BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved On: 07.05.2019
Date of Decision : 10.06.2019

Appeal No. 286 of 2017

Anand Rathi Share and Stock Brokers Limited
4th Floor, Silver Metropolis,
Jai Coach Compound,
Opposite Bimbisar Nagar,
Goregaon (East), Mumbai …Appellant

Versus

1. National Stock Exchange of India Limited
   Exchange Plaza, Bandra Kurla Complex,
   Bandra (E),
   Mumbai- 400 051

2. Nirpan Securities Pvt. Ltd.
   301, 308, 3rd Floor, Bhagwati House,
   A-19, Veera Desai Road,
   Andheri West
   Mumbai- 400 058

3. J M Global Equities Pvt. Ltd.
   Office No: 208/208A, Second Floor,
   Raghuleela Mega Mall,
   Off S.V. Road, Kandivali (West),
   Mumbai- 400 067

4. Transglobal Securities Ltd.
   3 Ashok Chambers,
   Bharuch Street,
   Masjid Bandar (E),
   Mumbai- 400 009

5. IKM Investors Pvt. Ltd.
   149-152, 1st Floor,
   Edmonton Mall, Bristol Hotel,
   M. G. Road, Gurgaon- 122 022

6. Gee Bee Securities Pvt. Ltd.
   5 Clive Row, 2nd Floor,
   Room No. 42P,
   Sarvamangala Building,
   Kolkata- 700 001

7. Haven Financial Services Pvt. Ltd.
   Room No. 306-307, Sagar Avenue,
   Opp. Shoppers Stop, S.V. Road,
   Andheri (W), Mumbai- 400 058

8. Inventure Growth & Securities Ltd.
   Viraj Towers, 201, 2nd Floor,
   Near Landmark, Western Express Highway,
   Andheri (East), Mumbai- 400 069

9. Todi Securities Pvt. Ltd.
   1st Floor, Room No. 12,
   Martin Burn House,
   1 R. N. Mukherjee Road,
   Kolkata- 700 001

10. Bhaijee Portfolio Ltd.
    3rd Floor, Building No. 14,
    Central Market,
    Phase 1, Ashok Vihar,
    New Delhi- 110 052

11. Lohia Securities Ltd.
    4 Brabourne Road, 5th Floor,
    Passport Building,
    Kolkota- 700 001 …Respondents

Mr. P. N. Modi, Senior Advocate with Ms. Kalpana Desai, Ms. Aashni Dalal and Ms. Stuti Shah, Advocates i/b J. Sagar & Associates for the Appellant.

Mr. Venkatesh Dhond, Senior Advocate with Mr. Rashid Boatwalla and Mr. Rahul Jain, Advocates i/b Manilal Kher Ambalal & Co for Respondent No. 1

Ms. Poonam Gadkari, Advocate i/b Juris Matrix Partners LLP for Respondent No. 4

Mr. Harsh Kesharia, Advocate with Mr. Vikas Bengani and Mr. Saurabh Bachhawat, Advocates i/b Mr. S. K. Jain, PCS for Respondent No. 5.

Mr. Ravikumar Varanasi, Advocate with Mr. Deepak Rane, Advocate for Respondent No. 7

None for Respondent Nos. 2, 3, 6, 8, 9, 10 & 11

CORAM: Justice Tarun Agarwala, Presiding Officer
Dr. C.K.G. Nair, Member
Justice M. T. Joshi, Judicial Member

Per: Dr. C.K.G. Nair

1. This appeal is filed challenging the order of the Independent Oversight Committee ("Oversight Committee" for short) of the National Stock Exchange of India Limited ("NSE" for short) dated July 07, 2017. By the said order the Oversight Committee rejected the request of the appellant for annulment of certain trades executed on September 26, 2013 in NIFTY Options Contract.

2. The relevant undisputed facts in the matter are the following:-

a) On September 26, 2013 at around 3:20 pm, the Ahmedabad Branch office of the appellant decided to square-off and close existing intra-day open positions in NIFTY Options of five of its clients. Since these Options Contracts were expiring on this day, approval of the clients was also sought and obtained for squaring-off their open position before closure of the trade hours since squaring off attracts lower Securities Transaction Tax (“STT”).

b) The dealers prepared batch files and placed orders around 3:26 pm, opting for the “market rate” and not the “limit rate”. This would mean that these batch orders would be executed at the prevailing market rates in terms of the price-time order matching of the trading system.

c) The total quantity of sell order was four batches each of NIFTY Options for 5700 call options and 6000 put options with a total quantity of 305000 units each as given at Pg. 179 of Appeal Memorandum. While the first batch got traded at market prices (near the last traded price), the subsequent trades resulted in substantially low prices resulting in a total loss of around ₹ 4.71 crores. For instance, for the 5700 strike prices the market price was around

₹ 180+ when the orders were placed whereas orders got executed at different rates between ₹ 178.30 and ₹ 21. Similarly, in the case of 6000 strike price the market was around ₹ 118 whereas, the orders got executed between ₹ 118.05 going down to a price of ₹ 1.30.

d) The appellant faxed a trade cancellation request to the NSE in the evening of September 26, 2013 citing "inadvertent punching error" as the reason for the request. On the same day vide an Email at 5:53 pm, the appellant submitted a trade cancellation request for "erroneous trades executed inadvertently" in the prescribed format. Further, on the same day the appellant filed a criminal complaint with the Crime Branch of Ahmedabad Police stating "fraud and criminal breach of trust by employees of the appellant" (3 dealers as well as head of the Regional Officer, (RO), HNI division of Regional Office of Ahmedabad). Ahmedabad Police asked NSE to enquire into the matter.

e) On September 27, 2013 at 8:51 am the appellant sent an Email to NSE requesting to withhold the payouts to the counter party brokers as the “appellants are initiating further action which will be intimated to you (Respondent) before today afternoon”.

f) On September 27, 2013 the appellant sent a detailed application to the Respondent (NSE) requesting for annulment of the trade carried out on the previous day. In this application it is contended by the appellant that the orders were placed at market rate due to inadvertent negligence of the dealer traders and was not based on the instructions given by the clients. Further, it was claimed that since the NIFTY was not volatile the market price should have been nearer to the last traded price. However, extremely low price at which some of the trades got executed were clearly against the various circulars issued by the Respondent (NSE) and NSE should investigate whether there was any fraudulent activity involved in the matter. Accordingly, the appellant sought annulment of the trades and sought further hearing in the matter and requested that in the interim not to make payout to the counter party brokers. It was also submitted that as per the bye-laws of the Stock Exchange as well as its Clearing Corporation annulment of trade is possible on account of factors as in the case of the trades of the appellant got executed on September 26, 2013.

g) NSE after forwarding the representation of the counter parties to the appellant and after hearing the parties including the counter parties rejected the appellant's application for annulment on May 06, 2014.

h) The appellant filed an Appeal No. 297 of 2014 against this order in this Tribunal.

i) On August 26, 2014 this Tribunal passed the judgement in the matter of ***M/s. Emkay Global Financial Services Limited V/s The National Stock Exchange of India Limited and Others***

(Appeal No. 64 of 2013 decided on August 26, 2014) ("Emkay" for short).

j) On November 16, 2016 this Tribunal remanded the matter to NSE to pass a fresh order in view of the judgement in the matter of Emkay (Supra) as sought by the counsel for NSE.

k) On July 07, 2017 the order impugned in this appeal is passed by the NSE Committee.

3. Shri P. N. Modi the learned senior counsel appearing on behalf of the appellant reiterated the above stated factual positions and further contended that various Circulars issued by the Respondent (NSE) at different points of time had advised the market participants not to place orders in the NIFTY Options Segment at unrealistic prices/ prices which are far away from normal market price/ theoretical price either on account of proprietary trade or on account of their clients. Particular references were made to such Circulars issued by the Futures & Options ("F&O") Segment Division of NSE, dated January 20, 2004, February 22, 2005 the consolidated Circular dated November 25, 2008; the Circular by the investigation

department dated March 23, 2007 and Circulars dated November 10, 2010, April 24, 2012 and August 14, 2013. Based on the content of these Circulars it was canvassed that in the present case when the market price is around ₹ 118+ the appellant cannot expect the market price to go down to a level of ₹ 1.30 when such instructions issued by the Exchange were in operation. It was further contended that as per these Circulars appropriate action should have been taken against the counter parties (brokers) who placed orders in the trading system at abysmally low prices far away from the market price / theoretical price and that too mainly from their proprietary accounts.

4. It was further submitted that the appellant was ready to appreciate the fact that some decline in price is possible and, therefore told NSE when the matter was heard that only trades executed below 50% of the market price need to be annulled, though this would result in some loss to the appellant. Further for such action by certain brokers in placing orders at low prices far away from market price exemplary action should be taken to bring discipline in the market and to promote market integrity.

5. The learned senior counsel for the appellant also took us through the trade logs of the NIFTY Options Contracts traded by the appellant in the few minutes before closure of the trading hours on September 26, 2013 and showed us how price moved drastically in split seconds between 3 digit and single digit ranges and submitted that only the best 5 prices quoted are shown on the trading screen and the appellant would not know what is beneath these best prices shown on the screen. Therefore, the appellant assumed that in the light of the instructions to brokers not to place orders at far away prices failing which disciplinary action would be initiated, prices too far away from what is shown on the trading screen are not in the system. Though, the appellant initially requested cancellation of all impugned trades, later on it was brought down to trades matched at less than 50% of the last traded price / market price which was further restricted to the trades in respect of the 10 respondents in this appeal. Accordingly, it was submitted, that for the genuine mistake of the dealer traders of the appellant by placing a market order instead of a limit order, the bye-laws of the Exchange and Clearing Corporation allow annulment of trade and the present matter is a fit case for invoking the bye-laws for annulling the trades. The appellant also submitted that

out of compulsion the appellant has already settled the matter with 2 respondents (i.e. Respondent Nos. 2 & 3).

6. The learned senior counsel for the appellant heavily relied on the decision of this Tribunal in the matter of Emkay (Supra) and submitted that following the majority order therein impugned trades may be annulled and exemplary action taken against the respondent counter party brokers.

7. Learned senior counsel Shri V. Dhond appearing on behalf of Respondent No. 1 (NSE) submitted that as per bye-law 5 of Chapter VII the Exchange (NSE) the Exchange may by a notice annul the deal(s) on an application by a trading member if the relevant authority is satisfied, after hearing the other party/parties to the deal(s), that the deal(s) is/ are fit for annulment on account of fraud or willful misrepresentation or material mistake in the trade. Thus, there are only these three conditions under which the Exchange may annul a deal. Even under these conditions it is not mandatory to annul the trade. In any case, in the present matter none of these conditions is satisfied. It is a clear case of three dealers and their supervisor placing the orders in the last few minutes of the closing hours of trade on the last trading day of the contracts on September 26,

2013. These contracts had to be closed on that day since it was the last trading day. Approval from the clients for squaring off was taken around 3:20 pm and orders had to be executed before 3:30 pm, the closing time. Therefore, the submission that by mistake the traders/ dealers of the appellant entered the market price option instead of the limit price option is without substance, because, the appellant being an experienced trader in the securities market was fully aware that a large quantity of NIFTY Options which had to be compulsorily squared off that day itself cannot be done by fixing a limit price option. So the choice of the market price option was done deliberately so that the entire quantity would be squared off in that limited four minutes of the remaining trading time, sine the first batch of orders of 20000 (10000 each of 5700 call options and 6000 put options) was placed at 3:26 pm.

8. It was further contended that the Circulars relied on by the appellant are all belonging to an earlier regime. The F&O consolidated Circular dated April 24, 2012 issued by the Respondent (NSE) to all its members clearly states the base price and operating ranges applicable to the contracts and how the theoretical price of such contracts are arrived at by using the Black-Scholes model. It is a complex pricing model for options

pricing and the minimum and maximum prices are decided by this model rather than decided by any manual exercise. Though, subsequently by a Circular dated April 11, 2014 this range has been narrowed and circuit filter introduced, at the relevant time of September 2013 there was no such specification and the range was automatically decided by the said Black-Scholes model. The appellant, like other brokers, was fully aware of this. The submission that they could see only the five best prices available on the screen, though is a fact, the appellant was fully aware that the price could potentially go down up to ₹ 0.05 as per the Black-Scholes based formula.

9. He further submitted that the market price was punched erroneously by the trader-dealers, instead of the limit price, does not stand to scrutiny because of the fact that the appellant filed a police complaint on the same evening alleging fraud and manipulation by his employees in the Ahmedabad Branch Office. Further in another submission the appellant also attributed negligence on the part of the traders in opting for the market price instead of the limit price option. Therefore, there is no consistency in the submissions made by the appellant as to why they opted for the market price option and that too in the last few minutes of the market when they had to sell a large

quantity of NIFTY Options. Every trader would know that on the last trading day and that too in the closing minutes if large quantities are to be squared off the price would fall and, therefore, being an experienced trader the appellant was conscious of multiple layers of prices based on the Black-Scholes model lurking below the five best prices shown on the trading screen. The learned senior counsel for Respondent (NSE) emphasised that the prices of the options premium at the relevant time were decided by the Black-Scholes formula only. There was no additional constraint except some advisory to the participants to trade at prices nearer to the market price. Being an experienced trader, particularly putting through large quantities of contracts, appellant should have exercised the limit price option in case of wanting to avoid far away prices and in the fact of the present matter bye-laws of the Exchange does not allow annulment of such trades.

10. Learned counsel appearing for other Respondent Nos. 4, 5 and 7 also adopted the submissions made by the learned counsel for Respondent No. 1. In addition Respondent No. 7 submitted that it did only client transactions, which was though disputed by the appellant stating that the client is a related party. Respondent No. 5 contended that they did trading through

'Algo' trading which responded to trades already on the screen and their trades did not match at the lowest price. Respondent No. 4 submitted that the orders placed by it were within the price range allowed by the system and those prices were not unrealistic and prices of the Options fall on the last traded day which is the expiry day and in fact as the Options near expiry the option price starts diminishing. Respondent No. 10, though did not appear on the day of final hearing, gave their written views on the above lines.

11. Before proceeding further, bye-law 5 of Chapter VII of the bye-laws of NSE is reproduced below for convenience:-

> *"Inviolability of Trade*
> *5 (a) All the dealings in securities on the Exchange made subject to the Bye Laws, Rules and Regulations of the Exchange shall be in-violable and shall be cleared and settled in accordance with the Bye Laws, Rules and Regulations of the Exchange. However, the Exchange may by a notice annul the deal(s) on an application by a Trading Member in that behalf, if the relevant authority is satisfied after hearing the other party/parties to the deal(s) that the deal(s) is/are fit for annulment on account of fraud or willful misrepresentation or material mistake in the trade.*

> *(b) Notwithstanding anything contained in clause (a) above, the Exchange may, to protect the interest of investors in securities and for proper regulation of the securities market, suo motu annul deal(s) at any time if the relevant authority is satisfied for reasons to be recorded in writing that such deal(s) is/are vitiated by fraud, material mistake, misrepresentation or market or price manipulation and the like.*
>
> *(c) Any annulment made pursuant to clauses (a) and (b) above, shall be final and binding upon the parties to trade(s). In such an event, the trading member shall be entitled to cancel the relevant contracts with its constituents."*

A reading of the above bye-law makes it clear that annulment of trade is resorted to only in rare cases particularly when fraud, willful misrepresentation or material mistake in the trade happens. The submission that error in punching market price instead of the limit price option in the instant matter is a material mistake cannot be accepted because it is evident from record that three different dealers and their supervisor of the Ahmedabad Branch Office were involved in executing the impugned trades and all of them could not have made the same "mistake" or "error" in punching. The subsequent steps taken by the appellant and the reasons given to the Police also indicate that the appellant is not consistent in its submissions. Moreover, it is an undisputed fact that huge volumes of NIFTY Options belonging to the clients had to be squared off by the appellant in the last few minutes before the expiry of the Contracts on September 26, 2013. All these clearly prove that it was not an unintended material mistake or error on the part of the appellant.

12. From the various cited Circulars, particularly Circular dated April 24, 2012, it was very clear that the price range was decided based on the Black-Scholes model where, we are told that the price applicable was in the range of ₹ 0.05 to ₹ 570.10 for NIFTY put Options ₹ 6000 and between ₹ 0.05 to ₹ 687.45 for NIFTY call Options ₹ 5700 at the relevant time. This Tribunal does not propose to judge whether such a range is appropriate or not. However, if that range is what the methodology brings out and if the market had accepted that methodology at the relevant time without challenging the same before an appropriate forum, the same has to be accepted as the appropriate range. All trading members who were doing the trades at the relevant time, therefore, were expected to be aware of the possibility of prices moving within these ranges. We are

also told that along with the best five prices shown on the trading screen the quantities on offer are also available against those best prices. So traders wanting to trade in large quantities had to be conscious of the possibility of matching their trades at prices substantially varying from the five best prices shown on the screen. It is not for this Tribunal to get into the issue of how prices can vary suddenly from ₹ 100 to ₹ 10 or even ₹ 1 within a fraction of a second except restating that the automated trading system of a highly liquid options market is so complex and fast changes in prices based on various factors are expected in milliseconds or even microseconds. In a liquid market, the market moves even within the time when an order is placed and a huge order itself will move prices are known to all experienced traders like the appellant.

13. Reliance placed by the appellant in the order of this Tribunal in Emkay (Supra) is distinguishable since admittedly the NIFTY Index itself moved substantially in the matter of Emkay while in the matter before us the NIFTY did not move at all, a point emphasised by the appellant. Moreover, in Emkay (Supra) it was evident from the facts that the counter parties therein had entered orders violating position limit and margin rules. Coupled with this fact and the abrupt movement in the

NIFTY Index and consequently some traders taking extra advantage of the movement in the NIFTY led to a SEBI investigation. In the present matter, on the contrary, without any movement in NIFTY, because of orders placed at prices far away from the last traded price contrary to the expectations of the appellant, and because of the large quantity of the order placed by the appellant in the last four minutes of trading part of his sell order got matched at low prices as well.

14. Though, certain cautionary Circulars had been issued by the respondent Exchange (NSE) over a period of time asking trading members not to place orders at far away prices from the market price/ intrinsic value, the pricing methodology prevalent at that time was only as per the formula set by the Black-Scholes methodology. This was known to all the market participants in the F&O Segment. There was no circuit filters in existence. Therefore, the only remedy available to trading members to limit loss while placing orders was to accept the limit order route rather than the market order route. It is an admitted fact that the traders of the appellant did not use the limit order route. It is also an admitted fact that a large quantity of NIFTY Options were placed for sell in the last few minutes of the closure of the trading day which was also the expiry day

of the contract. It is also a generally known fact that on the expiry day of a contract prices tend to fall and, therefore, executing large orders will invariably gravitate towards lower prices.

15. We find no merit in the submission of the appellant that the traders of the appellant committed an unintentional mistake in placing a market rather than limit order since all three traders and their supervisor cannot make the same mistake. Therefore, given the facts and circumstances it was a conscious decision taken by the appellant in squaring off the open position of its clients on the last trading day of the contract and that too in the last few minutes before closure of trading. Having taken such a decision the only valid contention of the appellant remains that of expectations regarding the depth of the market and at what level the prices would be moving. Here the price range was set by the Black-Scholes methodology and in the range of ₹ 0.05 to ₹ 570.10 for NIFTY put Options ₹ 6000 and between ₹ 0.05 to ₹ 687.45 for NIFTY call Options ₹ 5700. When a methodology was known to the market participants and as per the methodology price range was set we cannot interfere with such a system in arbitrarily deciding what should be far away prices from the intrinsic value. There were 101 counter parties who all

were aware of the applicable price ranges and placed orders at different prices.

16. We also note that bye-law 5 of the Exchange NSE is essentially about upholding the sanctity of trade since it is on “inviolability of trade”. Accordingly, we agree with the contention that annulment of trade should be resorted to only in extreme cases as specified under this bye-law. Considering all the factors in the present matter, we do not agree with the contention of the appellant that it was a material mistake from the side of the trader / dealers of the appellant and, therefore, we do not agree that the impugned trades are liable to be annulled.

17. However, we note that the Exchange was not very clear when they issued advisories to the trading members that they should not be placing orders at far away prices. It is also noted that such advisories were issued even on August 14, 2013. Similarly, the Circulars dated November 16, 2010 and April 24, 2012, the issue of price range and flexing of price range from ₹ 1 to ₹ 3 etc. is ambiguous. Regulatory instruction, particularly relating to trading and settlement matters should be clear and unambiguous and also clearly stating the consequences of violations. Such violations, if any, also need to be dealt with

appropriately. However, we refrain from issuing any directions to NSE in this regard at this time since by the Circular dated April 11, 2014 greater clarity and certainty have been brought in clearly stating the range within which only trading is possible in the options segment as well.

18. In the result, appeal is dismissed with no order on costs.

Sd/-
Justice Tarun Agarwala
Presiding Officer

Sd/-
Dr. C.K.G. Nair
Member

Sd/-
Justice M. T. Joshi
Judicial Member

10.06.2019
Prepared & Compared By: PK