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**NATIONAL COMMODITY CLEARING LIMITED**

Circular to all Members of the Clearing Corporation

Circular No. : NCCL/COMPLIANCE-006/2019

Date : February 26, 2019

Subject : Order in respect of M/s. Anand Rathi Commodities Limited

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Members and Constituents are required to note that the Securities and Exchange Board of India (SEBI) has issued an order against M/s. Anand Rathi Commodities Limited vide order no. WTM/MPB/EFD-1-DRA-IV/22/2019 dated February 25, 2019 inter-alia, directing as under:

Extract of the Order:

*"...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 received on December 16, 2015, filed by Anand Rathi Commodities Limited for registration as commodity derivatives broker. The Noticee shall cease to act, directly or indirectly, as a commodity derivatives broker.*

*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....."*

A copy of the said Order is attached herewith.

Detailed order is also available on the SEBI website.

In view of the above Members are advised to take note of the same and ensure compliance.

For and on behalf of  
**National Commodity Clearing Limited**

Hemalatha S.  
Chief Compliance Officer

Encl.: Annexure

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For further information / clarifications, please contact

1. Customer Service Group on toll free number: 1800 266 6007
2. Customer Service Group by e-mail to : [contactus@nccl.co.in](mailto:contactus@nccl.co.in)

## 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 respect of

Sl. No	NAME	PAN
1.	Anand Rathi Commodities Limited	AAACP6209K

## In Re: Fit and Proper Criteria

**BACKGROUND OF THE CASE:**

1. Anand Rathi Commodities Limited (hereinafter referred to as “ARCL” / “Noticee”) was/is a commodity derivative broker / member of National Spot Exchange Limited (hereinafter referred to as “NSEL”), Multi Commodity Exchange of India Limited (hereinafter referred to as “MCX”) and National Commodity & Derivatives Exchange Limited (hereinafter referred to as “NCDEX”), National Multi Commodity Exchange of India Limited (hereinafter referred to as “NMCE”), Ace Derivatives and Commodity Exchange Limited (hereinafter referred to as “ACE”) and Indian Commodity Exchange Limited (hereinafter referred to as “ICEX”).
2. NSEL was incorporated in May 2005 as a Spot Exchange for trading in commodities. In exercise of powers 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, ARCL had made an application to SEBI for registration as a commodity derivative broker which was received by SEBI 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 Borkar & Muzumdar, Chartered Accountants (hereinafter referred to as "**Auditor**") to carry out a performance audit/inspection of ARCL.

7. The Auditor submitted the Audit report along with Annexures 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 ARCL 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 ARCL. 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 ARCL submitted for registration as a commodity broker may not be considered in the interest of securities market and the application of ARCL 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 ARCL including the violation of the Government of India Notification issued under section 27 of FCRA.

**FIRST SHOW CAUSE NOTICE:**

10. Pursuant to the submission of Enquiry Report dated April 11, 2017 in respect of ARCL 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 ARCL wherein ARCL was advised to reply to the SCN within 21 days from the date of receipt of said notice. ARCL vide letter dated May 16, 2017 had acknowledged the receipt of SCN. The allegations in brief as specified/mentioned in the Enquiry report were as under:

- 10.1. The 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. The Noticee had made false representation in respect of assured / risk free return, arbitrage opportunity in spot market by way of pair contracts, making assurances that pair trades are backed by collateral in the form of stock / sufficiency of commodities in warehouses, making statements that goods in warehouse are backed by insurance cover; which are in violation of provisions of various circulars, rules and bye laws of NSEL and sections 21(g) of the FCRA.
- 10.3. The Noticee had done client code modifications with manipulative artifice; The Noticee had failed to dispatch the contract notes to its clients and failed to reserve delivery proof of the same, the Noticee through its NBFC, funded its clients, the Noticee failed to segregate the funds of the clients between derivate and spot exchanges, the Noticee failed to collect sufficient margins from its clients, etc., which are in violation of provisions of various circulars, rules and bye laws of NSEL.
- 10.4. The Noticee had failed to report suspicious transactions to Financial Intelligence Unit under PMLA thereby violated provision of NSEL Circulars.
- 10.5. The Noticee had to do system audit of IBT system and CTCL System for the period under audit; which are in violation of provisions of various circulars of MCX and NCDEX.

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

**ISSUE OF INSPECTION:**

11. ARCL, vide various letters/emails dated May 16, 2017, June 05, 2017, July 07, 2017, September 12, 2017, September 14, 2017, September 20, 2017, September 21, 2017, October 05, 2017, October 23, 2017, November 21, 2017, January 03, 2018, January 23, 2018 and February 20, 2018 etc., sought inspection of documents as well as copies of documents and submitted that SEBI has not provided complete inspection of all documents to them. However, SEBI submitted that it had granted inspection to ARCL on February 22, 2018 and copies of all relied upon documents were also provided to ARCL through various letters dated August 29, 2017, September 13, 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 27, 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. Vide the said order, the Noticee was given the opportunity to submit its reply on merit within a period of 3 weeks from the date of this order. However, the Noticee did not file any reply on merits of the case within the stipulated time.

**HEARING ON MERITS OF THE CASE & SUBMISSIONS:**

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

16. Meanwhile, ARCL vide letter dated July 19, 2018 had filed an application with SEBI for withdrawal of the application for registration / surrender of deemed registration made by them vide applications received on December 16, 2015. SEBI vide letter dated August 24, 2018 had informed ARCL 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 August 24, 2018, ARCL, filed a Writ Petition No. 3262 of 2018 before the Hon'ble High Court of Bombay challenging the said letter dated August 24, 2018 by which SEBI had not entertained the request of ARCL for withdrawal of the application for registration. The said Writ Petition before the Hon'ble High Court of Bombay was mentioned on September 24, 2018.

18. Shardul Amarchand Mangaldas & Co. on behalf of ARCL vide letter dated September 26, 2018, stated the said Writ Petition before Hon'ble High Court of Bombay was scheduled to be listed before regular bench on October 01, 2018. Therefore, in view of this, ARCL 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 the Hon'ble High Court of Bombay vide order dated October 04, 2018 rejected the Writ Petition no. 3262 of 2018 filed by the Noticee.

21. On October 09, 2018, Mr. Saurabh Bachhawat, Advocate, Mr. Amey Satish Gokhale, Advocate, Ms. Sukriti Jaiswal, Advocate along with Mr. Vasudev Gerewal, Asst. Vice President of ARCL, Authorized Representatives ("ARs") of ARCL appeared for the hearing. Following *inter alia* was noted during the hearing:

".....

(a) *During the course of hearing, ARCL 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, ARCL sought an adjournment of today's hearing.*

(b) *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 ARCL is brought to notice. Thus, the undersigned is of the view that, the enquiry proceedings in respect of ARCL is to continue.*

(c) *ARCL further stated that SEBI is in non-compliance of Hon'ble Whole Time Member order dated August 30, 2018 as they had failed to provide the documents mentioned at Sr. No. 46 of Table no. 1 of said order as per the instruction mentioned at paragraph 21(e) of the said order. ARCL further stated that SEBI is requested to provide the said document and thereafter 4 weeks' time be given to submit the comprehensive reply in the matter and present hearing be adjourned.*

(d) *The undersigned directed SEBI to provide the said document, if available, to ARCL today and if the said document is not available, then SEBI is directed to communicate its stand on the said document to ARCL by today.*

(e) *The undersigned expressed disinclination to accept the request of ARCL to adjourn the hearing, since notice of the hearing had been given well in advance and repeated*

*opportunities of hearing had already been granted to them. However, since other entities in similar matter were being granted hearing on October 12, 2018, ARCL was also granted hearing on October 12, 2018.*

*.....”*

I note that SEBI vide letter dated October 09, 2018, provided the copy of Sample Busniss Rules of NSEL as mentioned in the part of KYC and Extract of the copy of the Bye-law dealing with the obligation of Member to issue contract note. The AR of the Noticee acknowledged the receipt of the same.

22. On October 12, 2018, Mr. Pradeep Sancheti, Senior Counsel, Mr. Saurabh Bachhawat, Advocates from Shardul Amarchand Mangaldas & Co. along with Mr. Vasudev Gerewal, Asst. Vice President of ARCL, **ARs** of ARCL appeared for the hearing and made the oral submissions. The matter was part heard and adjourned to October 19, 2018.

23. On October 19, 2018, Mr. Pradeep Sancheti, Senior Counsel, Mr. Saurabh Bachhawat, Ms. Ameya Gokhale, Advocates from Shardul Amarchand Mangaldas & Co. along with Mr. Deepak Kedia, Mr. Chetan Bharkhada and Mr. Vasudev Gerewal, Asst. Vice President of ARCL, **ARs** of ARCL 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) Following queries were 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.*

*b) ARs granted time till November 22, 2018 for additional submissions in phases.”*

24. The Noticee submitted its preliminary submissions to the First SCN vide letter dated October 19, 2018. The submissions of the Noticee in brief are as under:

**Preliminary submissions/objections:**

**A. SEBI has no powers under Regulation 24 of the Intermediaries Regulations to appoint the Designated Authority, in relation to its application for registration:**

24.1 Regulation 24(1) of the SEBI (Intermediaries) Regulations 2008 provides that where a designated member is satisfied that a person (Intermediary) who has been granted a certificate of registration has committed any default, they may appoint a designated authority to look into default / violation. It is clear that a Designated Member is empowered to appoint a Designated Authority, only in a case where an Intermediary who is granted a certificate of registration has committed default. As mentioned above, ARCL has not been granted any certificate of registration under the SEBI Act or the regulations framed therein and hence the question of any proceedings against them cannot and does not arise.

24.2 The enquiry as contemplated under Regulation 24 of the SEBI (Intermediaries) Regulations, 2008 would be in respect of the activities of the broker from the date of registration. Chapter V of the Intermediaries Regulations have no relevance whatsoever, to an application seeking a certificate of registration as a broker under the SEBI (Stock Brokers and Sub-brokers) Regulations 1992. The power to grant a certificate of registration to any person to act as a Broker is only vested with the Board under Chapter II of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992.

**B. SEBI Regulations not applicable till 28<sup>th</sup> September 2015:**

24.3 That neither the SEBI Act nor any rules or regulations framed thereunder have any application to transactions/dealings in commodities (at NSEL) for the period prior to September 2015. It is further submitted that until September 2015, there was no

requirement for the Noticee to seek any registration under any law with any statutory authority;

24.4 That until September 2015, no rules or regulations were prescribed by any statutory authority as to the conduct of business as a commodity broker (at NSEL). It is clear that in the present case the allegations in the SCN pertain to the period up to July 2013 and not for the period after the Noticee applied for registration as a commodity broker i.e. 4<sup>th</sup> November, 2015. Hence, there can be no enquiry under the present SCN for the period up to September 2015 as the said period is beyond the scope of SEBI Regulations which became applicable only after 28<sup>th</sup> September 2015.

**C. Mandate of the Designated Authority is limited by the order of the appointing authority:**

24.5 The bench of Designated Authorities was appointed purportedly by an order dated October 06 2016 for enquiring into alleged violation under Regulation 23 of Intermediaries Regulations read with Section 12 (3) of the SEBI Act. Chapter V has no relevance whatsoever to an application seeking a certificate of registration as a broker under the SEBI (Stock Brokers and Sub-brokers) Regulations 1992. The power to grant a certificate of registration to any person to act as a Broker is only vested with the Board under Chapter II of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992. In view of this, the appointment of the bench of Designated Authorities is ex-facie without any jurisdiction and / or authority in law. *Ipso facto*, the proceedings conducted and/or the report / recommendations made by the bench of Designated Authorities have no force/sanctity in law.

**D. The Bench of Designated Authorities has no authority/power to give recommendations with respect to any alleged violations in relation to transactions which formed subject matter of trades on NSEL:**

24.6 The bench of Designated Authorities being governed by the terms of its appointment, which were for the limited purposes of conducting an enquiry under Chapter V of Intermediaries Regulations had no authority to exercise powers under Section 29-A of the FCRA. Even otherwise, Regulation 27 of the Intermediaries Regulation provides that a specific recommendation can be made by the designated authority. In the present case, the bench of Designated Authorities has *inter alia* recommended that SEBI ought to

prosecute ARCL for its alleged violations of law. The bench of Designated Authorities has no power or authority in law to make any such recommendations.

- 24.7 In view of the above, the Report made by the bench of Designated Authorities is without any authority and/or beyond the power and/or authority vested in them in law and outside the scope of their appointment and hence void ab initio and bad in law. Furthermore the entire action is demonstrably malafide and a premeditated attempt on the part of SEBI.

**E. The proceedings initiated by SEBI against the Noticee is without any authority and jurisdiction:**

- 24.8 The FCRA was amended vide the Finance Act, 2015 and Section 28A was inserted. On bare perusal of Section 28A of the FCRA makes it *prima facie* clear that SEBI can exercise all powers of the Commission (i.e. FMC) with respect to recognized association (deemed exchanges). Further, on perusal of the provisions contained in sub-section (d) and (e) of Section 29A of the FCRA, it is evident that proceedings for offence under FCRA can be initiated by the Security Board under that Act (i.e. FCRA only). Thus, the show-cause notice dated October 28, 2016 for violations purportedly committed prior to repeal of FCRA cannot be initiated under SEBI Act and/or regulations framed thereunder.

**F. Assuming any recommendation could have been made by the Designated Authority the same could have been only for cancellation/ suspension of registration:**

- 24.9 That even assuming that any recommendation could have been made by the Designated Authority the same could have only been with respect to cancellation or suspension of registration. However, in the present case no such recommendation has been made. Instead, the said SCN recommends that the application for registration as commodity should not be considered and to initiate criminal proceedings against the Noticee. It is submitted that both the recommendations are therefore beyond the scope of Regulation 27 of the Intermediaries Regulations and are therefore, void *ab initio*.

**G. Once the Noticee has withdrawn its application, the question of non-consideration of application does not survive:**

24.10 As per the Report, it has been recommended that “*the application for registration as commodity broker submitted by the Noticee may not be considered....*”

- (i) ARCL has vide a letter dated July 19, 2018, (“19th July Letter”), intimated the Market Intermediaries Regulation and Supervision Department (MIRSD) of SEBI, its decision to withdraw its application for registration as commodity broker.
- (ii) The order dated 4<sup>th</sup> October, 2018, passed by the Hon’ble Bombay High Court in the Writ Petition (L) 3262 of 2018, filed by the Noticee has not passed any categorical order/direction as to the validity (or otherwise) of the Noticee’s withdrawal of application for registration. The Hon’ble Bombay High Court has further observed thus: “*At this stage, we do find it necessary to go in the correctness or otherwise of the findings made in the said reports, inasmuch as the proceedings are pending before the Whole Time Member of SEBI.*”
- (iii) The Noticee withdrawn the application for registration, there is no warrant in law that such application can be considered as pending or live. The withdrawal of application is self-operative and comes into effect immediately once communicated. Further, in any case, the decision communicated purporting to refuse the withdrawal is invalid and without authority. Moreover, the officer communicating the purported decision was not even authorized in law to consider the application and to take such decision. Reliance is placed on (a) *Prakaash Kaur v. Sandhooran & Anr.* (1993) 3 SCC 312 (b) *Shiv Prasad v. Durga Prasad & Anr.* (1975) 1 SCC 405- Paragraph 12. The said judgment has been followed in the matter of *Curewell India Ltd. v. Sahib Singh* (1982) DRJ (3) 193.(c) *Mahant Biharidasji v. Parshootan Das* 1908 ILR 32 Bom 345.

**H. The SCN is also not issued in accordance with the mandatory requirement under law, in as much as the same has not been issued by the Chairman or WTM:**

24.11 That the SCN issued to the Noticee under Regulation 28(1) of the Intermediaries Regulation has not been issued by the WTM and/or the Chairman who are defined as the

Designated Member under the said Regulations; However, the said SCN has been issued by one Ms. Sakeena P.V. who is not the Designated Member as defined under the said Regulations. Regulation 28 of the Intermediaries Regulations clearly stipulates that on receipt of report recommending measures from the designated authority it is the designated members who can consider the same and issue a show cause to a Noticee. It ought to be noted that the said SCN does not even mention that the same has been issued under the authority of or on behalf of any designated member i.e. a WTM or the Chairman. The issuance of the SCN by the designated member is a mandatory requirement under the said regulations which has been found wanting in the present SCN.

**I. Violation of Principles of Natural Justice / Not furnishing the documents/Inspection of documents:**

24.12 The Designated Authorities in its Report have failed to deal with all the Preliminary Objections raised in reply dated January 06, 2017 (“**Reply**”). The Designated Authorities have failed to deal with the Preliminary Objection - A (“Violation of Principles of Natural Justice / Not furnishing the documents”). That pursuant to receipt of SCN, vide various emails/letters the Noticee requested SEBI to provide relevant documents. Pursuant to this, vide an e-mail dated 15<sup>th</sup> February, 2018, SEBI allowed the Noticee to take inspection of documents on February 22, 2018.

24.13 Post Inspection Meeting and Inspection Hearing, they should be granted with an opportunity to cross-examine the complainants/witnesses, whose statements/complaints have been referred to and relied upon in issuance of the Report and Second SCN. However, at the Inspection Meeting dated February 22, 2018, SEBI yet again failed and neglected to provide the documents sought by us. On February 27, 2018, the Inspection Hearing was held before the WTM. Vide order dated August 30, 2018 passed by the WTM of SEBI, they have been denied the right to seek inspection/copies of all the documents sought. Several documents as listed in the reply are extremely crucial and critical for ascertaining the basis of the observations/allegations/charges made against us in the Enquiry Report and the SCN.

24.14 Thus, it is clear that we have not been provided the entire material/documents in connection with the present proceedings, which is in gross violation of principles of natural justice. Same also vitiates the whole proceedings, as the proceedings miserably lack fairness. Needless to state that the documents/materials as sought by us are crucial and critical for us for filing an effective reply in the matter. Undisputedly, the charges/allegations involved in the mater are exceedingly serious involving severe adverse civil consequences. Same therefore necessitate providing of reasonable opportunity to meet the allegations and strict adherence to procedural fairness. The non-provision of documents/materials by SEBI, has resulted not only in a denial of natural justice which has caused us serious prejudice, but the same has also resulted in denial of a fair trial which has now been interpreted by the Supreme Court as being a facet of the right to life under Article 21 of the Constitution of India.

**J. Immunity under Article 20(3) of the Constitution of India –Right against self-incrimination:**

24.15 The Noticee has learnt through various newspaper reports that during the pendency of the SCN, SEBI has already filed a complaint/First Information Report (“**FIR**”) with the EOW and therefore, criminal proceedings have now been initiated against the Noticee. However, till date, a copy of the said complaint/FIR has not been provided to the Noticee.

24.16 On 15<sup>th</sup> October, 2018, the Noticee had approached the offices of the EOW for seeking a copy of the criminal complaint/FIR filed by SEBI. However, the EOW refused to accept the Noticee’s application for certified copy of the criminal complaint/FIR and asked the Noticee to obtain it from the concerned court having jurisdiction over EOW. In view thereof, on 16<sup>th</sup> October, 2018, Application was preferred in the department of the 47<sup>th</sup> Court of Additional Chief Metropolitan Magistrate, Mumbai, seeking certified copy of the F.I.R./ complaint lodged by SEBI with EOW. However the department of the said court asked to verify from the register whether the EOW forwarded the said F.I.R. to the said court or not. After perusal of the register maintained by the department it appeared that the EOW has not forwarded the said F.I.R. to the Court of Additional Chief Metropolitan Magistrate, 47<sup>th</sup> Court, Esplanade at Mumbai being the court of

jurisdiction (as per the knowledge of the Noticee). The Noticee has tried all possible ways to obtain a copy of the criminal complaint/FIR filed by SEBI before the EOW. However, till date, the Noticee does not have access to a copy of the criminal complaint/FIR filed by SEBI before the EOW in relation to the Noticee.

24.17 Furthermore, the Noticee has learnt that the aforesaid FIR has been filed pursuant to a decision/resolution of the SEBI Board. It is thus obvious that the note containing the necessary information/allegations along with the documents in support (if any) would have been submitted to the SEBI Board, on the basis of which the SEBI Board would have drawn an adverse conclusion against the Noticee and others which would have then lead to the decision of filing the FIR/Complaint with the EOW.

24.18 In these circumstances, not only the decision made by SEBI but also the documents/information themselves become pertinent and must be made available to the Noticee to enable it to represent its case fairly and squarely.

24.19 The Noticee states that (i) unless a copy of the complaint/FIR along with necessary documents/information are provided to us for inspection, the Noticee will be unable to file our reply in the matter (ii) that Clause (3) of Article 20 of the Constitution of India, 1950 provides that “No person accused of any offence shall be compelled to be a witness against himself”. Therefore, since SEBI has already filed criminal complaint/FIR against the Noticee, the Noticee cannot now be forced to make any statements by way of a reply and/or personal hearing which may and/or can be used against us in the criminal proceedings, especially in light of the fact that not even a copy of the complaint/FIR has been provided to the Noticee. In view thereof, the Noticee has to take an informed decision, after considering the FIR/documents/information, whether the Noticee’s participation in the present proceedings, particularly any statement/documents submitted, is likely to affect the Noticee in the aforesaid FIR, wherein the Noticee is an ‘accused’ as per SEBI’s allegation. It is submitted that that once SEBI provides us with a copy of the complaint/FIR and information submitted to the authority, the Noticee will decide whether the Noticee intends to file a reply or not, on the allegations common to those proceedings. In this regard, it would also be

pertinent to note and consider whether the SEBI Board which took its decision included all the members of the Board. It is respectfully submitted that any member of the Board who participated in the decision-making process of the Board is to that extent, a complainant or a part of the body of complainants and should therefore, in all fairness, not participate in the capacity as a decision maker.

#### **K. Right to Cross-Examine Witnesses**

24.20 In the present proceedings initiated against the Noticee, the report of designated authority/ Enquiry Report is *inter-alia* based on the EOW Interim report dated April 04, 2015. That the purported EOW Interim report annexed to EOW letter dated April 04, 2015 is neither signed nor stamped. The Report of DA also refers to and relies upon the purported “Post Inspection Analysis” report. This Report is neither signed nor discloses the name of the officer and the authority/powers under which the same has been carried out. Thus, these reports cannot be relied upon without requisite proof.

24.21 The Noticee denies the correctness of all the allegations and contentions set-out in the EOW Interim Report, Post-Inspection Analysis and the DA Report. Moreover, none of the documents have been proved or even sought to be placed in the present show cause proceedings. The Noticee also sought an opportunity to cross-examine the concerned officers/persons who are the authors/signatories thereof.

24.22 Needless to say, the report by the EOW is neither binding on the concerned Court to whom it is presented nor binding on us. The EOW is required to prove the Report as also the other information/documents on which it is based, before the concerned Court.

24.23 That SEBI has placed reliance on Order dated December 17, 2013 (“Fit and Proper Person Order”) passed by Forward Markets Commission in the matter of “Fit and Proper Person” status of M/s. Financial Technologies (India) Limited, Mr. Jignesh Shah and others. It is noteworthy to mention here that the Noticee was neither a party to the said proceedings nor any opportunity was given to make any submission in the said

proceedings. Thus, the said Fit and Proper Person Order cannot be referred and relied upon in the present proceedings to draw any adverse inference.

24.24 FMC officials (in the aforesaid report) also refer to and rely upon complaints, made to various authorities. Similarly, the DA has considered the Fit and Proper Person Order and the findings made therein which are *inter alia* based on various complaints. The Noticee submits that it was not part of the proceedings, it was not provided with the opportunity to rebut any of the findings made in the said Fit and Proper Person Order. In view thereof, and in compliance with the principles of natural justice, it is imperative that the Noticee is provided with an opportunity to cross-examine all the necessary complainants / persons / officials whose statements have been referred to or relied upon by SEBI in the SCN.

25. Thereafter, the Noticee vide letter dated November 03, 2018 submitted Second Part of the Written Submission dated 3<sup>rd</sup> November, 2018 (over email as well as hard copy along with a compilation of Judgments) and sought extension of time to file the Third Part of the Written Submissions by 26<sup>th</sup> November, 2018. The additional written submissions of the Noticee in brief are as under:

A. **Preliminary Objections as to Jurisdiction and Maintainability:**

The Noticee reiterated its earlier submissions made vide letter dated October 19, 2018. The same is not reproduced hereunder for the sake of brevity.

B. **Submissions**

**Lack of Jurisdiction:**

25.1 The jurisdiction of an authority is circumscribed by the statute under which it seeks to exercise jurisdiction. Any action in excess of such jurisdiction render the proceedings or any orders passed thereunder void *ab initio*.

25.2 Jurisdiction conferred on SEBI Board under FCRA (repealed) as amended or SCRA by virtue of the Finance Act 2015:

In addition to the powers conferred under SCRA, by virtue of the amended Section 28A (5) of FCRA, the SEBI Board was empowered to exercise the powers of FMC in respect of deemed exchanges (MCX and NCDEX) for a period of one year. Sub-section (d) and (e) of Section 29A of the FCRA empowered the SEBI Board, to initiate proceedings under FCRA for any offence committed under FCRA within 3 years from the date of repeal. Thus the power of SEBI post-merger in relation to initiation of prosecution proceedings for violation of the provisions of the FCRA is merely vested with the Board under the SEBI Act. By reason of amendment to the definition of “*securities*” in the SCRA and the inclusion of the term “*commodity derivatives*”, Section 12(1) of the SEBI Act read with Regulation 3(1) of the Stock Broker Regulations became applicable and SEBI became empowered to exercise jurisdiction to decide its application.

25.3 *Jurisdiction of SEBI under the SEBI Stock Broker and Sub Brokers Regulation, 1992 (“Stock Broker Regulations”) is as under:*

For considering the application, SEBI Board is required to take into account matters set out in Regulation 5 of the Stock Broker Regulations. One of such matters is whether the applicant is a ‘fit and proper person’ based on the criteria specified in Schedule II of the Intermediaries Regulations. Merely because the criteria to determine whether the applicant seeking a certificate of registration is a ‘fit and proper person’ is set out in the Intermediaries Regulations, does not in any manner mean or empower the SEBI Board much less the WTM to invoke Chapter V of the Intermediaries Regulations. It is thus submitted that this Authority has no jurisdiction to either commence and/or try the present proceedings, much less decide as to whether or not the applicant should be granted a certificate of registration.

25.4 *Lack of Jurisdiction of the Designated authority (Officer or a bench of Officers of the Board), under Regulations 23 to 27 of Chapter V:*

That under the garb of considering an application seeking a certificate of registration, which is required to be considered by the Board, neither can a designated authority be appointed nor can such designated authority initiate an inquiry.

25.5 *The jurisdiction of the WTM under Regulation 28 of Intermediaries Regulations:*

- i. That the only power of the WTM under Regulation 28 of the Intermediaries Regulation is to issue a show cause and decide as to whether the recommendations contained in the Report should be accepted or not, the scope of authority of the WTM under the said Regulation is also circumscribed to either pass an order for suspension of a certificate of registration or for cancellation of certificate of registration in respect of a person who has already been granted such a certificate. Since the Noticee is not a stock broker who has been granted a certificate of registration, the WTM has no jurisdiction to issue a notice under Regulation 28 or pass any orders thereupon in so far as the Noticee is concerned.
- ii. The proceedings under Regulation 28 are on receipt of a report from the designated authority required to be considered by 'the designated member'. In the instant case, the designated authority was appointed by Mr. S Raman, the WTM of SEBI (being the designated member) and as such the person entitled to issue a notice under Regulation 28 or pass orders thereupon would be the same designated member viz. Mr. S Raman and not the present WTM as in the present case. Thus the present WTM has no authority or jurisdiction to have either issued the show cause or to conduct a hearing in pursuance thereto.
- iii. SEBI has registered complaint against around 300 brokers (including ARCL) for purported violations of FCRA. In view of the above, the present proceedings have now become infructuous.
- iv. Basis of the SCN is Report of the designated authority and Report proceeds only on the basis of two documents viz. (i) the Audit Report of M/s. Borkar & Mazumdar appointed by SEBI; and (ii) an alleged post inspection analysis (alleged observations and comments contained in a tabular form).
- v. In so far as the Audit Report of M/s. Borkar & Mazumdar is concerned, admittedly the same does not hold that the Noticee is guilty of any violation of any nature whatsoever and hence the question of the Recommendation in the Report making any allegations of alleged violations by the Noticee on that basis cannot and does not arise.
- vi. In so far as the post inspection analysis (the tabular chart is concerned), the same is (a) undated; (b) not signed; (c), does not disclose the author(s) of the document (d) there is no order disclosed as to appointment of such authority and/or the powers under which it was constituted; (e) the process followed while arriving at such

comments or analysis, much less any reason for differing from the findings contained in the Audit Report is patently flawed. In view thereof, the question of the said tabular chart forming the basis for the recommendation or forming the basis of the SCN does not arise. Any reliance placed thereupon and the proceedings initiated on the basis of the aforesaid are not only illegal, but an abuse of the process of law.

- vii. That the Noticee had specifically sought to cross-examine the author of this tabular chart/post inspection analysis
- viii. These very recommendations are treated as allegations in the SCN issued under Regulation 28 and hence the entire proceedings are vitiated on this ground. Once the WTM has expressed in unequivocal terms that no reliance is being placed on the comments contained in the post inspection analysis coupled with the fact that the Audit Report of M/s. Borkar & Mazumdar is in favour of the noticee, the question of showing cause does not arise.
- ix. That the present proceedings before the WTM cannot continue simultaneously with the criminal proceedings filed by SEBI and during the pendency of the criminal proceedings, the Hon'ble WTM ought to be restrained from continuing further with the proceedings in relation to the Enquiry Report and the SCN. It is a well-established fact that when a particular subject-matter is a part of two separate enquiries simultaneously, the criminal enquiry is likely to take precedence over any other kind of enquiry in relation to the said subject-matter. In this context, reliance is placed by the Noticee on the following judgement- *Amarendra Nath v. Union of India*[(1989) 1 Cal LT 80]
- x. That by simultaneous holding of the present proceedings, during the pendency of the criminal proceedings initiated by SEBI, the Noticee would be compelled to disclose his defence, which he may use in the criminal trial, since the charges on which the present proceedings is based, may be the same as those in the criminal proceedings. Hence, the Noticee would be seriously prejudiced, if the criminal proceedings, which are pending at the stage of investigation would give an unfair advantage to the prosecution, which is not intended in a criminal trial. Hence, in the interest of fairness, it is expedient that present proceedings be stayed pending the criminal proceedings which have admittedly been initiated by SEBI against the Noticee.

- xi. Moreover the Noticee's request to furnish copies of the relevant SEBI board resolution and the FIR (with documents) was refused. Hence, the Noticee is not even in a position to take an informed decision as to the extent of its participation in the present proceedings.

**Reply on merits:**

26. Thereafter, vide letter dated November 26, 2018, the Noticee filed its 'Further Written Submissions on merits' to the SCN. The submissions/contentions already dealt in the previous written submissions are not repeated for the sake of brevity.

The allegations/findings contained in the recommendation report and the Noticee's submissions in relation thereto are as under:

**False presentations/misleading statements:**

26.1 As regards allegation 1 and its findings in the Enquiry Report, the Noticee submitted that the very nature of the allegation is that the Noticee had made false presentations and/or misleading and/or false assurances without mentioning the risk associated or any disclaimer. That every presentation made by the Noticee to its individual prospective client or existing client contained a specific 'Disclaimer'.

26.2 That the object of incorporating a disclaimer clause is to maintain transparency so that the client can take an independent/ informed decision. A reading of the Disclaimer clause clearly shows that the Noticee has categorically informed its prospective clients that (i) they did not guarantee either the accuracy or the completeness of the information; (ii) that the information or any opinion expressed does not constitute an offer or an invitation to make an offer to buy or sell any securities and; (iii) most importantly that the investor should seek independent financial advice regarding the appropriateness of investing in any securities or commodities. In view of such a specific 'Disclaimer' and the settled principle of law that an investor is required to take an independent decision based on such Disclaimer, the question of it being alleged that the Noticee has made any false presentation or made any false assurances or misleading statements cannot and does not arise.

26.3 That the bench of Designated Authority has itself observed that the Noticee has complied with the requirement of publishing disclaimer and risk associated with the trading at NSEL. The aforesaid disclosure forms an integral part of the PPT. The same is also set out in the Index of PPT.

26.4 That NSEL Circular no. NSEL/MEM/2012/024 dated February 7, 2012 is advisory in nature and deals with Guidelines for Issuance of Advertisements and Usage of NSEL Logo by the Members. As per the aforesaid circular, Members shall take prior approval of NSEL with details before issuing any advertisement. The said NSEL circular provides that the advertisement shall include advertisement, brochures, pamphlets, catalogues, circulars, leaflets, descriptive literatures, business cards, representation by the members or their Authorized representatives / Approved users or such other kind of descriptive material intended to be used for newspaper, radio, magazines, periodicals, television etc.

26.5 NSEL Circular NSEL/MEM/2012/154 dated August 6, 2012 is in continuation to earlier circular no. NSEL/MEM/2012/024 dated February 07, 2012. This circular of NSEL deals with “Issuance of Advertisements and Do’s & Don’ts by the Members”. The aforesaid circular refrains members from using terms like ‘assured / guaranteed return’ or any other misleading statements and draws attention towards guidelines issued by NSEL vide circular number NSEL/MEM/2012/024 dated February 07, 2012. Thus, this circular has to be read in conjunction with NSEL circular number NSEL/MEM/2012/024 dated February 7, 2012.

26.6 That the Noticee has not caused to be made any advertisement as alleged in the recommendation report. The said fact has been expressly confirmed even by SEBI’s Auditors in their report dated July 4, 2016.

26.7 It is submitted that insofar as the alleged violation of the NSEL circular dated February 7, 2012 is concerned, the SEBI appointed auditors have categorically held that the same have no application to the presentations (PPTs) made by the Noticee on a one to one basis to its clients or prospective investors.

26.8 It is submitted that the Noticee has not given any misleading statements or false presentations to client by promising any assured returns. This fact is also confirmed by the SEBI appointed auditors in their report.

26.9 Thus, it is clear and categorical case that we have not issued any advertisement or disseminated PPT through any public media like newspaper, television or periodical magazines. It is for this reason that no such factual allegations is found in the report of the Designated Authority.

26.10 That the bench of Designated Authority in its Report has categorically admitted that the statement in the presentation that exchange remains the counter party to all the trades and guarantee the settlement of net financial obligation is not misleading.

- 26.11 It is well established that the entire responsibility for storage and warehousing was that of NSEL as per NSEL's bye-laws. Seller was required to deposit stocks in warehouses which were approved and designated by NSEL. NSEL was responsible for checking and verifying the quality and quantity of the commodities and the goods are required to be completely weighed at designated weigh-bridges/weigh scale and certified by NSEL warehouse supervisor. At all points of time, NSEL was responsible for the storage of the goods and at no point of time it was the responsibility of the broker to conduct any physical verification of the goods in the warehouse maintained by NSEL. Reliance is placed in the observations made by Hon'ble Bombay High Court in its judgement dated 4<sup>th</sup> December, 2017 in respect of Writ Petition No. 2743 of 2014.
- 26.12 As per SEBI's allegations and even as per the Report of the SGS Auditors, based on inspection of only 16 out of 120 number of Warehouses they found Commodities of only Rs.358/- crores. Therefore, the allegation that they found no Commodities stored in the Warehouse is obviously not correct.
- 26.13 That the allegations regarding false assurance made in the SCN dated 24<sup>th</sup> April, 2017 in relation to the availability of Settlement Guarantee Fund (SGF) and/or the mentioning of safe arbitrage in the presentation are devoid of any merit and/or any particulars. We have already referred the emails and website contents of NSEL confirming SGF. A member/broker be it at any exchange platform is not authorized to verify the SGF and/or records of the exchange and in his capacity as an intermediary has to rely upon the presentations/information made available by the Exchange. Further, the allegation as to arbitrage is based on a misconception as to the scope of the term "arbitrage". As an intermediary, the Noticee did not have any responsibility verifying the statement regarding SGF and/or carry out any due diligence in respect thereof.

### **Violation of Exemption of Notification of GOI**

- 26.14 As regards allegation 2 and its findings in the Enquiry report, the Noticee submitted that the notification of Ministry of Finance, Department of Economic Affairs withdrawing exemption granted to NSEL does not talk about legality of paired contracts at NSEL.
- i. That the finding in the recommendation report that the exemption notification was violated by the Noticee is on a hypothetical and based on erroneous premise in law that a violation of the exemption notification by NSEL results in the provision of FCRA becoming automatically applicable to NSEL and its members. If the

conclusion of the designated authority on automatic applicability of the provisions of FCRA was correct, then in such an event there was no reason or necessity for the Government to issue a notification withdrawing the exemption.

- ii. From the various submissions made by FMC and others before the court of law and the document disclosed by SEBI and various correspondence between the Central Government, FMC and NSEL, clearly establishes that even the Central Government and the regulatory agencies who were fully aware of the nature of trades, did not come to any final conclusion or finding that paired contracts were either illegal and/or were in violation of the exemption notification dated June 5, 2007. In view of the aforesaid, it is submitted that if the regulators themselves could not come to the conclusion whether the trades were legal or not, the Noticee being held accountable for alleged illegality of paired contract which was a product of the exchange does not arise and the same is required to be verified by the regulator and not by the broker.
- iii. That the Bench of Designated Authorities, vide the Enquiry Report and the SCN have failed to point out any material to substantiate that the Noticee was allowing the clients to do short sale. On the contrary, there was no short sale by the Noticee's clients, since in all cases, the clients of the Noticee had purchased the goods on exchange with respect to any sales that were made by them, none of the clients of the Noticee had any open sales position.
- iv. That the allegation in the recommendation report that the Noticee indulged in suspicious trades allegedly being in violation of NSEL Circular Ref No. NSEL/COMP/2013/042 dated May 27, 2013 and NSEL Circular Ref No. NSEL/COMP/2013/056 dated July 1, 2013 is vague and without any particulars. It is submitted that firstly, this authority as stated hereinabove is not entitled to conduct any inquiry into alleged violations of NSEL Circular inasmuch as the same is beyond the authority vested in it in law. Secondly, the Circulars are essentially in the nature of KYC norms and a duty to report transactions which the Noticee may have thought as being suspicious in the context of money laundering. It is submitted that the Noticee at no point in time had any reasons to believe nor were there any reasonable grounds to suspect that any transactions entered into by them for any client on the NSEL platform was a 'suspicious transaction'. Lastly, there is no transaction executed by the Noticee for any client which has been till date termed as

being a 'Suspicious transaction' as defined under the NSEL Circulars. It is thus submitted that the allegations and/or the findings in the recommendation report are devoid of any merit.

- v. During the course of hearing, the learned WTM referred to the judgment of the Hon'ble Bombay High Court in the case of *63 Moons Technologies Limited (formerly Financial Technologies (India) Ltd. & Ors.) v. The Union of India & Ors* to suggest that there is already a finding as to the legality of such paired Contracts. The issue of legality or illegality of Contracts did not directly arise for consideration in the aforesaid Writ Petition; It is for this reason that the Bombay High Court was careful in pointing out that these are only prima-facie observations (therefore not conclusive); The matter is now pending before the Hon'ble Supreme Court of India where the said judgment has been challenged (S.L.P.(C) No. 004210 of 2018); hence the issue is at large and not concluded by the aforesaid judgment.

**Failure to provide delivery allocation letters and verification of existence of commodities in the warehouses:**

26.15As regards allegation 3 and its findings in the Enquiry report, the Noticee submitted that allegation in relation to the Noticee not providing delivery allocation letters is clearly without understanding the functioning of the exchange. Delivery Allocation Reports were issued by NSEL (also commonly referred to as Allocation Letters) as a part of its functions and in accordance with its rules/procedure and not by the Noticee. The Noticee had absolutely no role in issuing allocation letters to the clients. Furthermore, the byelaws and/or circulars issued by NSEL did not cast any obligation on any member to issue a Delivery Allocation Letter to their clients much less verify or doubt the actual existence of the commodities in the warehouse or the genuineness of the Delivery Allocation Letter issued by the exchange.

**Client Code Modification:**

26.16As regards allegation 4 and its findings in the Enquiry report, the Noticee submitted that the NSEL Circular categorically permits client code modification. It is reiterated that the client code modifications were carried out by the Noticee in the ordinary and usual course of business for administrative convenience and/or for correction of errors in punching as the case may be and are strictly in consonance with the provisions of the said circular.

There is not a single instance where the Client Code modification concerned, any self-trade by the Noticee (i.e. either the Client Code as originally inserted or as modified); none of the clients have even stated that any transaction was done without their instructions or charge; all the concerned clients have made payment for respective transactions; there is no case that upon Client Code modification there was any splitting of the quantity. Client code is generated by the brokers and meant for convenience and identification of parties to the trade. No client has any proprietary right or interest in such unique client code. It is only the issuance and acceptance of contract notes and bills that creates any rights/obligation. Hence change of UCC is of no consequence at all for any client and is a mere red herring. All the contract notes and bills issued to clients after modification and such clients having made payments confirms that trades were executed on such client's instructions and the modification of the client code is wholly irrelevant. Furthermore it is an admitted position that the Noticee has not made any gain or caused any loss to any client due to such client code modification. In fact out of the said 851 instances, save and except 4 transactions the rest of the transactions were concluded in all respects and settled prior to the suspension of trading on NSEL.

**Execution of trades without client's permission:**

26.17 As regards allegation 5 and its findings in the Enquiry report, the Noticee submitted that the original allegation contained in the notice issued by the Designated Authority has been answered in favour of the Noticee and therefore it is accepted by the Designated Authority that no trade were executed without client's permission. The transactions/ trades in relation to which it is alleged that the Noticee has not met the requirement of sending the contract notes/ ECNs and/or kept proof of delivery thereof pertain to the period prior to July 2013.

- (a) That in relation to the 93 instances where proof of ECN or physical delivery of contract notes are not available, all the trades were done by us pursuant to the instructions of the clients; the ECNs or physical contract notes were delivered, however, unfortunately the Noticee was unable to locate the proof of only 93 ECNs out of total 39500 ECNs sent to clients. The failure to furnish the proof of the same is not relevant and cannot be expected to be produced after a lapse of more than 3 years. More so when the respective clients have admittedly made payment against their obligations and no client has raised any complaint or objection in this regard as admitted by the Designated Authority. It is submitted that the factum of

payments having being made by the clients itself demonstrates that they were obviously delivered with the ECNs and a presumption contrary to the same cannot be drawn as against the Noticee.

(b) Furthermore the observations of the SEBI Auditor in this regard are relevant which states that “*We have not seen any objection or grievance from any client that ARCL has issued any Contract notes without their mandate.*”

**Funding of the clients through its NBFC:**

26.18As regards allegation 6 and its findings in the Enquiry report, the Noticee submitted that the Noticee has not funded our clients to trade in NSEL as alleged. The said allegation has been made on the basis that there are 28 common clients appearing in the records of Anand Rathi Global Finance Limited (RBI registered NBFC) and the Noticee. However, nothing has been brought on record in the SCN to substantiate the said allegation that the Noticee has funded trades on NSEL. During the inspection done by the SEBI appointed Auditor, the Noticee had inter alia pointed out that no funding was done by AGRFL to Noticee’s clients to trade in NSEL.

**Non- segregation of funds between Spot Exchange and other Exchanges**

26.19As regards allegation 7 and its findings in the Enquiry report, the Noticee submitted that the transfer of funds if any were made on the specific request of an individual client from the funds belonging to such client lying to the credit of their account in one exchange to the client’s account with the Noticee on another exchange for the benefit of the same client. This was with the express authority and at the request of such clients and purely for the benefit and the interest of such a client. There was no advantage or gain occasioned to the Noticee on account of such a transfer. There was no cross margining and separate ledger accounts were maintained for the transactions of each exchange as required under the regulations. There has not been any complaint by any clients in this regard and secondly, the amount of funds transferred are miniscule compared to volume of the total transaction (i.e. less than 0.01 percent).

**Failure to collect margins from the clients:**

26.20 As regards allegation 8 and its findings in the Enquiry report, the Noticee submitted that he Noticee normally collects margins from all its clients. However, during the period under

review between 2012-13 and 2013-14 there are cases of short collection of margins of 14 clients out of 14,495 clients (0.1%) for MCX and only 8 clients out of 3,683 clients (0.2%) in respect of NCDEX. It had been explained to the exchanges during their inspection that such cases occur sometimes due to delay in deposit of cheques or due to some clerical errors. Such small instances cannot be considered as negligence or non-compliance of any provisions. That the concerned authorities and/or exchange have already initiated proceedings in relation thereto and in exercise of the powers conferred upon them compounded the violation by the Noticee by levy of penalty. It is thus not open for this authority to reopen the aforesaid issue and subject the Noticee to an inquiry in this regard in as much as the same would amount to double jeopardy.

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

26.21 As regards allegation 9 and its findings in the Enquiry report, the Noticee submitted that the finding of the designated authority is erroneous and does not correctly record or consider the submission made by the Noticee. Since all the back office and IT systems for equity and commodity exchange were common at the relevant time, coupled with the fact of the Noticee having an integrated front office and back office software, the same were audited by a systems auditor and software vendor. The Noticee has never stated that no such audit has been conducted as is sought to be alleged in the report. MCX and NCDEX specified systems audit format only for ALGO Trading in 2013-14 and no format for CTCL and IBT Audit was prescribed. Upon such formats being prescribed by the concerned exchanges, the Noticee has conducted the separate audit and submitted the reports accordingly. The allegation regarding mismatch in declarations made in the ACR list in MCX and NCDEX for the year 2012-13 and 2013-14 is completely erroneous and without any basis inasmuch as there was no such requirement prescribed by either of the exchanges. The Noticee has complied with all the requirements as were applicable at the relevant time.

**Failure to take insurance policy:**

26.22 As regards allegation 10 and its findings in the Enquiry report, the Noticee submitted that other than a test trade, the Noticee has not done any client trading on these exchanges. Thus the question of any violation of any Rules, Bye-laws or Business Rules cannot and does not arise. Furthermore, the Noticee had obtained a registration for ACE on 7th October, 2010 and which was surrendered on 17th June, 2015. Similarly, the Noticee had

obtained a registration for ICEX on 25th January, 2010 and surrendered the same on 8th October, 2015. In view of the aforesaid, since the concerned authority has not questioned the Noticee on this account even at the time of surrender of membership, it is not open to this authority to now allege a violation in this regard or conduct and inquiry on the basis of the same.

**SECOND SHOW CAUSE NOTICE, REPLY AND HEARING:**

27. While the proceedings in the matter were in progress, Serious Fraud Investigation Office (“SFIO”), Ministry of Corporate Affairs (“MCA”) vide letter dated November 01, 2018 had forwarded its detailed investigation report on “National Spot Exchange Limited and others” dated August 31, 2018 to SEBI.
28. Subsequent to the receipt of SFIO investigation report, SEBI issued a Second Show Cause Notice dated December 27, 2018 (hereinafter referred to as “**Second SCN**”) to the Noticee. Vide the said Second SCN, the 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, the Noticee was also called upon to show cause as to why the information/materials as brought out in the Second SCN concerning the fit and proper person criteria, should not be considered while deciding the Noticee’s application for registration dated December 23, 2015, for rejection in accordance with the provisions of Regulation 5(e) read with regulation 7(1) of Brokers Regulations.
29. The Noticee 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 29, 2019 at 10:30 A.M., SEBI Head Office, Mumbai.
30. On January 31, 2019, Mr. Pradeep Sancheti, Senior Counsel, Mr. Saurabh Bachhawat, Ms. Sukriti Jaiswal, Advocates from Shardul Amarchand Mangaldas & Co. along with Mr. Anand Vardhan Narayan, Mr. Chetan Bharkhada and Mr. Vasudev Gerewal, Asst. Vice President of ARCL and Mr. Nazeeb S., Consultant, **ARs** of ARCL appeared for the hearing and reiterated the earlier submissions and made the oral submissions and filed

written submissions/preliminary objections to the Second SCN. The submissions in brief are as under:

30.1 The Second SCN is purportedly issued in furtherance of and as a corollary to the earlier Show Cause Notice dated 24<sup>th</sup> April 2017, however, the proceedings in relation to the earlier Show Cause Notice dated 24<sup>th</sup> April 2017 are already concluded and reserved for orders thereon. That the hearing on the aforesaid Show Cause Notice dated 24<sup>th</sup> April 2017 was conducted before the WTM on 12<sup>th</sup> October 2018 and 19<sup>th</sup> October 2018 after which the hearing stood concluded and the Noticee filed Written Submissions on 19<sup>th</sup> October 2018, 3<sup>rd</sup> November 2018 and 26<sup>th</sup> November 2018. In view thereof, the question of any Second SCN which is purported to be a corollary to the previous Show Cause Notice seeking to rely upon certain information or material for determination of the charges contained in the earlier SCN cannot and does not arise.

30.2 Furthermore, it is surprising to note that by issuing the Second SCN, SEBI appears to have changed the very basis of the previous show cause notice by replacing the main regulation /charge under which the previous show cause notice was issued to the Noticee. In this regard, we dispute and deny the legality/applicability of the notice under Regulation 28(1) of the Intermediary Regulations.

30.3 The Second SCN is purportedly issued under Regulation 28(1) of the Intermediary Regulations, the same is not backed by any report or not based on any recommendation made by any designated authority, as per the procedure prescribed under the Intermediary Regulations.

30.4 Furthermore, with respect to the two Bombay High Court decisions referred to by SEBI vide the Second SCN, namely National Spot Exchange Limited v. State of Maharashtra (*Writ Petition 1403 of 2015*) and 63 Moons Technologies Limited Union of India (*Writ Petition 2743 of 2014*), it is submitted that the Noticee was never a party to any of the aforementioned proceedings. Therefore, any observations made therein neither bind the Noticee nor it be used against the Noticee as per settled law. Reliance is placed on the decision of the Hon'ble Supreme Court in the matter *JS Yadav v.*

*State of Uttar Pradesh & Ors.* (2011) 6 SCC 570, and also on *Public Service Commission Uttaranchal v. Mamta Bisht & Ors.* (2010) 12 SCC 204.

30.5 Moreover the purported extract from SFIO Report, being a report stated to be made by the concerned investigating authority to the Government containing mere allegations not even proved in any court of law, can by itself have no bearing, unless any party who wishes to rely upon the said report as evidence, proves the same by examining the author of the report. From the purported extract of the SFIO Report, it appears that this refers to allegations made by the EOW, based on the purported investigation conducted by the EOW and its remand application dated March 04, 2015. Needless to add that equally, the EOW report or its alleged conclusions can by itself have no bearing, unless any party who wishes to rely upon the said report as evidence, proves the same by examining the author of the report. The extract also refers to the enquiry (query) made by the SFIO with clients. While the extract contains alleged conclusions, based on the alleged enquiry, however, no such documents/statements of customers/clients are made available. Needless to add even in such a case, if any such statements were proposed to be relied upon, the same will have to be proved by examining the author.

31. Further, vide the said letter, ARs sought an opportunity to conduct inspection of the relevant documents with respect to the Second SCN and thereafter an opportunity of personal hearing in the matter on merits. The same was acceded to and the hearing on merits of the Second SCN was adjourned to February 11, 2019.

32. The Noticee conducted inspection of the relevant documents on February 05, 2019. Subsequently, the Noticee vide letter dated February 08, 2019, filed further written submissions to the Second SCN. The submissions made by the Noticee in brief are as under:

32.1 That the extracts from the SFIO Investigation report in respect of ARCL is provided in Annexure A of the captioned Show Cause Notice, wherein page 614 of the said extract states that “the statement of Amit Rathi was verified vis-à-vis information provided by the clients of ARCL in response to the queries raised by SFIO”. It further states that “a total of 525 clients registered with ARCL responded to SFIO questionnaire”. Under

inspection dated February 05, 2019, the said questionnaire and/or statements submitted by the clients to SFIO were not available for inspection. In this regard, it is further submitted that certain annexures (B-29 and D-57) to the SFIO report was not made available for inspection, particularly, the email of Anjani Sinha to FMC dated 04.08.2013, wherein he had sent an excel sheet to FMC, confirming that stock worth more than Rs. 6,000 crores was there in various warehouse.

32.2 All the annexures of the SFIO report was not provided to the Noticee and violated the principles of natural justice. Same also vitiates the whole proceedings, as the proceedings patently lack fairness. In the absence of EOW report, statements of clients / customers of Noticee which forms the basis of SFIO report, no reliance can be placed on the same; equally, in the absence of all the annexures which form the basis of SFIO report, no reliance can be placed on the same.

32.3 In the Second SCN, reference is made to Regulation 5 (e) and 7 (1) of Brokers Regulations (as amended / modified from Regulation 7(2) of Intermediary Regulation); there is no warrant or justification to conduct proceeding under Regulation 5 (e) and 7 (1) since the Noticee is not pursuing its application and has in fact withdrawn the same. The withdrawal of application is self-operative and comes into effect immediately once communicated.

32.4 As regards the charges levelled against the Noticee, specifically with respect to allegation No. (iii) in the SCN, it is submitted that SEBI appointed Auditors have carried out audit and there is not a single instance of “trades done without uploading UCC by ARCL”; Further, as regards allegation No. (iv) in the SCN, SEBI appointed Auditors have carried out audit and there is not a single instance of ARCL trading through conduit accounts without mandate from clients. As regards allegation No.(v) above, it is stated / affirmative case of Noticee that it did not “undertook any short sales on NSEL”. No such instance has been found by SEBI’s Auditors.

32.5 As regards allegation No.2, this allegation was also stated by EOW before the Hon’ble Bombay City Civil and Sessions Court at Mumbai in the bail application of Mr. Amit Anand Kishor Rathi and the Order passed therein speaks for itself.

32.6 That the EOW’s application for police custody remand application dated 4th March, 2015, filed before the Hon’ble Sessions Judge, Special Court under the MPID Act is a mere application, submitted by one of the investigating officers of the EOW and cannot be relied upon or considered to be equivalent to a decision or an order from a

court or tribunal. In fact, to the contrary, it is pertinent to note that the bail order dated 23rd March, 2015 passed by the Hon'ble Bombay City Civil and Sessions Court at Mumbai in the bail application of Mr. Amit Anand Kishor Rathi ("Bail Order") explicitly states that the evidence of conspiracy as alleged vide the EOW application against Mr. Amit Rathi is extremely weak and hence, Mr. Amit Rathi is entitled to be released on bail.

32.7 The orders referred to in the Second SCN are interlocutory/interim orders and not final orders, the same cannot be possibly relied upon by SEBI while issuing the Second SCN.

33. On February 11, 2019, Mr. Pradeep Sancheti, Senior Counsel, Mr. Saurabh Bachhawat, Ms. Sukriti Jaiswal, Ms. Ameya Gokhale, Advocates from Shardul Amarchand Mangaldas & Co. along with Mr. Anand Vardhan Narayan, Mr. Chetan Bharkhada and Mr. Vasudev Gerewal, Asst. Vice President of ARCL and Mr. Nazeeb S., Consultant, **ARs** of ARCL appeared for the hearing and reiterated the earlier submissions and made the oral submissions. The Noticee was granted time upto February 15, 2019 to file additional written submissions.

34. Further, the Noticee vide letter dated February 15, 2019, filed *inter alia* the following additional written submissions:

A. **SFIO Report is an incomplete document as annexures are missing hence cannot be relied upon by SEBI:**

34.1 As the complete annexure has not been provided to the Noticee by SEBI during the inspection, the Noticee is not able to assess as to what extent the observations made by the SFIO are based on SEBI's information. Thus, the Noticee cannot provide an effective response on merits to the observations in the said letters.

B. **The SFIO Report is not a certified copy and is at best, hearsay evidence:**

34.2 It is submitted that as a part of its investigation, the SFIO gathers information from various authorities including SEBI, EOW and the MCA. SFIO Report, being a culmination of all the information collected by the SFIO from different persons / authorities cannot be considered as it is merely hearsay evidence. **As already indicated hereinabove, hearsay evidence is inadmissible in law.** Hence, on the basis of this

itself, the SFIO Report cannot be considered as evidence in law. Since these are mere allegations, not even proved in any court of law, can by itself have no bearing, unless any party who wishes to rely upon the said report as evidence, proves the same by examining the author of the report.

**C. Legality of the SFIO Report:**

34.3 That Section 212 of the Companies Act, 2013 enlists the procedure to be followed by the SFIO investigative authorities while investigating an entity. That the company being investigated by the SFIO was NSEL and not the Noticee. Furthermore, Section(s) 212 (12-14) of the SFIO Report make it explicitly clear that on completion of an investigation, the SFIO forwards the investigation report to the Central Government and if the Central Government after examination of the report, directs the SFIO to initiate prosecution, then such prosecution needs to be initiated against the *company and its officers or employees, who are or have been in employment of the company*. In view of this, it is evident that action, if any can only be initiated against the Company i.e. NSEL, its employees and officers and not the brokers i.e. the Noticee. Hence, the SFIO Report in law cannot even form the basis to initiate against the brokers in accordance to Section 212 of the Companies Act, 2013.

**D. SEBI has issued a Second show cause notice on the basis of SFIO report which has not been proved in any court of law**

34.4 Instead of awaiting the final order/judgment of the SFIO investigation, SEBI has extracted the excerpts of the SFIO report (equivalent to Section 173 of the Code of Criminal Procedure, 1973) and initiated proceedings against the Noticee. The aforesaid is completely illegal and contrary to the provisions of the law.

**E. The findings in the SFIO report are baseless and hence denied in its entirety:**

34.5 Under inspection dated February 05, 2019, the said questionnaire and/or statements submitted by the clients to SFIO were not available for inspection. It is submitted that the above observation of SFIO in its report is vague and incomplete in nature. Further, since the SFIO have not analysed the statements of the remaining clients and therefore, the investigation in respect of statements of the clients is incomplete in nature.

Thus, in the context of the submissions made by the Noticee it is once again submitted that the present proceedings should be closed as being infructuous without any observations and/ or determination.

## **FINDINGS AND CONSIDERATION**

35. I have perused the SCN, Second SCN, submissions, 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?**

36. 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:**

##### **36.1. 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;

#### **36.2. 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.

#### **36.3. 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:**

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

**Jurisdiction:**

38. The Noticee submitted that the jurisdiction of an authority is circumscribed by the statute under which it seeks to exercise jurisdiction and any action taken by SEBI in excess of such jurisdiction render the proceedings or any orders passed thereunder void ab initio. In this regard, I note from the documents available on record that since the Noticee has applied to SEBI, for the purpose of granting registration to the Noticee to act as a commodity derivative 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 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.

**Applicability of Intermediaries Regulations:**

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

39.1. It is noted that the Finance Bill, 2015 was introduced in Parliament in the month of February 2015, *inter alia*, proposing the merger of Forward Market Commission

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

- 39.2. On September 28, 2015, FMC got merged with SEBI and provisions of Finance Act, 2015 as stated above came into effect from September 28, 2015 and September 29, 2015. Pursuant to the merger of FMC with SEBI, the regulation and supervision of the commodity derivatives brokers has been entrusted to SEBI.
- 39.3. It is noted that prior to coming into effect of Finance Act, 2015, the intermediaries dealing with the commodity derivatives were not required to be registered under FCRA. As per amendments / insertion of second proviso to Section 28A(1) of FCRA through Section 131B of Finance Act, 2015, “*an intermediary, who was associated with the commodity derivatives market, for which no registration certificate was necessary prior to merger, may continue to buy, sell or deal in commodity derivatives as a commodity broker for a period of three months from the date of merger or, if an intermediary has made an application for such registration within a period of 3 months from the date of merger, till the disposal of such application*”.
- 39.4. It is also noted that Section 133B of Finance Act, 2015 has included “*commodity derivatives*” within the definition of *Derivative* under Section 2(ac) of SCRA, thereby, *commodity derivatives* falls under the definition of *Securities* with effect from September 28, 2015.
- 39.5. Thus, after the Finance Act, 2015 has come into effect, it has become necessary for every intermediary, who is dealing in commodity derivatives to get registered with SEBI. As a transitory measure, three months period had been given to them, so as to enable them to get themselves registered with SEBI. Also, if within three months such persons/intermediary move an application for registration, they are entitled to continue with their activities, till their application is finally decided / disposed by

SEBI. Thus, by virtue of second proviso of Section 28A(1) of FCRA inserted through Section 131B of Finance Act, 2015 such intermediaries who were dealing with commodity derivatives and who had made an application within a period of three months have been brought under the control of SEBI.

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

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

39.7. Thus, from the above, it is summarized that, prior to September 28, 2015, IICL was functioning as a commodity derivatives broker and was recognized as such by the exchanges. Before merger of FMC with SEBI, IICL was required to be the member of recognized commodity derivative exchanges and was not required to be registered under FCRA with DCA or FMC or any other regulatory authority. The Finance Act, 2015, recognized the said fact and also that the commodity derivative brokers should now be regulated by SEBI. Considering the same, it was made mandatory for all commodity derivative brokers, who wished to continue their activities, to apply for registration with SEBI within a period of 3 months from September 28, 2015. Thus, all the commodity derivative brokers, who applied to SEBI and whose application was in process, were allowed to carry on their functions as commodity derivative brokers till the disposal of their respective application. Thus, by virtue of provisions of Finance Act, 2015 all those commodity derivatives brokers, who were functioning as commodity derivatives brokers, after having made their application to SEBI

- within 3 months from September 28, 2015, were under the supervision and control of SEBI like any other intermediary holding a certificate of registration.
- 39.8. It is noted that pursuant to merger of FMC with SEBI, the Noticee 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, the Noticee was permitted to continue to buy, sell or deal in a commodity derivatives as a commodity broker till the disposal of its application for registration.
- 39.9. It is pertinent to mention the normal circumstances in the securities market which are detailed as under:
- 39.9.1. Intermediaries Regulations is applicable when an intermediary is registered with SEBI and a certificate of registration is granted to them under SEBI Act and rules and regulations made thereunder, thereby operating and functioning in securities market as per the rules and regulations made under SEBI Act.
- 39.9.2. An entity that had applied for registration under regulation 3 read with regulation 5 of Brokers Regulations, would not normally be functioning or operating as stock broker till the disposal of application in his favor and consequent registration under regulation 7 of Brokers regulations.
- 39.10. However, in view of the facts and circumstances of the case discussed above i.e. prior to the merger of FMC with SEBI, an intermediary was not required to be registered under FCRA, but operating / functioning in commodity derivatives market, and pursuant to the merger of FMC with SEBI, by virtue of the Finance Act, 2015, if an intermediary had made any application of registration within a period of three months from September 28, 2015, they were permitted to continue their activities and operate in the commodity derivatives market from September 28, 2015 till the disposal of their application of registration by SEBI even though technically they were not holding a certificate of registration. An entity cannot operate in a regulatory vacuum for the period when they operate as a commodity derivative broker till the disposal of their application of registration by SEBI. Thus, they were brought under the supervision and control of SEBI, by virtue of the Finance Acts, 2015, even as their application for registration was pending.
- 39.11. Thus, in view of the facts and circumstances of the case, the nature / status of the Noticee that it was operating and functioning in commodity derivatives market as

commodity derivatives broker, prior and after the merger of FMC with SEBI, without technically holding a certificate of registration from SEBI but within the regulatory supervision and control of SEBI from September 28, 2015 and at the same time, the Noticee is an applicant for registration as a commodity derivatives brokers under Brokers Regulations.

40. Thus, the Noticee 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. The bench of Designated Authorities for conducting an enquiry under Chapter V of Intermediaries Regulations had exercised only the power under Chapter V of Intermediaries Regulations and not the powers under Section 29-A of the FCRA as contented by the Noticee.

41. In this context the question that also arises for consideration is whether Intermediaries Regulations and Brokers Regulations can be clubbed together. In this regard, I note that the proceedings under regulation 23 of Intermediaries Regulations and regulation 7 read with regulation 5(e) of Brokers Regulations have been clubbed together. I am of the view that, in view of the aforesaid facts and circumstances outlined in paragraph 39 and considering the fact that, pursuant to Finance Act, 2015 the Noticee was already dealing in commodity derivatives, 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.

**Effect of withdrawal of Application.**

42. The Noticee has contended that since the Noticee has already withdrawn its application for registration as a commodity derivative broker, the present proceedings to consider whether the Noticee is a fit and proper person does not survive. In this regard, it is noted that SEBI vide its letter dated August 24, 2018 had informed the Noticee that enquiry proceedings under Intermediaries Regulations against it are in progress; therefore, in view of pending

enquiry proceedings, its request for withdrawal of the application for registration cannot be entertained. Aggrieved by SEBI's letter dated August 24, 2018, the Noticee filed a Writ Petition No. 3262 of 2018 before Hon'ble High Court of Bombay. It is noted that Hon'ble High Court of Bombay vide its order dated October 04, 2018 rejected the Writ Petition No. 3262 of 2018 filed by the Noticee upholding the stand of SEBI. The power of SEBI not to entertain withdrawal of the application for registration has already been determined by Writ Petition No. 3262 of 2018 by the Hon'ble High Court of Bombay. Thus, the submission of the Noticee does not hold any merit.

### **Parallel Proceedings –Enquiry and Criminal Complaint**

43. The Noticee has submitted that the SEBI Board having already filed a complaint before EOW in purported exercise of powers under Section 29A of FCRA, a parallel inquiry seeking to determine the very same allegations which are subject matter of a complaint before EOW is not maintainable in law.

In this regard, I note that extant proceedings and filing of complaint are parallel proceedings and are independent of each other. The current proceedings are quasi-judicial proceedings in order to determine the fit and proper status of the Noticee for the purpose of accepting / rejecting the application of the Noticee. The other proceeding is criminal in nature addressing the issues arising out of violation of FCRA and other penal laws. The scope of both the proceedings are different and there is no overlap between them. Moreover, decision of SEBI to file a complaint, is not equivalent to the determination of the violations for which FIR is filed. In light of the same, the submission of the Noticee is untenable.

### **Authority to issue SCN**

44. It has been submitted by the Noticee that the SCN is not issued in accordance with the mandatory requirement under law, in as much as, the same has not been issued by the Chairman or a WTM. I note that the submission of the Noticee is erroneous. The power vested with the Designated Member can be delegated to the Deputy General Manager in terms of Section 19 of the Securities and Exchange Board of India Act, 1992 by general or special Order in writing. However, in the instant matter I note that factually also, the post enquiry show cause notice had been placed for approval of the concerned Designated

Member who after due consideration of the same, authorized the issuance of the SCN. The same was consequently issued by the Deputy General Manager.

45. Further, the Noticee has also contended that the present WTM has no authority or jurisdiction to either issue SCN or to conduct the present proceedings in as much as, in the present case, the designated authority was appointed by another Member and hence the same person has to issue notice and pass orders under Regulation 28. In this regard, I note that there is no such mandate in the Intermediaries Regulations that the Designated Member who had appointed the Designated Authorities has to pass the Order. In view of the same, I do not find any merit as to the contention of the Noticee.

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

46. The Noticee has contended that SEBI has no powers under Regulation 24 of the Intermediaries Regulations to appoint the Designated Authority, in relation to its application for registration and the mandate of the Designated Authority to enquire into alleged violations under Regulation 23 is void as the Noticee is not a registered intermediary hence the proceedings under Chapter V of the Intermediaries Regulations is not applicable to the Noticee.
47. In this context, the following observations of the **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 are noteworthy:

“ .....

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.*

.....”

48. 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.

49. However, in view of the facts and circumstances of the case discussed above in paragraph 39, SEBI's Jurisdiction, observation of the 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.

50. 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.

51. I note that SEBI was entrusted with regulatory supervision and control of commodity derivatives brokers from September 28, 2015 and the Noticee has made an application to SEBI for registration as commodity derivative broker received on December 16, 2015 under regulation 3 of Brokers Regulations. As per regulation 5(e) of Brokers Regulations, SEBI, while considering the application for grant of registration to the Noticee was required to take into account whether the Noticee is a fit and proper person based on the criteria specified in Schedule II of the Intermediaries Regulations. Further, I note that “*fit and proper person*” criteria specified in Schedule II of the Intermediaries Regulations forms the part of Securities Laws. Thus, I am of the view that from September 28, 2015, SEBI was entrusted to look into the status of “*Fit and Proper*” criteria, specified in Schedule II of the Intermediaries Regulations, of the intermediary/person who had made an application for registration. As laid down by the Hon’ble Securities Appellate Tribunal in ***Jermyn Capital LLC vs. SEBI*** vide order dated September 06, 2006 “*The Regulations apply across to all sets of regulations and all intermediaries of the securities market including those who associate themselves with the market and they all have to satisfy the criteria of fit and proper person before they could be registered under any of the relevant regulations and this criteria they must continue to satisfy through out the period of validity of their registration and through out the period they associate with the market*” Hence, I am of the view that at the time of submitting the application for registration, the 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.

52. 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 the 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?**

53. I note that under normal circumstances, the Designated Authority, under regulation 25 of Intermediaries Regulations issues a notice to the concerned person requiring it 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.

54. 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:

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

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

55. I note that under normal circumstance, the Designated Authorities can only make the recommendations specified under regulation 27 of Intermediaries Regulation, but in the present matter the Designated Authorities had made the aforesaid two recommendations which are not specified under regulation 27 of Intermediaries Regulations. However, it is to be noted that in the facts and circumstances of the case discussed above in paragraph 39 and the fact that pursuant to Finance Act, 2015 the Noticee was already dealing in commodity derivatives, I am of the view that the recommendation of rejection of Noticee's application for registration is equivalent / similar to the recommendation of cancelation of certificate of registration that is envisaged under regulation 27 of Intermediaries Regulations.
56. 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.
57. 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.
58. Hence, in the interest of investors and responsibility entrusted by the Legislature to SEBI of regulatory supervision and control of Commodity Derivatives Market, and considering the facts and circumstances of the matter as detailed in paragraph 39 and considering the fact that the Noticee was already acting a commodity derivative broker pursuant to the Finance Act, 2015, 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. Since it has already been acted upon by SEBI, I

am of the view that I need not consider the second recommendation of the Designated Authorities to initiate prosecution against the Noticee, in the instant proceedings.

**Second Show Cause Notice:**

59. The Noticee has contended that the Second Show Cause Notice was issued after the proceedings in relation to the earlier Show Cause Notice dated April 24, 2017 were concluded and reserved for orders and the same is patently illegal, without any authority and/or jurisdiction. The Noticee has also contended that issuance of Second SCN was not based on any recommendation made by any designated authority and the designated member has bypassed the procedure prescribed under Regulation 24 to 27. It is also stated that Second SCN refers to orders of the Hon'ble High Court as well as other courts/forums which are admittedly of a date, prior to the report dated 28th October 2016 issued by the designated authority /committee and/or prior to the issuance of the earlier SCN dated 24th April 2017 and/or prior to the commencement of hearing of the earlier SCN. The Noticee further argued that there is no reason why all the relevant documents should not have been placed for its consideration at the relevant time. Hence, the Second SCN issued by SEBI as to if it can rely upon material/information that was in fact, available to SEBI, even prior to the issuance of the Show Cause Notice dated 28th October 2016 must be answered in the negative. Further, the submission of Noticee 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 Noticee comes to the logical end only on passing of the order on merits. In any event, SEBI had received new materials such as the SFIO Report dated August 31, 2018 along with its annexures which were observed to be relevant to the matter before the final reply dated November 26, 2018 in respect of SCN dated April 24, 2017 was filed the Noticee. The SFIO Report along with other materials such as, 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”) which were relevant to the matter were also provided to the Noticee in compliance with the principles of natural justice. Further, the Noticee was

granted time to submit its reply to the said SCN if any, and subsequently an opportunity of hearing was also provided to the Noticee. Therefore, I do not find any merit in the said argument of the Noticee.

**Findings on Merits of the case:**

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

60. 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."*

61. 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.

62. 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 observations of the Hon'ble Securities Appellate Tribunal in the matter of ***Jermyn Capital LLC vs. SEBI*** decided 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.*  
.....”

63. I also place reliance on the following observations of the Hon’ble SAT in the matter of **Mukesh Babu Securities Limited vs. SEBI & Others** decided 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' .....*”

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

65. From the above two judgments of the Hon’ble SAT, I note the following:

65.1. 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 reasonable prudent man thinks of the entity. This impression or opinion or belief is generally formed on the basis of the association it has with others and/or on the basis of its 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.

65.2. 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 the securities market 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 objectives 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.

65.3. 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:

65.3.1. 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.

65.3.2. 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:**

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

66.1. **First SCN dated April 24, 2017:** The Enquiry Report dated April 11, 2017 observes 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, giving unverified / false information regarding trades backed by collateral in the form of stock, assuring investors regarding arbitrage opportunity, UCC modification, suspicious transactions, non-forwarding of contract notes/ ECNs to clients, funding the clients through its NBFC, failure in system audit of IBT/CCTL, etc. The enquiry

report dated April 11, 2017 has found the above conduct of the Noticee in violation of various provisions of laws such as FCRA, GOI Notifications, NSEL Circulars, Rules and Bye-laws, MCX and NCDEX Circulars. In view of the above findings of the Enquiry Report dated April 11, 2017, allegations to that extent have been levelled in the SCN dated April 24, 2017.

66.2. **Second SCN dated December 27, 2018:** The second SCN was in furtherance to the first SCN dated April 24, 2017. The second SCN 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 in the nature of lending and borrowing transactions rather than trading in commodities. The SCN further alleges that in view of the observations 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.

67. 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.

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

69. 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.*

70. 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’.

71. With regard to the transactions in paired contracts on NSEL, the 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.*

*.....”*

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

*“.....*

*We observe 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."

73. With respect to the role of members / brokers at NSEL, the **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, *inter alia*, 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 projects the applicant as the main offender, rather the defaulting parties.*

.....

18. Though the case has been projected as a 'scam of Rs. 5600 crores', it needs to be kept in mind that these amounts have not been received by NSEL. As already observed, it is difficult to accept that the brokers and / or their clients for whom they were working were 'deceived' by the NSEL inasmuch as in all probability, the brokers and the investors were well aware that they were not entering into a genuine sale and purchase contract. When there is a clear and obvious possibility that these persons knew about the transactions, the 'deception' if any, caused to them cannot be said to have been caused by the nature of the transactions and, at the most, they can be said to have been misled by a propaganda that 'investing' money in those transactions, was safe. The money invested has not come to NSEL, but has gone to the borrowers i.e. bogus sellers. It is the borrowers who have been befitted by the transactions and the money of 'investors' has gone to them. The names of 25 different companies who are the defaulters have been mentioned in the FIR itself. Thus, though projected a 'scam of Rs. 5600', the ill-gotten amount has not gone to the applicant, or for that matter, to NSEL. In fact, it is not the case of anyone.

19. The picture that emerges is as follows. Indeed, illegal and bogus transactions of sale and purchase were shown as having taken place. This has been possible because the NSEL did not stick to its business model. Instead of providing a platform for genuine buyers and trader, this platform was permitted to be used – and actually used by businessmen who wanted safe investments for their money. These investments were made through brokers who were well experienced with the working of the market. To show bogus sales, bogus documents were created by the bogus sellers/brokers, and this has been possible with the connivance of the officers and directors of NSEL. Though the applicants contention that the was not aware of the illegalities, or that he being a Non-Executed Director of NSEL was not concerned with the illegal activities, cannot be accepted, it is also clear that, that the transactions were not genuine, was in all probability, known to the 'investors' at least to a great number of them – and in any case, certainly known to the brokers who were entering into the contracts for their customers -investors. This fact is obvious to the investigating Agency also, inasmuch the buyers and sellers are freely described as 'investors' and 'borrowers'. The NSEL, by its improper and wrong working, did provide an opportunity for the unscrupulous 'borrowers' to have huge funds for themselves. However, in the zeal of opposing the

*applicant's application for bail, it is, perhaps, conveniently ignored that the funds had not come to NSEL, but had gone to such borrowers. Though a number of contentions showing his complicity in the whole matter are raised, on a careful consideration and scrutiny of the matter, the only real allegation against the applicant is that he allowed NSEL to violate the rules and regulations, and its own business model which enabled the 'borrowers' to dupe the 'investors'.*  
.....”

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

**Observations by various courts/authorities regarding NSEL and paired contracts and findings related to them.**

74. 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 .....*”

75. 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.....”*

76. The observations of the **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.

.....”

77. 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....”*

78. 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.
79. 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.
80. 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 of competence, fairness, honesty, integrity of NSEL and paired contracts.

81. In view of the parameters already mentioned in previous paragraph 65.3, 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.

82. As per the Noticee, it, as a broker had only entered into the so-called paired contracts on behalf of its clients in accordance with the Bye-laws/ Business Rules of NSEL.

83. From the submissions of the Noticee, I note that Noticee admitted that it had facilitated trading on NSEL by providing the required infrastructure and services to its clients, the role of the Noticee was limited to facilitate the investors to trade on the platform of NSEL and Noticee was only a facilitator of trades and was placing the orders on NSEL as per the instruction of the clients. I note that for the clients, the face of the NSEL and the paired contracts was the Noticee itself and the paired contracts could not have been executed in such large volumes, across the large number of clients without the actions and facilitation of the broker. In my view this facilitation is sufficient to establish the close association of the Noticee with NSEL and paired contracts. Hence, I am of the view that Noticee is closely associated with NSEL and paired contracts.

84. 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.

85. 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:

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

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

All the above, clearly demonstrate an association of the Noticee with NSEL and the paired contracts that goes well beyond transacting on behalf of brokers on behalf of its clients. In essence, the 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.

86. However, the Noticee has contested that these observations are not against the Noticee and that it is not even a party to the Court proceedings.

87. 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**.

88. 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..”*

89. 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.

90. In respect of the SFIO Report, the Noticee contented that the contents of the SFIO report contains mere allegations which are not yet proved before any court of law and unsubstantiated SFIO observations cannot be relied upon by SEBI without verification of the same by SEBI or by examining the author of such Report.

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

92. I also note that the Noticee has sought the cross-examination of SFIO investigating officer and the clients of the Noticee referred in the SFIO investigation report. The SFIO had recorded the statement of the some clients of the Noticee during the course of its Investigation. In this regard, I note that what is relevant in the current proceedings is the fact that SFIO has conducted an investigation and rendered its findings/observations. The findings of SFIO investigation would be established in the competent courts. The fact that such findings are yet to be established does not come in the way of SEBI exercising its responsibility. SEBI has been conferred the responsibility of determining whether in view of the existence of SFIO report and its adverse observations on paired contracts reproduced in paragraph 77, the Noticee has become an unfit person to be a commodity derivative broker. As determined in previous paragraphs, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has been seriously eroded and thus,

the fit and proper status of the Noticee, is affected *inter alia*, by virtue of adverse observation by SFIO on the paired contracts with which the Noticee is closely associated. As noted earlier, the fact that the allegations are yet to be determined by the Competent Court is not a relevant consideration for assessing the fit and proper criteria of the Noticee. Cross examination is meant for assisting the courts in final determination of statements which are yet to be established. Since such determination is not relevant for assessment of fit and proper criteria, the question of cross examination does not arise. In any event the contents of the complaints/survey as such are not relied upon in the present proceedings. In view of the aforesaid discussion, the request for cross examination is accordingly disposed off. I also note that the Noticee contested the legality and scope of the SFIO Report. I note that Noticee may have to raise the issue of legality and scope of SFIO Report in other appropriate forum.

93. The Noticee contended that SFIO has sought, received and gathered information from various authorities in relation to all the proceedings ongoing against the Noticee. The SFIO report is therefore, a mere culmination of all the information sought by the investigative authorities. It is evident from the report that SFIO has merely repeated and reiterated all the allegations/observations made by SEBI/EOW/other authorities in their own report. It is imperative to note that the SFIO report by itself cannot be evidence. The evidence is the substantive material on the basis of which it is formed. In view thereof, the SFIO report, is at best, hearsay evidence and it is a settled law that hearsay evidence is no evidence at all.

I note that what is relevant in the current proceedings is the fact that SFIO has conducted investigation and rendered its findings/observations. The findings of SFIO investigation would be established in the competent courts. The question of hearsay evidence comes before the forum where the SFIO findings would be tested and established. Since this forum is testing the fitness of the Noticee on the basis of the existence of the adverse observations against the Noticee, the argument based on hearsay evidence and any consequential argument thereon, is not relevant in this forum.

94. The Noticee further contended that admittedly SEBI did not have original or a certified copy of the SFIO Report hence the same cannot be considered as evidence in law. In this regard, I note that the present proceedings being quasi-judicial in nature strict rules of Indian Evidence Act is not applicable herein. In any event, what is being noted upon in the current proceedings is the existence of adverse observations in the SFIO Report qua NSEL and paired contracts which is not specifically contested by the Noticee.

**Observations regarding MPID violations and findings related to them:**

95. Over and above, the determination made so far, I proceed to determine whether the observations made by the 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".....”*

96. As before, in respect of the observations of the Hon’ble Bombay High Court also, the Noticee contended that the Noticee was neither a party to the said proceedings nor the order passed was against the Noticee. Therefore, the observations in this Order are of no relevance to the Noticee. In any event these observations as recorded by the Hon’ble Court itself are *prima facie* in nature.

97. I have already observed the relevance of *prima facie* findings for the consideration of the fit and proper criteria in line with the judgments rendered in *Jermyn Capital LLC vs. SEBI* and *Mukesh Babu Securities Limited vs. SEBI & others* as confirmed by the Hon’ble Supreme Court. On perusal of paragraph 10 of the judgment of the Hon’ble Bombay High Court, I note that the observations made are equally applicable to the clients, (and therefore their

brokers) who were given assurance of fixed returns @ 14% to 16% pa. At paragraph 11 of the judgment it is further observed that the MPID Act is invoked as there is an assurance to the clients that if they invest in T+2 and T+25 Scheme, they would get assured returns. It goes without saying, the observations of the Hon'ble High Court capture both sides of the transactions; one side which is attracted with the fixed returns for their investment and the other side which receives such investment. Therefore, it is incorrect to state that the observations of the Hon'ble High Court are not in respect of the Noticee as these observations are factually relatable to the Noticee as already discussed in paragraph 87 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.

98. As brought out above, the basis of the present findings are existence of adverse observations by the competent authorities/courts and in view of such observations the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has been affected. Advancing of any contentions or submitting any reply in this regard by the Noticee, for instance, in support of its case either that such observations don't exist or such observations are not adverse in nature or that such adverse observations cannot be ground for considering the fit and proper status of the Noticee, does not in any way incriminate the Noticee in alleged violations covered in the F.I.R filed against the Noticee. Therefore, any arguments on the basis of perceived self-incrimination does not hold any merit.

99. The Noticee has also sought inspection of various documents as mentioned in its various replies. As far as the inspection of documents prior to second Show Cause Notice, the same has been dealt with and a separate order dated August 30, 2018 has been passed in this regard. In respect of other documents for which inspection was sought, it is noted that inspection has already been granted in respect of relied upon documents. The Noticee has also sought for cross examination as mentioned in its various replies. As determined in previous paragraphs, the reputation and belief in competence, fairness, honesty, integrity and character of the Noticee has been seriously eroded and thus, the fit and proper status of

the Noticee, is affected *inter alia*, by virtue of adverse observations by various competent authorities. As noted earlier, the fact that final determination on the veracity of certain allegations/observations are yet to be determined by the Competent Court is not a relevant consideration for assessing the fit and proper criteria of the Noticee. Cross examination is meant for assisting the courts in final determination of statements which are yet to be established. Since such determination is not relevant for assessment of fit and proper criteria, the question of cross examination does not arise. Accordingly, the requests for cross examination made in its various applications are disposed of.

100. 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 and submissions of the Noticee in that respect, does not arise in this case to determine the fit and proper status of the Noticee.

**Summary:**

101. In summary, I note the following :

- 101.1. 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.
- 101.2. 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 Hon'ble Supreme Court in second appeal.
- 101.3. The Noticee, by virtue of being a broker, and by its own admission, has facilitated transactions in the said Paired Contracts for its clients on the NSEL platform. This

in itself establishes a close association between the Noticee on the one hand and Paired Contracts and NSEL on the other. Over and above this, the Noticee, by its own admission, allowed itself to become a channel and instrument for NSEL to promote Paired Contracts amongst its clients.

101.4. 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 Capital LLC vs Sebi* was confirmed by the Hon'ble Supreme Court in second appeal.

101.5. Reputation is an important factor for consideration of Fit and Proper Criteria and the reputation of the Noticee has been seriously eroded. Thus, I find that the Noticee is not a fit and proper person to be granted registration/ to operate as a commodity derivatives broker.

**Order:**

102. In view of the foregoing, 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 received on December 16, 2015, filed by Anand Rathi Commodities Limited for registration as commodity derivatives broker. The Noticee shall cease to act, directly or indirectly, as a commodity derivatives broker.

103. 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.

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

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

**FEBRUARY 25 , 2019**

**MUMBAI**

**MADHABI PURI BUCH**

**WHOLE TIME MEMBER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**