BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Order reserved on: 26.06.2014
Date of decision: 09.07.2014

Appeal No.130 of 2014

Financial Technologies (India) Ltd.
CTS No. 256 & 257,
Suren Road, Chakala,
Andheri (East),
Mumbai – 400 093 …Appellant

Versus

Securities and Exchange Board of India,
SEBI Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai – 400 051 …Respondent

Mr. Janak Dwarkadas, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Paras Parekh, Mr. Abhishek Venkataraman, Mr. Dhaval Kothari, Advocates for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Mr. Jayesh Ashar, Mr. Mihir Mody, Mr. Pratham V. Masurekar, Advocates for the Respondent.

CORAM: Justice J.P. Devadhar, Presiding Officer
Jog Singh, Member
A.S.Lamba, Member

Per: Justice J.P. Devadhar (Majority View)

1. This appeal is filed by Financial Technologies (India) Limited (FTIL) to challenge order passed by Whole Time Member (WTM) of Securities and Exchange Board of India (SEBI) on March 19, 2014. By that order passed under Section 19 read with Section 11 and 11B of the Securities and Exchange Board of India Act, 1992 (SEBI Act) and Section 12 A of the Securities Contracts (Regulation) Act, 1956 (SCRA)

read with regulation 20(2) and 49 of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 (SECC Regulations), WTM of SEBI has issued following directions:-

> "(a) FTIL is not a 'fit and proper person' to acquire or hold any equity share or any instrument that provides for entitlement for equity shares or rights over equity shares at any future date, in a recognized stock exchange or clearing corporation, either directly or indirectly;
>
> (b) FTIL shall divest the equity shares and/or any instrument that provides for entitlement for equity shares or rights over equity shares at any future date, held by it, directly or indirectly, in MCX-SX, MCX-SX CCL, DSE, VSE and NSEIL within 90 days from the date of this order through sale of shares and/or instruments; and
>
> (c) FTIL and the entities through whom it indirectly holds equity shares or any instrument entitling voting rights in MCX-SX, MCX-SX CCL, DSE, VSE and NSEIL shall cease to be entitled to exercise voting rights in respect of those shares or instruments, with immediate effect."

2. Appellant is in the business of developing technology products to facilitate trading on exchanges such as stock exchanges and commodity exchanges. Shares of appellant are listed on Bombay Stock Exchange (BSE), National Stock Exchange of India Ltd. (NSEIL), Ahmedabad Stock Exchange and Madras Stock Exchange. About 58,000 public shareholders hold about 54% of the paid-up equity share capital of the appellant which is itself a company in which there is a wide spread and substantial public interest.

3. Basic question that falls for consideration in this appeal is, whether it is open to SEBI to conclusively declare that appellant is not a "fit and proper person" to acquire or hold any equity shares in MCX-SX,

MCX-SX CCL, DSE, VSE and NSEIL ('Relevant Entities' for convenience) without any basis of its own to sustain such view, but solely based on order dated December 17, 2013 passed by the Forward Market Commission (FMC) which regulates commodity futures market. In other words, question that falls for consideration in this appeal is, whether SEBI by impugned order is justified in holding that the appellant is disqualified to acquire or hold shares of Relevant Entities under regulation 20(1)(b)(v) of SECC Regulations solely based on order passed by FMC on December 17, 2013 which is yet to attain finality.

4. It is not in dispute that appellant has filed Writ petition No.337 of 2014 before the Bombay High Court to challenge decision of FMC dated December 17, 2013 and on February 28, 2014 Bombay High Court has admitted above Writ Petition but declined stay of operation of the order passed by FMC. Thus, as on date, order passed by FMC on December 17, 2013 holds the field.

5. Regulation 7(2)(c), 19 & 20 of SECC Regulations are relevant for this appeal and those Regulations read thus:-

> "**Consideration of grant of recognition**.
>
> 7.(1)……..
>
> (2) An applicant seeking recognition as a stock exchange or clearing corporation shall comply with the following conditions, namely:—
> (a) ……
>
> (b) ……..

(c) the applicant, its directors and its shareholders who hold or intend to hold shares, are fit and proper persons as described in regulation 20;

(d) to (f)…….

Eligibility for acquiring or holding shares.

19. (1) No person shall, directly or indirectly, acquire or hold equity shares of a recognised stock exchange or recognised clearing corporation unless he is a fit and proper person.

(2) Any person who, directly or indirectly, either individually or together with persons acting in concert, acquire equity shares such that his shareholding exceeds two per cent. of the paid up equity share capital of a recognised stock exchange or recognised clearing corporation shall seek approval of the Board within fifteen days of the acquisition.

(3) A person eligible to acquire or hold more than five per cent. of the paid up equity share capital under sub-regulation (2) of regulation 17 and sub-regulation (2) of regulation 18 may acquire or hold more than five per cent. of the paid up equity share capital of a recognised 11 stock exchange or a recognised clearing corporation only if he has obtained prior approval of the Board.

(4) Any person holding more than two per cent. of the paid up equity share capital of the recognised stock exchange or the clearing corporation on the date of commencement of these regulations, shall ensure compliance with this regulation within a period of ninety days from the date of such commencement.

(5) If approval under sub-regulation (2) or (3) is not granted by the Board to any person, such person shall forthwith divest his excess shareholding.

(6) Any person holding more than two per cent. of the paid up equity share capital in a recognised stock exchange or a recognised clearing corporation, as the case may be, shall file a declaration within fifteen days from the end of every financial year to the recognised stock exchange or recognised clearing corporation, as the case may be, that he complies with the fit and proper criteria provided in these regulations.

Fit and proper criteria.

20. (1) For the purposes of these regulations, a person shall be deemed to be a fit and proper person if—

(a) such person has a general reputation and record of fairness and integrity, including but not limited to—

(i) financial integrity;

(ii) good reputation and character; and

(iii) honesty;

(b) such person has not incurred any of the following disqualifications—

(i) the person, or any of its whole time directors or managing partners, has been convicted by a court for any offence involving moral turpitude or any economic offence or any offence against the securities laws;

(ii) an order for winding up has been passed against the person;

(iii) the person, or any of its whole time directors or managing partners, has been declared insolvent and has not been discharged;

(iv) an order, restraining, prohibiting or debarring the person, or any of its whole time directors or managing partners, from dealing in securities or from accessing the securities market, has been passed by the Board or any other regulatory authority, and a period of three years from the date of the expiry of the period specified in the order has not elapsed;

(v) any other order against the person, or any of its whole time directors or managing partners, which has a bearing on the securities market, has been passed by the Board or any other regulatory authority, and a period of three years from the date of the order has not elapsed;

(vi) the person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force; and

(vii) the person is financially not sound.

(2) If any question arises as to whether a person is a fit and proper person, the Board's decision on such question shall be final."

6. Mr. Janak Dwarkadas, learned Senior Advocate appearing on behalf of appellant submitted that WTM of SEBI was not justified in holding that appellant was not a fit and proper person to hold shares of

Relevant Entities under regulation 20(1)(b)(v) of SECC Regulations for following reasons:-

a. To invoke regulation 20(1)(b)(v) of SECC Regulations, it must be shown first that the order passed by any other regulatory authority has bearing on the securities market. In the present case, no such finding is recorded and hence the impugned order is liable to be quashed and set aside.

b. Impugned order seeks to prematurely inflict far reaching consequences of an irreversible nature on the appellant and its public shareholders based on an order passed by FMC which has not attained finality, because, Writ Petition No.337 of 2014 filed by the appellant to challenge order of FMC is admittedly pending before the Bombay High Court.

c. Appellant holds miniscule and insignificant shares in Relevant Entities which has no bearing on the securities market as that holding is confined only to a limited economic interest and does not entitle appellant to any management control over the Relevant Entities. Therefore, as the holdings of the appellant in Relevant Entities does not have any bearing on the securities market, WTM of SEBI was not justified in invoking regulation 20(1)(b)(v) of SECC Regulations.

d. Appellant's holding in the Relevant Entities has been compliant with all applicable law and their operations have been unblemished. FMC's order dated December 17, 2013

does not relate to any of the Relevant Entities in which the appellant holds shares. There are no other facts or circumstances set out in the impugned order, or any material adduced to demonstrate any wrongdoing by the appellant in its capacity as shareholder in Relevant Entities. Despite aforesaid position, by impugned order drastic consequences of an irreversible nature are inflicted upon the appellant which is totally unjustified.

e. Expression "having bearing on the securities market" under regulation 20(1)(b)(v) read with regulation 20(2) of SECC Regulations contemplate that the order passed by any other regulatory authority must be such an order which is final and conclusive and not subject to any further examination by any superior forum. In the present case, since order of FMC is pending before the Bombay High Court, SEBI is not justified in passing the impugned order.

f. Impugned order proceeds on erroneous footing that the FMC's order against appellant ipso facto has bearing on the securities market. Since order of FMC relates to holding shares in commodities exchange and not stock exchanges, it is absurd to hold that the order passed by regulatory authority under commodities exchange would ipso facto have bearing on holding shares in Relevant Entities.

g. In any event, impugned order does not set out reasons as to how order of FMC has adverse bearing on the securities market on account of shareholding of appellant in Relevant Entities. Without assigning any reasons, SEBI could not have concluded that the decision of FMC would have adverse bearing on the securities market.

h. Although appellant holds 56.24 crore warrants in MCX-SX, those warrants are not eligible for conversion into equity shares, except to the extent permitted under SECC Regulations. Appellant has decided not to convert warrants to the extent permitted or to increase its voting rights in MCX-SX and other Relevant Entities. Further, the board of directors of MCS-SX does not have a single nominee of the appellant. Thus, the management of MCX-SX is independent of any control or influence of the appellant. Appellant does not have any nominee or representatives on board of MCX-SX.

i. Both DSE and VSE are defunct and in fact are completely inactive with no trading taking place. It is possible that these exchanges may in fact seek cancellation of their recognition as stock exchanges by using the exit opportunity provided by SEBI. In these circumstances, regardless of appellant's miniscule shareholding, SEBI is not justified in holding that order passed by FMC would have adverse effect on the securities market.

j. MCX-SX is a demutualised entity under Section 4A of SCRA. Corporate governance structure enforced by SEBI on the Relevant Entities ensure that an order against one of the shareholders do not have any bearing on the entire securities market. If the stand of SEBI in the impugned order is correct, then many trading members of recognized stock exchanges who are also shareholders should have been disqualified by SEBI from holding any shares. Since no such orders have been passed against any broker/trading member, SEBI is not justified in passing the impugned order against the appellant.

k. It is a matter of public knowledge that MCS-SX and NSEIL are in fact competitors. It is also a fact that appellant and NSEIL fought legal battles on certain issues relating to software. Any shareholding in NSEIL's equity share capital in the company of appellant, regardless whether the holding is miniscule, can never lead to the appellant having any say in the functioning and operation of NSEIL. Therefore, it goes without saying that the appellant's holding in NSEIL is wholly irrelevant for the securities market, and therefore, there is no reasonable or rational basis to pass any order in connection with the same.

l. Order passed by FMC, permits appellant to retain 2% shareholding in MCX whereas by the impugned order, appellant is not permitted to retain even one share of

Relevant Entities. Moreover, by impugned order, appellant is debarred from holding shares of Relevant Entities permanently, whereas disqualification under regulation 20(1)(b)(v) is incurred only if three years has not elapsed from the date of the order passed by another regulatory authority. Therefore, impugned order which holds that appellant must divest all shares of Relevant Entities permanently based on FMC order which is yet to attain finality must be quashed and set aside.

7. Mr. Shiraz Rustomjee, learned Senior Advocate appearing on behalf of SEBI, submitted, firstly, that appeal against impugned order is not maintainable because, regulation 20(2) of SECC Regulations provides that if any question arises as to whether a person is a fit and proper person, then decision of SEBI on such question shall be final. Therefore, appeal filed against impugned order is not maintainable. Secondly, regulation 20(1)(b)(v) of SECC Regulations empowers SEBI to declare a person to be not a fit and proper person to hold equity shares in Relevant Entities if that person is declared to be not fit and proper person by any other regulatory authority. Order passed by FMC has bearing on securities market and therefore, no fault can be found with the impugned decision. Thirdly, in the Writ Petition filed by appellant against order of FMC, Bombay high Court has declined to grant stay and therefore order passed by FMC operates as on date. Therefore, no fault can be found with the impugned order passed on basis of order passed by FMC. Fourthly, fact that guidelines framed in relation to commodity

market permit a person declared to be not a fit and proper person to retain shareholding up to 2%, does not mean that person should be allowed to retain shareholding up to 20% in the securities market because there is no such provision under SECC Regulations.

8. We have carefully considered rival submissions.

9. Before dealing with the merits of the case, we propose to dispose of the preliminary objection raised by counsel for SEBI regarding maintainability of the appeal. Section 15T(1) of SEBI Act permits any person aggrieved by an order passed by the Board or by an adjudicating officer to prefer an appeal before this Tribunal. Bar in filing appeal contained in the then prevailing Section 15T(2) or the bar contained in Section 15JB(4) inserted to SEBI Act by Ordinance No.2 of 2014 does not apply to order impugned in this appeal. Therefore, since substantive provision contained in the SEBI Act permits filing of an appeal against impugned order, it is not open to the counsel for SEBI to contend that appeal is not maintainable in view of provisions contained in the regulations, because regulations framed by SEBI cannot override the provisions contained in the SEBI Act. Accordingly, preliminary objection raised by counsel for SEBI regarding maintainability of appeal is rejected.

10. In support of impugned order, Mr. Rustomjee, learned Senior Advocate appearing on behalf of SEBI wanted to rely on facts and reasons set out in the order of FMC on the basis of which it is held that the appellant is not a fit and proper to hold shares of Multi Commodity

Exchange in excess of 2%. We have not permitted Mr. Rustomjee to rely on facts and reasons set out in the order of FMC because, firstly, in the impugned order WTM of SEBI has not relied on facts and reasons recorded by FMC but has relied only on conclusion drawn by FMC. Therefore, it is not open to the counsel for SEBI to rely on facts and reasons which are neither set out nor relied upon in the impugned order. Secondly, question as to whether facts and reasons set out in the order passed by FMC are correct or not cannot be gone into before this Tribunal and in fact that question is raised in Writ Petition No.337 of 2014 filed by appellant before the Bombay High Court. Therefore, counsel for SEBI is not justified in relying on facts and reasons set out in the order passed by FMC for sustaining impugned order passed by SEBI, especially when the impugned order itself does not rely on facts and reasons set out in the order of FMC.

11. Only question therefore to be considered in this appeal is, whether WTM of SEBI is justified in declaring that appellant is not a fit and proper person to hold shares of the stock exchanges in the securities market solely based on order passed by FMC which is the regulatory authority for the commodity market.

12. Ordinarily, order passed by one regulatory authority would bind entities controlled by that regulatory authority alone and would not bind entities controlled by other regulatory authorities. However, it is open to a regulatory authority to frame regulations to apply orders passed by any other regulator to the extent it deems fit. Therefore, in the present case,

question to be considered is, whether order passed by FMC relating to commodity market can be said to be an order having bearing on the securities market under regulation 20(1)(b)(v) of SECC Regulations.

13. Regulation 7(2)(c) and regulation 19(1) of SECC Regulations framed by SEBI under SCRA provide that an applicant seeking recognition as a stock exchange and any person seeking to acquire or hold equity shares of a recognized stock exchange or recognized clearing corporation shall be a fit and proper person. Regulation 20(1) defines expression "fit and proper person" under SECC Regulations to mean a person who has qualities specified in regulation 20(1)(a) and who does not incur any of the disqualifications set out in regulation 20(1)(b)(i) to 20(1)(b)(vii).

14. Regulation 20(1)(b)(v) stipulates that where an order having bearing on the securities market is passed by any other regulatory authority declaring a person to be not a fit and proper person, then that person shall be deemed to be not a fit and proper person under SECC Regulations. Precise question therefore to be considered in this appeal is, whether a person declared to be not a fit and proper person to acquire or hold shares of exchanges in the commodity market can be said to be not a fit and proper person to acquire or hold shares of exchanges in the securities market under regulation 20(1)(b)(v) of SECC Regulations?

15. Object of establishing FMC under Section 3 of Forward Contracts (Regulation) Act, 1952 and establishing SEBI under Section 3 of the Securities and Exchange Board of India Act, 1992 is with a view to

promote development of and to regulate the commodity market and securities market respectively. As regulatory authorities, it is the responsibility of FMC & SEBI to ensure that commodity exchanges and stock exchanges operating within the commodity market and stock market respectively are managed in a sound and prudent manner and shareholders whose holdings are above specified threshold limits or shareholders who exercise material influence on their operations meet the fitness criteria prescribed under the guidelines/regulations framed thereunder.

16. Order passed by FMC, declaring a person to be not a fit and proper person to hold shares of Multi Commodity Exchange can have bearing on the securities market only if the role played by Multi Commodity Exchanges and Stock Exchanges are akin to each other. Therefore it is necessary to find out as to whether the respective exchanges regulated by FMC and SEBI perform functions which are akin to each other or comparable with each other.

17. Distinction between commodity market and securities market is that in the commodity market, commodities such as agricultural products (e.g. food grains) or hard commodities such as gold, iron etc. are traded, whereas in the securities market, securities such as shares, scrips, stocks, bonds etc. are traded. Futures contracts have been the oldest mode of investing in commodities. Futures contracts are traded on Futures Exchanges, whereas, securities are traded on stock exchanges. Thus, underlying asset that is traded in the commodity exchange is

commodities and the underlying asset that is traded in the stock exchanges is securities. Although the underlying assets traded on these exchanges are different, basically exchanges in both markets operate within the wider financial market.

18. Since economy of the country depends upon its financial system, market regulators such as FMC and SEBI regulating trades executed on exchanges regulated by them, have found it necessary to introduce criteria of fit and proper person inter alia for holding shares of exchanges in the commodity market as well as securities market. In fact, guidelines/regulations prescribe eligibility criteria for holding shares of the exchanges operating in the commodity market and securities market in identical terms. Guidelines/regulations framed for both the markets stipulate that no person shall acquire or hold shares of the respective exchanges unless he is a fit and proper person. Definition of the expression 'fit and proper person' is identically worded in the guidelines/regulations framed for persons holding shares of the exchanges operating under the commodity market and securities market.

19. As per guidelines/regulations, a person can hold shares of exchanges operating in the commodity market and securities market, only if he possesses general reputation and record of fairness and integrity including but not limited to financial integrity, good reputation and character and honesty. Guidelines/regulations further provide in identical words that if a person is disqualified to acquire or hold shares of exchanges by an order of regulator which has bearing on their

respective market, then that person shall be disqualified to hold shares of the exchanges regulated by FMC/SEBI. Since there are several market regulators regulating several markets in India, regulation 20(1)(b)(v) refers to order passed by a regulatory authority having bearing on the securities market. Obviously, order passed by FMC would have bearing on securities market, because both FMC and SEBI are regulating trades executed on the respective exchanges which form part and parcel of the financial market system operating in the country.

20. It is not the case of appellant that regulation 20(1)(b)(v) in SECC Regulations refer to orders passed by any other regulatory authority other than FMC. Regulation 20(1)(b)(v) of SECC Regulations cannot be said to refer to orders passed by regulatory authorities in India like Telecom Regulatory Authority of India or Biotechnology Regulatory Authority of India, or Petroleum and Natural Gas Regulatory Board because orders passed by those regulatory authorities are not comparable with the order passed by SEBI in relation to fit and proper person criteria for a person to acquire or hold shares of stock exchanges. Order passed by FMC in relation to fit and proper person criteria for a person to acquire or hold shares of exchanges in the commodity market is comparable with the fit and proper person criteria framed by SEBI for securities market, because, both markets demand high integrity of persons manning the respective exchanges as also shareholders of those exchanges. Therefore, it is just and proper to hold that regulation 20(1)(b)(v) refers to orders passed by FMC. In other words, if a person is declared by FMC to be not a fit and proper person to acquire or hold

shares of exchanges operating under the commodity market, then as per regulation 20(1)(b)(v), that person shall be deemed to be not a fit and proper person to hold shares of exchanges operating under the securities market.

21. Expression 'having bearing on the securities market' in regulation 20(1)(b)(v) of SECC Regulations cannot be construed to mean that the order passed by other regulatory authority must be relatable to a market which is identical to the market regulated by SEBI. When two regulators are regulating two different markets, obviously there would be some difference in the mode and the manner of regulating trades in each market. Therefore, the expression 'having bearing on the securities market' in regulation 20(1)(b)(v) of SECC Regulations, obviously refers to an order passed by any other regulator who regulates trades similar to the trades regulated by SEBI. There can be no dispute that the trades regulated by FMC are similar to the trades regulated by SEBI. Moreover trades regulated by FMC and SEBI are trades which are nothing but different facets of the trades that are operating within the financial market system in India, and therefore order passed by FMC would have bearing on the securities market as provided under regulation 20(1)(b)(v) of SECC Regulations.

22. Argument of appellant that the order passed by FMC has not attained finality and in view of Writ Petition filed against order of FMC is still pending before the Bombay high Court, impugned order which has far reaching consequences must be quashed and set aside is without

any merit. Admittedly, Bombay high Court by its order dated February 28, 2014 has declined to stay operation of the order passed by FMC dated December 17, 2013. Admittedly, above order passed by Bombay High Court is in force as on date and as a result, order passed by FMC operates. Effect of the order passed by the Bombay High Court is that the appellant is obliged to comply with the order passed by FMC. Since order passed by FMC has bearing on the securities market, as stipulated in regulation 20(1)(b)(v), appellant is obliged to comply with the impugned order passed by SEBI. Therefore, argument of appellant that order of FMC would attain finality only after the disposal of Writ Petition pending before the Bombay High Court and till then order of FMC cannot be invoked by SEBI under regulation 20(1)(b)(v) of SECC Regulation is unsustainable.

23. Argument of appellant that its shareholding in the Relevant Entities is miniscule/ insignificant, moreover, that shareholding does not entitle appellant to have any management control over the exchanges and therefore order passed by FMC cannot be said to have any bearing on the securities market is also without any merit. When a person is found to be not a fit and proper person to acquire or hold shares of any exchange then that person cannot hold any share in that exchange. In such a case, whether the appellant holds miniscule or insignificant shares in the Relevant Entities or not and whether appellant is entitled to have any management control over the exchanges or not is wholly irrelevant.

24. In the present case, FMC in its order dated December 17, 2013 has permitted the appellant to hold shares of MCX up to 2%, whereas, SEBI in the impugned order has held that the appellant cannot hold any share of Relevant Entities. Question, therefore, to be considered is, whether SEBI is justified in holding that appellant who is deemed to be not a fit and proper person cannot hold any shares of the Relevant Entities.

25. Perusal of Guidelines dated July 29, 2009 as amended on April 22, 2010 clearly show that under the Multi Commodity Exchanges, no person is entitled to hold 2% or more of the paid up equity capital of the exchanges without satisfying the criteria for 'fit and proper person' as given in Note 2 of Guidelines dated July 29, 2009. No such provision is to be found in the SECC Regulations framed by SEBI. In fact regulation 19(1) specifically provides that no person shall acquire or hold shares of a recognized stock exchange or recognized clearing corporation unless he is a fit and proper person. Therefore, once a person is declared to be not a fit and proper person under regulation 20 of SECC Regulations, then under regulation 19(1) that person cannot hold any shares of recognized stock exchange or recognized clearing corporation. Requirement of seeking approval of SEBI under other sub regulations of regulation 19 are relatable to a fit and proper person acquiring or eligible to acquire shares in excess of the limit prescribed therein. Thus, reading regulation 19 in its entirety, it is evident that a person acquiring or holding equity shares of a recognized stock exchange or recognized clearing corporation should meet the criteria of fit and proper person and

if that fit and proper person acquires or is eligible to acquire shares in excess of the limit specified therein, then he must seek approval of SEBI within the time stipulated therein. In these circumstances, irrespective of the fact that the appellant is entitled to retain shares up to 2% of the Multi Commodity Exchange, under SECC Regulations appellant cannot hold any shares of the Relevant Entities on being declared as not a fit and proper to hold shares of the exchanges in the securities market.

26. Argument of appellant that regulation 20(1)(b)(v) of SECC Regulations refers to an order passed by any other regulatory authority which has become final and conclusive cannot be accepted, because, apart from the order passed in Writ Petition No.337 of 2014 declining to stay operating of order FMC, Bombay High Court has passed another order dated June 13, 2014 in Writ Petition (Lodging) No.1516 of 2014, wherein it is recorded that the appellant in compliance of the order passed by FMC is in the process of completing disinvestment albeit without prejudice to its rights regarding the validity of the order of FMC dated December 17, 2013. If without prejudice appellant is implementing decision of FMC, there is no reason as to why appellant should not do the same thing with reference to impugned order. Object of prescribing identical criteria for a person to be a fit and proper person to hold shares of the exchanges in both markets is because both markets require same standard of integrity. Therefore, it would be totally improper to stay operation of impugned order, till disposal of Writ Petitions, especially when Bombay High Court has declined to stay

operation of the order passed by FMC and appellant has agreed before the Bombay High Court to take steps to implement the order of FMC.

27. Fact that appellant has complied with all applicable law in the past and its operations have been without blemish has no relevance because once a person is deemed to be not a fit and proper person as per SECC Regulations, then irrespective of past conduct that person cannot be permitted to hold shares of the stock exchanges because, very object of SECC Regulation is to take precautionary measures on the basis of order passed by regulatory authority in the commodity market and not to await till such incidence occurs in the securities market. Argument that the order of FMC was in the context of appellant being anchor investor and hence distinguishable is also without any merit because, 'fit and proper person' criteria under SECC Regulation is applicable to all persons and it is irrelevant whether that person is anchor investor or not.

28. Argument of appellant that decision of FMC cannot ipso facto be applied to shareholders of the exchanges in the securities market and without giving any specific reason SEBI could not have held that the order of FMC has adverse bearing on the securities market is also without any merit. As noted earlier, FMC and SEBI regulate commodity market and securities market respectively and both markets are components of wider financial market operating in India. In view of the sensitivity of the role of exchanges in the respective market, guidelines/regulations have been framed so as to hold that a person found to be not a fit and proper person by one regulator, shall be deemed

to be not a fit and proper person by another regulator. In such a case, order passed by one regulator would ipso facto have to be applied by another regulator, because, very object of imposing such stringent condition is to set high standards for the exchanges operating in both the financial markets. Accepting contrary argument of appellant would defeat the object with which SECC Regulations have been framed and any argument which defeats the object with which SECC Regulation is framed cannot be accepted.

29. Various other arguments advanced on behalf of appellant do not survive in view of clear and unambiguous language used in regulation 20(1)(b)(v) of SECC Regulations. Grievance of appellant that SEBI could not have barred appellant from holding shares of exchanges in the securities market permanently is also without any merit. It is true that regulation 20(1)(b)(v) of SECC Regulations empower SEBI to take cognizance of an order passed by any other regulatory authority relating to criteria of 'fit and proper person' which is not more than three years old. In the present case admittedly order passed by FMC is less than three years old and hence no fault can be found with the decision of SEBI. What would be consequences if order of FMC is set aside or the order of FMC becomes more than three years old, is a question that would have to be considered as and when that question is raised by appellant and answered at that stage depending upon the facts prevailing at that time. In other words, fact that subsequent events may entitle the appellant to challenge continuation of impugned order cannot be a

ground to set aside the impugned order at this stage, because, as on date order of FMC operates.

30. Accordingly, we hold that as per SECC Regulations, a person declared to be not a fit and proper person to hold shares of exchanges operating in the commodity market shall be deemed to be not a fit and proper person to hold shares of exchanges operating in the securities market. In such a case, order passed by regulatory authority under the commodity market would ipso facto apply to the securities market.

31. For all the aforesaid reasons, impugned decision of SEBI in holding that appellant shall be deemed to be not a 'fit and proper person' to hold shares of the stock exchanges solely based on decision of FMC cannot be faulted.

32. Appeal is accordingly dismissed with no order as to costs. Since time for disinvestment set out in the impugned order has already expired, we extend time for disinvestment of shares of Relevant Entities held by the appellant by further four weeks from today.

Sd/-
Justice J.P. Devadhar
Presiding Officer

Sd/-
Jog Singh
Member

09.07.2014
Prepared & Compared By: Pk

Per: A S Lamba (Minority View)

1. The appeal has been filed by Financial Technologies (India) Limited (hereinafter referred to as FTIL Appellant) against Securities and Exchange Board of India (SEBI Respondents), regarding Respondent's directions to Appellants for divesting its holding in MCX-SX, MCS-SXCCL, DSE, VSE and NSEIL, after declaring Appellant as not a "fit and proper person" to hold; equity shares, instruments - that provides for entitlements for equity shares or rights over equity shares at any future date; in exercise of powers conferred on Respondent under Section 12A of Securities Contract (Regulation) Act, 1956, Section 11 and 11B of SEBI Act, 1992 and as per regulation 7(2) and 19(1) read with regulation 20(1)(b)(v) of SEBI, Securities Contract (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012.

2. Facts leading to issue of directions by Respondents upon Appellant as per above are:

- ***Appellant is a public limited company, with 58,362 public shareholders - holding 54% of paid-up share capital of Appellant.***
- ***Appellant holds stock in stock exchanges, as under :***

Sl. No.	Name of stock exchange/clearing corporation	Number of shares/ warrants held
1.	MCX Stock Exchange Limited (MCX-SX)	2,71,65,000 shares i.e. 5% of paid up capital of MCX-SX and 56,24,60,000 transferable warrants for which Appellant has undertaken not to exercise option for

		conversion to stocks.
2.	MCX Stock Exchange Clearing Corporation Limited (MCX-SX CCL):	57,50,000 shares i.e. 23% of paid up capital of MCX-SXCCL
3.	Delhi Stock Exchange Limited (DSE)	14,96,500 shares i.e. 4.95% of paid up capital
4.	Vadodara Stock Exchange Limited (VSE)	2,90,000 shares i.e. 23% of paid up capital
5.	National Stock Exchange of India Limited (NSEIL):	10000 shares i.e. 0.0222% of paid up capital

- ***Impugned order of Respondent is on basis of an order passed by another regulator, namely Forward Market Commission (FMC), declaring Appellant as not being a "fit and proper person" in holding more than 2% of share of MCX, which order of FMC has been appealed in writ petition by Appellant before Hon'ble Bombay High Court and has not been decided by Hon'ble High Court, though admitted, but no stay on operation on order of FMC has been granted.***
- ***Relevant legal provisions for consideration is Regulation 20(1)(b)(v) of the SECC Regulation which authorizes Respondent to declare a person not "fit and proper" in terms of Regulation 19(1) of SECC Regulation, in case an order has been passed by any other regulator declaring that person or any of its whole time directors or managing partners of that person, as not fit and proper person, if such order of other regulators "<u>has a bearing on securities market</u>".***

3. With regard to relevance of bearing of such order as above of other regulator on securities market, the following has been submitted by Appellant:

- ***Burden of proof to demonstrate fact of FMC order having bearing on securities market, is on Respondent.***
- ***Respondent has merely proceeded on basis of FMC order and has declared Appellant as not "fit and proper person" in terms of regulation 20(1)(b)(v) of SECC Regulations; without any basis and solely assuming that FMC order operates automatically to declare Appellant as not "fit and proper person".***
- ***Show cause notice issued to Appellant alleged that FMC order has declared Appellant as not being a "fit and proper person" and hence in terms of regulation 20(1)(b)(v) of SECC Regulations, Respondent alleges that FTIL is not a "fit and proper person" to acquire or hold equity shares of recognized stock exchanges or recognized clearing corporations but no ground whatsoever is stated in SCN, substantiating such an allegation.***
- ***An addendum to show cause notice was issued for inclusion of shareholding of FTIL in NSEIL to extent of 10,000 but still no material was furnished to show that FMC order has bearing on securities market.***
- ***FTIL held more than 26% of paid-up capital of NSEL and had anchoring role as promoter of NSEL and hence***

could be held to have control over management of NSEL; but FTIL holds miniscule holding in Relevant Entities (MCX-SX, MCX-SXCCL, VSE, DSE, NSEIL), which is limited economic interest and does not entitle Appellant (FTIL) to exercise any management control over Relevant Entities and thus FMC decision on FTIL has no bearing on FTIL holding shares in stock exchanges or clearing corporation and on securities market.

4. As per order of FMC dated 17th December, 2013 in the matter namely, "Fit and Proper Person Status of FTIL and Others", FMC had concluded that since 30.9.2005, FTIL was holding 99.99% shares of NSEL and possessed effectual and absolute control over its subsidiary NSEL, and since affairs of NSEL were not running satisfactorily as per prudent financial practices or as per rules/regulations of the entity and from 20.8.2013 onwards, and it was observed that NSEL had defaulted substantially in payouts; hence keeping in view, bad state of governance of NSEL by FTIL, FMC issued SCN to NSEL in which mismanagement of NSEL by FTIL was stated and FTIL were asked as to why it should be declared as not "fit and proper person"; in terms of guidelines of Government of India for capital structure of commodities exchange, post 5 years of operation. Based on reply to SCN by FTIL; FMC declared FTIL as person not "fit and proper" to hold more than 2% of paid up capital of MCX, in terms of Government of India's guidelines.

5. At this juncture it may be stated that, the entire impugned order is based on "bearing" of FMC's order regarding MCX on Securities market, to which Respondent has enumerated the following reasons in impugned order:

> "(a) Commodity future exchange and stock exchange basically discharge similar functions and obligations except that the two exchanges deal in different underlyings – physical being the underlying in the stock exchange.
>
> (b) Systems and processes such as trading platform, clearing and settlement are similar in both the markets. Settlement defaults in both the markets pose systemic risk to the respective markets.
>
> (c) The regulatory objective in both the exchanges are same as far as investor protection, market integrity, transparency, fairness and governance are concerned.
>
> (d) Both the markets are connected through substantial number of common stakeholders and flow of finance.
>
> (e) Commodity future exchange as well as stock exchange and clearing corporation are Market Infrastructure Institutions of the financial markets needing the same level of integrity and governance standards."

6. Now coming to examination of question of "bearing" of FMC order concerning MCX, on securities markets; in the light of above reasons cited by Respondents; following is for consideration.

7. It is stated that commodity future exchange and stock exchange basically discharge similar functions and obligations, except that the two exchanges deal in different underlying– physical and commodity being underlying in commodity future exchange and the securities being the underlying in stock exchange.

8. In this context, it may be held that MCX and stock exchanges discharge similar functions in the generic sense since both are exchanges and hence something will be exchanged there but apart from mere similarity of exchange of something; no other similarity is forthcoming in impugned order, in specific terms. Stock Exchange and Commodity Exchange; differ in so many respects, like commodities are traded in future only while stocks are traded in cash (spot) segment and Futures & Options Segment (derivative market); some commodities exchange are based on commodities in ware-houses and its receipts being traded while stock exchanges, trade is based on availability of stocks with investors or its being purchased in future; some commodities exchange trade on availability of goods in warehouses as security whereas stock exchanges trade depends on margin money as security of trade; stock exchanges guarantee settlement of trade on exchange, irrespective of default of buyer/seller and these exchanges have long tradition of honouring their commitment being governed by bye-laws, rules and regulations whereas NSEL was established not long ago, in 2005 only, with no traditions of exchange guaranteeing settlement and NSEL becoming a defaulter from August, 2013, after covering default as rollover since much before that; that Stock Exchanges (BSE & NSE) have grown gradually since their

inceptions and have given good account of themselves, in facing various crisis of economic downturn in recent years, but NSEL grew very rapidly and unrealistically and very foundation of same was not good management or good practices from very beginning. However, it may be mentioned that we are not comparing commodities exchanges, in general, with stock exchanges but NSEL, which is specialized commodity exchange based on goods in physical terms, which is not the case with other healthy commodities exchange, which are functioning well and properly. Recognizing NSEL as representing general commodity future exchange is not a prudent choice and hence comparison as in para 14(a) of impugned order is not proper.

9. Second finding, as in para 14(b) of impugned order, detailing bearing of FMC order on stock exchanges states that system and processes, such as trading platform, clearing and settlement are similar in both the markets and settlement default pose systemic risk to respective markets.

10. Nothing can be far from reality than to say that trading platform of NSEL and Stock Exchange is the same. In NSEL, trading platform extends to warehouses, where main action takes place and receipt of deposit of goods in warehouses, forms basis of trading in commodities on NSEL. However, no such concept of warehouses and its receipt exist in stock exchanges, where shares in de-materialized form are transacted i.e. sold and brought from exchange and trading is exchanges, is through brokers, who form backbone of transactions and each player such as stock exchange, clearing corporation, brokers, investors, etc play their

role, which is regulated and controlled by SEBI as head of regulator and as per bye-laws, rules and regulations of stock exchanges. Even, it is assumed that what is stated in para 14(b) as correct, there is need to show bearing of FMC decisions on functioning of stock exchanges which; is not apparent, clear or forthcoming.

11. Similarly para 14(c), (d) and (e) state that objectives of both exchanges are same, these two exchanges are connected through substantial number of stakeholders and flow of finance and both exchanges are Market Infrastructure Institutions etc. In the first instances, it must be stated that logic in para 14(c), (d) and (e) has not be elaborated for correct appreciation of bearing of FMC order on stock exchange and how reasoning in these paras go to prove that decision of FMC, under consideration, has bearing on stock exchanges.

12. As a matter of fact this question was put to learned senior counsel for Respondent, who read out what was stated in para 14(a) and (e); but did not elaborate on these paras and how logic/reasoning in these paras, show bearing of decision of FMC on stock exchanges, Learned senior counsel was requested to show connection/bearing of FMC ruling on FLIT in MCX, on stock exchanges, but no response could be elicited from him.

13. In fact, as already stated, it was for learned Whole Time Member of Respondent to show bearing of FMC ruling on FTIL in managing affairs of NSEL, a future commodity exchange, on stock exchanges; but learned Whole Time Member has generalized NSEL to commodity

exchanges and spelled “possible” similarities between commodity exchanges and stock exchanges.

14. Another problem with impugned order has been show cause notice dated December 20, 2013, which does not contain any relevant material to prove the changes in SCN. SCN merely stated FMC decision, quotes some regulations and states that since FMC has declared FTIL as not “fit and proper person” and hence FTIL is also not a “fit and proper person” to hold equity shares in recognized stock exchanges/clearing corporation and why directions to this effect be not issued, as per relevant sections of SEBI Act, 1992 and regulations of SRCC Regulation, 2012.

15. FTIL could not have not known on basis of SCN, the reasoning/logic/rationale for SCN and what has to be stated in the reply. However, FTIL did attempt to frame a reply as to their inability to manage affairs of stock exchange and clearing corporation, on basis of their miniscule shareholding in these entities and also tried to explain that FMC ruling on FTIL in matter of NSEL has no bearing on their shareholding in stock exchange/clearing corporations.

16. Before proceeding further I feel constrained to mention, pleading of learned senior counsel for Appellants, who while responding to Respondents pleas in the matter, stated that Appellants wanted to cross-examine forensic auditor, namely Grant Thornton, who had investigated matter of FTIL and NSEL, since FMC has ruled on basis of forensic

auditors report that FTIL is not a "fit and proper person" to hold more than 2% shareholding on MCX; which was not allowed by FMC, on plea that report, under question, has to be presented in Parliament, due to meet in two days. However, on perusal of page 156 to 165 of MOA, it is amply clear that reasonable opportunity was afforded to Appellant to cross examine Grant Thornton, who made themselves available in full strength on date decided by FMC for cross-examination, in consultation with Appellant; but Appellant did not avail of this opportunity. In the circumstances, may be seen it that plea of learned senior counsel in this matter of cross examination of Grant Thornton, is not borne out by facts and learned senior counsel is advised to be more careful in his submissions.

17. Considering totality of matter, it is seen that entire case has been dealt in an un-professional manner and justice has not been done by Respondent in many aspects of the cases, starting with issue of SCN - which does not contain any reasoning and to dealing with the matter in adjudicating proceedings, wherein new reasoning, not contained in SCN, has been introduced, and most important relevant provision of showing bearing of FMC order on FTIL in MCX regarding Appellant's shareholding in stock exchanges and clearing corporations, which is the raison-d'etre of the entire case, has been dealt in a lackadaisical manner without due seriousness or with logical reasoning; resulting in a situation where no purposeful/meaningfulness "bearing" of FCA order to stock exchanges has been brought out or to import declaration of FTIL as not "fit and proper person" by FMC for FTIL to be also not a

"fit and proper person" in matter of shareholding in stock exchanges and clearing corporation. Accordingly, the impugned decision of Respondent is set aside and appeal is allowed.

Sd/-
A S Lamba
Member

09.07.2014
Prepared & Compared By
RHN