NATIONAL COMMODITY & DERIVATIVES EXCHANGE LIMITED

Circular to all trading and clearing members

Circular No	: NCDEX/SURVEILLANCE & INVESTIGATION-002/2021
Date	: February 01, 2021
Subject	: SEBI order in the matter of trading in castor seed contract at NCDEX

The Securities and Exchange Board of India (SEBI) has issued a circular no. WTM/AB/IVD/ID-11/ 22/2020-21 dated January 29, 2021 on “Order under Section 15-I (3) of SEBI Act, 1992 in the matter of Castor Seeds Contract at NCDEX”.

A copy of the referred SEBI circular is enclosed as Annexure.

Members are requested to take note of the same.

For and on behalf of
National Commodity & Derivatives Exchange Limited

Ravindra Shetty
Vice President

For further information / clarifications, please contact

1. Customer Service Group on toll free number: 1800 26 62339
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WTM/AB/IVD/ID-11/ 22/2020-21

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Section 15I (3) read with Section 19 of the Securities and Exchange Board of India, 1992 – In respect of Adjudication order dated April 24, 2020 passed against Investmart Comodities Ltd. (PAN: AAECM3447N), Neer Ocean Multitrade Pvt. Ltd. (AADCN3061E) and Mid-India Comodities Pvt. Ltd. (AABCT1983F) in the matter of Castor Seed Contracts at NCDEX.

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1. Present proceedings have emanated from a show cause notice dated July 10, 2020 (hereinafter referred to as "**SCN**") issued by Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") under Section 15-I(3) of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "**SEBI Act, 1992**") to Investmart Comodities Ltd. (hereinafter referred to as "**Noticee no. 1**"), Neer Ocean Multitrade Pvt. Ltd**.** (hereinafter referred to as "**Noticee no. 2**") and Mid-India Comodities Pvt. Ltd. (hereinafter referred to as "**Noticee no. 3**"), calling upon them to show cause as to why a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees in terms of Section 15HB of the SEBI Act, 1992, should not be imposed on Noticee no. 1, 2 and 3 (hereinafter collectively referred to as '**the Noticees'**) for the violation as alleged in the show cause notice dated September 11, 2019 issued by adjudicating officer which led to passing of Adjudication Order dated April 24, 2020 (hereinafter referred to as the '**AO Order'**). For further clarity, the relevant contents of the present SCN are reproduced hereunder:

……

4. It is observed from the above that, the AO has held that the Noticees, on account of delay in meeting MTM obligations, have failed to act with appropriate diligence in violation of Clause A(2) of Schedule II read with Regulation 9 of the Stock Brokers Regulations. The Adjudication Proceedings were disposed of by the AO without imposition of any penalty under Section 15HB of SEBI Act in view of the penalty already been levied by the exchange for contravention of the exchange rules. However, the Section 15HB of the SEBI Act as amended vide Securities Laws (Amendment) Act, 2014 effective from September 08, 2014 stipulates a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees. It is further noted that the aforesaid violation by the Noticees pertains to the investigation period from January 01, 2016 to January 27, 2016 i.e. after the said amendment to the SEBI Act. Thus, Section 15HB of the SEBI Act mandates at least a

minimum penalty of one lakh rupees on the Noticees once the violation by them has been established under Clause A(2) of Schedule II read with Regulation 9 of the Stock Brokers Regulations.

5. *Therefore, after examining the records of the above mentioned adjudication proceedings, SEBI is of the opinion that the Adjudication Order No. Order/MC/DS/2020-21/7516-7518 dated April 24, 2020 is erroneous and it is not in the interest of securities market as no penalty was imposed on the Noticees for violating Clause A(2) of Schedule II read with Regulation 9 of the Stock Brokers Regulations, though the Section 15HB of the SEBI Act as amended vide Securities Laws (Amendment) Act, 2014 stipulates a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees. Thus, the aforesaid AO order is fit for review as under section 15-I (3) of the SEBI Act, 1992.*

6. *……..*

7. *In view of the above, the instant Show Cause Notice is being issued under section 15-I(3) of SEBI Act, and the Noticees are called upon to show cause as to why a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees in terms of Section 15HB of the SEBI Act, should not be imposed on the Noticees.*

8. ……..

2. Show Cause Notice dated September 11, 2019 issued by adjudicating officer came to be issued as SEBI had initiated adjudication proceedings under Section 15HB of SEBI Act, 1992 against the Noticees, who are trading members of NCDEX, for the alleged failure of the Noticees to make the requisite payment of margins and other obligations within the prescribed timelines and they were alleged to have violated the Code of Conduct as specified in clause A(1) and (2) of Schedule II read with Regulation 9 of the SEBI (Stock Brokers) Regulations, 1992. Thereafter, the AO Order under Section 15-I (2) of the SEBI Act, 1992 came to be passed wherein the adjudication proceedings initiated against the Noticees were disposed of by the adjudicating officer with the following observations:

"26. I note from the SCN that Noticees were alleged to have violated code of conduct as specified in clause A(1) and (2) of schedule II read with regulation 9 of the Stock Brokers Regulations on account of failure to deposit the required MTM within the stipulated bank run in violation of Rules 6.3, 6.4 and 6.5 of the NCDEX Bye-laws, Rules and Regulations. It was also alleged in the SCN that Noticee No. 1, 2 and 3 were irregular in meeting its MTM obligation on 4 days, 7 days and 14 days respectively during the investigation period.

27 .Noticee No. 1, Noticee No. 2 and Noticee No. 3 in their replies submitted that there were delays on 3 occasions, 7 occasions and 16 occasions in first run in payment of MTM. The

said delays in meeting the MTM pay-in obligation by Noticees on January 27, 2016 occurred under extraordinary circumstances and not due to any negligence or failure to exercise due care and diligence on the part of the Noticees. Further, the Noticees also submitted the correspondence between Noticee and NCDEX regarding the delay in meeting MTM payment obligations.

28. I have perused the submissions of the Noticees and the correspondence between Noticee and NCDEX on MTM shortfalls. There is nothing on record to contradict the submissions of the Noticees that in the said instances, the shortfall was only on account of delay in inter-bank payments, and that the shortfalls were cleared on the same day in all the instances mentioned, except for the following instances:

a) *One instance on January 27, 2016 in case of Noticee No.1 of Rs.6.66 Crores which remained unpaid by client, and position was closed out. Additional capital of Noticee No.1 was used to meet the MTM losses of Rs.15.66 Crores as on January 28, 2016.*
b) *One instance on January 25, 2016 in case of Noticee No.2, where it requested NCDEX to square up its positions on account of inability by clients to pay MTM losses. I note that the position was closed out and additional capital of Noticee No.2 was used to meet MTM losses of Rs.13.98 Crores.*
c) *In case of Noticee No.3, there is no documented instance of overnight delay. Rs.14.58 Crores was used to meet MTM losses from additional capital on close out of positions.*

29.From the above I note that, the Noticees requested for squaring up positions due to the extraordinary circumstances prevailing in the Castor Seed contract, and the fact that positions could not be squared up due to absence of buyers and hitting of circuit filters in the contract. However, I note that all 3 Noticees had sufficient additional capital with NCDEX which was utilized to clear all MTM losses upon close out of positions.

30. In view of the above, I find that given the circumstances of extreme price fall in the castor seed contracts, the Noticees were able to meet the MTM and pay-in obligations with the help of sufficient balance maintained by them with the exchange. Hence, it cannot be held that the Noticees failed to maintain high standards of integrity, promptitude or fairness, and thus the charge of violation of Clause A(1) of schedule II read with regulation 9 of the Stock Brokers Regulations is not established.

31. On account of delay in meeting MTM obligations, I find that the Noticees failed to act with appropriate diligence in violation of Clause A(2) of schedule II read with regulation 9 of the Stock Brokers Regulations. The exchange was well within its rights to penalize the Noticees

for delays which occurred in meeting the MTM obligations, and I note that a penalty of Rs. Ten lakhs each has been levied on all the 3 Noticees by NCEDX for violation of rules 6.3, 6.4 and 6.5 of the Exchange Bye-laws, Rules and Regulations and additional penalty of Rs. 5 Lakh was levied on Noticee No. 3, since it had traded in Castor Seeds Contract through his proprietary account. Hence, for the same violation, the initial regulator in such situation the exchange i.e. NCDEX has already taken suitable action against the Noticee by imposing penalty as stated above.

32.Asappropriate penalty has already been levied by the exchange for contravention of the exchange rules, further imposition of penalty upon the Noticees for the same cause of action would not be appropriate. Hence I find that this is not a fit case for imposition of penalty."

Personal Hearing, Replies and Submissions:

3. I note that personal hearing for the Noticee no. 1 and 2 was held on September 9, 2020 and for Noticee no. 3 was held on November 11, 2020. Noticee no. 1 has filed its merit based reply dated August 31, 2020 to the SCN, Noticee no. 2 has filed his merit based reply dated September 1, 2020 to the SCN and Noticee no. 3 has filed his merit based reply dated August 31, 2020 to the SCN. Noticee no. 3 has also filed its written submissions dated December 16, 2020.

4. The following is a gist of the contentions raised by the Noticee no. 1 and 2 (their contentions being similar in nature, hence clubbed together) in their replies and in their oral submissions made during the personal hearing:

   a. At the outset, it is submitted that the Ld. AO has committed a grave error in arriving at the finding that "the Noticee on account of delay in meeting MTM obligation has failed to act with appropriate diligence in violation of Clause A (2) of Schedule II read with Regulation 9 of Stock Brokers Regulations". The Ld. AO has failed to appreciate that the act of delay in meeting MTM obligations does not amount to lack of diligence within the meaning of Clause A(2) as held by AO, but amounts to promptitude within the ambit of Clause A(1). However, it is submitted that the Ld. AO has categorically stated that there has been no violation of Clause A(1) by the Noticees. In view of the above, it is submitted that if the findings of the AO is examined

in depth, it would emerge that the Ld. AO has erred in holding us liable for violation of Clause A (2).

b. The finding of the AO that "on account of the delay in meeting the MTM obligations, the Noticee failed to act with appropriate diligence", is contrary to the Ld. AO's own observation in para 27, 28 and 29 of the AO Order. Against this backdrop, the findings of the AO that on account of delay in meeting MTM obligations, the Noticee failed to act with appropriate diligence in violation of Clause A(2), is without any basis and logic.

c. Review of AO Order by SEBI is contemplated if such order is so erroneous that it is not considered by SEBI to be in the interest of securities market. It is submitted that there is no such situation. The alleged violations are of venial nature and could not cause any systemic risk. It is not enough to invoke the power of review if the AO Order is merely erroneous, it has to be erroneous to such extent that it is not in the interest of securities market.

d. It is pertinent to note that a similar order based on similar facts, has been passed by the same AO, on December 23, 2019 in the matter of Leo Commodities Ltd., but SEBI has not found the said order erroneous for the purpose of review under section 15-I(3) of the SEBI Act, 1992. It is not clear as to how and on what basis, the said case has been distinguished from the case of the Noticee.

e. As held by the Hon'ble Supreme Court in the matter of Adjudicating Officer, SEBI v. Bhavesh Pabari ((2019) 5 Supreme Court Cases 90), the penal provisions of the SEBI Act, 1992 levying minimum and maximum penalty have to be read along with the provisions of section 15-I (2) and section 15 J, which vest discretion in the AO while imposing penalty or determining the quantum of penalty. Hence, it is submitted that, it is not mandatory to impose penalty in all cases, whether venial or technical violations. Further, the mitigating factors as specified in Clause (a), (b) and (c) of section 15J are not exhaustive and in the given facts of the case, the AO may consider other relevant factors also while deciding on penalty. It is submitted that in the instant case, the AO has rightfully considered the penalty imposed by NCDEX as "the other relevant factor" while determining the penalty to be imposed by her.

5. The following is a gist of the contentions raised by the Noticee no. 3 in its reply and in its written submissions and also at the time of personal hearing:

f. The documents asked vide our reply dated August 31, 2020 has not been provided to us by SEBI. The SCN and copy of the AO Order can never be said to be records of the said proceedings, much less its examining thereof for initiation of the present proceedings.

g. The Final Order dated November 14, 2018 by WTM of SEBI exonerated the Noticee with respect to all charges. The appreciation of this fact arising from the final order in the matter of Castor Seed Contracts found to have escaped the attention of learned AO while issuing SCN. Had the Ld. AO appreciated that the Noticee has been exonerated from the charges and allegations with respect to PFUTP Regulations, the question of inquiry to find out possible violation of bye-laws 6.3, 6.4 and 6.5 of NCDEX does not arise at all, much less impugned proceedings under section 15-I(3) of SEBI Act, 1992.

h. The fact of Noticee keeping average balance of Rs. 40 Crores with NCDEX and consequent refund by NCDEX after completing all proceedings of Castor Seed Contract, makes it abundantly clear that there was neither a shortfall in MTM nor margin by the Noticee, either on behalf of its client or PRO account. Therefore, the question of violation of Rules, Regulations and Bye-laws of NCDEX, does not arise at all, warranting invoking of section 15HB of SEBI Act, 1992.

i. It is pertinent to note that a similar order based on similar facts, has been passed by the same AO, on December 23, 2019 in the matter of Leo Commodities Ltd., but SEBI has not found the said order erroneous for the purpose of review under section 15-I(3) of the SEBI Act, 1992. It is not clear as to how and on what basis, the said case has been distinguished from the case of the Noticee.

j. On conjoint reading of the Final Order dated November 14, 2018 and August 12, 2020, it is established beyond doubt that trade in Castor Seed had not impacted the safety and integrity of the securities market and the interest of investors. Under such circumstances, the question of inviting and invoking the provisions of section 15-I(3) of SEBI Act, 1992, does not arise at all.

k. The order passed by WTM on August 12, 2020 in the matter of Castor Seeds contracts at NCDEX must be seen as guiding light. In most respectful submission, the opinion formed by SEBI, on the conclusion derived by the Ld. AO as erroneous, is crippled with self-contradiction and therefore it deserves reconsideration on part of SEBI.

Consideration of submissions and findings thereon:

6. Before dealing with the contentions of the Noticees, it would be appropriate to refer to the brief background of the matter which is important for determination of the issue involved in the present proceedings. The background facts of the case are as under:

(i) NCDEX under the provisions of its Rules, Bye-laws and Regulations suspended the trading in Castor Seed Contracts at the close of business hours, vide its circular (NCDEX/TRADING-007/2016/012) dated 27 January, 2016. Pursuant to the same, SEBI undertook a preliminary examination in respect of trading in Castor Seed Contracts at NCDEX platform for the period January 01, 2016 to January 27, 2016 (hereinafter referred to as '**investigation period'**).

(ii) Vide ad-interim ex-parte orders dated March 2, 2016 and May 24, 2016, a total of 18 entities (4 Trading Members i.e. Noticee no. 1 to 3 and Leo Global Commodities Pvt. Ltd., and 14 clients) were restrained from buying, selling or dealing in the securities market, either directly or indirectly, in any manner whatsoever, till further directions.

(iii) It was observed that these 18 entities had large open positions in Castor Seeds Contracts and had repeatedly expressed inability to collect/deposit Mark to Market (MTM) and pay-in obligations. Further, it was also observed that these 18 entities were holding approximately 62.48% of the Open Interest of the February –2016 (contract expiry was on February 19, 2016) contracts which constituted a value of Rs. 540 crores. SEBI, vide confirmatory order dated March 8, 2017, confirmed the restrictions imposed

by the Interim Orders on 17 entities subject to certain relaxations. The restrictions imposed on 1 entity viz. Narsinpuria Korodimal were revoked.

(iv) The Noticee No. 1 to 3 were amongst 4 trading members of NCDEX which were restrained vide the interim and confirmatory orders for the trades of their clients in Castor seeds contracts. After conclusion of investigation, SEBI did not find any adverse evidence/ conclusion in respect of violation of SEBI (PFUTP) Regulations, 2003 against the four trading members and hence the directions imposed vide the interim order and the confirmatory order were revoked against them vide the Final Order dated November 14, 2018. However, in respect of the said four trading members (which also includes the Noticees herein), the investigation had found adverse findings with regard to violation of Clauses A(1) and A(2) of Code of Conduct for Stock Brokers as specified in Schedule II under regulation 9 of SEBI (Stock Brokers) Regulations, 1992 which warranted Adjudication Proceeding under Chapter VIA of SEBI Act, 1992.

(v) Accordingly, a show cause notice dated September 11, 2019 under Rule 4(1) of SEBI (Procedure for Holding Inquiry and imposing penalty by Adjudicating Officer) Rules, 1995 came to be issued against the Noticees, alleging that the Noticees had allowed a build-up of large debit balance towards the end of January 2016 and had not ensured the timely collection of margins and other obligations from their clients. The allegations were on the basis of summary of the number of days when the Noticees were allegedly irregular in meeting the MTM obligations during the investigation period and the aggregate debit balance of their clients in the ledger of the Noticees on the last day of the investigation period. It was alleged that the Noticees had not performed appropriate due diligence, care and promptitude in the conduct of business. As a result of the Noticees failure to collect and pay MTM obligations, NCDEX was compelled to suspend the trading of Castor Seeds Contracts. Furthermore, at NCDEX, in a given trading day, there are 6 bank runs running from 9:30 AM up to 5:00 PM for deposit of required MTM margin with the Exchange by a trading member. It was observed that in respect of the Noticees, there were several instances of bank runs.

Multiple bank runs indicate inability of the Noticees to deposit MTM and pay-in obligations of its clients at a specified time during a trading day. It was alleged that Failure to deposit the required MTM by the Noticees within the stipulated bank run amounts to violation of Exchange rules 6.3, 6.4 and 6.5 of Bye-laws, Rules and Regulations. In view of the above, the show cause notice dated September 11, 2019 issued by the Adjudicating Officer, alleged that the Noticees have violated Clauses A(1) and A(2) of Code of Conduct for Stock Brokers as specified in Schedule II under regulation 9 of SEBI (Stock Brokers) Regulations, 1992.

(vi) The AO Order while disposing of the show cause notice dated September 11, 2019, did not hold the Noticees guilty of violating Clause A(1) of Code of Conduct in Schedule II of regulation 9 of the SEBI (Stock Brokers) Regulations, 1992, giving the following reason *"given the circumstances of extreme price fall in the castor seed contracts, the Noticees were able to meet the MTM and pay-in obligations with the help of sufficient balance maintained by them with the exchange. Hence, it cannot be held that the Noticees failed to maintain high standards of integrity, promptitude or fairness, and thus the charge of violation of Clause A(1) ……. is not established."* However, on account of delay in meeting MTM obligations and thereby failing to act with appropriate diligence, I note that AO Order held the Noticees guilty of violating Clause A (2) of Code of Conduct, I also note that the AO Order did not impose any penalty upon the Noticees under section 15HB of SEBI Act, 1992 for the aforesaid violation by holding that "*As appropriate penalty has already been levied by the exchange for contravention of the exchange rules, further imposition of penalty upon the Noticees for the same cause of action would not be appropriate"*.

(vii) Upon examination of record of the adjudication proceedings, SEBI noticed that while the AO Order has found the Noticees guilty of violating Clause A(2) of Code of Conduct in Schedule II read with Regulation 9 of SEBI (Stock Brokers) Regulations, 1992, however, the AO Order erred in not imposing penalty on the Noticees since pursuant to introduction of minimum penalty under section 15HB of SEBI Act, 1992 (as amended vide the Securities Laws

(Amendment) Act, 2014, effective from September 8, 2014), the Adjudicating Officer should have imposed the minimum penalties as prescribed under the said provision. On this ground alone, SEBI found the AO Order to be erroneous to the interests of the securities market and thereby issued the present SCN calling upon the Noticees to show cause as to why appropriate penalty under section 15HB of SEBI Act, 1992, which shall not be less than one lac rupees but which may extend upto one crore rupees, should not be imposed against the Noticees.

7. I note that the stock exchange i.e. NCDEX has imposed penalty for violation of rules 6.3, 6.4 and 6.5 of Bye-laws, Rules and Regulations of NCDEX, on its members i.e. Noticees. However, it was observed by SEBI that there were several instances of Bank run against Noticees on multiple occasions. From conduct of the Noticees, SEBI *prima facie* observed that Noticees are guilty of failure to exercise due diligence which is in violation of Clauses A(1) and (2) of the Code of Conduct in Schedule II read with Regulation 9 of SEBI (Stock Brokers) Regulations, 1992, therefore, the adjudication proceedings were initiated against the Noticees. However, it is observed that AO Order after finding that there is violation of Clause A(2) of Code of Conduct, did not impose penalty on the Noticees, taking into account that NCDEX has already levied penalty on Noticees. After coming to finding that there is violation of Code of Conduct and Section 15HB which provide minimum penalty, AO Order has erroneously not imposed penalty provided under Section 15HB of SEBI Act, 1992.

8. I note that, a proceeding under Section 15-I(3) of SEBI Act, 1992 can be undertaken if an order passed by the adjudicating officer is erroneous to the extent that it is not in the interests of securities market. In the instant case, the SCN has alleged the erroneous appreciation of law by the AO Order, whereby the adjudicating officer has allegedly failed to appreciate the mandatory and stringent nature of the provision of section 15HB of SEBI Act, 1992 which stipulated a compulsory minimum penalty when a violation has been established. To this, Noticee no. 1 and 2, by placing reliance on the judgement of the Hon'ble Supreme Court in the matter of ***Adjudicating Officer, SEBI v. Bhavesh Pabari ((2019) 5 SCC 90),*** have contended that the penal provisions of the SEBI Act, 1992 levying minimum and

maximum penalty have to be read along with the provisions of section 15-I (2) and section 15 J, which vest discretion in the AO while imposing penalty or determining the quantum of penalty. Hence, it is submitted by Noticee no. 1 and 2 that, it is not mandatory to impose penalty in all cases, whether venial or technical violations. Further according to the said Noticees, the mitigating factors as specified in Clause (a), (b) and (c) of section 15J are not exhaustive and in the given facts of the case, the AO may consider other relevant factors also while deciding on penalty. It is contended by them that in the instant case, the AO has rightfully considered the penalty imposed by NCDEX as "the other relevant factor" while determining the penalty to be imposed by her.

9. I note that Section 15I (2) of the SEBI Act, 1992 provides that adjudicating officer may impose such penalty as he thinks fit in accordance with the penalty provisions. However, the question to be determined in present proceedings is whether in exercising his discretion under Section 15I(2) and 15J of the SEBI Act, 1992, adjudicating officer can impose a penalty which is less than the minimum penalty prescribed under the penalty provisions. As per the contention of the Noticee no. 1 and 2, adjudicating officer can do so, in view of the order passed by the Hon'ble Supreme Court in the Bhavesh Pabari case (*supra*). I have perused the said judgment. Firstly, I find that Bhavesh Pabari matter dealt with the applicability of Section 15J of the SEBI Act, 1992 to the penalty provisions, as existed before the amendments made in the penalty provisions in the year 2014. However, Hon'ble Court also made following observations regarding penalty provisions as amended in the year 2014, as follows:

> *"7……..We would prefer read and interpret Section 15-A(a) as it was between 25th October, 2002 and 7th September, 2014 in line with the Amendment Act 27 of 2014 as giving discretion to the Adjudicating Officer to impose minimum penalty of Rs.1 lakh subject to maximum penalty of Rs.1 crore, keeping in view the period of default as well as aggravating and mitigating circumstances including those specified in Section 15-J of the SEBI Act……..."*

It is important to note here that in the Bhavesh Pabari case (*supra*) a bench of three Hon'ble Judges of the Hon'ble Supreme Court was dealing with a reference made by a bench of two Hon'ble judges of Supreme Court in the matter of *Siddharth*

Chaturvedi vs SEBI (2016) 12 SCC 119 regarding the correctness of the judgment of a bench of two Hon'ble Judges in the matter of *Chairman, SEBI vs Roofit Industries Ltd. (2016) 12 SCC 125* wherein it was held that Section 15J was not available to the adjudicating officer during the period from 2002 (when the penalty provisions were first amended) to 2014 (when the penalty provisions were again amended) and the adjudicating officer is bound to impose monetary penalty as provided under the respective penalty provisions. In this context, the judgment in Bhavesh Pabari case (*supra*), after taking into account *inter alia* insertion of Explanation in Section 15J by the Finance Act, 2017, held that adjudicating officer can exercise its discretion between the minimum penalty and maximum penalty taking into consideration Section 15J while imposing penalty under the provisions, as amended by the amendments made in the year, 2002. Secondly, I find that Bhavesh Pabari's judgment was rendered on the penalty provisions as they existed after amendments made in the year 2002. Subsequently, these penalty provisions were again amended in the year 2014 and in the present case Section 15HB, as amended by the amendments made in the year 2014, is applicable. I note that there is remarkable difference in the penalty provisions, as they existed after the amendments made in the year 2002 and as they exist after the amendments made in the year 2014. Penalty provisions after the amendments made in the year 2014 introduces minimum penalties that too with the use of the words "……. *shall be liable to penalty which shall not be less than…..*" which *per se* indicates the legislative intent that the provisions are mandatory. The penalty provisions, as amended by the 2014 amendments, were not under consideration before Hon'ble Supreme Court in the Bhavesh Pabari case (*supra*). Thus, interpretation of the penalty provisions, as amended in the year 2014, as sought to be canvassed by the Noticee no. 1 and 2 on the basis of the Bhavesh Pabari case (*supra*) is not correct.

10. Now the question arises is whether imposition of minimum penalty is mandatory. In this regard, as observed above, penalty provisions after the amendments made in the year 2014 use the words "……. *shall be liable to penalty which shall not be less than…..*" which *per se* indicates the legislative intent that the provisions are mandatory. In this regard, it would be apposite to refer to the judgment of Hon'ble Supreme Court in *Union of India & Others Vs. A. K. Pandey (2009) 10 SCC 552* wherein it was held as under:

> *"……..22. The principle seems to be fairly well settled that prohibitive or negative words are ordinarily indicative of mandatory nature of the provision; although not conclusive. The Court has to examine carefully the purpose of such provision and the consequences that may follow from non-observance thereof. If the context does not show nor demands otherwise, the text of a statutory provision couched in a negative form ordinarily has to be read in the form of command. When the word "shall" is followed by prohibitive or negative words, the legislative intention of making the provision absolute, peremptory and imperative becomes loud and clear and ordinarily has to be inferred as such……."*

11. I note that as per Statement of Objects and Reasons of SEBI (Amendment) Bill, 2002 amendments to penalty provisions in the year 2002 were made as penalties existing before the amendment were too low and did not serve as effective deterrent. Therefore, intention of the amendments made in the year 2002 was not to introduce the minimum penalties but to introduce stricter/ enhanced penalties. Subsequently, Expert Group constituted by SEBI under the Chairmanship of Justice Kania, recommended that in Sections 15A to 15H of SEBI Act, 1992, the words "one lac rupees for each day during which such failure continues or one crore rupees, whichever is less" may be replaced by the words "not exceeding one lac rupees for each day during which such failure continues subject to a maximum of one crore rupees" to bring clarity in the provisions regarding availability of the exercise of discretion available under Section 15J by the adjudicating officer while imposing penalty under these sections. SEBI Board in its meeting held on June 18, 2009, *inter alia*, approved the proposal for amendment to securities laws relating to penalties, as recommended by the Group and also approved proposal for enhancement of penalties by doubling the amount of the maximum penalties provided. These proposals were then sent to the Central Government for taking appropriate steps in this regard. Thereafter, by the Securities Laws (Amendment) Act, 2014, the penalty provisions were amended not by enhancing the penalties but by introducing the minimum penalties which was not there under penalty provisions as amended in the year 2002. Regarding the amendments made to penalty provisions, as amended by Securities Laws (Amendment) Act, 2014, the Statement of Objects and Reasons of Securities Laws (Amendment) Bill, 2014 provides that amendments to these provisions have been made to provide that while imposing monetary penalties, the

adjudicating officers have discretion to impose minimum penalties, which shall not be less than one lakh rupees, for contravention of the provisions of the said Act. Thus, legislative intention behind the amendments made to the penalty provisions in the year 2014 is also to introduce minimum penalties and no other interpretation of these penalty provisions is called for. In this regard reference may also be made to the observations made by the Hon'ble Supreme Court in in the A. K. Pandey case (*supra*) which squarely applies to the interpretation of the penalty provisions which use the words "……*shall be liable to penalty which shall not be less than…..*" and the minimum penalty provided thereunder becomes mandatory. Therefore, I find that penalty provisions, as amended by 2014 amendments, provides for minimum penalties which are mandatory in nature.

12. I note that, Noticee no. 1 and 2 have sought to canvass that if minimum penalty is imposed without having regard to Section 15J, it would render the Section 15J otiose. In my view, Section 15J is available to adjudicating officer even after the amendment made in the penalty provisions in the year 2014. However, discretion available under Section 15J can be exercised between the minimum and maximum penalty provided under the respective Sections. In the present case also, adjudicating officer could have exercised his discretion between the minimum penalty i.e. Rs. one lakh and maximum penalty i.e. Rs. one crore. Thus, Section 15J is not rendered otiose. Therefore, the contention of the Noticee no. 1 and 2 in this regard, is misplaced and hence, untenable.

13. In view of the aforesaid discussions, I find that the minimum penalty of Rs. One lac which is provided for in Section 15HB, as amended by the amendments made in the year 2014, is mandatory in nature and the adjudicating officer does not have a discretion in not imposing the minimum penalty when a violation has been established.

14. As discussed above, the show cause notice issued by the adjudicating officer alleges that the Noticees have violated Clause A(1) and Clause A(2) of the Code of Conduct for Stock Brokers. In the AO Order, the Noticees have been found guilty of violating only Clause A(2) and violation of Clause A(1) was not found by the adjudicating officer. In reply to the present SCN, the Noticees have *inter-alia*

contended that the AO Order has erroneously held them guilty of violating Clause A(2) of the Code of Conduct for the Stock Brokers and that there is no question of enhancement of penalty under section 15-I(3) of the SEBI Act, 1992, as there is no violation called for imposition of any penalty, much less the minimum penalty. Before dealing with the aforesaid contention of the Noticees, it may be pertinent to refer to the relevant provisions of law, which are reproduced hereunder:

Securities and Exchange Board of India (Stock Brokers) Regulations, 1992

Conditions of registration.

9.Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely,

……

(f) he shall at all times abide by the Code of Conduct as specified in Schedule II

SCHEDULE II

Securities and Exchange Board of India (Stock Brokers Regulations, 1992

CODE OF CONDUCT FOR STOCK BROKERS

[Regulation 9]

A. **General.**

(1) Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

(2) Exercise of due skill and care : A stock-broker shall act with due skill, care and diligence in the conduct of all his business

15. I note that the Noticees were the Clearing Member of NCDEX. The Clearing Members of a stock exchange play a pivotal role in the risk management architecture under the settlement guarantee framework under aegis of clearing corporation of the anonymous trading platform offered by a stock exchange. They act as intermediaries between the client/ trading member and the clearing corporation and prevent the risk of default in settlement by adopting various risk management/containment measures such as margin collection, etc. In the event of the default by a client/ trading member, the clearing member is expected to ensure as a clearing member that the settlement is seamless, without the default turning into an event of systemic risk. Thus, even if there is a default by the client, the clearing member, at the first instance, is expected to absorb the loss i.e. make good

the default and ensure that the settlement is not disrupted. Similarly, every call for MTM obligations made by the stock exchange, is expected to be met by the clearing member on time, regardless of any delay/ default by the client/ trading member. I note that, meeting the MTM pay-in obligations on time in the derivatives market, is as critical as meeting the pay-in obligations on the final settlement day. I note that every delay in meeting the MTM obligations by the clearing member, aggravates the potential risk of default at the time of settlement of the underlying derivative contract. I note that, as matter of prudent business practice and for maintaining integrity of market, there ought not to have been a second or subsequent bank run event. A second bank run is initiated by the clearing corporation only when there are insufficient funds in the first bank run. In the instant case, according to the Noticees own admission, there were delays on 3 occasions, 7 occasions and 16 occasions in the first bank run in payment of MTM obligations by Noticee no. 1, 2 and 3, respectively. I note that such delay on multiple occasions was a matter of concern and reflects poorly on the intermediary for failure to exercise due diligence which is part of risk management measure to prevent default in settlement. I also note that on certain occasions, the Noticees were unable to deposit the MTM obligations even on the end of T+1 day. This was a matter of even greater concern. I note that each of the Noticees herein, have argued that the Noticees cannot be said to have defaulted in their MTM obligations, since the shortfall was ultimately met from their Additional Base Capital as maintained by each one of them with NCDEX. I do not find any merit in such an argument. The Additional Base Capital was meant to serve as cushion/collateral for providing exposure to all the clients of the Noticees. It was only when the Noticees failed to meet the MTM obligations on time, NCDEX was forced to draw funds from Additional Base Capital. which indirectly effected the ability of other clients of the Noticees to take exposure. Having Additional Base Capital, could never have substituted the requirement of meeting the MTM obligations. Had the Noticees been diligent in the conduct of their business as a clearing member, the requirement for using the Additional Base Capital ought not to have arisen in the first place. In view of the above, I find that the Noticees are guilty of violating Clause A(2) of the Code of Conduct as contained in Schedule II read with regulation 9 of the SEBI (Stock Brokers) Regulations, 1992. Therefore, the contention of the Noticees that they are not liable for the violation of Clause A(2) of the Code of Conduct as held by the AO Order, is not tenable.

16. The aforesaid violations render the Noticees liable for imposition of penalty under Section 15HB of the SEBI Act, 1992 which reads as follows:

> **Penalty for contravention where no separate penalty has been provided.**
> **15HB.** Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

17. As discussed in para 8 to 13 above, the imposition of minimum penalty as provided under Section 15HB of SEBI Act, 1992, when the Noticees have been found guilty of violating Clause A (2) of the Code of Conduct as contained in Schedule II read with Regulation 9 of the SEBI (Stock Broker) Regulations, 1992, is mandatory. In this regard, I note that the AO Order has referred to Section 15HB as it existed prior to the amendment made in the year 2014, when there was no minimum penalty provided under Section 15HB. However, as the violations in the present case took place during January 2016, therefore, the provisions of Section 15HB, as amended vide the Securities Laws (Amendment) Act, 2014 are applicable and imposition of minimum penalty is mandatory.

18. The Noticees have raised another contention that similar order based on similar facts, has been passed by the same Adjudicating Officer on December 23, 2019 in the matter of Leo Commodities Ltd., but SEBI has not found the said order erroneous for the purpose of review under section 15-I(3) of the SEBI Act, 1992. I note that a common show cause notice dated September 11, 2019 was issued by the adjudicating officer against four entities i.e. Noticee no. 1, 2, 3 and Leo Commodities Ltd. However, a settlement application was filed by Noticee no. 1, 2 and 3, but no settlement application was filed by Leo Commodities Ltd., thus the adjudication proceedings against Leo Commodities Ltd continued and a separate order came to be passed by the adjudicating officer against Leo Commodities Ltd on December 23, 2019. The adjudication proceedings against Noticee no. 1, 2 and 3 resumed after these Noticees withdrew their settlement application. Therefore, another order came to be passed by the adjudicating officer against Noticee no. 1,

2 and 3 on April 24, 2020. I note that the drcision to revise the adjudication orders passed in the matter, was crystalized only in July 2020, by which time more than three months from the passing of the first adjudication order dated December 23, 2019, had already lapsed. Hence, being constrained by the period of limitation, as stipulated in the second proviso to section 15-I (3) of SEBI Act, 1992, no revision of the adjudication order dated December 23, 2019, could be considered. In view of the above, I note that the contention raised by the Noticees with respect to parity in enforcement action, is untenable.

19. In view of the above, I, in exercise of the powers conferred by Section 15-I(3) read with Section 19 of the SEBI Act, 1992 impose penalty Rs. 1,00,000/- (Rupees One Lac) on each of the Noticee no. 1, 2 and 3, under Section 15HB of the SEBI Act, 1992.

20. The Noticees shall pay the said amount of penalty within 45 days of receipt of this order by way of Demand Draft in favour of “SEBI -Penalties Remittable to Government of India”, payable at Mumbai.

21. The aforesaid Demand Draft shall be sent to “The Division Chief - ID-11, Investigation Department, Securities and Exchange Board of India, SEBI Bhavan II, Plot No. C –7, “G” Block, Bandra Kurla Complex, Bandra (E), Mumbai –400 051.”

22. Copy of the order shall be sent to the recognized stock exchanges, depositories and the Noticees for information and necessary action, if any.

sd/-

Date: January 29, 2021 **ANANTA BARUA**

Place: Mumbai **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA