third party report or any report for granting or not granting permission. Without prejudice to the aforesaid contentions it is submitted that having not permitted our client to know the deficiency in writing and answering them the whole report is bad and therefore the SCN is bad in law and is liable to be and should be withdrawn.

- 23.41. That both the paired contracts and trade beyond 11 days were never barred till July 2013.
- 23.42. With reference to paragraph 19 of enquiry report, that Geofin have merely followed the circulars issued by NSEL prior to them becoming a member and circulars issued thereafter from time to time. So far as T+25 and T+36 long-term sale contracts are concerned, it was prevalent under circulars of 2009. It cannot be therefore said that Geofin were party to circular in connivance or collusion with NSEL as Geofin was not even connected in any manner whatsoever with NSEL at that time.
- 23.43. With reference to paragraph 20 and 21 of enquiry report, Geofin stated that the allegation is made in general that the members of NSEL including the Noticee, i.e. Geofin have not conducted the business in accordance with the conditions stipulated in GOI notifications dated 5th June 2007. This allegation on face of it is general devoid of merits in particulars. No documentary evidence has been produced to show that Geofin did not conduct the business in accordance with the circular. Assuming without admitting that, the notification provided certain conditions, but if NSEL issued circulars contrary to those conditions mentioned in the government notification meant for NSEL, the members cannot be made liable personally unless it was specifically brought to the notice of the members through NSEL circulars (which in the present case was not done). The byelaws clearly provides that the members are supposed to follow the business rules and circulars issued by NSEL. Therefore, if one has followed the circulars issued by NSEL one cannot be blamed for the same. So far as short sale or compulsory delivery of outstanding position at the end of the day as per GOI notifications is concerned as stated above, from 2009 (when our clients were not the members of the Exchange) the circular issued by NSEL provided T+25 and T+36. Therefore, Geofin are not liable for the same.

- 23.44. With reference to paragraph 22 of enquiry report, Geofin states that when the byelaws provides certain rules and regulations issued by NSEL, member has to strictly adhere to the regulations. If one of the regulations makes it mandatory for the members to follow the circular issued or business rules issued by NSEL no fault can be found with the person/member who followed those byelaws strictly.
- 23.45. With reference to paragraph 23 of enquiry report, Geofin stated that, it was NSEL that was monitoring the delivery in the accredited warehouses and was also providing complete settlement guarantee. The role of Geofin was limited to enter into contract as an Intermediary on the Exchange platform. It was the Exchange who could modify, cancel vary terms of the contract under the regulations, if so required subject to superintendence of the designated agency. If that was not done by NSEL, NSEL has deemed to be admitted the contract as it stood and was obliged to deliver the goods as contracted and it was not an obligation of Geofin to do the same, as Geofin merely acted as an intermediary and the obligation of delivery was not upon Geofin as per the regulations of NSEL.
- 23.46. With reference to paragraph 24 of enquiry report, Geofin stated that no independent responsibility was cast upon the members as per GOI notifications. Geofin deny that it being the member of NSEL, ipso-facto came within the regulatory ambit, if the same has to be read in conjuncture with GOI notifications. Geofin submitted that the members are bound by the circulars issued by NSEL from time to time only. If the members are not made aware or kept aware of all the notifications/circulars issued, withdrawn, varied from time to time issued by the GOI, the members cannot be held responsible.
- 23.47. That Geofin denied each and every allegations mentioned in the enquiry report which are contrary thereto and inconsistent therewith.
- 23.48. With reference to paragraph 46 of enquiry report, Geofin stated that they have not violated the provisions of PMLA. NSEL had never stated that the transaction in T+2/T+25 contracts simultaneously would be treated as financial transaction / structured deal. Exchanges intimate the brokers whenever there is a transaction which would come under the definition of financial / structured transactions. This is followed by futures exchanges like MCX / NCDEX / NMCE. Exchanges have the necessary infrastructure to identify a suspicious / financial / structured transaction, whereas for a member it would not be possible as the counter party to the trade is not known to the member. The transactions in NSEL were according to the Rules and Regulations of the exchange and were not suspicious. The clients were registered after executing the KYC documents along with the submission of their ID / Address and PAN proof. All payments were made through banking channel and the transactions were not questionable. As the transactions by clients were genuine, there was no necessity for the same to be reported to FIU and there is no violation of PMLA. Rather, NSEL should have reported these transactions and about the defaulters to FIU. Since FMC was reportedly aware of the violations by NSEL, they ought to have taken action and

reported to FIU. Geofin have learnt that the appellate authority of FIU-IND has upheld the imposition of penalty qua NSEL and there is no finding against any members of NSEL.

- 23.49. With reference to paragraph 57, 58 and 59 of enquiry report, Geofin deny that they have indulged in making false/misleading presentation to the public at large. Geofin further states that FMC in its finding has concluded that NSEL was giving misleading information on its website and therefore if NSEL has given misleading information, the members or its constituents cannot be faulted for the same.
- 23.50. With reference to paragraph 61 of enquiry report, Geofin states that if the Bye-Laws itself provides of advertisements for getting the work, the question of obtaining permission for such advertisement from the Exchange did not arise. The Bye-Laws does not mention of requirement of leave from NSEL, prior to issuance of any advertisement.
- 23.51. Geofin deny that the transactions which were referred to in the enquiry report were structured or were financial transactions.
- 23.52. Geofin deny that they had given false/misleading presentation and/or had assured/risk free return, arbitrage, trade opportunity as alleged or otherwise. Geofin further deny that they have violated circular dated 7th February 2012, 6th August 2012 and Clause 14 of code of conduct as per byelaw 14.2.5 or provisions of Section 21 (g) of FCRA.
- 23.53. With reference to paragraph 115 of the enquiry report, Geofin state that each of the allegations that the EOW had made in its Remand Application (against the Director of Geofin), the same was contested in the Hon'ble MPID Court and the Bail Order dated 23rd March, 2015 decimated such allegations. EOW has since then not sought any information whatsoever from Geofin and not yet filed any charge-sheet against Geofin or its Director.
- 23.54. With reference to paragraph 116 of the enquiry report, Geofin state that till date no competent authority has held Geofin to be guilty of any offenses nor any competent authority has given finding as to the integrity and character of Geofin of their competence including financial solvency and net worth of Geofin.
- 23.55. The findings mentioned in the report clearly shows a non-application of mind and also contrary to records. With reference to paragraph 117 to 120 of the enquiry report, Geofin submitted that on the contrary it is the NSEL who has misled all their members and their respective clients in issuing circulars and business rules. It was NSEL which permitted all the transactions on its Exchange with all powers to challenge the transaction if found contrary to the regulations, rules, NSEL has never challenged any of Geofin transaction. Having given a guarantee to give delivery and having control of the accredited warehouses and not adhering to them, itself shows the violation by NSEL itself and for which no members can be penalized, in any manner whatsoever

24. On October 31, 2018, Mr. Dipan Merchant, Senior Counsel, Ms. Dimple Merchant, Advocate, Mr. Chirag Shah, Advocate, Mr. Digant Bhatt, Advocate, Ms. Anisha Agarwal, Advocate, Ms. Juhi Shah and Mr. Simon Mathews, Chief Manager from GCL, **ARs** of GCL 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 submit the additional compilation of documents vide letter dated October 30, 2018. ARs reiterate the oral submissions made during the hearing held on October 12, 2018 and further reiterate and made the oral submissions in line with reply dated October 12, 2018.*

(b) *ARs granted time till November 15, 2018 to submit the replies of the queries asked during the hearing held on October 12, 2018 alongwith additional written submissions in the matter.*

..... ”

25. Thereafter, the Noticee vide letter dated November 13, 2018 submitted its additional written submissions in the matter. The additional written submissions of the Noticee in brief are as under:

25.1. That the present proceedings ought not to have continued without giving inspection of all the documents which were sought for. That Noticee has preferred an Appeal to the Securities Appellate Tribunal being Appeal No. (L) 458 of 2018 from the Order dated- 30th August 2018 passed by SEBI Whole Time Member refusing to grant inspection. The said Appeal has been served on SEBI. The said Appeal No. (L) 458 of 2018 is pending.

25.2. That SEBI issued a Show Cause Notice dated 28th October 2016 (hereinafter referred to as “the first Show Cause Notice”) under Regulation 25 read with 27 of Intermediaries Regulations. Geofin has filed a detailed Reply to the said first Show Cause Notice on 6th December 2016.

25.3. That no action has been taken under the said first Show Cause Notice. No hearing was given and the issue of jurisdiction raised in the said first Show Cause Notice was also not decided and no finding has been given on the jurisdiction aspect.

25.4. That SEBI issued a second Show Cause Notice on 24th April 2017 (hereinafter referred to as “the second Show Cause Notice”). The said second Show Cause Notice does not refer to the first Show Cause Notice and therefore, this second Show Cause Notice is an independent Show Cause Notice and not connected with the first Show Cause Notice to which there is no finding against Geofin and as there was no hearing given in respect thereof. The second Show Cause Notice only annexes the Enquiry

Report dated 11th April 2017 and it does not mention that SEBI has accepted the said Enquiry Report dated 11th April 2017. The second Show Cause Notice only mentions that the Report of the Designated Authorities is self-explanatory and contains their recommendations. Further submitted that before the finding given by the Designated Authorities on 11th April 2017, no opportunity was given to Geofin to present their case before the Designated Authorities or give their submissions on the Report of the independent Auditors appointed by SEBI.

- 25.5. That when the DAs were deciding the issue of jurisdiction, it was incumbent upon them to give a personal hearing to Geofin on the issue of jurisdiction as non-granting of hearing was violation of principles of natural justice. Non-granting of personal hearing to Geofin to present their case and SEBI basing its case on its own finding makes the finding of the DAs bad in law.
- 25.6. That Geofin ought to have been granted opportunity to cross-examine the Auditors appointed by SEBI upon which the DAs had given their findings. This was necessary in view of the fact that before SEBI, there was a Report of M/s. B. Purushottam & Co., Chartered Accountants appointed by FMC which in turn stated that Geofin was not involved in *“unauthorized or illegal trading activities /fictitious transactions or unfair trade practice including circular trading, cross deals, price rigging, price manipulation and other market abuses”*. It was also further observed that *“We have verified with 30 clients about their existence and dealings with the member and all of them have confirmed their dealings with the member”*. Therefore, it confirms the existence of all the clients. There is no observation of Geofin violating any rules, bye-laws, business rules or circulars.
- 25.7. In the judgment of *Stock Exchange, Mumbai vs. Vinay Bubna & ors* reported in 1999 (3) *Mh. LJ* 810, the Hon'ble Bombay High Court has held that the bye-law is a statutory bye-law having force of an enactment. It has further held that bye-laws made prior to grant of recognition to the Stock Exchange do not require publication in Official Gazette and bye-Laws prior to its recognition would still be valid and enforceable. The Court was considering whether the bye-law of the Exchange would prevail upon the Central enactment of Arbitration & Conciliation Act, 1996 where the Act provided to have odd numbers of arbitrators in the dispute to be referred to arbitration while Bye-Law 249(a) of the Bombay Stock Exchange permitted even number of arbitrators in case of dispute to be referred to. The Hon'ble Bombay High Court held that Bye-Law 249(a) was a statutory bye-law and if such bye-law was even prevailing prior to recognition of the Exchange, the said bye-law would prevail upon the statute, which came into force later on and thus, the Court held that the Bye-Law 249(a) permitting even number of arbitrators override the provisions of the Arbitration & Conciliation Act, 1996 as sub-section (4) of Section 2 provides that any other enactment would prevail over the Act. Considering the bye-laws "as in any other enactment", the Court came to the conclusion that it prevailed over the statute.

- 25.8. That the bye-laws in the present case were in existence prior to the recognition of the Spot Exchange. The bye-laws therefore had prevailing effect over any enactment or statute coming into force unless the bye-laws were amended.
- 25.9. The bye-laws did not restrict any trading beyond T+1. The trading on NSEL commenced in June 2008 when it started its membership drive and set out its bye-laws and rules. It launched its official website during that time. In fact, NSEL assured its clients fixed returns of 14% to 16% per annum. It published brochures which gave assurance to the clients of NSEL that if they entered into contract of T+2 and T+25, they would get returns in range of 14% to 16% per annum. These aspects can be seen from the judgment of the Hon'ble Bombay High Court dated 1st October 2015 in Writ Petition No. 1403 of 2015 and connected Writ Petitions. The finding of the Hon'ble High Court clearly shows that it was NSEL who published the brochures and also invited clients from all over. NSEL continued to have T+25 transactions from 2008 onwards. Geofin did not start or commence its business on NSEL till March 2010 when it got registered on NSEL Exchange. It is to be noted that up until October 2011, Geofin did not undertake any transaction in paired contracts.
- 25.10. That FMC had been appointed as Designated Agency for overseeing the Spot Exchanges including NSEL on 13th September 2011, which was informed to the members of NSEL by its circular dated 19th September 2011.
- 25.11. That Geofin relies upon the judgment of the Apex Court reported in (1979) 2 SCC 409 in the case of *Motilal Padampat Sugar Mills Co. Ltd. vs. State of Uttar Pradesh & Ors.* wherein the Hon'ble Court was considering the aspect of waiver and also in respect of promissory estoppel against the Government. Geofin also relies on the English judgment of *Martindale vs. Falkner*, wherein it was held that *'there is no presumption in this country that every person knows the law, it would be contrary to common sense and reason if it were so'* and in *Evans vs. Bartelam* held that *"The fact is that there is not and never has been a presumption that everyone knows the law. There is a rule that Ignorance of law does not excuse, a maxim of very different scope and application"*.
- 25.12. SEBI's contention that there was a Notification of 5th June 2007 under Section 27 of FCRA issued to NSEL ought to have been known to Geofin, it is submitted that first of all, admittedly, it was a Notification and not a Statute. The Notification was issued to NSEL way back in June 2007 when Geofin was not connected with NSEL. NSEL started its trading in 2008. Geofin became a member of the Exchange in 2010, and the first paired contract transaction was undertaken in October, 2011 after FMC was appointed as Designated Agency in September 2011. Geofin genuinely believed that NSEL was regulated by FMC and they had not objected to the paired transaction going on since 2008 even after being appointed as the Designated Agency.
- 25.13. That the said Notification did not cast any independent responsibility on the members of NSEL, but saddled NSEL with the responsibility of seeing that no transaction was contrary to the said Notification, as it is being sought to be done now. The condition

No. 6 in the said Notification clearly states *"In case of exigencies, the exemption will be withdrawn without assigning any reason in public interest"*. Admittedly, the Department of Consumer Affairs or FMC (after becoming the Designated Agency) or any Authority did not find any such exigencies to withdraw the exemption at any given point of time in the public interest which clearly shows that none of them found any violation of the Notification. That in spite of the provisions made in the Notification of 5th June 2007 giving authority to withdraw the Notification in the public interest as stated above, the Notification was not withdrawn till September 2014. It was withdrawn on 19th September 2014.

- 25.14. That under the bye-laws, it was the responsibility of NSEL to disallow any contract which according to it was not in consonance with the Regulatory approvals and the bye-laws. NSEL never stopped any contract of T+25 from 2008 to 2013. On the contrary, NSEL explicitly allowed the brokers including Geofin to believe that the said contracts had the necessary regulatory approval and in consonance with the exchange bye-laws.
- 25.15. That it was Exchange itself who permitted these types of contracts which the FMC found contrary to the basic function of the Exchange in 2012. The finding of the FMC clearly establishes the case of Geofin that NSEL itself permitted these contracts and itself acted as guarantor for assured returns. Geofin could not therefore be held responsible for the trades available on the Exchange as a broker.
- 25.16. That on NSEL website under the webpage 'about us' stated that NSEL is recognized by the Ministry of Consumer Affairs, Food & Public Distribution, Government of India. Similarly, in the webpage "Regulatory set-up" stated that activities of the Exchange cover the wide domain of regulation depending upon the nature and form of transaction, the spot exchange is mainly regulated by three different regulators i.e. State Agricultural Marketing Board (SAME), Forward Market Commission (FMC) and Warehouse Development Regulatory Authority (WDRA). By FMC letter dated 12th February 2013, NSEL was directed to remove above information from the website which FMC found to be misleading. This website was there since 2007 when NSEL started its operations and continued till February 2013 which made the brokers like Geofin believe that NSEL was regulated by above referred Regulatory Authorities and therefore, there was no need for Geofin to doubt the trades on the Exchange. This letter forms part of the compilations tendered to SEBI.
- 25.17. That at no point of time, it was brought to the notice of Geofin that the paired contracts were not legal nor was it pointed out at any given time by NSEL through its circulars that T+25 transactions were not permissible. The bye-laws were never amended to disallow the transaction of T+25.
- 25.18. That on a query put by the Whole Time Member that whether Geofin had in place independent assessment mechanism to analyze the products. Geofin had answered in affirmative. It is submitted that as a broker, what is analyzed is only the product for its client and not the mechanism which is adopted by the Exchange and/or in

consonance with the bye-laws of the Exchange. In view thereof, it would not be appropriate to expect Geofin to challenge the working of the Exchange which was prevailing since 2007. In any event, as stated above, the bye-laws being in nature of an enactment as held by the courts, would prevail.

- 25.19. That the Show Cause Notice dated 24th April 2017 as stated above, does not express the nature of defaults committed by Geofin, are not specific in nature giving the points which according to SEBI Geofin has violated. The Show Cause Notice simply annexes the Enquiry Report by the Designated Members. Geofin relies on the judgment of the Apex Court in the matter of *K.I. Shepard & Ors. vs. Union of India* reported in (1987) 4 SCC 431.
- 25.20. That Geofin relies on judgments of the Apex Court in the case of *Dr. Indramani Pyarelal Gupta & Ors. vs. W.R. Natu & Ors.* (AIR 1963 SC 274), *The Trustees of Port of Madras vs. Aminchand Pyarelal & Ors.* (AIR 1975 SC 195) and in the judgment of *Stock Exchange, Mumbai vs. Vinay Bubna & Ors.* [1999 (3) Mh. LJ 810] that bye-laws prevail over the enactments if there is a contradiction between the two. The bye-laws of NSEL would therefore certainly prevail over the conditions in the Notification, till the recognition of the Exchange is in force.
- 25.21. That for the purpose of violation of principles of natural justice, Geofin cited the following judgments:
- 25.21.1. Lalitkumar Modi vs. Special Director, Director of Enforcement, Western Region (unreported) in Writ Petition No. 2803 of 2015 passed by the Hon'ble Bombay High Court on 30th January 2018;
- 25.21.2. Meenglas Tea Estate vs. Workmen reported in AIR 1963 SC 1719;
- 25.21.3. Phulbari Tea Estate vs. Workmen reported in AIR 1959 SC 1111;
- 25.21.4. Union of India vs T.R. Varma reported in AIR 1957 SC 882.

SECOND SHOW CAUSE NOTICE, REPLY AND HEARING:

26. 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.
27. 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.

28. GCL 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 30, 2019 at 10:30 A.M., SEBI Head Office, Mumbai.

29. In response, the Noticee submitted its reply dated January 22, 2019 on merits to the Second SCN. The said reply of the Noticee in brief are as under:

29.1. That the Annexures to the Second Show Cause Notice dated December 27, 2018 had been received by Geofin in a pen-drive along with the CD on 5th January 2019. CD and Pen-drive does not contain full record of the proceedings before SFIO. Therefore, Geofin would like to take inspection of the originals referred to in the pen-drive and the CD.

29.2. That the hearing in respect of the Show Cause Notice No. EFD/DRA-II/SPV/9231/2017 dated 24th April 2017 took place on 12th October 2018 and 31st October 2018 as referred to in the Second Show Cause Notice itself. However, till date, Geofin have not received any order of the said hearings.

29.3. That the Second SCN states that *"it is in furtherance of the Show Cause Notice No. EFD/DRA-II/SPV/9231/2017 dated 24th April 2017"*. The said Second SCN issued to Geofin when the hearing on the Show Cause Notice dated 24th April 2017 was complete in all respects with Written Submissions filed and order was awaited. Therefore, SEBI could not have issued the said Second SCN *'in furtherance'* to the SCN.

29.4. That the Second SCN cannot be based on the earlier Show Cause Notice as the event which is being now taken for furtherance of the Second SCN was not the subject matter of that Show Cause Notice issued earlier.

29.5. That the second SCN proceeds on the line that it is under Regulation 28(1) of the Intermediaries Regulations. Regulation 28(1) is follow up of the action to be taken under Regulation 27 and the recommendation which are referred in Regulation 28(1) are the recommendations as required under Regulation 27 and not recommendation of any authority or authorities other than SEBI. Therefore, the Second SCN based on the recommendation of SFIO is not within the purview of Regulation 28(1) and therefore, the Second SCN is bad in law.

- 29.6. That Second SCN mentions about the detailed SFIO's investigation report, Geofin have not been furnished with the complete report and the statements recorded by SFIO/Inspector under Section 217 of the Companies Act r/w Section 212 of the Companies Act.
- 29.7. That section 212 of the Companies Act is a code by itself and it provides for all the remedies after the report of the Inspector. It is the Central Government who alone on examination of the report of the SFIO, and upon receiving legal advice, initiate prosecution against any Company or its officers, it does not provide any authority or power to any of the agencies of the Central Government or any authority like SEBI to initiate any proceedings against the company or its officers based on SFIO's report. Therefore, the Second SCN now based on SFIO's report issued to Geofin is bad in law.
- 29.8. That Sections 212 and 224 of Companies Act, there is no power vested in the SFIO to recommend any steps to be taken by any authority or authorities including SEBI. It is only the Central Government upon legal advice can launch a prosecution, therefore, the Second SCN based on any recommendation or any finding of the SFIO is bad in law and is liable to be quashed.
- 29.9. That the Annexures given in the CD contain the Order dated 28th October 2016 issued by the Joint Director, Government of India, Ministry of Corporate Affairs stating that *"the Central Government hereby assigns the investigation into the affairs of National Spot Exchange Limited, Financial Technologies (India) Limited (name changed to 63 Moons Technologies Limited), their 18 subsidiaries & associate companies (Annexure-I), the 20 defaulting entities (Annexure-II) and their role/nexus with the brokers, who were responsible for the payment crisis to the Serious Fraud Investigation Office."*
- 29.10. That Annexure-I and Annexure-II of the said order dated 28th October 2016 gives the names of the entities against whom investigation was to be launched. Geofin name does not appear in either of the Annexure. Therefore, SFIO could not have gone into investigation of Geofin or investigation of the transaction of Geofin with its clients. If any other order is passed by Ministry of Corporate Affairs giving SFIO power to investigate into working of Geofin, such order is not forming part of the documents furnished to us in CD or pen drive, Geofin requested to furnish copy of any such order passed by Ministry of Corporate Affairs after the order dated 28th October 2016.
- 29.11. That the scope of investigation has been enlarged by SFIO. There is no recommendatory power vested in SFIO to recommend any steps to any regulatory authority like SEBI to take any action against any company or companies like Noticee. Therefore, the Second SCN issued on the basis of such report, which has travelled beyond the scope of enquiry cannot be considered the base of the Second SCN.
- 29.12. That what is mentioned in paragraph 7 of the Show Cause Notice, it is a matter of fact and does not require any comments. Though reference is made to the arrest of Geofin Director, there is no reference to the bail order dated 23rd March 2015 in the Second SCN, where the learned Judge has given detailed reasoning for granting the

bail and not accepting the contention of the prosecution for rejecting the bail. Geofin have learnt that the supplementary charge-sheet has been filed in the Court, however, they do not have the copy thereof. In any event, if the charge-sheet is filed, till those charges are decided by the Hon'ble Court, the question of making Geofin Director guilty of offence does not arise and based on that Geofin cannot be held liable, till it is held to be so by the court of competent jurisdiction.

- 29.13. With regard to paragraphs 9 and 10 of the Second SCN, Geofin states that the allegations made therein are not against them, but against NSEL.
- 29.14. With regard to paragraphs 11 of the Second SCN, Geofin states that the Hon'ble High Court order clearly mentions that *"...therefore, to say 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...."*.
- 29.15. With regard to paragraphs 12 of the Second SCN, Geofin states that they are not parties to the Criminal Bail Application No. 1236 of 2014.
- 29.16. Geofin requested to give inspection of following documents:
- 29.16.1. Interim Report filed before the Central Government of the SFIO, if any.
 - 29.16.2. The statements, if any, recorded of Geofin clients by SFIO.
 - 29.16.3. Any orders passed by the Ministry of Corporate Affairs after 28th October 2016 expanding the scope of investigation, if any.
 - 29.16.4. The letter dated 30th December 2014 of Ministry of Finance, Department of Economic Affairs and Observations of the Special Team of Secretaries referred to in paragraph 10 of the Second SCN.
 - 29.16.5. Papers and proceedings in Writ Petition No. 2743 of 2014 including reply, if any, filed by SEBI and FMC.
 - 29.16.6. Papers and proceedings in Criminal Bail Application No. 1236 of 2014.

30. On January 30, 2019, the ARs of the Noticee appeared for hearing. During the hearing, ARs stated that SEBI has not sent the annexures of the Second SCN to the Noticee. Therefore, ARs had requested to provide the annexures of the Second SCN and also requested for adjournment of hearing. Accordingly, SEBI was directed to give the annexures of the second SCN to the Noticee and in the interest of natural justice, hearing in the matter was adjourned to February 06, 2019. After the hearing, SEBI gave annexures of the second SCN to the Noticee.

31. On February 06, 2019, Mr. Dipan Merchant, Senior Counsel, Mr. Chirag Shah, Advocate, Mr. Digant Bhatt, Advocate, Ms. Anisha Agarwal, Advocate, Ms. Juhi Shah and Mr. Simon Mathews, Chief Manager from GCL, **ARs** of GCL appeared for the hearing and reiterated the earlier submissions and made the oral submissions in line with the reply dated January

22, 2019. ARs were granted time till February 15, 2019 to make additional written submissions in the matter.

32. Pursuant to the hearing, the Noticee submitted its additional written submission dated February 14, 2019 which is similar to the reply dated January 22, 2019. In order to avoid repetition, below are the additional submissions in brief which are not mentioned in the reply dated January 22, 2019:

- 32.1. That in reply dated January 22, 2019 Geofin had asked for inspection of the items mentioned therein. However, no inspection was granted by SEBI. At the time of personal hearing held on 30th January, 2019 except ordering orally to issue a copy of the Annexure E (as Annexure E was not served to Geofin along with the Second Show Cause Notice), No inspection was ordered therefore, it is submitted that non-granting of inspection of the documents relied upon by SEBI is in violation of principles of natural justice. During the course of the arguments on 30th January, 2019 when it was pointed out that annexures to the documents forming part of the Second SCN referred to and relied upon were not furnished. The Learned Whole Time Member only stated orally, that they will not rely upon the annexures. The annexures are important documents and stating that SEBI has not and will not rely upon the annexures would certainly affect the hearing, as the document has to be read as a whole with its annexures.
- 32.2. That the report of SFIO cannot be stated to have attained finality. Under the provisions of Section 224 of the Companies Act, 2013, from the inspectors report made under Section 223 of the Companies Act, 2013 it is only, the Central Government who can initiate prosecution. The very fact that, on the base of the inspection report prosecution is permissible if Central Government deems fit, clearly establishes, the fact, that the report is not final and till the Court of competent jurisdiction holds the person guilty after proper hearing than only the person can be considered not to be fit and proper person and not otherwise. Mere report of the inspector appointed under section 212 of the Companies Act, 2013 does not make it incumbent for SEBI to take any action based on such a report. The Second SCN therefore is premature and is therefore liable to be and should be struck down.
- 32.3. That vide notification dated 19th September, 2014, the Central Government in exercise of powers under section 27 of the FCRA has withdrawn the exemption granted to NSEL. The Central Government came to the conclusion that trading in such unregulated entities in the areas of monitoring and surveillance risk management and settlement system, corporate governance, equity structure, warehousing, conflicts, etc. the forward trading in such unregulated entities was not in public interest. Therefore, it clear from the notification itself that, the Central Government and the authorities dealing with the issue were fully aware of the fact that the exchange alone is responsible for and guilty of violating the exemption conditions which was the basis

- of granting these entities the exemption under section 27 of FCRA. The brokers registered on the exchange therefore cannot be considered to be liable for any of their bonafide acts which are based on the bye laws, regulations, notifications issued by the exchange pursuant to the exemption under section 27.
- 32.4. The Central Government had examined the activities of the exchange but has not sanctioned any prosecution to any members of the exchange or exchange itself which is an important factor to be considered. The authority under the act, who has powers to launch prosecution on the report from the inspector does not choose to do the same while SEBI without any powers under the enactment has chosen to issue Second SCN to declare the person not fit and proper which itself is a violation of the fundamental right available to a citizen, namely in this case the directors of Geofin as this Second SCN will affect their reputation too and their right to earn their livelihood.
- 32.5. That it is Central Government which holds the recommendatory powers and not SFIO. Since SFIO has given recommendations to SEBI, it prima facie appears that SFIO has travelled beyond the scope of the enquiry powers given to it vide Order dated 28th October, 2016 issued by the Joint Director, Government of India, Ministry of Corporate Affairs and in view thereof the said Second SCN is bad in law.
- 32.6. With reference to the allegations mentioned in paragraph 6 of the Second SCN against Geofin, it is submitted as follows:
- 32.6.1. With reference to paragraph 6(i) of the said Second SCN, Geofin repeats, reiterates and confirms all that is stated vide its first reply dated 6th December, 2016. (Para (f) at page 9 of first reply).
- 32.6.2. With reference to paragraph 6(ii) & 6(iv) of the said Second SCN, it is submitted that, SEBI had already absolved Geofm from the charge as mentioned therein.
- 32.6.3. With reference to paragraph 6(iii) of the said Second SCN, Geofin repeats, reiterates and confirms all that is stated vide its replies dated 6th December, 2016 and 12th October, 2018 (Para (ee) of First Reply at page 37 and Para 18 of Second Reply at page 19).
- 32.6.4. With reference to paragraph 6(v) of the said Second SCN the allegations are vague and lacking the particulars, it is submitted that, SEBI has failed to establish as to which criminal act are they referring to and it is submitted that the directors of Geofin have not been found guilty in any courts of law.
- 32.6.5. With reference to paragraph 6(vi) of the said Second SCN, Geofin repeats, reiterates and confirms all that is stated in their second reply dated 12th October, 2018 and denies what is stated in the said Second SCN. (Para 92 at pg.57 of the second reply)
- 32.6.6. With reference to paragraph 6(vii) to 6(x) of the said Second SCN, it is submitted that, Achal Agarwal has withdrawn his case and in view thereof, the allegations are infructuous.
- 32.7. With regard to paragraphs 11 of the Second SCN, Geofin submitted that, the observations made in Annexure F to the said Second SCN is an extract of the

observation made by the Hon'ble Bombay High Court in Writ Petition No.2743 of 2014. In paragraph 88 of the aforesaid order it was observed that, '*Under the guise 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....*'. The Hon'ble High Court categorically lays the blame squarely on the fact that there were no regulatory checks due to the exemption notification dated 5th June, 2007. Hence, it further substantiates arguments of Geofin that they as brokers were only following the rules and regulations of the exchange, which was functioning under the watchful eyes of Department of Consumer Affairs (Food & Public Distribution) under the GOI.

32.8. With regard to paragraphs 14 of the Second SCN, Geofin submitted that, its application for withdrawal has been kept in abeyance by SEBI owing to pending proceedings under the said SCN. It is further submitted that, as observed by the Securities Appellant Tribunal in *Almondz Global Securities Ltd vs. Securities and Exchange Board of India [2016 SCC Online SAT 219]* in such a situation SEBI needs to look at the true rationale behind the imposition of punishments on the companies. SEBI's aim in imposing punishments upon companies should be to make the companies, law compliant, so as to ensure that the interests of the securities market are secured. SEBI should not view punishments from a perspective of thinning the herd, rather it should help in fostering a healthy environment where intermediaries act cautiously and responsibly under the overall supervision of the market regulator.

32.8.1. With relation to declaring Geofin "*Not fit and proper person*", Geofin is relying on the judgment of *Almondz Global Securities Ltd vs. Securities and Exchange Board of India [2016 SCC Online SAT 219]*.

32.8.2. With relation to "*Second Show Cause being bad in law*", Geofin is relying on the judgment of *Nizam Sugar Factor vs. Collector of Central Excise, A P [(2006) 11 SCC 573]*

FINDINGS AND CONSIDERATION

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

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

34. 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:

34.1. **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;

34.2. **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.

34.3. **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:

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

Jurisdiction and Applicability of Intermediaries Regulations:-

36. 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.

37. As regards, the applicability of Intermediaries Regulations, the Noticee stated that SEBI does not have jurisdiction to issue an inquiry under Intermediaries Regulations because under regulation 24(1) of Intermediaries Regulations the designated member had to first come to a conclusion that any person has committed default under Regulation 23 of Intermediaries Regulations and then only power to appoint designated authority will come into play. Since there is no breach on the part of Noticee of Intermediaries Regulations or Brokers Regulations, the appointment of designated authority is itself bad. Therefore, SEBI does not have any jurisdiction to issue SCN as it was not in consonance with Intermediaries Regulations nor in consonance with Brokers Regulations.

38. With respect to the issue of applicability of Intermediaries Regulations, I note that the present matter is peculiar in nature. The ***Peculiar Facts and Circumstances*** of the present case are as under:

38.1. 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).

38.2. 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.

- 38.3. 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”*.
- 38.4. 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.
- 38.5. 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.
- 38.6. **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....”

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

38.8. It is noted that pursuant to merger of FMC with SEBI, GCL 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, GCL 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.

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

38.9.1. 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.

- 38.9.2. 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.
- 38.10. 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.
- 38.11. 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.
39. Thus, GCL was and continues to be under the supervision and regulatory control of SEBI from September 28, 2015 onwards till the disposal of its application for registration. Therefore, in view of aforesaid facts and circumstances of the case, I am of the view that Chapter V and VI of the Intermediaries Regulations is applicable to the Noticee even though technically it does not hold a certificate of registration.

Clubbing of Proceedings:

40. 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 38 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?

41. 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.*

.....”

42. 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.

43. However, in view of the facts and circumstances of the case discussed above in paragraph 38, 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.

44. 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.

45. I note that SEBI was entrusted with regulatory supervision and control of commodity derivatives brokers from September 28, 2015 and Noticee had made an application to SEBI for registration as commodity derivative broker on December 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.

46. 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?

47. 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.

48. 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:

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

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

49. 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 38 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.

50. 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.
51. 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.
52. 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 38 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.
53. **Hearing Opportunity before DA's:** With respect to the contention of the Noticee that an opportunity of hearing was not provided to the Noticee before the bench of Designated Authorities, it is noted that under Intermediaries Regulations, there is no requirement of providing opportunity of hearing before the bench of Designated Authorities. I also note that under regulation 28(2) of Intermediaries Regulations the requirement for providing opportunity of hearing is before Designated Member. Therefore, I note that before the undersigned i.e. Designated Member, Noticee was provided with and indeed availed, several

opportunities of hearings on the issue of inspection as well as on merits. Hence, I am of the view that, in accordance with law, principal of natural justice has been duly followed in the present matter and the Noticee was not deprived of the same.

Cross Examination of Auditors appointed by SEBI:

54. Noticee had requested an opportunity to cross-examine the Auditors appointed by SEBI upon which the DAs had given their findings. In this regard, I note that the conclusions of the Auditors in the auditor report have been drawn on the basis of the facts that emerged from the material collected during the audit. The auditors have not brought out any facts in the auditor report or has drawn any conclusions therein from his personal knowledge. An inference drawn by the auditors on examination of specific facts and circumstances that were noted by him during the audit cannot be equated with assumptions and presumptions. Moreover, the conclusions / inferences drawn by the auditors in their report are not final in any manner and the Noticee has been given ample opportunity to submit its defense to the allegations levelled against it. Further, the auditor report along with all the annexures, which were relied upon by SEBI for the purpose of this proceeding were already given to the Noticee during inspection. Considering the above, I do not find any merit in the request of the Noticee for cross-examination of the auditors and reject the application of the Noticee in that regard. Without prejudice to the above findings regarding the request of Noticee for cross-examination, I find that in any event the findings of the auditor report have not been relied upon in this order, hence, no prejudice would be caused to Noticee if its request for cross-examination is denied.

Other contentions:

55. Noticee submitted that the Show Cause Notice dated April 24, 2017 as stated above, does not express the nature of defaults committed by Geofin and are not specific in nature giving the points which according to SEBI Geofin has violated. The Noticee also submitted that the second SCN proceeds on the line that it is under Regulation 28(1) of the Intermediaries Regulations. Regulation 28(1) is follow up of the action to be taken under Regulation 27 and the recommendation which are referred in Regulation 28(1) are the recommendations as required under Regulation 27 and not recommendation of any authority or authorities other

than SEBI. Therefore, the Second SCN based on the recommendation of SFIO is not within the purview of Regulation 28(1) of Intermediaries Regulations and therefore, the Second SCN is bad in law. The Noticee also submitted that the Second SCN was issued to the Noticee when the hearing on the SCN dated April 24, 2017 was complete in all respects with Written Submissions filed and order was awaited, therefore, SEBI could not have issued the said Second SCN '*in furtherance*' to the SCN and the Second SCN cannot be based on the earlier SCN as the event which is being now taken for furtherance of the Second SCN was not the subject matter of that SCN issued earlier.

- 55.1. I find that the post-enquiry SCN had enclosed the enquiry report to the Noticee. The said enquiry report contains the specific findings against the Noticee and it is self-explanatory. The enquiry report also contains the recommendations. By enclosing the enquiry report which contains specific findings and its recommendations thereon, the post-enquiry SCN clearly states that why the recommendations or any other actions as deemed fit by the competent authority should be taken against the Noticee. Therefore, the argument that the show cause notice is not specific is devoid of merit.
- 55.2. The Noticee argued equating the recommendation of the DAs and the SFIO and further argued that the SFIO recommendation can be acted upon only by the Central Government and not by SEBI. I note that it is not the case of SEBI that SFIO recommendations are recommendations falling within regulation 27 of Intermediaries Regulations. The SFIO Report containing adverse observations and recommendations have been relied in second SCN for the purpose of alleging that the Noticee's fit and proper status is in question. Therefore, the argument that second show cause notice is bad on the ground that SFIO recommendations under regulations 27 of Intermediaries Regulations has been relied upon for the purpose of second SCN is devoid of merit.
- 55.3. Further, the submission of Noticee is that after the hearing in respect of SCN dated April 24, 2017 was over, the second show cause notice should not have been issued. In case of quasi-judicial enquiry proceedings, the proceedings subsequent to the issuance of post enquiry show cause notice comes to the 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 that SEBI cannot issue second SCN after the hearing in respect of SCN dated April 24, 2017 was over.

56. Noticee submitted that the application for registration made under Section 131 of Finance act, 2015 is pending, and therefore, regulation 7 of Intermediaries Regulations would come into operation. Thus, before rejecting an application, the Noticee ought to have been given the opportunity in writing to make good the deficiencies within the time specified by the board. Noticee further submitted that no such opportunity in writing has been given to it to make good the deficiencies. In the instant matter, I note that several opportunities of hearings as well as sufficient time was granted to the Noticee to file its submission which indeed Noticee had availed. The Brokers Regulations under which the application for registration as commodity derivatives broker is to be processed, does not envisage such a scenario of giving an opportunity to cure any deficiency. In any event the reference to making good deficiencies could only mean procedural shortfalls in the application and it cannot be in respect of the requirement of fit and proper status. Therefore, I do not find any merit in the said submission of the Noticee.

57. Noticee submitted that SEBI issued a post-enquiry SCN dated April 24, 2017, the said SCN does not refer pre-enquiry SCN and therefore, this post-enquiry SCN is an independent Show Cause Notice and not connected with the pre-enquiry SCN to which there is no finding against Noticee and there was no hearing given in respect thereof. The post-enquiry SCN only annexes the Enquiry Report dated April 11, 2017 and it does not mention that SEBI has accepted the said Enquiry Report dated April 11, 2017. The post-enquiry SCN only mentions that the Report of the Designated Authorities is self-explanatory and contains their

recommendations. Noticee further submitted that before the finding given by the DAs on April 11, 2017, no opportunity was given to the Noticee to present their case before the DAs.

57.1. I note that the current proceeding is initiated under Intermediaries Regulations. The procedure under Intermediaries Regulations is that under Regulation 24, Designated Authorities are appointed, then under regulation 25 the Designated Authorities issue show cause notice to the Noticee directing the Noticee to submit the written representation within the specified time limit, thereafter, under regulation 26 the Noticee have to submit its written representation within the specified time limit, then under regulation 27 the designated authorities after considering the written representations of the Noticee, make recommendation and submit the report to the board. Thereafter, on receipt of report, designated member under regulation 28(1) issue a show cause notice to the Noticee enclosing a copy of the report submitted by the designated authority calling upon the Noticee to submit its written representation. Under regulation 28(2) the designated member after considering the reply, if any received from the Noticee and providing the person with an opportunity of being heard, passes an appropriate order.

57.2. From the above regulations, it is clear that there is no mandate that the post-enquiry show cause notice dated April 24, 2017 has to refer to the pre-enquiry show cause notice. The allegations made through the pre-enquiry show cause notice are dealt with and findings are given in the enquiry report. The Intermediaries Regulations does not provide for a mandate of passing an order at that stage. Therefore, in view of the procedure laid down under Intermediaries Regulations, I do not find any merit in the said 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, assuring investors regarding arbitrage opportunity, UCC modification, suspicious transactions, not reporting the change in shareholding, not obtaining prior approval from exchanges w.r.t change in shareholding pattern, not maintaining separate margin book, discrepancies in KYC forms, non-collection / partial collection of margin, not adhering to guidelines related to pre-funded instruments, non-settlement of client accounts 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, NCDEX and NMCE 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 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 he 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 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 and it had started trading on behalf of its clients on NSEL in or about October, 2011. Noticee also admitted that it had informed its respective clients about its becoming a member of NSEL on its website. Noticee also admitted that as an intermediary, Noticee was on one hand connected with its respective client and on the other hand with NSEL. 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. Further, Noticee submitted that there is no conviction by any competent court nor any civil liabilities attributed to Geofin by any court of competent jurisdiction. In this regard, I note that conviction is only one of the requirements to determine 'fit and proper' status of the person. To determine the 'Fit and proper' status the competent authority have look into the other requirement like integrity, reputation, competence and character of the person. Thus, I do not find any merit in the said submission of the Noticee.

Noticee also submitted that no competent authority has held that Geofin to be guilty of any offenses nor any competent authority has given finding as to the integrity, competence and character of Geofin. In this regard, I note that on the basis on facts and circumstances of the case, SEBI itself is competent enough to give findings on reputation, integrity, competence and character of the Noticee. Therefore, I do not find any merit in the said submission of the Noticee.

Noticee also submitted that none of exchanges i.e. NSEL, MCX, NCDEX and NMCE have lodged any disciplinary action/complaint against Geofin. In this regard, I note that this does not dilute the requirement of determining the Fit and Proper status of the Noticee. Thus, I do not find the any merit in the said submission of the Noticee.

82. 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.

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

83.1. That it had white labelled the PPT / presentations of NSEL which was on the website of NSEL.

83.2. That it did not do a presentation of its business to solicit work contrary to the byelaws (which I understand to mean that the Noticee did make a presentation of its business to solicit work, albeit, in their view was in accordance with the byelaws of NSEL).

83.3. That the said presentation was not circulated to the outside world at large (which I understand to mean that the Noticee had circulated the said presentation among its clients).

83.4. That it was NSEL on the basis of whose representation / acceptance of the transaction, Geofin would be able to give a guaranteeing service.

All the above, clearly demonstrate an association of the Noticee with NSEL and the paired contracts that goes well 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.

84. The Noticee has contested that Courts / Competent Authorities observations are not against the Noticee. In response to the DEA letter and SFIO observation regarding ‘Concept of Paired Contract’, the Noticee stated that the allegations made therein are not against the Noticee but against NSEL. In respect of observations in Writ Petition No. 2743 of 2014, Noticee had placed reliance on the observation Hon’ble High Court in the said writ petition that “...therefore, to say 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....” i.e. the observations are against FTIL and NSEL. In response to the observation in FMC order regarding ‘paired contracts’, Noticee stated that findings are against NSEL.

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. In respect of the SFIO Report, the Noticee contented that the report of SFIO cannot be stated to have attained finality. Noticee further submitted that it is the Central Government who alone on examination of the report of the SFIO, and upon receiving legal advice, initiate prosecution against any Company or its officers, it does not provide any authority or power to any of the agencies of the Central Government or any authority like SEBI to initiate any proceedings against the company or its officers based on SFIO’s report. Noticee also submitted that the SFIO report is not final and till the Court of competent jurisdiction holds the person guilty after proper hearing then only the person can be considered not to be fit and proper person and not otherwise.

89. Regarding the contention of the Noticee in respect of SFIO Report, I note that the basis of contention of the Noticee is that SFIO report has not attained finality i.e. that the observations therein are only prima facie in nature and till the Court of competent jurisdiction holds the person guilty after proper hearing then only the person can be considered not to be fit and proper person and not otherwise. 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.

90. Pursuant to the issuance of Second SCN, Noticee has requested for inspection of documents such as Interim Report filed before the Central Government of the SFIO, if any; the statements, if any, recorded of Geofin clients by SFIO; any orders passed by the Ministry of Corporate Affairs after October 28, 2016 expanding the scope of investigation, if any. It may be noted 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. However, as discussed in preceding paragraph, 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 documents cannot be entertained. Moreover, SEBI is not in possession of the documents requested above. Without prejudice to the above findings, in any event, for the purpose of this order, such documents have not been relied upon, hence, no prejudice would be caused to Noticee if its request for inspection of such documents are denied.

I also note that Noticee had also requested the inspection of papers and proceedings in Writ Petition No. 2743 of 2014 including reply, if any, filed by SEBI and FMC; Papers and proceedings in Criminal Bail Application No. 1236 of 2014. In this regard, I note that for the purpose of this order, reliance has been made only on the existence of adverse observation of High Court orders in Writ Petition No. 2743 of 2014 and Criminal Bail Application No. 1236 of 2014.

Further, letter dated December 30, 2014 of Ministry of Finance, Department of Economic Affairs was provided to the Noticee after hearing on January 30, 2019. With respect to the Observations of the Special Team of Secretaries referred in letter dated December 30, 2014, I am of the view that, for the purpose of this order, neither the existence nor the observations of the Special Team of Secretaries have not been relied upon.

91. It is also noted that the Noticee has raised certain issues with respect to SFIO Report like SFIO has enlarged its scope of investigation and has given finding in the report against the non-defaulting brokers including Noticee whose name does not appear in either of annexure attached to the GOI order dated October 28, 2016; That there is no recommendatory power

vested in SFIO to recommend any steps to any regulatory authority like SEBI to take any action against any company or companies like Noticee. In this regard, it may be noted that this forum is not the appropriate forum to contest the scope and findings of the SFIO Report and therefore, the same are not relevant in the extant proceedings.

Observations regarding MPID violations and findings related to them:

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

“

10. The material collected by the EoW during the course of the investigation reveals that the Petitioner did not carry out its operations as per the bye-laws and permission granted to it by the Government of India. From the statements recorded by the Investigating Agency, copies of which were placed before us for our perusal, it would *prima facie* reveal that the Petitioner represented to the Traders / Suppliers of the goods that they would be provided security free loan. The Petitioner had assured its clients fixed returns @ 14% to 16% pa. A copy of the brochure published by the Petitioner -Exchange gives an assurance to its clients that if they enter into contract of T+2 and T+25, they would get returns in the range of 14% to 16% pa. The record indicates that the Petitioner convinced its clients that since the actual possession of the commodities will be kept in the accredited warehouses under its control, this will enable its members to trade on its platform without there being actual physical stock. The statements of various investors recorded during the investigation shows that the Petitioner had assured them a fixed returns of 14% to 16% on their investments. The statements recorded by the Agency *prima facie* also indicates that the Petitioner represented to them that it would provide security free loan. The record placed before us further reveals that transaction of the Petitioner and the traders / suppliers of the goods are not fully supported by the actual delivery of goods. In many cases, the

accounts of the Petitioner and the suppliers of the goods are not tallying with each other due to bogus entries. The physical delivery of the commodities has not been verified and there has been no control over the stock lying in the ware-houses. The record further indicates that there are many accommodation entries which resulted into financial mishap due to collusion between the Petitioner and its selling trading members.

11. Section 3 of the MPID Act defines the offence, identifies the person liable and prescribes the penalty. Section imposes a penalty for fraudulent non-payment of the deposit along with benefit by the financial establishment. Section 2(d) defines the term "financial establishment" means any person accepting any deposit under any scheme or arrangement or in any other manner. Section 2(c) defines the terms "deposit". The definition is inclusive. The inclusive definition when used enlarges the meaning of the expression defined so as to comprehend not only such things as they signify according to their natural merit but also those things which the interpretation clause declares that they shall include. The terms "deposit" defined under clause (c) of section 2 includes any receipt of money or acceptance of any valuable commodity by any financial establishment to be returned after specified period of otherwise, either in cash or kind or in the form of specified services with or without any benefit in the form of interest, bonus, profit or any other form. In the present case, **the provisions of MPID Act are invoked as the Petitioner assured its clients** if they invest in T+2 and T+25 schemes they would get assured returns of 14 to 16% pa. Hence the said receipt of money, in our prima facie view fall within the definition of "deposit".....”

93. In respect of the observations of the Hon’ble Bombay High Court, the Noticee did not made any submissions in that regard. 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.

94. The Noticee argued that on the basis of SAT judgment in *Almondz Global Securities Ltd vs. Securities and Exchange Board of India*, SEBI needs to look at the true rationale behind the imposition of punishments on the companies. I note that declaration of an intermediary to be not fit and proper person is not equivalent to punishment as the same is an eligibility criteria for being / acting as an intermediary. Therefore, the arguments of the Noticee based on the above SAT judgment are not applicable in the present case.

95. 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:

96. In summary, I note the following :

- 96.1. 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.
- 96.2. 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.
- 96.3. 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.
- 96.4. 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.
- 96.5. Reputation is an important factor for consideration of Fit and Proper Criteria and the reputation of the Noitcee 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:

97. 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 Geofin Comtrade Limited 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.

98. 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.

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

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

-Sd-

Date: FEBRUARY 25, 2019

MADHABI PURI BUCH

Place: MUMBAI

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA