

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Date of Decision: 15.05.2019

Appeal No. 138 of 2019

IL&FS Securities Services Limited
IL&FS House, Raheja Vihar,
Chandivili, Andheri (East),
Mumbai- 400 072
Maharashtra

...Appellant

Versus

1. Securities and Exchange Board of India,
SEBI Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai - 400 051
2. NSE Clearing Limited
Exchange Plaza, Plot No. C/1,
G-Block, Bandra Kurla Complex,
Bandra (East),
Mumbai- 400 051
3. National Stock Exchange of India Limited
Exchange Plaza, Plot No. C/1,
G-Block, Bandra Kurla Complex,
Bandra (East),
Mumbai- 400 051
4. Allied Financial Services Private Limited
304-305, Vikas Deep Laxmi,
District Center, Vikas Marg,
New Delhi- 110 092
5. Dalmia Cement (Bharat) Limited
11th and 12th Floors, Hansalaya Building,
15, Barakhamba Road,
New Delhi- 110 001
6. Novjoy Emporium Private Limited
2, Rupchand Mukherjee Lane,
Kolkata- 700 025

...Respondents

Mr. Gaurav Joshi, Senior Advocate with Ms. Shruti Rajan, Ms. Garima Joshi, Mr. Aditya Sikka, Mr. Rushin Kapadia and Mr. Vishnu Sumanth, Advocates i/b Cyril Amarchand Mangaldas for the Appellant.

Mr. Rafique Dada, Senior Advocate with Mr. Sushant Yadav, Mr. Nirav Parmar and Mr. Tabish Mooman, Advocates i/b K. Ashar & Co. for Respondent No. 1

Mr. Jitendra Motwani, Advocate with Mr. Vivek Shah, Advocate i/b ELP for Respondent No. 2

Mr. Rashid Boatwalla, Advocate with Mr. Shreya Anuwal, Advocate i/b Manilal Kher Ambalal & Co. for Respondent No. 3

Mr. Somasekhar Sundaresan, Advocate with Ms. Yugandhara Khanwilkar, Mr. Tomu Francis and Mr. Manish Chhangani, Advocate i/b Khaitan & Co. for Respondent No. 5

Mr. Ravi Vijay Ramaiya, Chartered Accountant with Ms. Tanvi Gaitonde, Advocate i/b Zerick Dastur for Respondent No. 6

None for Respondent No. 4

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

Per: Justice Tarun Agarwala

1. The appellant is a clearing member empanelled with NSE Clearing Limited (hereinafter referred to as "NCL"). The appellant is a subsidiary of Infrastructure Leasing and Financial Services Limited (hereinafter referred to as "IF&FS). The Board of IL&FS has been superseded by members appointed by National Company Law Tribunal (hereinafter referred to as

“NCLT”). Allied Financial Services Private Limited (hereinafter referred to as “Allied”) is the stock broker and a member of National Stock Exchange of India Limited (hereinafter referred to as “NSE”).

2. The appellant and Allied executed a ‘Clearing Member-Trading Member Agreement’ dated November 14, 2017 and, in this agreement, Allied was obligated to place the margin with the appellant. Pursuant to this agreement, Allied provided margins to the appellant by way of mutual fund unit’s apart from some cash, as collateral on the basis of which the appellant was clearing the trades of Allied in Futures & Options (F&O) Segment of the NSE. The mutual funds provided by Allied was transferred to the appellant’s demat account and, thereafter, in the approved custodian account of NCL.

3. In December 2018, Allied sold certain Options Contracts on NIFTY in the F&O Segment expiring on March 28, 2019 and June 27, 2019 (“Options Contracts”). It is alleged that as consideration for selling these Options Contracts, Allied received an upfront premium of around ₹ 380 crores and the appellant was required to clear these Options Contracts using these mutual funds.

4. Before these mutual funds could be utilized for clearing the trades of Allied, Securities and Exchange Board of India (hereinafter referred to as “SEBI”) received an interim report from NSE with regard to the irregularities committed by Allied. In this report it was observed that there was non-availability of client’s funds, non-availability of client’s securities, misuse of client’s funds and use of client’s funds to meet proprietary obligations by Allied. Based on this report and other preliminary investigation, SEBI passed an ex-parte interim order dated February 27, 2019 against Allied and other entities issuing a slew of directions restraining Allied from accessing the securities market and desisting Allied from any activity in the securities market and further restraining Allied from alienating any movable or immovable assets. The depositories were also directed to ensure that no debits were made in their demat accounts and the Banks were also directed that no debits were made in their bank accounts.

5. It further transpires that the mutual funds of Novjoy Emporium Private Limited, OCL India Limited and Dalmia Cement East Limited were alleged to be illegally transferred by Allied to the appellant’s demat account as collateral for the margins of Allied. It further transpires that complaint in this

regard was made to SEBI as well as to the Economic Offence Wing (“EOW”) and, therefore, on March 29, 2019 EOW passed an order directing the appellant not to deal with these securities till further orders. It was noticed that the value of these mutual funds are to the tune of ₹ 344.07 crores.

6. If further transpires that the appellant filed a Writ Petition before the Delhi High Court for setting aside of the order of the EOW which petition is pending before the Delhi High Court.

7. The appellant also filed an application dated March 20, 2019 before SEBI praying that SEBI should protect the interests of the appellant as it is a victim of fraud perpetuated by Allied and also prayed that the ex-parte interim order be modified. It was contended that in view of the freezing of the securities it would be unjust to meet the obligations arising out of the Options Contracts with Allied. It was further contended that the settlement of trades have been entered into based on fraudulently transferred collateral which is not in the interests of the securities market and, therefore, prayed that the trades made by Allied be annulled. It was further prayed that pending annulment, SEBI may exempt the appellant from the said options which is required to be squared off before March 29,

2019 and that the appellant may also be permitted to utilize the collateral in accordance with the agreement entered with Allied.

8. SEBI by an order dated March 29, 2019 held that the ex-parte interim order was passed against 11 noticees in which the appellant is not a noticee and, therefore, the appellant has no locus standi to apply for modification of the ex-parte interim order. With regard to the request of the appellant from being exempted from providing mark to market margin money SEBI informed that the matter shall be examined by the concerned department. SEBI also directed that the collaterals have been frozen by the EOW and not by SEBI and, therefore, such de-freezing is not within the purview of SEBI. On the question of annulment of trades, SEBI directed that the appropriate authority is the Stock Exchange in terms of SEBI Circular dated July 16, 2015.

9. The appellant being aggrieved by the said order of SEBI has filed the present appeal praying not only for the quashing of the order passed by SEBI but also praying that appropriate direction be issued for the annulment of the trade undertaken by Allied.

10. We have heard Shri Gaurav Joshi the learned senior counsel for the appellant and Shri Rafique Dada the learned senior counsel for SEBI (Respondent No. 1). We have also heard Shri Somasekhar Sundaresan the learned counsel for Respondent No. 5 and Shri Ravi Ramaiya, Chartered Accountant for Respondent No. 6. While no one appeared for Respondent No. 4, no specific submissions were made on behalf of Respondent Nos. 2 and 3.

11. The learned senior counsel for the appellant submitted that SEBI has committed a manifest error in holding that the annulment of trades can only be considered by the Stock Exchange and that it was not within the purview of SEBI. It was urged that SEBI has wide powers under Section 11 and 11B of the Securities and Exchange Board of India Act, 1992 read with Section 12A of the Securities Contracts (Regulation) Act, 1956 ("SCRA, 1956" for convenience) of which powers can be used even to annul the trades. It was contended that SEBI for reasons best known to them is abdicating its powers in not considering the complaint of the appellant for annulment of trades where in a related matter ex-parte interim order has been passed against Allied and other entities, and where Allied has played a fraud upon the appellant. It was further contended that

the appellant cannot approach the Stock Exchange for annulment of the trade since under the bye-laws made by the Stock Exchange, only a trading member could apply for annulment of the trades. It was contended that the appellant is not a trading member but is only a clearing member empanelled with NCL. It was also contended that the bye-laws of the NCL only contemplated that the clearing corporation may annul a deal only after the relevant authority is satisfied and contended that the relevant authority is none other than SEBI. It was also urged that, in any case, as per the directions issued by SEBI vide its Circular dated July 16, 2015 only material mistakes or erroneous orders could be annulled but where fraud or misrepresentation has been made the annulment can only be made by SEBI. It was also urged that because of the ex-parte interim order, the appellant was vitally affected and, therefore, the finding of the SEBI that the appellant had no locus standi was manifestly erroneous in law. It was contended that the Options Contracts of Allied which was expiring on March 28, 2019 have been squared off by the appellant and that the second Options Contracts will expire on June 27, 2019 and therefore proactive measures are required to be considered immediately otherwise the appellant would become bankrupt. It was, thus, urged that SEBI is required to be proactive and take appropriate

measures immediately as it is not only affecting the appellant but the scam made by Allied will affect the securities market.

12. Shri Dada the learned senior counsel, on the other hand, contended that the plea of the appellant for annulment of the trades is patently misconceived as he is not a party to the contracts. The securities which were given to the appellant as collateral by Allied have been frozen by the EOW against which the appellant has filed a Writ Petition where he is pursuing the matter before the Delhi High Court. It was contended that if a fraud has been committed by Allied the trades which Allied have entered with counter parties cannot be annulled at the instance of the appellant. It was urged that the appellant is obligated to square off the trades of Allied under the Agreement executed between the appellant and Allied. It was urged that if a fraud has been played upon the appellant by Allied such fraud is no ground for annulment of the trades.

13. In the light of the rival stand taken by the parties, it becomes necessary for this Tribunal to figure out as to whether the appellant is entitled to apply for annulment of trades.

14. Section 11 and 11B gives wide powers to SEBI (Board) to protect the interest of investors in securities and to promote the

development and to regulate the securities market. Under Section 12A of the SCRA, 1956 SEBI (Board) has powers to issue directions to any Stock Exchange, Clearing Corporation or agencies associated with the securities market. Section 9 of the SCRA, 1956 gives powers to the Stock Exchange to frame its bye-laws subject to the approval of SEBI.

15. SEBI issued a Circular dated July 16, 2015 giving certain guidelines for annulment of trades resulting from material mistake or erroneous orders and also with regard to annulment of trade resulting from willful misrepresentation or manipulation of fraud.

16. The NSE framed its bye-laws under Section 9 of SCRA 1956 Clause 5(a) of Chapter VII of the bye-laws relates to annulment of trades which is extracted hereunder:-

“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.”

From a perusal of aforesaid provision it is clear that annulment of a trade can either be done suo motu by the relevant authority or on an application by a trading member. The appellant is not a trading member and, therefore, cannot apply under the bye-laws of the Stock Exchange. The direction of SEBI is that the

Stock Exchange deals with the annulment of the trades is incorrect in so far as it relates to the appellant since he is a clearing member and is not a trading member.

17. The appellant is however, a member of the NCL which has also framed its bye-laws. The relevant Clause for annulment of trades has been specified in Clause 5 of Chapter VII of the bye-laws. For facility, the said provision is extracted hereinunder:-

“5. INVIOLABILITY OF ADMITTED DEALS

(1) All the dealings in securities on the F & O Segment of the Clearing Corporation made subject to the Bye-laws, Rules and Regulations shall be in-violable and shall be cleared and settled in accordance with the Bye-laws, Rules and Regulations. However, the Clearing Corporation may by a notice annul the deal(s) on an application by a Clearing 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 deal.

(2) Notwithstanding anything contained in clause (1) above, the Clearing Corporation 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.

(3) Any annulment made pursuant to clauses (1) and (2) above, shall be final and binding upon the parties to deal(s). In such an event, the Clearing Member shall be entitled to cancel the relevant deal(s) with its constituents.”

18. Relevant authority has been defined under Clause 14 of Chapter I, which provision is extracted hereunder:-

“14. RELEVANT AUTHORITY

"Relevant Authority" means the Board, Securities and Exchange Board of India or such other authority as specified by the Board from time to time as relevant for a specified purpose.”

19. The Board and Clearing Corporation have also been defined under Clauses 1 and 5 Chapter I of the bye-laws which are also extracted hereunder:-

“1. BOARD

“Board” means Board of Directors of National Securities Clearing Corporation Limited.”

“5. CLEARING CORPORATION

Clearing Corporation means National Securities Clearing Corporation Limited.”

20. From a perusal of the aforesaid, it is apparently clear that a Clearing Member can apply for annulment of a “deal”. In our opinion such deal mentioned in Clause V will also include trades done on the Exchange platform. The relevant authority to decide the annulment of the deal would be the Board of Directors of National Securities Clearing Corporation Limited (now, NCL) and SEBI. Thus, the contention of SEBI in the impugned order that it is not within its purview to consider the request for annulment of trades is erroneous. SEBI in exercise of powers under Section 11, 11B of SEBI Act, 1992 read with 12A of the SCRA, 1956 has wide powers to consider a complaint with regard to annulment of the trades.

21. However, in the given circumstances, we find that since bye-laws have been framed by NCL in exercise of the powers conferred under Section 9 of SCRA, 1956 therefore, in our

opinion, the appropriate measure is for the appellant to approach the relevant clearing house. In our opinion, the appellant is required to file an application under Clause 5 of Chapter VII of the bye-laws of the National Securities Clearing Corporation Limited for annulment of the trades. A perusal of Clause 5 makes it clear that if there is a willful misrepresentation or material mistake or if there is fraud the relevant authority is empowered to annul the trades.

22. In so far as the freezing of the demat account is concerned, we are of the opinion that SEBI was justified in directing the appellant to approach the EOW. We do not find any error in this regard. We find that EOW has passed an order for freezing the demat account. The appellant is already pursuing the matter before the Delhi High Court. Thus, no order could be passed by SEBI in this regard.

23. In the light of the aforesaid, we dispose of the matter directing the appellant to move an appropriation application under Clause 5 of Chapter VII of the bye-laws of National Securities Clearing Corporation Limited (NCL). If such an application is filed, the said Clearing Corporation will decide the matter at the earliest after hearing all concerned parties.

24. Before parting, the Tribunal observes that the finding of SEBI that the appellant had no locus standi for modification of the ex-parte interim order is erroneous. We are of the opinion that even though the appellant may not be a party in those proceedings but if the appellant is affected either directly or indirectly the appellant has a right to apply for modification of the order. The ex-parte interim order observes that Allied has committed various violations of SEBI bye-laws by misappropriating clients securities which need to be returned. Such securities were given to the appellant as collateral to square off the trades of Allied. In our view, the appellant is an affected party. We thus, leave it as that and hold that in the event the appellant applies for being heard and for protection of its interests the WTM of SEBI cannot deny the opportunity of it being heard.

Sd/-
Justice Tarun Agarwala
Presiding Officer

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

Sd/-
Justice M. T. Joshi
Judicial Member