

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Section 12(3) of the Securities and Exchange Board of India Act, 1992 read with Regulation 27 of Securities and Exchange Board of India (Intermediaries) Regulations, 2008 in the matter of National Spot Exchange Limited.

NOTICEE	PAN
Motilal Oswal Commodities Broker Pvt. Ltd.	AAACP3147N

BACKGROUND

1. Motilal Oswal Commodities Broker Pvt. Ltd. (“**MOCBL / Noticee**”) is a commodity derivatives broker and a member of the Multi Commodity Exchange of India Ltd. (“**MCX**”), the National Commodity & Derivatives Exchange Ltd. (“**NCDEX**”), National Multi Commodity Exchange (“**NMCE**”) and Ace Derivatives and Commodity Exchange Limited (“**ACE**”). The Noticee was earlier a member of the National Spot Exchange Ltd. (“**NSEL**”).
2. In the Union Budget for the FY 2015-16, it was announced that Forward Market Commission (“**FMC**”), the regulator of the commodity derivatives market, would be merged with the Securities and Exchange Board of India (“**SEBI**”). The Finance Act, 2015, provided that any person dealing in commodity derivatives prior to the aforesaid merger of FMC with SEBI could continue to do so, provided he / it had made an application for registration with SEBI within a period of three months from the date of such merger. The merger took effect on September 28, 2015 and the Noticee filed an application before SEBI, seeking registration as a commodity derivatives broker, on December 16, 2015.
3. The registration application, submitted by the Noticee, was rejected by SEBI vide its Order dated February 22, 2019 (“**SEBI Order**”) on the grounds that the Noticee failed to satisfy

the '*fit and proper person*' criteria specified under Schedule II of the SEBI (Intermediaries) Regulations, 2008 ("**Intermediaries Regulations**").

4. While arriving at the decision that the Noticee did not satisfy the '*fit and proper person*' criteria, the SEBI Order had taken into consideration the following material:
 - a) The '*paired contracts*' traded on the NSEL platform were observed to be in the nature of financing transactions by Courts and other authorities. These transactions in '*paired contracts*' were also held to be violative of the provisions of Forward Contracts (Regulation) Act, 1952 ("**FCRA**").
 - b) The role of the Noticee in facilitating access to its clients to take exposure in the '*paired contracts*' offered on the NSEL platform.
 - c) The close connection between the Noticee and NSEL and the observations made against the NSEL by various authorities and Courts.
5. The Noticee preferred an appeal against the SEBI Order before the Hon'ble Securities Appellate Tribunal ("**SAT**"), which vide an Order dated June 9, 2022 ("**SAT Order**"), set aside the SEBI Order and remanded the matter back to SEBI for fresh consideration. The SEBI Order further stated that SEBI, while deciding the matter afresh, will have the liberty to consider additional material which had come into existence after the passing of the initial SEBI Order.
6. Consequently, a Designated Authority ("**DA**") was appointed by SEBI. The DA issued a Supplementary Show Cause Notice ("**Supplementary SCN**") dated July 07, 2022. Subsequently, after providing an opportunity of hearing to the Noticee, the DA submitted his Report dated October 03, 2022 ("**DA Report**") recommending that the application for registration submitted by the Noticee be rejected. The DA Report also recommended that the Noticee's application for registration as a commodity broker not be considered for another two years from the date of conclusion of the present proceedings before SEBI or till disposal of FIR filed by Economic Offences Wing ("**EOW**"), whichever is earlier.
7. A copy of the DA Report was furnished to the Noticee vide show cause notice dated October 11, 2022, and the Noticee was advised to submit its reply to the recommendations contained in the DA Report. The Noticee was also provided with opportunities of personal hearing on November 09 & 15, 2022. The opportunities of personal hearing were availed

by Noticee and Mr. Ravichandra Hegde, Advocate, appeared on behalf of the Noticee. The Noticee also submitted written submissions vide letters dated November 04, 2022, November 9, 2022 and November 14, 2022. A summary of the written and oral submissions made on behalf of the Noticee is given below:

- a. *The present enquiry is in relation to proceedings remitted pursuant to an order of the Hon'ble SAT dated June 9, 2022, where SEBI Order dated February 22, 2019, was set aside and the matter was remitted back to SEBI to decide specific issues afresh. As SEBI, in the course of the proceedings before the SAT, had sought to rely upon additional documents which did not form part of the enquiry process, the SAT had directed that SEBI shall consider such material only after the same has been supplied to the various noticees and an opportunity is granted to make submissions. In this regard, the Supplementary SCN only relies upon SEBI's own complaint to the BOW dated September 24, 2018, and its own FIR dated September 28, 2018 in support of the only allegation pertaining to purported violation of provisions of Forward Contracts Regulation Act ("FCRA"). Besides the fact that the whole allegation in the complaint is against NSEL, neither the complaint nor the FIR disclosed any allegation on the alleged role of the Noticee except to state that the Noticee was a trading member of NSEL.*
- b. *As Regulation 23 of the Intermediaries Regulations presumes contravention of the provisions of the securities laws defined in Regulation 2(1)(k) of the Intermediaries Regulations, which does not include within its ambit provisions of FCRA, the Noticee had repeatedly requested SEBI to inform and identify the documents and material being relied upon to allege the violation of any securities laws, however, no clarification in this regard has come from SEBI.*
- c. *Similarly, upon the conclusion of the proceedings before the DA, vide a separate communication dated September 2, 2022, provided a copy of Company Special Complaint No. 19 of 2019, filed by the Serious Fraud Investigation Office ("SFIO") and sought 'comments' from the Noticee. The above complaint was filed by the SFIO against NSEL, FTIL (later 63 Moons Technologies Ltd.) and their 18 subsidiaries and 20 defaulting companies and had no relevance to either to the Noticee or any stockbroker. Once again, vide our email dated September 5, 2022, the Noticee intimated SEBI that there was no clarity on which portion of the above complaint was being relied upon and the allegation being made in that regard against the Noticee.*
- d. *Pertinently, the issue regarding the lack of jurisdiction and the lack of any allegation of violation of specific provisions of any securities laws to commence proceedings under Regulation 23 of the Intermediaries Regulations has not been dealt with by the DA, though the Noticee had raised this issue before the DA.*

- e. *As regards Para 7 of the DA Report, it is apparent that the same does not demonstrate any violation of securities laws by MOCBL. The said paragraph only alleges that MOCBL is purportedly not fit and proper for the grant of certificate of registration. However, such requirement is only relevant in context of registration, which MOCBL has already withdrawn.*
- f. *Further, though Sections 29A(l)(e) of the Finance Act, 2015 allows SEBI to initiate action in relation to violation of The Forward Contracts (Regulation) Act, 1956 ("FCRA") within 3 years, there is no provision allowing SEBI to apply 'securities laws' to the transactions at the NSEL. There is therefore no question of any violation of securities laws in relation to the transactions on the NSEL on account of which there is no jurisdiction on part of the DA to have issued a fresh Show Cause Notice and issuing the DA Report. The present proceedings, being based solely on the DA Report, are also therefore without jurisdiction. The issue in relation to the alleged violation of securities laws has not been decided by the SAT and therefore is open for MOCBL to agitate in the present proceedings. Further, the present proceedings are beyond the scope of the remand pursuant to the SAT Order as the SAT had specifically directed the Ld. WTM to decide the present issue. However, in clear disregard of the SAT Order, the proceedings have been conducted by the DA instead of the Ld. WTM. Such an approach is in defiance of the specific ruling of the SAT Order and the DA Report ought to therefore be disregarded as being without jurisdiction.*
- g. *Instead of restricting the proceedings to the aspects remanded to by the SAT Order, the DA has incorrectly expanded the scope thereof, which is contrary to the legal position above. The DA Report contains an incorrect reference to the ruling of the SAT in Vasudev Ramchandra Kamat v. SEBI (decided on February 25, 2020). However, this reference is incorrect as the SAT had, in that case, remitted the matter entirely, as opposed to the present facts where there are very specific terms on which the remand is made. Further, it is apparent from the SAT Order that the remand was only for the specific issue of the additional material and not for the entirety of the matter. The various aspects, other than those specifically remanded by the SAT Order, are therefore without jurisdiction and need to be set aside.*
- h. *The DA Report concluded incorrectly that there is violation on part of MOCBL of provisions of various laws. The entire argument against MOCBL is that of the violation of the FMC's notification by NSEL. However, the notification in this regard was applicable to NSEL and not to MOCBL. MOCBL had merely acted as a broker in relation to trades at NSEL. Therefore, in the absence of any adverse observations against NSEL, there is no question of any adverse observation against MOCBL.*
- i. *The DA Report incorrectly contends that since there is a registration sought by MOCBL, the provisions of Chapter V of the Intermediaries Regulations can be initiated against it. This is ex*

facie incorrect because of the clear provisions of Regulation 23 of the Intermediaries Regulations as there is no violation of terms of certificate of registration or of securities laws by MOCBL. Assuming while denying that there was any violation of provisions applicable to NSEL, the same cannot be the basis of alleging violation of securities laws by MOCBL.

- j. The DA Report has incorrectly relied upon the amended portions of Schedule II of the Intermediaries Regulations. The proceedings before the DA were only limited to the aspects laid down by the SAT Order. The SAT Order did not keep the entire aspect open for consideration by the DA. The present proceedings ought to be determined on the basis of the law as was applicable to the proceedings before the SAT. The present proceedings, being continued only on account of the SAT Order, cannot apply legal provisions that were enacted at a later date. The DA Order contends incorrectly that the requirement of fit and proper being continuing, provisions enacted later can also be applied.*
- k. Mere filing of an FIR alone cannot be a determinative standard for rendering a decision on an entity being fit and proper. The purpose of registering an FIR is to set the machinery of criminal investigation into motion, which culminates with filing of the police report in terms of Section 173(2) of CrPC. While filing an FIR is a right afforded to any person, consideration of simply an existence of an FIR as a factor will cripple the securities market and render almost every broker and intermediary not fit and proper. In this regard, reliance is placed on the order of the SAT in DLF Ltd. v. SEBI (decided on March 13, 2015). In the absence of any further material beyond the existence of an FIR, no allegation has been made out in the Supplementary SCN to render MOCBL 'not fit and proper'.*
- l. The SAT Order has ruled specifically that the Jermyn Order and the Mukesh Babu Case are not applicable to the present facts. Despite this, in an abject disregard of the SAT Order, the DA Report relies upon these orders to issue recommendations against MOCBL.*
- m. SEBI has fundamentally mixed up two issues i.e., issue with regards to the Noticee's application for grant of certificate of registration under the Stock Brokers Regulations and issue with regards to the alleged role of brokers in trading through NSEL and consequently has incorrectly commenced proceedings under the Intermediaries Regulations. The Noticee had applied for its certificate of registration under the Stock Brokers Regulations upon repeal of the FCRA and the merger of FMC with SEBI, for grant of which various qualifications have to be satisfied under Regulation 5 of the Stock Broker's Regulations, including the requirement of fit and proper specified in Schedule II of the Intermediaries Regulations. However, the outcome of this application is not the issue before the Ld. WTM presently. The issue before the Ld. WTM presently is in regard to the enquiry proceedings which must meet the requirements spelled out under Regulation 23 of the Intermediaries Regulations.*

Regulation 23, dealing with cancellation or suspension of registration, clearly stipulates that SEBI may take such action against a person, who has been granted a certificate of registration, for contravening conditions of the grant of its certificate of registration or for violation of provisions of securities laws. As such, the issue of determination of fit and proper does not arise in the proceedings under the intermediaries Regulations.

- n. *The conflation of two independent issues is evident from the fact that the Supplementary SCN issued by the Ld. DA and the DA Report not only assumes that the Noticee has been granted a certificate of registration but further proceeds to make a recommendation on the basis of an assessment of fit and proper of the Noticee instead of adjudication on violation of any securities laws, which is sine qua non under Regulation 23 of the Intermediaries Regulations.*

8. I have carefully considered the SEBI Order, the SAT Order, the DA Report, the arguments made on behalf of the Noticee and the additional material available on record. I note that the only question that arises for consideration in the present matter is whether the Noticee satisfies the ‘fit and proper person’ criteria laid down under Schedule II of the Intermediaries Regulations.

SCOPE OF THE PRESENT REMAND

9. I note that while considering this issue afresh, I shall be guided by the findings and observations made by Hon’ble SAT in in the SAT Order while setting aside the earlier SEBI Order. In this regard, the grounds on which the SEBI Order was set aside by SAT and the matter was remanded back to SEBI are summarized as under:
- a. Observations of the Bombay High Court in the matter of **63 Moons vs. Union of India** (Writ Petition No. 2743 of 2014) cannot be relied upon as the said judgement has been set aside in appeal (Civil Appeal No. 4467 of 2019) by Hon’ble Supreme Court vide judgment dated April 30, 2019.
- b. Observation from the order dismissing the Writ Petition filed by NSEL against the invocation of the Maharashtra Protection of Interest of Depositors (in Financial Establishments) Act, 1999 (“MPID Act”) (**NSEL vs. State of Maharashtra - Writ Petition No. 1403 of 2015**) cannot be relied upon, as in a subsequent Writ Petition (No. 1181 of 2018) moved by 63 Moons, a Division Bench of the Bombay High Court has allowed the prayer and held that NSEL is not a financial establishment and therefore

the provisions of the MPID Act are not applicable. The Division Bench also observed that the *prima facie* observations made by the single bench while dismissing the NSEL petition could not be relied upon as they were preliminary observations and such observations do not foreclose the issue about the applicability of the provisions of the MPID Act. The Hon'ble SAT was of the opinion that *prima facie* observations cannot be utilized to judge the reputation, character or integrity of NSEL.

- c. Observations in the bail rejection order dated August 22, 2014, passed by the Hon'ble Bombay High Court in the matter of ***Jignesh Prakash Shah vs. The State of Maharashtra***, cannot also be relied upon, as the observations in the said bail rejection order were limited to the fact as to whether the bail should be granted or not.
- d. Reliance on the SFIO Report was misplaced. The report only directs EOW/Police to initiate appropriate proceedings against NSEL and its directors/promoters. Based on the SFIO Report, the Special Session Judge took cognizance of the matter by an Order dated July 29, 2019. But this Order was challenged by NSEL and two other accused and has since been stayed by the Bombay HC. Also, no complaint yet has been filed against the Appellants pursuant to the SFIO Report.
- e. Effect of SFIO Report under The Code of Criminal Procedure, 1973, was not considered by SEBI.
- f. Reliance placed on decisions of the Hon'ble SAT in the matter of ***Jermyn Capital vs. SEBI*** (Appeal No. 26 of 2006, Decided on September 6, 2006) and ***Mukesh Babu Securities vs. SEBI*** (Appeal No. 53 of 2007, Decided on December 10, 2007) is misplaced as decisions in the said matters are distinguishable on facts. Jermyn Capital was held to be in relation to an Interim Order passed by SEBI, and the SAT was of the view that the criteria for passing an Ad Interim Order are based on a different criterion, namely *prima facie* case, the balance of convenience and irreparable injury which are distinct and different while considering an application grant of Certificate of Registration. The decision in the matter of ***Mukesh Babu Securities*** was distinguished by the Hon'ble SAT on the basis that in the matter a criminal complaint was filed against the Chairman of the Company. The SAT noted that there was no evidence to show that any proceedings had yet been initiated against the appellants in the matter under consideration.
- g. Reputation of the applicant cannot be lightly considered based on observations which are not directly related to the applicant.
- h. Forensic report commissioned by SEBI does not find any close connection between applicant and NSEL. This was overlooked by SEBI.

- i. The SEBI Order does not state for how long the rejection of application will continue. The Hon'ble Tribunal was of the view that the rejection cannot continue indefinitely, and in such cases, a time period should be provided during which the applicant would become ineligible to seek fresh registration.
10. It is noted that the Hon'ble SAT had remanded the matter back to SEBI by taking into consideration the contention made by the counsel appearing on behalf of SEBI that there was additional material available, which had come into existence post the SEBI Order, based on which the findings in the SEBI Order could be sustained. In this regard, the Hon'ble SAT has held:

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

ADDITIONAL MATERIAL BROUGHT ON RECORD

11. As the matter was remanded back to SEBI, a DA was appointed to undertake a fresh enquiry. The DA then issued a Supplementary SCN, bringing on record the following additional material:
- a. Order of the Hon'ble Supreme Court in the matter of **63 Moons vs. Union of India** (Civil Appeal No. 4467 of 2019).
 - b. Order of the Hon'ble Supreme Court in the matter of **The State of Maharashtra vs. 63 Moons Technologies Ltd.** (Civil Appeal No. 2748-49 of 2022)
 - c. Copy of the complaint dated September 24, 2018, filed by SEBI with EOW against brokers, including the Noticee.
 - d. Copy of the FIR dated September 28, 2018, filed by EOW, acting on the complaint filed by SEBI against the brokers, including the Noticee.

- e. The amendments made to *'fit and proper person'* criteria specified in Schedule II of the Intermediaries Regulations, vide SEBI (Intermediaries) (Third Amendment) Regulations, 2021.

PRELIMINARY OBJECTIONS

12. I note that the Noticee has raised a preliminary objection to the current proceedings. It has been submitted by the Noticee that in terms of Regulations 25(3) of the Intermediaries Regulations, the DA is required to specify in the notice calling upon the Noticee to show cause, the provision of securities laws or the direction or the order of the Board alleged to have been contravened by it. It was contended by the Noticee that the DA Report proceeds on the basis of certain alleged violations of the provisions of the FMC Act and does not specify the provisions of securities laws alleged to have been contravened by it.
13. Having considered the above contention, I note that in terms of Regulation 5(e) of the SEBI (Stock Brokers) Regulations, 1992 ("Stock Brokers Regulations"), every stock broker at the time of seeking registration, and thereafter throughout the time it holds a valid certificate of registration, has to satisfy the "fit and proper person" criteria specified in Schedule II of the Intermediaries Regulations. I further note that the DA Report proceeds on the basis that the past conduct of the Noticee in facilitating access to the "paired contracts" traded on NSEL calls into question the compliance of the Noticee with 'fit and proper person' criteria. Further, SEBI while examining the compliance of an applicant, or even a registered intermediary, with the "'fit and proper person' criteria can take into consideration not just contravention of the provisions of securities laws, but also the general conduct of the Noticee which may have a bearing on its functioning as a registered intermediary. As an illustration, let us assume a case where an applicant seeking registration is implicated in a cheating or forgery case and consequently proceedings have been initiated under the relevant provisions of the India Penal Code, 1862. In such a case, SEBI would not be precluded from taking that into consideration these proceedings, just because the contravention does not pertain to securities law, while determining compliance of such entity with the 'fit and proper person' criteria. I, thus, find no merit in the preliminary objection raised by the Noticee.

14. Before moving forward to consider the matter on merits and decide whether the Noticee fulfilled the *'fit and proper person'* criteria, in light of the additional material that has been brought on record post the SEBI Order (as detailed at paragraph 11), it would be appropriate to look at the background of NSEL and understand the nature of the *'paired contracts'* that were offered on the exchange – which ultimately is the genesis of the entire proceedings. While undertaking this exercise, without independently recording any findings on the nature of the contracts that were entered on the NSEL platform or commenting on the actions of any entity which is not a party to the present proceedings, I have relied on the observations made by other authorities including the Hon'ble Supreme Court, wherever appropriate.

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

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

17. On February 6, 2012, the Department of Consumer Affairs, Government of India, vide Gazette Notification S.O. 228(E) partially amended the Notification dated June 5, 2007, to the effect that “*all information or returns relating to the trade as and when asked for shall be provided to the Central Government or FMC*”.
18. Thereafter, MCA on April 27, 2012 directed NSEL to show cause as to why action should not be initiated against it for the following alleged contraventions:
 - a. Permitting short sale of commodities: NSEL had not made it mandatory for the seller to actually deposit goods in the warehouse before he took a short position through a member of the exchange, The Exchange had no stock check facility which validated the member position. The exchange allowed trading on the exchange platform without verifying whether the seller member had the stocks with him or not.
 - b. Contracts made available by NSEL were for periods exceeding 11 days.
19. Subsequent to this, MCA vide its letter dated July 12, 2013, directed NSEL to give an undertaking that:
 - a. No further/fresh contracts shall be launched by NSEL until further instructions from concerned authority; and
 - b. All the existing contracts will be settled on the due dates.
20. Thereafter, FMC vide an Order No.4/5/2013-MKT-1/B dated December 17, 2013 (“**FMC Order**”), observed that: “55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA” and “the condition of ‘no short sale by members of the exchange shall be allowed’ was not being met by NSEL”.
21. Further, in the above mentioned Order, FMC *inter alia* held that the contracts traded on NSEL violated the following conditions stipulated in the aforesaid Notification no. SO906(E) dated June 5, 2007, that granted permission to NSEL to offer spot trading in commodities:

a. **Short Sale.**

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

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

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

22. From the above, it is clear that NSEL was initially set up as a spot exchange for trading in commodities. It was essentially meant to only offer forward contracts having one-day duration. I note from the FMC Order that FMC had observed that 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA. I further note from the FMC Order that under the FCRA, a “*forward contract*” is defined as a “*contract for delivery of goods and which is not a ready delivery contract*”. A “*ready delivery contract*” is defined as “*a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days*”. Given the said definition contained in FCRA, FMC was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as *Non-Transferable Specific Delivery contracts*.
23. It is therefore noted that even though MCA had stipulated in the exemption Notification that only contracts of one-day duration were permitted to be offered on NSEL, FMC, in its Order, relying on the definition of “*forward contract*” under FCRA, had held that NSEL was allowed to trade only in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days. Therefore, even going by the interpretation adopted by FMC, it becomes clear that the 55 contracts having duration longer than 11 days, which were permitted by NSEL, were *ex facie* in contravention of the exemption granted to NSEL. It is pertinent to note that all the 15 contracts that were publicized by NSEL, which are

captured in the Hon'ble Supreme Court's Judgement *in the matter of NSEL* and the extracts of which are quoted in the next paragraph, were for durations exceeding 11 days.

24. Now, while considering the additional material that has been brought on record, I note that the Hon'ble Supreme Court has extensively commented on the nature of the 'paired contracts' traded on NSEL in its two judgments. The said observations are captured below:

a. The Two-Judge Bench of the Hon'ble Supreme Court in the course of determining the validity of the amalgamation order in the matter of 63 Moons had observed as under:

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

b. The Hon'ble Supreme Court in the MPID matter has drawn reference to the presentations made by NSEL in respect of the 'paired contracts' and has observed as under:

"44. ... NSEL in the course of its brochures has held out representations about the trading and investment opportunities available for:

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

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

<i>Commodity</i>	<i>Duration</i>	<i>Investment (lacs.)</i>	<i>Yield</i>
<i>Castor Seed</i>	<i>T+3 & T+36</i>	<i>7.5 -9</i>	<i>16%</i>
<i>Castor Oil</i>	<i>T+5 & T+30</i>	<i>7-9</i>	<i>16%</i>

<i>Cotton Wash Oil</i>	<i>T+2 & T+25</i>	<i>10</i>	<i>16%</i>
<i>Paddy</i>	<i>T+2 & T+25</i>	<i>3.5-4.5</i>	<i>16%</i>
<i>Steel</i>	<i>T+2 & T+25</i>	<i>4.5-5</i>	<i>16%</i>
<i>Raw Wool</i>	<i>T+2 & T+25</i>	<i>3.5-4</i>	<i>16%</i>
<i>Wool Top</i>	<i>T+2 & T+25</i>	<i>1.8-2</i>	<i>16%</i>
<i>Crude Soybean Oil</i>	<i>T+2 & T+25</i>	<i>3.3.-3.5</i>	<i>16%</i>
<i>Soya DOC</i>	<i>T+2 & T+25</i>	<i>1.7-2.0</i>	<i>16%</i>
<i>Refined Mustard Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Refined Soybean Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Refined Sunflower Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>RBD Palmolein Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Sugar</i>	<i>T+2 & T+25</i>	<i>3.0</i>	<i>16%</i>
<i>Maiᳵe</i>	<i>T+2 & T+25</i>	<i>3.0</i>	<i>16%</i>

The above representation specifies:

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

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

Opportunities

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

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

Features of Trading Opportunity:

- *T+2 and T+25 contract offers unique trading opportunity to traders*
- *Trader purchases T+2 contract and simultaneously sells T+25 contract*

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

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

Comparison

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

The above representation indicates that 'paired contracts' were designed as a unique trading opportunity by NSEL under which a trader would, for instance, purchase a T+2 contract (with a pay-in obligation on T+2) and would simultaneously sell a T+25 contract (with a pay-out of funds on T+25). The price differential between the two settlement dates was represented to offer an annualized return of about 16%. NSEL categorically represented that all trades were backed by collaterals in the form of stocks and its management activities included selection, accreditation, quality testing, fumigation and insurance. **Therefore, NSEL represented that on receiving money and commodities, the members would receive assured returns and a service.** Though NSEL has been receiving deposits, it has failed to provide services as promised against the deposits and has failed return the deposits on demand. Therefore, the State of Maharashtra was justified in issuing the attachment notifications under Section 4 of the MPID Act." (emphasis supplied)

25. From the above, it is noted that the Hon'ble Supreme Court has already commented on the nature of the 'paired contracts' offered on the NSEL platform. In the merger petition (**63 Moons Technologies Ltd. vs. UOI**), the Hon'ble Supreme Court has held that these contracts were in the nature of financing transactions. Further, in the MPID matter (**The State of Maharashtra vs. 63 Moons Technologies Ltd.**), it was held that such transactions come within the definition of 'deposits' under the MPID Act.

26. I note that the Hon'ble Supreme Court, in the MPID matter, had extensively referred to the claims made on the website of the NSEL and the contents of the publicity material and other investor resources. In this regard, from the data provided in the table reproduced under para 24(b) above, it can be seen that NSEL was publicizing a uniform return of 16% p.a. on the '*paired contracts*' traded on its platform. The return offered was the same across commodities. The return remained the same irrespective of the duration of the contract. For example, return offered on a T+2 & T+25 paired contract in steel was same as the return offered on T+ 2 & T + 35 paired contract in castor oil. It is thus noted that the '*paired contracts*' were being projected as an alternative to fixed deposits.
27. I note that the FMC Order, the EOW compliant and the abovementioned two judgments of the Hon'ble Supreme Court have extensively dealt with the issue of NSEL permitting short sales, i.e. permitting sellers to offer contract for sale of commodities on its platform without ensuring that requisite quantity of commodity was available in the warehouse. It is further noted from the Hon'ble Supreme Court's Order in the MPID matter that an overwhelming majority of the sale leg of the '*paired contracts*' which were executed were short sales i.e. commodities to back such sales were not available at the designated warehouses of NSEL. However, I note that it was primarily the responsibility of NSEL, and not the brokers, to ensure that there was adequate collateral against sell orders posted on its platform. I am therefore not going to delve any deeper on this issue.
28. I shall now proceed to look into the issue of violation of the third condition mentioned in the exemption Notification i.e. the compulsory delivery of outstanding position at the end of the day. In this regard, I take note of the observations made in this respect by various authorities. I note that the FMC Order records that "*NSEL Board allowed launching of paired back-to-back contracts on its exchange platform comprising a short-term buy contract (T+2 settlement) and a long-term sell contract (T+25 settlement) with predetermined price and profit for the buyer and seller, **which violated the very concept of spot market of commodities and the transactions ultimately were in the nature of financial transactions.**" Further, it has already been stated in the preceding part of this Order that the Hon'ble Supreme Court has held '*paired contracts*' to be in the nature of financing transactions. I thus note that the '*paired contracts*' offered by NSEL, which were by design structured in a manner that resulted in no delivery of commodities, have already been found by authorities including the Hon'ble Supreme Court*

to be in blatant violation of the conditions prescribed in the exemption Notification issued by MCA.

29. I note that that apart from the abovementioned two decisions of the Hon'ble Supreme Court, certain additional material was brought out during the enquiry conducted by the DA. In this regard, I note that DA Report also takes into consideration the contents of SFIO Report. It is however noted that in the SAT Order it was held that reliance on the SFIO Report was misplaced as the SFIO Report only directed EOW/Police to initiate appropriate proceeding against NSEL and its directors/promoters. The Hon'ble SAT has further observed that based on the SFIO Report, the Special Sessions Judge took cognizance by an Order dated July 29, 2019. However, I note that the abovementioned Order dated July 29, 2019 of the Special Sessions Judge taking cognizance was challenged by NSEL and two other accused and the said Order has been stayed by the Hon'ble Bombay High Court. In view of the above, I do not propose to place any reliance on the material brought out in the SFIO Report.
30. Further, I note from the records that SEBI has filed a complaint dated September 24, 2018, against brokers who facilitated access to '*paired contracts*' traded on NSEL, including the Noticee, with EOW. On the basis of this complaint, an FIR dated September 28, 2018 was filed against the Noticee with EOW.
31. The above observations essentially lead to the question as to whether the Noticee should have been aware that the '*paired contracts*' offered by NSEL, rather than being spot contracts in commodities, were actually an entirely different product which was far removed from the spot trading, as such '*paired contracts*' did not result in compulsory delivery of commodities. As stated in the table reproduced under para 24(b) above, NSEL itself was publicizing such contracts as an alternative to fixed deposits and the return offered was 16% across all commodities irrespective of the nature of the contract or the duration. Further, these contracts were structured in a manner which ensured that the buyer always made pre-determined profits.
32. It is an undisputed fact that there was a settlement default at NSEL and unsuspecting investors suffered losses of more than INR 5600 Crore. In this context, the question that needs to be considered is whether there were enough red flags to alert a reasonable person that what was being offered was not spot contract in commodities but rather a financial

product offering fixed returns, which should have made him act in a more circumspect manner when the “*paired contracts*” were first offered by NSEL. I note that during the period when “*paired contracts*” were offered by NSEL (2009 -2013), the policy repo rate ranged from 4.75 % to 8% whereas NSEL, in its own publicity material, was promising an ‘*assured return*’ of 16%. Contracts were structured in a manner where the buy side always made a profit. The return across commodities, as highlighted in the table under para 24(b) above, were the same irrespective of the duration of the contract. These are apart from the other *ex facie* deviations from the exemption notification that “*paired contracts*” suffered from.

33. I therefore find that the writings on the wall were quite visible and there were enough red flags for a reasonable person to come to conclude that what was being offered as paired contracts on NSEL were not spot contracts in commodities. Having reviewed all the material on record, I am constrained to conclude that the Noticee, presumably driven by its desire to earn brokerage, provided a platform for its clients to access a product which raised serious questions on the ability of the Noticee to conduct proper and effective due diligence regarding the product itself. The lure of extra yield proved to be an irresistible bait. Brokers with vast experience like the Noticee should have been more careful while offering such a product to its clients.

‘Fit and Proper Person’ CRITERIA

34. Regulation 5(e) of the SEBI (Stock Brokers) Regulations, 1992 (“Stock Brokers Regulations”) provides that for the purpose of grant of certificate of registration, the applicant has to be a fit and proper person in terms of Schedule II of the Intermediaries Regulations .

Stock Broker Regulations

5. The Board shall take into account for considering the grant of a certificate, all matters relating to trading, settling or dealing in securities and in particular the following, namely, whether the applicant, -

...

(e) is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008;”

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

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

[See regulation 7]

- (1) *The applicant or intermediary shall meet the criteria, as provided in the respective regulations applicable to such an applicant or intermediary including:*
- (a) the competence and capability in terms of infrastructure and manpower requirements; and*
 - (b) the financial soundness, which includes meeting the net worth requirements.*

- (2) *The 'fit and proper person' criteria shall apply to the following persons:*
- (a) the applicant or the intermediary;*
 - (b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and*
 - (c) the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:*

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

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

- (3) *For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but not limited to the following:*
- (a) integrity, honesty, ethical behaviour, reputation, fairness and character of the person;*
 - (b) the person not incurring any of the following disqualifications:*
 - (i) criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;*
 - (ii) charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences and is pending;*

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

disqualification failing which the 'fit and proper person' criteria may be invoked against such intermediary.

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

36. I note that the post the amendment carried out in 2021, the *'fit and proper person'* criteria now has both a 'principle based criteria' and a 'rule based criteria', as opposed to the earlier criteria which was 'purely principle based'. The Noticee has contended that the revised criteria introduced in 2021 should not be made applicable to him as the present proceeding essentially pertain to considering an application filed by the Noticee in 2015. It is noted that *'fit and proper person'* criteria is a requirement that has to be satisfied by the intermediary not only at the time of registration with SEBI but also throughout the time it holds a valid registration with SEBI. Therefore, even if an intermediary was granted a Certificate of Registration in 2015, such intermediary would still be required to comply with the revised criteria post the amendments carried out in 2021. In this case, since the application filed by the Noticee, though filed prior to the amendment in Schedule II, is being considered afresh, the criteria applicable as on date of such consideration ought to be applied. I therefore find no merit in the argument of the Noticee that revised 'fit and proper' criteria cannot be applied in his case.
37. It is noted that paragraph 3(b) of the amended criteria lays down a list of disqualifications which includes, under para 3(b)(i) "*criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending.*"
38. As already stated above, a criminal complaint has been filed by SEBI before the EOW against the Noticee. It is, therefore, noted that the Noticee attracts the disqualification provided in paragraph 3(b)(i). Further, the act of Noticee in offering access to *'paired contracts'* also seriously calls into question the integrity, honesty and lack of ethical behaviour on the part of the Noticee. These contracts, as stated earlier, were *ex facie* offered in violation of the exemption Notification issued by MCA and far removed from the spot contracts in commodities which were permitted to be traded on NSEL. The *'paired contracts'* were nothing but financing transactions masquerading as spot contracts in commodities.

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

39. In view of the above, I hold that the Noticee does not satisfy the ‘*fit and proper person*’ criteria specified in Schedule II of the Intermediaries Regulations.
40. I note that while the “paired contracts” offered by NSEL pertained to the period from 2009 to 2013, the application for registration that is being considered in these proceedings was submitted in 2015. There was even an attempt by the Noticee to withdraw the application, which was not permitted by SEBI. The said decision of SEBI was challenged by the Noticee before the Hon’ble Bombay High Court, which eventually held that SEBI was justified in refusing the withdrawal as proceedings were pending. Thereafter, SEBI vide Order dated February 22, 2019 had rejected the application filed by the Noticee. I cannot lose sight of these facts while deciding the appropriate directions to be issued in this matter.
41. The DA in his Report dated October 03, 2022 has recommended that the application submitted by the Noticee be rejected and that the Noticee’s application for registration as a commodity broker not be considered for another two years from the date of conclusion of the present proceedings before SEBI or till disposal of FIR filed with EOW, whichever is earlier.
42. Given the facts that have been brought out in the preceding parts of this order, I differ with the recommendation of the DA with regard to the period for which the Noticee should be debarred from making a fresh application seeking registration with SEBI, especially considering the timeline over which the events have played out. In view of the same, I am of the view that the Noticee being debarred from making a fresh application seeking registration for a period of 3 months from the date of this Order or till the disposal of FIR filed with EOW, whichever is earlier, would be commensurate with the findings against the Noticee in this Order.

Order –

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

-Sd-

Place: Mumbai

Date: November 29, 2022

ASHWANI BHATIA

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA