सत्यमेव जयते

GOVERNMENT OF INDIA
FORWARD MARKETS COMMISSION
(DEPARTMENT OF ECONOMIC AFFAIRS)
MINISTRY OF FINANCE

ORDER

No. 4/5/2013-MKT-I/B **Date : 17th December, 2013**

In the matter of

"Fit and Proper Person" status of

1. **M/s. Financial Technologies (India) Limited, Mumbai, the anchor share-holder and promoter of Multi Commodity Exchange of India Limited (herein after 'MCX')**
2. **Shri Jignesh Shah, Ex- Director, MCX, Mumbai**
3. **Shri Joseph Massey, Ex-Director, MCX, Mumbai**
4. **Shri Shreekant Javalgekar, Ex-Managing Director & CEO, MCX, Mumbai**

Forward Markets Commission (hereinafter "the Commission") is a regulatory authority set up by the Government of India in accordance with the provisions of section 3(1) of the Forward Contracts (Regulation) Act,1952 (hereinafter "FCRA, 1952") to regulate the commodity futures market. Section 3(2) of the FCRA, 1952 provides for the constitution of the Commission, comprising a Chairman and up to three Members. Presently, the Commission consists of one Chairman and two Members. Section 4 of the FCRA, 1952, *inter-alia*, entrusts the Commission with various functions and section 4A(1) confers upon it the powers of a civil court under the Code of Civil Procedure, 1908 (5 of 1908) in the performance of its functions under section 4 of the FCRA, 1952.

2. Section 6 of the Forward Contracts Regulation Act, 1952 empowers the Central Government to grant recognition to an Association which has made an application under section 5 of the FCRA, 1952, for regulation and control of forward contracts. Accordingly, the Government of India, Ministry of Consumer

Affairs Food & Public Distribution, Department of Consumer Affairs (hereinafter 'DCA') vide letter No. 12/1/2007-IT dated 14th May, 2008 (as amended on 17th June, 2010) issued Guidelines for setting up of a Nationwide Multi Commodity Exchange. At para 5.3 of the said guidelines the framework for shareholding has been provided. Clause (f) of the aforesaid para provides for the revision of shareholding of a Nationwide Multi Commodity Exchange after completion of 5 years of operation in the Commodity Derivatives Market. Accordingly, on 29th July, 2009, the Government of India, Ministry of Consumer Affairs Food & Public Distribution, Department of Consumer Affairs vide letter No. 12/1/2007-IT issued Guidelines on the Equity Structure of National Commodity Exchanges after five years of operation. Clause 4 of the said Guidelines requires that investors in the Exchange must fulfill the criteria for a 'fit and proper person' as defined in Note 2 annexed to the said Guidelines.

3. As per rule 7 (2) (II) of the Forward Contracts (Regulation) Rules, 1954 and the Notification granting recognition to an Association / Exchange, the recognition granted to an Association under section 6 of the FCRA, 1952, is subject to the condition that the Association/Exchange shall comply with such directions as may be, given by the Forward Markets Commission from time to time. In exercise of the powers conferred under Rule 7(2)(II) of the Forward Contracts Regulation Rules,1954 and the condition of the notification granting recognition to National Commodity Exchanges, the Commission has been issuing guidelines and directions from time to time aimed at better governance and transparency for ensuring market integrity, safety and investors' protection.

4. The Commission on 29th February, 2008 issued directions to the National Commodity Exchanges in the form of Guidelines on the Constitution of the Board of Directors, Nomination of Independent Directors and appointment of Chief Executives at the National Multi-Commodity Exchanges. Subsequently, such guidelines have been revised from time to time with the most recent one being issued on 12th August, 2013. **Clause 1.5 and 4.2 of the aforesaid Guidelines stipulate that the persons to be appointed as Directors on the Board of Directors and persons to be appointed as Managing Director / Chief Executive of the Exchange should satisfy the criteria of fit and proper person**.

5. The Multi Commodity Exchange of India Limited (hereinafter "MCX") with its office at Exchange Square, Suren Road, Chakala, Andheri (East), Mumbai – 400 093, is an Association recognised under section 6 of the Forward Contracts (Regulation) Act, 1952 and registered with the FMC under section 14B of the said Act. The MCX is promoted by Financial Technologies of India Ltd. (hereinafter 'FTIL') as the Anchor Investor. FTIL is a public listed company wherein the promoter entities hold 45.63% of its share. The main promoter shareholders of FTIL are as under:-

(i)	La-Fin Financial Services Pvt. Limited	:	26.76%,
(ii)	Shri Jignesh Shah	:	18.08%,
(iii)	Shri Dewang Neralla	:	0.13%.

The **FTIL being the promoter shareholder of MCX and holding 26% equity capital is required to satisfy the criteria of "fit and proper" person as per the Guidelines on Equity Structure of National Commodity Exchanges after five years of operation** issued by the Government of India, Ministry of Consumer Affairs Food & Public Distribution, Department of Consumer Affairs issued on 29th July, 2009 (as amended on 9th July, 2010) read with FCRA/Rules/Other Relevant Guidelines.

6. Among others, **Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar** were on the Board of Directors of MCX . Shri Massey withdrew his consent for re-appointment as Director, MCX in the month of September, 2013 while Shri Shah and Shri Javalgekar resigned from their respective posts as Directors, MCX in October, 2013. Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar, **were required to satisfy the criteria of "fit and proper person" as per the Guidelines on "Constitution of the Board of Directors, Nomination of Independent Directors and appointment of Managing Director / Chief Executives at the National Multi-Commodity Exchanges"** issued by Commission and as amended from time to time.

7. The criteria for a person to be deemed to be a **"fit and proper person**" for becoming a share holder of or / and a Director in a Multi Commodity Exchange recognized under FCRA,1952 as prescribed under the afore-said guidelines are re-produced as below :-

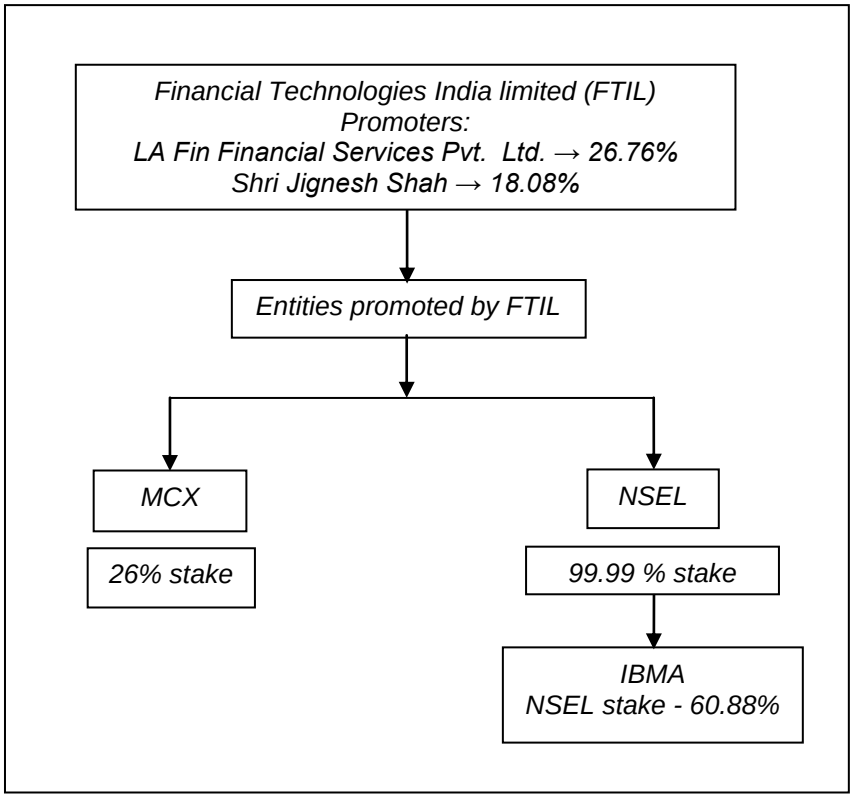
> *"For the purpose of these guidelines, a person shall be deemed to be a fit and proper person if:-*
>
> ***(i)*** ***<u>such person has a general reputation and record of fairness and integrity, including but not limited to –</u>*** *[emphasis supplied]*
>
> ***a)*** *financial integrity;*
> ***b)*** *good reputation and character, and*
> ***c)*** *honesty*
>
> *(ii) such person has not incurred any of the following dis-qualifications :*
>
> *(a) the person has been convicted by a Court for any offence involving moral turpitude or any economic offence, or any offence against any laws;*
> *(b) an order for winding up has been passed against the person;*
> *(c) the person or any of its whole time directors or managing partners has been declared insolvent and has not been discharged;*
> *(d) an order, restraining, prohibiting or debarring the person, or any of its whole time directors or managing partners for dealing in commodities / securities or from accessing the market has been passed by any regulatory authority and a period of three years from the date of the expiry of the period specified in the order has not been elapsed;*
> *(e) any other order against the person or any of its whole time directors or managing partners which has a bearing on the commodities market, has been passed by any regulatory authority and a period of three years from the date of the order has not elapsed;*
> *(f) the person has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force; and*
> *(g) the person is financially not sound.*
>
> *(iii) If any question arises as to whether a person is a fit and proper person, the decision of the Forward Markets Commission in this behalf shall be final."*

8. The Commission had issued Show-Cause Notice (SCNs) vide letter No.4/5/2013-MKT-I/B dated 4.10.2013 to FTIL, asking it to explain, within two weeks of receipt of the notice, as to why it should not be declared as not "Fit & Proper" to be a share holder of MCX for the reasons elaborated in the said SCN. Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar were also issued similar show-cause notices (SCNs) on 04.10.2013 and were directed to explain, within two weeks of receipt of the SCN, as to why they should not be

declared as not “Fit & Proper” to be a Director in MCX. The series of recent events at NSEL revealing gross mismanagement, non-compliance with rules, regulations and with their own bye-laws and the negligence by the promoter and Board of Directors, of all the principles of corporate governance leading to a colossal payment default of about Rs.5,500 crore on NSEL’s trading platform which caused / prompted the Commission to issue the SCN to the above named persons / company, have been delineated in the SCNs, the contents of which commonly apply to all the above-named three persons as well as FTIL. It would be therefore appropriate here to re-produce the relevant extracts of one of such SCNs, in the following paragraphs.

“5. The FTIL is dominant share holder in the case of NSEL, holding 99.99% of shares. Indian Bullion Market Association (hereinafter referred to as ‘IBMA’) is a subsidiary Company of the NSEL, wherein NSEL holds 60.88% shares. NSEL is the holding company of IBMA and FTIL is the ultimate holding company of NSEL and IBMA.

Chart: Showing Shareholding of FTIL in MCX, NSEL and IBMA



6. Events at NSEL:

6.1 DCA in exercise of powers conferred to it under section 27 of the FCRA vide notification no. S. O. 906(E) dated 5th June, 2007 (Copy enclosed as Annexure-IV) had exempted all forward contracts of one day duration for the sale and purchase of commodities traded on the NSEL, from operation of the provisions of the said Act subject to the following conditions, namely:-

a. *No short sale by members of the Exchange shall be allowed;*
b. *All outstanding positions of the trade at the end of the day shall result in delivery;*
c. *The National Spot Exchange Ltd shall organize spot trading subject to regulation by the authorities regulating spot trade in the areas where such trading takes place;*
d. *All information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency;*
e. *The Central Government reserves the right to impose additional conditions from time to time as it may deem necessary and*
f. *In case of exigencies, the exemption will be withdrawn without assigning any reason in public interest.*

6.2. DCA had issued a notification dated 6th February 2012 (Copy enclosed as Annexure-V) substituting the words 'its designated agency' in condition (iv) in para 6.1 above by the words 'Forward Markets Commission, Mumbai', which implies that all information or returns relating to the trade as and when asked for shall be provided by these commodity spot exchanges to the Central Government or the Commission. The Commission had accordingly called for trade data from the Spot Exchanges including NSEL in prescribed reporting formats.

6.2.1 After analyzing the trade data received from NSEL, the Commission identified the following issues relating to contracts traded on NSEL and sought clarifications from NSEL on 22nd February, 2012.

a) *As per the trade data submitted by NSEL, it was observed that 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA.*
b) *The condition of 'no short sale by members of the exchange shall be allowed' was not being met by NSEL.*

The Commission, on examination of the clarification submitted by NSEL on 29th February, 2012, vide its letter dated 10.04.2012 informed the DCA that the NSEL was not fulfilling the conditions (i) & (ii) stipulated under notification dated 5th June, 2007 and requested the DCA to take necessary action regarding the above violations. (Copies of the letters enclosed at Annexure-VI)

6.2.2. DCA vide its letter dated. 27th April 2012 (Copy enclosed at Annexure-VII), directed NSEL to explain as to why action should not be initiated against them for violation of the conditions of the notification dated. 5th June, 2007. In response to the above, NSEL submitted a reply vide their letter dated. 29th May, 2012. DCA vide its letter dated 31st May, 2012, sought comments of the Commission on the NSEL letter dated 29th May, 2012.

6.2.3 The Commission vide its letter dated. 2nd August, 2012 (Copy enclosed at Annexure-VIII), forwarded comments to the DCA, on NSEL letter dated. 29th May, 2012, on the following issues:-

a) *Short Sale by members of the Exchange: From the reply submitted by NSEL vide its letter dated. 29th May, 2012, it appeared that NSEL does not insist upon ownership of goods before allowing its members to place the sale order. The Commission was of the view that all those sale transactions which are not backed by the ownership of goods are in violation of the*

condition of "no short sale by the members of the Exchange shall be allowed".

b) *Contracts in which settlement period goes beyond 11 days period: - In view of the definition of forward contract under FCRA, the Commission was of the view that all the contracts traded on NSEL which provide settlement schedule for a period exceeding 11 days are Non- Transferable Specific Delivery (NTSD) contracts. Thus even if the gazette notification does not specify the delivery period, the NSEL has to settle the delivery for all open position within a period of 11 days as the NSEL was allowed to only trade in one day forward contracts and was obliged to ensure delivery and settlement within 11 days.*

6.3. The Commission vide its letter dated 16th September, 2013 called for the Agenda notes and Minutes of the meetings of the Board of Directors of NSEL. Perusal of the minutes of the meetings of Board of Directors of NSEL, which were received by the Commission on 17th September, 2013 reveal that such trades which provided for delivery and settlement beyond 11 days were first allowed in September 2009 which was ratified by the Board of Directors of NSEL on 16th November, 2009. The Board Minutes dated 19 December, 2009 ratified trading of T+25 contracts. Subsequently, a number of such contracts were introduced on the NSEL.

6.4 It has also come to the knowledge of the Commission from the report of the forensic auditor that a large volume of NSEL exchange trades were carried out with paired back-to-back contracts. Investors simultaneously entered into a "short term buy contract" (e.g. T + 2 – i.e. 2 day settlement) and a "long term sell contract" (e.g. T + 25 – i.e. 25 day settlement). The contracts were taken by the same parties at a pre-determined price and always registering a profit on the long term positions. Thus, there existed a financing business where a fixed rate of return was guaranteed on investing in certain products on the NSEL. This is in contravention to the representation made by NSEL to the Commission in response to the complaint received by the Commission on 4th July, 2012 regarding assured return scheme offered at NSEL. The NSEL vide its letter dated 24th July, 2012 clarified that NSEL does not guarantee assured returns and reiterated the same in its letter dated 17th November, 2012. At NSEL, such paired transactions grew in size year after year as under:

Type of Contract	*2008-09 crores*	*2009-10 crores*	*2010-11 crores*	*2011-1 crores*	*2012-13 crores*	*2013-2014 (April -July 2013)*
Turnover excluding e-series	*763*	*3,359*	*14,032*	*59,981*	*73,390*	*38,520*
Paired Contracts	*0*	*848*	*6,207*	*18,100*	*71,127*	*38,204*
% of Paired contracts to the Turnover	*0%*	*25%*	*44%*	*30%*	*97%*	*99%*

6.5 The internal audit report of NSEL for the period 1st April, 2011 to 30th September 2011 wherein the internal auditor, M/s. Mukesh P Shah & Co., Chartered Accountant in their audit observations pertaining to item A II have mentioned that "NSEL was taking higher risk of credit default as it does not hold any security or line. The activity entail funding of the transactions and the

provisions of NBFC and the Company has not secured any such license as an NBFC for carrying out such activity and in order to avoid the application pertaining to NBFC, the transaction needs to be restructured in the books of Accounts of the Company." ***Copy of the Report is enclosed at Annexure-IX.***

6.6. An article "NSEL product under lens over short selling Charge" was published in the Economic Times on 3rd October, 2012 ***(Copy enclosed at Annexure- X****). In the article, it was stated that DCA had issued a show cause notice to NSEL and is probing into alleged discrepancies in contract position at NSEL. NSEL issued a clarification in October, 2012* ***(Copy enclosed at Annexure-XI)*** *addressed to its members and published the same on its website wherein NSEL stated that it had responded to DCA's Letter dated 27th April, 2012, seeking its comments on short selling and settlement of contracts resulting into delivery beyond 11 days period. NSEL stated that it had submitted its reply to the Ministry and that it was in full compliance with the provisions of FCRA read with the Gazette Notification dated 5th June, 2007. With such wide publicity given to the matter and NSEL's above clarification, the Board of NSEL is bound to be aware of the issue and its seriousness.*

6.7 The Commission was informed in a stakeholders meeting on 15th December, 2012 in Delhi that NSEL was giving misleading information on its website that among others regulated by the Commission also. On 12th February, 2013, NSEL was asked by the Commission to remove the misleading information and NSEL removed the same.

*6.8. DCA vide its letter dated 12th July, 2013 (****Copy enclosed at Annexure-XII****) directed NSEL to give an undertaking that:-*

a) No further/fresh contracts shall be launched by NSEL until further instructions from concerned authority; and

b) All the existing contracts will be settled on the due dates.

In response to the above letter, the NSEL vide its letter dated 22nd July, 2013, submitted the following undertaking:

Undertaking 1:

We undertake not to launch any further / fresh contracts in new commodities and/or at new places till further instructions from concerned authority.

Undertaking 2:

We undertake that we shall settle all the contracts traded on the Exchange on their respective 'settlement due dates', as per contract specification notified by the Exchange.

The Commission on examination of the above undertaking informed DCA vide its letter dated 2nd August, 2013 that the undertaking submitted by NSEL was completely in contrast to the undertaking called for by DCA (Copy enclosed at Annexure- XIII). The Commission had informed DCA that even the futures contracts permitted for trading on Nationwide Multi Commodity Exchanges have a certain 'launch date' as well as an 'expiry date'. Even the contracts launched by NSEL indicate that these contracts are 'daily contracts' as stated in the specifications, whereas in their undertaking, NSEL has taken a different stand

stating that the contracts once launched, are valid and subsisting in continuum without any maturity or expiry. The Commission therefore informed the DCA that the undertaking submitted by NSEL was not in conformity with the directives of the Government.

6.9 NSEL vide its circulars dated 16th July 2013 and 22nd July, 2013 announced the suspension of launching of any new commodity, product or new centre and reduced the settlement and delivery period of existing contracts to T+10 days and made them 'trade to trade' (i.e. no netting is permitted). (Copy of circulars enclosed at Annexure-XIV).

6.10 On 31st July, 2013, NSEL announced that trading in all contracts, (except e-series contracts) was suspended and that it had been decided to merge the delivery and settlement of all pending contracts, and defer the same for a period of 15 days. (Copy enclosed at Annexure- XV)

6.11 On 1st August, 2013, the Commission directed the MD and CEO of NSEL to remain present in the office of the Commission and to furnish the information about the rationale of the NSEL for sudden suspension of trading in all contracts and merging of delivery and settlement of pending contracts, cumulative settlement obligation of all members in buy side as well as sell side, details of the margin/collateral collected by the NSEL from the members, details of physical stocks of commodities lying in the warehouses etc, and the plan of action of the NSEL for meeting the settlement obligation of the open contracts. Mr. Anjani Sinha, the then MD and CEO of NSEL did not submit any information on 1st August, 2013, though he appeared before the Commission that evening. Since the requested information was not furnished by the then MD and CEO, NSEL, the members of the Board of Directors of NSEL were asked to be present before the Commission on 3rd August. 2013 to submit the requisite information. The fact that inadequate and unreliable information was being furnished by NSEL was pointed out to the Board and the Board was asked to ensure that such instances are not repeated. The Minutes of discussion with the Board is enclosed at Annexure-XVI.

6.12. DCA, vide its notification dated August 6, 2013, in partial modification of the Gazette notification dated June 5, 2007, imposed additional conditions on NSEL. It stated that no trading in the existing e-series contracts, and no further or fresh one day forward contracts in any commodity, shall be undertaken by NSEL without the prior approval of the Central Government and that the settlement of all outstanding one day forward contracts at NSEL shall be done under the supervision of the Commission. (Copy enclosed at Annexure-XVII). NSEL suspended the trading in e-series contracts w.e.f. from 6th August, 2013.

6.13. Commission instructed NSEL to open a settlement escrow account for receiving all deposits of pay-in on or after July 31, 2013. Disbursements from this account could be made only with the approval of the Commission. The Commission also deputed its officials to the NSEL to verify the information submitted by the NSEL with regard to its settlement obligations, Settlement Guarantee Fund (hereinafter referred to as SGF) and goods lying at the warehouses. NSEL was directed to disclose on its web-site the information about the stocks of commodities lying in its accredited warehouses. The Commission also directed NSEL to appoint appropriate agencies to secure custody of commodities and to assess the quality and quantity of commodities lying in accredited warehouses of NSEL; ascertain the exact pay in and payout liabilities; devise a formula (in consultation with the Commission) to disburse the amount collected from the buyers to investors/brokers in compliance with the bye-laws of

the NSEL; and advised NSEL to collect funds from the buyers and to initiate default proceedings against the defaulters.

*6.14. The Commission noted from a news report published in the Mint Newspaper dated August 27th, 2013 that the Directorate of Marketing, Maharashtra State Government had suspended the license of private market of NSEL in December, 2012. As per the order of the Directorate of Marketing dated 26th December, 2012 (**Copy enclosed at Annexure- XVIII),** it was observed that "NSEL has failed to exercise its regulatory function in respect of the activities at its terminals and thereby ensuring transparency in transactions". **It states that, "The farmers have to sell their produce to a solitary player i.e. sub-broker, forget about the national reach through on line trading platform as per the condition of license. Even it is not ensured whether a farmer not willing sale his produce can store it at the terminal, as the entire physical infrastructure is owned and possessed by the sub-broker."** The authority concluded that NSEL is not fulfilling the objectives aimed at by the State in view of the Agricultural Marketing Reforms agenda set by the Government of India. Therefore, the license of Private Market issued under the provisions of Section 5 D (4) of the Maharashtra Agricultural Produce Marketing (Development and Regulation) Act 1963 was suspended. The Board Minutes of NSEL however did not reflect knowledge of this development. The Key Management Personnel of NSEL (KMP) are bound to be aware of this development but they did not take appropriate action and also failed to adhere to good accounting principles with respect to disclosures in the financial statements although at various board meetings of NSEL, they have made references to talks with/permission from various state agencies. The DCA, the Commission, and the market participants were kept in dark regarding this important development which brought into question the entire modus operandi of the NSEL.*

6.15. The NSEL announced a settlement plan on August 14, 2013. According to this plan, NSEL had to receive Rs. 5574.35 crore from 24 buyers and to make a pay-out of Rs. 5380.53 crore to 148 members. The settlement calendar announced by NSEL was spread over 30 weeks for pay-out on pro-rata basis to 148 members subject to the condition that the pay-out would depend upon the pay-in by the buyers and the realization of their cheques. In order to have credibility of adhering to the payment schedule agreed to by buyers, NSEL was directed by the Commission to submit details of party wise details of post dated cheques with date, number and amount submitted and also confirm whether they had taken Bank Guarantee from these buyers at least for the first month commitment which shall roll over to next month.

6.16. On August 16, 2013, the Commission pointed out to NSEL that it has the sole responsibility of settlement of trade on the NSEL as per the pre-announced settlement schedule and it cannot simply depend upon the realization of pay-in obligation from buyers.(Copy of the letter enclosed at Annexure- XIX). In this regard, the following provisions of the bye-laws and rules of NSEL were pointed out:-

i. Bye-law No.5.26 heading 'Transaction Where the Exchange to Act as a Legal Counter Party': 'The Relevant Authority of the Exchange may specify from time to time the types of transactions in specific commodity or commodities, with regard to which the Exchange shall act as a legal counter party and the transactions that may be excluded for this purpose."

ii. Bye-law No.7.9.1: "In respect of commodities, or price indices, as may be determined by the Exchange from time to time, and traded and cleared by the Exchange in the manner specified in these Bye-Laws, the Exchange shall be deemed to guarantee the net outstanding financial obligations to clearing members.

iii. Bye-law No.7.9.2: "If any party to such contract defaults in respect of his financial obligations or fails to deliver goods on maturity of the contract, the defaulting member shall be liable for appropriate disciplinary action by the Relevant Authority and his contract will be closed out by the Relevant Authority in accordance with the Bye-Laws, Rules, Business Rules and Regulations or notices, or orders issued there under. The Exchange shall then be entitled to recover dues of any defaulting member from his security deposit and other funds, if any lying with the Exchange."

iv. Bye-law 9.6: "Once a trade is matched and marked to market by the Clearing House, the Exchange shall be substituted as counter party for all net financial liabilities of the clearing members in specified commodities in which the Exchange has decided to accept the responsibility of guaranteeing the financial obligation"

v. Bye-law No. 12.2.3: "The settlement, as a result of multi lateral netting followed by it in respect of settlement of transactions, guarantee financial settlement of the transactions to the extent it has acted as a legal counter party, as may be provided in the relevant Bye-Laws from time to time".

vi. Rule 41 on 'Default' provides that "A member of the Exchange shall be declared by the relevant authority a defaulter, where the monies, commodities, securities and bank guarantees deposited with the Exchange are not adequate to discharge the member's obligations and liabilities. A member of the Exchange being declared a defaulter, a notice of that effect shall be posted forthwith on the notice board of the Exchange and defaulter shall hand over all his books, documents, papers, assets, cheque books and other documents, as may be specified by the Exchange, to the Relevant Authority". Rule 41(i) also provides that "Ipso facto on declaration of a defaulter / deemed defaulter automatically as provided hereinabove, all monies, commodities, securities, bank guarantees lying with the Exchange in respect of a defaulter shall vest with the relevant authority for the benefit and on account of the creditors, who may have a tenable claim and the relevant authority shall deal with such monies, securities or bank guarantees and claims, as provided in the relevant Rules herein and specifically as provided in these Rule".

As per Bye-law 2.68, " Relevant Authority means and refers to the Board of Directors/any Committee of the Board of Directors/any Committee appointed by the Board of Directors, managing Director or any other official authorized by the Managing Director or Exchange or clearing house to take such decisions and/or actions related to operations of the Exchange or clearing house, as may be provided for in the Articles of Association, Rules, Bye-laws, Business Rules, Regulations, Circulars or any Notice or any internal order that may be issued by the Exchange in this regard from time to time."

6.17. Subsequently, NSEL was directed to submit the terms of appointment along with letter of appointment of SGS, a collateral management firm reportedly appointed by the NSEL, to make detailed assessment of quality and quantity of stocks of commodities lying at all the accredited warehouses of the NSEL. NSEL was also directed to appoint a forensic auditors' firm to establish the credibility of books of accounts, record maintenance by the NSEL. NSEL was further directed to inform Commission on daily basis the party wise amounts deposited in the escrow account and also disclose the same on daily basis on NSEL's website.

6.18. Commission pointed out in the letters to NSEL, that it had failed to comply with its direction in timely manner and also had submitted wrong information regarding SGF. As per the Audit Report of NSEL for the year ending 31st March 2013, the figures of SGF has been shown as Rs. 84.66 lakhs (Note no. 35 of the NSEL Audit Report for the year 2012-13). However, in response to the information asked by the Commission, NSEL had given different information on different occasions. For example, in his meeting with Commission on 1st August, 2013, Shri Anjani Sinha, MD & CEO of NSEL informed that NSEL had SGF of about Rs.850 crores, whereas in a written reply to the mail dated 1st August, 2013, NSEL submitted that it had SGF of Rs.738.55 crores. However, during interaction with Board of NSEL, buyer and sellers on 4th August, 2013, it was informed by the then MD and CEO of NSEL in the presence of the Board members that SGF had only Rs. 62 crores.

*6.19. The first pay-out was scheduled on August 20, 2013. NSEL could make a payment of only Rs. 92.12 crore against the scheduled payment of Rs. 174.72 crore. The Commission vide its letter dated 20th August, 2013 (**Copy enclosed at Annexure-XX**) asked the Board of Directors of NSEL to take complete responsibility for the completion of settlement of all outstanding trade at NSEL or else the status of the members of Board of NSEL as a "fit and proper" person would be at risk. NSEL was also directed to auction the commodities lying in its accredited warehouses in the custody of the NSEL as collateral on the NSEL platform as per the bye-laws and rules of the NSEL.*

6.20. It is observed that, the NSEL has defaulted in all the six payouts since the announcement of this settlement plan as would be evident from the details as below:-

Date of Payout	*Amount to be collected from buyers & to be disbursed to the Members as per the settlement plan*	*Amount actually disbursed*	*Short fall*
20.08.2013	*Rs.174.72 crores*	*Rs.92.12 crores*	*Rs. 82.60 crores*
27.08.2013	*Rs.174.72 crores*	*Rs.12.60 crores*	*Rs.162.12 crores*
03.09.2013	*Rs.174.72 crores*	*Rs.15.37 crores*	*Rs.159.35 crores*
10.09.2013	*Rs.174.72 crores*	*Rs.13.46 crores*	*Rs.161.26 crores*
17.09.2013	*Rs.174.72 crores*	*Rs. 8.58 crores*	*Rs.166.14 crores*
24.09.2013	*Rs.174.72 crores*	*Rs.11.45 crores*	*Rs.163.27 crores*

7. NSEL was granted exemption u/s 27 of FCRA for forward contract of one day duration for sale and purchase of commodities. This was with an intention to develop electronic nation-wide spot exchange in commodities. As such NSEL should have resorted to proper trading, risk management, warehousing and Membership system. However various short comings have been noticed in its functioning which are summarized under various heads as under:

7.1. Warehousing:

As per procedure laid out by NSEL under its circulars, participants have to comply with following procedure for the warehouse transaction: For example, in Raw Wool contracts, Members and their respective clients willing to deposit commodity (Raw Wool) in the NSEL Warehouse or NSEL accredited warehouse were required to give at least 1 day prior intimation to the warehouse for necessary storage arrangements. The commodity was required to reach the warehouse latest by 2.30 PM on any working day before executing trade. On the date of deposit of commodity in the warehouse, the goods had to be brought by the depositor and deposited in the warehouse for 'PRE-CERTIFICATION' along with a duly filled in Commodity Inward Document (CID) in the prescribed format. In case the respective clients of the member had already purchased / deposited the commodities in the warehouse, the concerned member through whom they had sold the commodity was required to give only the warehouse receipts (WR) / NOC of allocated WR for tendering the WR against Sale. At the time of deposit at the warehouse, the seller trader was required to submit a proof of ownership of stock through invoice of the commodity to NSEL. The depositor was to get only the photo copy / scan copy of WR and the original WR was to be retained by the NSEL for transferring it to buyer upon the onward sale by the depositor. The depositor could sell the commodities on any day after obtaining the copy of the WR. The members were free to sell it in normal market or through the negotiated deal entered into with any other member of NSEL. On the date of pay-in, the seller was to intimate NSEL the exact WR, which he intends to tender against his obligation through the member. On receipt of the intimation before the scheduled pay-in time by NSEL, the pay-out was to be made by NSEL and the WR was to be transferred to the buyer after due endorsement subject to their completion of funds pay-in obligation. However in actual practice in force at NSEL, forensic auditor has made the following findings:

7.1.1 "In reference to the short term contracts, the Seller at the time of engaging in the** trade **submitted an Offer letter to the NSEL. Such an offer letter was a declaration by the Seller member that they have the physical custody of the underlying collateral stock in reference to the trade. Once the stock was deposited in the NSEL approved warehouse and underwent the necessary quality and quantity tests, a Commodity Inward Document was issued. Following day, the NSEL issued the Warehouse Receipt (WR) and a copy of the same was dispatched to the Buyer to take delivery of the stock on settlement. Such a WR receipt was the proof of the Buyer having met his obligation and having a right of ownership to the underlying stock. Based on discussion of forensic Auditor with the employees of the warehouse management team of NSEL, while the above mentioned process of issuing of WR was followed for all short-term contracts, no such process was adopted for long-term contracts."

7.1.2. "For long term trades the NSEL did not carry out any diligence on the offer letter from the Seller or maintain adequate documentation to support the existence of the stock at the designated warehouses. There is an absence of documentation for the proof of any inward or outward movement of the stocks from the warehouses, which raises doubts on the very existence of the stocks which were the collateral to the trades being executed at the NSEL."

7.1.3. " Stock in relation to such transaction was being reflected to have been held in specific earmarked warehouses for long-term contracts – the Electronic Warehouse Delivery and Management System (eWDMS) system

had specific code assigned to raise WR in relation to such contracts. There are approximately 47 of such warehouses identified in the system."

7.1.4. "As per the eWDMS system for warehouse management, at the time of generation of the WR receipt for the Buyer as the stock ownership document 'ORIGINAL' was printed on the face of the WR; all subsequent WR receipts printed via the system were marked 'DUPLICATE'. As per the Forensic Auditor's review of the WR raised in the eWDMS system it was found that no prints of the WR was initiated and hence, not delivered to the Buyer."

7.1.5 "Before, January 2013, on the completion of the trade (all financial obligations being met) the delivery notes were issued by the NSEL on the request of the Buyer to take the actual delivery of the commodities underlying a trade. However, for trades highlighted above no delivery note was being issued which further corroborates the fact that the Buyers for such long-term contracts did not enter the trade in reference to the commodity trading."

7.1.6. Lack of due-diligence and control over warehouses: The forensic auditor noted that ***"NSEL did not carry out any due diligence to establish the existence of stock at member managed warehouses, upon which trades were being executed. The NSEL did not have or exercise any effective controls to manage the commodity stocks as the collateral to the trades executed on the NSEL. The lack of controls is manifested in the form of standalone IT systems being maintained which were neither integrated at any stage nor a reconciliation exercise was carried to reconcile the data on different systems."*** *Forensic Auditors were informed that such systems did not support any management information system (MIS) reports which would give visibility on the actual commodity stocks supporting the trades. These are not isolated cases of poor governance but a deliberate ploy by a technology driven parent company (FTIL) to facilitate these wrong-doings with full knowledge of directors, promoters and the holding companies.*

7.1.7. Warehouse sans stocks: At the time of the site visit to the selected warehouses, forensic auditor noted that ***"no documentation has been maintained at the warehouse site in reference to the delivery, quality and quantity checks and dispatch of the stocks indicating that such stocks were neither deposited in the warehouses nor the Buyers to the trade took delivery for the contracts executed. Further, NSEL had not implemented the process to verify if the physical stock maintained at the member controlled warehouses actually existed. The NSEL has no process of verifying that the goods in some of the member owned warehouses are not pledged with any banks, an essential element to establish the unencumbered title of stocks to meet the obligations."***

7.1.8. ***"The absence of any documentation in relation to the warehouse activities for long term trades indicates*** *such* ***contracts were not guaranteed by the stocks in the warehouse. All these warehouses identified were customer managed warehouses; the underlying collaterals were not in the custody of NSEL. Undertaking of the long-term trades by the members of the NSEL was not backed by the underlying collateral led to NSEL acting as a platform for financing."***

7.2. Three sets of information were given by NSEL to the Commission in respect of the goods lying at the accredited warehouses of NSEL as collateral in a short

*span of seven days between 1st to 7th August. Now the forensic auditor in their report has also confirmed that NSEL had given wrong information to Commission. To refute the media coverage on the storage capacity in respect of castor seed and castor oil, NSEL issued a public advertisement in leading news paper confirming the declared storage capacity at Kadi village. NSEL in its press release dated 21st July, 2013 stated that there were 6 Silos (50,000MT),3 warehouses (50,000 MT) and open storage space of 60,000 sqft (20,000MT) for NSEL at Kadi, Gujarat, the combined storage capacity of NSEL at Kadi is 1.20 lac MT. It further stated that the current stock position for NSEL at Kadi is 1.04 lac MT (for 6715 participants). However as per the findings of the forensic auditor, the total capacity of the small Silos (2 Silos) were 2500 MT each and the capacity of a Big Silo on-site was 10,000 MT which totals to 15,000 MT of maximum Castor Seeds capacity. This is significantly lower than the expected tonnage of Castor Seeds traded (96,581 MT). It was also observed that the capacity of the Castor oil tanks (3 Tanks) were 1200 MT each which totals to 3,600 MT maximum capacity for Castor Oil. This is significantly lower than the expected tonnage of Castor oil traded (7,553 MT). It was further observed that the total capacity of Tanks (2 Tanks) is 2,000 MT each which totals to 4,000 MT for Cotton wash oil which is very low as compared to stock quantity shown available on website. (**Copy of press release is enclosed at Annexure-XXI**).*

7.3. An interim report regarding inspection of warehouses by SGS has been received from the NSEL. SGS has reported that as against the total value of stock reported by NSEL of Rs. 2389.36 crores lying in 16 warehouses, the physical verification has shown that the commodity lying in these warehouses was about Rs. 358 crores only. Besides these 16 warehouses, 22 warehouses were visited by their team but could not be inspected as the SGS inspection team was not permitted to inspect these warehouses.

7.4. The Commission received a copy on 22nd August, 2013 of the report of a Survey conducted by the Income Tax Department on 23rd May, 2013 at M/s ARK Imports Ltd, a member of NSEL which found discrepancies in quantity and quality. It found that as against the declared stock of 11760.5 MT of raw wool in 2 godowns, the actual stock was 3152.6 MT. There was also discrepancy in the quality of raw wool. The NSEL and its Board is bound to be aware of this very important development in which a Government agency had found huge shortages and quality issues in the NSEL accredited godowns. However, no cognizance of such a critical development was taken and this information was not disclosed to the market participants.

7.5. RISK MANAGEMENT: -

NSEL should have adopted proper risk management system in compliance of their bye laws to ensure settlement of all contracts as per the schedule. It should have collected adequate capital and margins to protect against the financial liability of a member. However in practice, NSEL had not adopted adequate risk management measures but also compromised on its actual implementation. The facts gathered by the forensic auditor indicate that the Board of Directors was in complete knowledge of the facts leading to the settlement default. Some of the instances pointed out by forensic auditor are as under:

*7.5.1. Risk Management shown the door to favour defaulters: "**As per the NSEL rules, a member who does not have sufficient collateral/ monies etc. to discharge his obligations would not be allowed to trade further. This rule was overridden on a recurring basis. Further, despite repeated defaults members were allowed to trade and increase their** exposures**. For example,***

Lotus Refineries had defaulted, as per the Rules of the NSEL, on 198 days during the fifteen month period of 1 April 2012 and 30 July 2013."

7.5.2. "Members who were in a *default* ***position or who had exhausted their margin limits on trading were granted an exemption from margin requirements and thus allowed them to increase their exposure by engaging in new trades. More than 1,800 margin limit exemptions were granted between 2009 through to 2013."***

7.5.3. "Approvals for increase in margin limits were not supported by any documentation evidencing request from members along with the reasons. The approval sheet (blue sheet) was not member specific, capturing the request, reasons, and linkage to the past credit / payment history of the member. Consolidated approval sheet for each day for all the members were prepared, without any supporting back-up documentation."

7.5.4. *Board allows repeated defaulters to trade without margin money:* ***"As per the rules of the NSEL (Mentioned at Para 6.15), if a member defaults (for example due to a delivery shortage), then the member is not permitted to conduct further trading until the outstanding dues/receivable is settled. However, several members appear to have defaulted on their exchange obligations on numerous occasions. The list of top five such members include defaulting members such as N.K. Proteins Limited and Lotus Refineries Pvt. Limited. Thus, the conduct of business at NSEL is in violation of its own rules which undermined risk management at the NSEL. Ineffective monitoring controls and recovery mechanisms for defaulting members were in place. Several members have defaulted on their Exchange obligations (funds pay-in) on numerous occasions. However, no action was initiated against these defaulting members and neither their trading rights restricted / revoked."*** *NSEL should have declared such members as defaulters and auctioned the goods lying in the warehouses. The Board deliberately did not do so despite clear bye laws and rules of NSEL and knowing their specific responsibility. This shows the complacency of the board that they were aware of the fact that no commodities were lying as collateral in the accredited warehouse of the NSEL and to protect the defaulters, parallel loan arrangements were being made with the approval of the Board as in the case of N.K Protine., Lotus refineries*

7.5.5. *Poor Clearing and Settlement System:* ***"NSEL appears to have a number of stand-alone systems, with no data migration facilities, even for critical operations. No reconciliations are*** *performed* ***where manual intervention is required between critical stand-alone systems. For example, the system for generating warehouse receipts (which are trading instruments) requires manual input in the clearing and settlement (CNS) system, i.e. the exchange. This indicates significant lapses in the processes involved in business operations with virtually no checks and controls in place. System controls and checks configured for controlling the margin limit can be overridden by manual interference by NSEL Admin team. Manual override of system controls could facilitate grant of additional margins without requisite / nil underlying collaterals. Member creation in CNS system is an editable field and also does not restrict back-dating."***

7.5.6. *Misutilisation of Margin Money Account:* *"****The funds of the initial margin account were utilized for meeting the Exchange obligation for defaulting members and financial obligations of the other business operations in contravention of the Rules of the NSEL which do not allow the utilization of***

such money besides meeting member obligations. FTIL, parent company of NSEL has raised concerns with respect to such utilization of the Initial margin money account." *This indicates that the management of both NSEL & FTIL were aware about this fact. For example, on 28th March, 2013, Rs 236.5 crores was withdrawn from the Settlement Fund in order to fund NSEL's own business overdraft account."*

7.5.7 ***"In the Trading system, a member can trade beyond the limit e.g. a member that has utilized 95%*** *of* ***the margin limit can execute a trade of any size breaching the margin limit up to the max-single-value transaction defined in the contract. Further, system controls like 'Max-Single-Transaction Value', 'Max-Single-Transaction quantity' are not configured to restrict exposure. "***

7.5.8 ***Roll over was allowed to buyers though they had defaulted huge amounts multiple times. As a result, his exposure kept on increasing every year by 20-25% due to*** *impact* ***of roll over cost and exchange fee."*** *An unpermitted financing scheme was being run on the NSEL platform wherein the NSEL was allowing the defaulting buyers to get more money and fresh money was being brought in to ensure that the earlier members are not exposed. The market participants and general public as well as the Government were kept completely in the dark by the Board and Management of NSEL on his critical issue.*

7.5.9 ***"There was no correlation between trading exposure limit allowed to members and the member's net worth. The member's payment capacity, credit score, track*** *record****, etc. are not factored in determining the trading exposure limit."***

*7.6. MEMBERSHIP: NSEL had laid out criteria for enrolment of members from time to time . "****25 buyers were introduced on the NSEL Platform over a period of last 4 years. No due diligence of these buyers was done and buyers with very poor credentials had been introduced into*** *the* ***NSEL system."*** *forensic auditor have made following observations on membership in NSEL:*

*7.6.1. Membership allotted to applicants and activated without proper KYC documentation: In their report, the forensic auditors have observed that "****Exceptional approvals have been granted to a few parties where one or more required documents were not available and/or membership applicants were in violation of bye-laws. However, the grounds for granting exceptional approval have not been documented in any cases. E.g. Loil Continental Food Ltd, Loil Health Foods Ltd and Loil Overseas Foods Ltd., are three companies that had a common director named Balbir Sinha. This is in contravention of Rule 33 of NSEL Rules. Exception approval note was approved by V Gopinathan (AM – Membership), Santosh Mansingh (AVP - Marketing operations), Amit Mukherjee (AVP- Business development) and Anjani Sinha - MD & CEO."***

*7.6.2. Members were activated without exceptional approval even though some KYC documents were incomplete: "****In the cases of Mohan India Pvt. Ltd., N K Proteins Ltd, Sankhya Investments, Yathuri Associates, Namdhari Food International Pvt. Ltd, Tavishi Enterprises Pvt. Ltd., Shree Radhey Trading Co, Metkore Alloys & Industries Ltd and Topworth Steels & Power Pvt. Ltd. routine approvals were granted even in cases where one or more necessary KYC documents such as identity proof, address proof, auditor certificate,***

shareholding pattern, details of promoter group, Memorandum of association, Articles of Association, Net worth certificate, etc. were not available. In certain cases, members have paid less than the required security deposit, however the same was not backed by an 'exception' approval and members got approved in ordinary course. e.g. In the cases of Loil Continental Food Ltd., Loil Health Foods Ltd. and Sankhya Investments, amount of security deposit was partially received."

*7.6.3. No monitoring was done post activation of member to ensure adherence to NSEL's rules and guidelines: The forensic auditor further observed that "**no evaluation is conducted based on annual compliance documents collected from members. In the absence of effective monitoring, no penal actions have been initiated against members not submitting / delayed** submitting **the required documents. No member has ever been debarred / deactivated by the NSEL on any such grounds**."*

7.6.4. The Minutes of the proceedings of the Board Meeting of the Board of Directors of NSEL held at 3:00 pm on 19th December, 2009 was ratified at Agenda Item No. 5 of the Board Meeting of FTIL held on 29th January, 2010. The FTIL Board Meeting has taken note of the "minutes of the Membership Committee" of NSEL which mentions that the "list of members admitted was noted and confirmed". Clearly, the Board of FTIL including Mr. Joseph Massey, Mr. Jignesh Shah and Mr. V. Hariharan were (who were also present in the NSEL Board Meeting) in full knowledge of the members being admitted at NSEL. Hence, the responsibility of granting membership of NSEL without due diligence and proper KYC documentation, even in accordance with NSEL's own laws/ bye-laws falls squarely on these 3 Directors of NSEL above and all on FTIL Board.

8. Corporate Governance and related party transactions:

8.1. Section 211 of the Companies Act, 1956, requires that every profit and loss account and balance sheet of a company shall comply with the accounting standards. For the purpose of Section 211, the expression "accounting standards" means the standards of accounting recommended by the Institute of Chartered Accountants of India. The Ministry of Corporate Affairs, Government of India, has vide notification G.S.R. 739(E) dated 7.12.2006 prescribed that every company and its auditor(s) shall comply with the Accounting Standards 1 to 7 and 9 to 29 as recommended by the Institute of Chartered Accountants of India in the preparation of its General Purpose Financial Statements. As per Accounting Standard 18 issued by the Institute of Chartered Accountants of India, the term 'key management personnel' has been defined as follows:- Key management personnel means those persons who have the authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. It is observed from the Annual Reports of NSEL for the period from 2005-06 to 2012-13, that the following were the key management personnel (KMP):

Year	*Key Management Personnel*
2005-06	*Mr. Jignesh Shah, Mr. Joseph Massey, Mr. V. Hariharan*
2006-07	*Mr. Jignesh Shah, Mr. Joseph Massey, Mr. V. Hariharan*
2007-08	*Mr. Jignesh Shah, Mr. Joseph Massey, Mr. V. Hariharan, Mr. Shankarlal Guru, Mr. B. D. Pawar*
2008-09	*Mr. Jignesh Shah, Mr. Joseph Massey, Mr. V. Hariharan, Mr. Shankarlal Guru, Mr. B. D. Pawar*
2009-10	*Mr. Jignesh Shah, Mr. Joseph Massey, Mr. V. Hariharan, Mr. Shankarlal Guru, Mr. B. D. Pawar*

Year	*Key Management Personnel*
2010-11	*Mr. Jignesh Shah, , Mr. V. Hariharan, Mr. Anjani Sinha*
2011-12	*Mr. Jignesh Shah, Mr. Anjani Sinha*
2012-13	*Mr. Anjani Sinha*

Since Annual Reports have to be approved by the Board, clearly the KMPs were ratified by the Board itself.

As per the above definition, the responsibility for planning, directing and controlling the activities of the company (NSEL) has been placed on the KMP. However, it is observed that the KMP of NSEL over the years have failed to meet their responsibilities with respect to planning as is evident from the fact that:

i) As per the exemption granted under Section-27 of the FCRA, only one day forward contracts were permitted, whereas paired contracts were being run on NSEL since September, 2009.
ii) NSEL instead of carrying out the functions of the Exchange which was to provide an electronic platform for spot transactions had increased its activities to being a service provider, i.e. warehousing, financing, buying and selling etc and taken the important function of warehousing on itself.
iii) No due diligence was done in the selection of members.

Similarly with respect to directing and controlling, the KMP have failed to meet their responsibilities as is evident from below:-

i) There have been serious lapses in the control of warehousing system with the stocks not been as reported.
ii) IBMA, a subsidiary of NSEL was allowed to trade and which became the top member of NSEL.
iii) The defaulters were given more and more time to bring in funds whereas Rule 28 of NSEL provided for debarment of defaulting members. On the other hand, NSEL allowed and facilitated continuous trading by the defaulting members allowing them to receive more and more funds through the Exchange without verification of goods in the warehouses.

8.1.2 <u>Financing of Defaulters</u>: It is thus observed from the above that during the period from 2005-06 to 2011-12, Shri Jignesh Shah, was one of the Key-Management Personnel. Buyers with poor credentials had been introduced over last 4 years period and the default had started in 2011-12 itself. It is also observed that all Key Management Personnel (except Shri Jignesh Shah, Director & Shri Anjani Sinha, former MD & CEO NSEL) have ceased to be KMPs since year 2011-12 when the default had started indicating that such KMPs may be aware of the irregularities on NSEL. Shri Jignesh Shah also ceased to be KMP in the year 2012-13 for which no reason has been given, which is ostensibly meant to distance himself from NSEL when things had totally out of control during this period and is also evidence of the concerned person(s) abdicating his/their responsibility.

8.1.3. <u>Active involvement of all Directors including Shri Jignesh Shah:</u>

8.1.3.1 As per the Minutes of Meeting held on 18th July, 2011 Shri Anjani Sinha was appointed as MD & CEO for a period of 3 years w. e. f. 18th July, 2011. Prior to that he had worked as COO in 2007 (till 11th June, 2008) as CEO (from11th June 2008 till 18th June 2009) again as COO (from 18th June 2009 to 31st March 2010) as CEO (from 31st March 2010 till 18th July 2011). In fact, in the Board meeting held on 25th May, 2011, Shri Jignesh Shah, and all other members of the

Board complemented Shri Anjani Sinha, for the performance of the company for the year 2010-11while approving the annual accounts for the year ending 31.03.2011. In the Board meeting held on 30th March, 2012, Chief Financial Officer of NSEL placed before the Board the performance of the NSEL for the period April 2011 to February 2012 indicating a PBT (Profit before tax) growth by 1149% and PAT (Profit after tax) growth by 953% compared to F.Y. 2011. It was also informed in the meeting that during the period from April 2011 to Feb. 2012, NSEL clocked a total volume of Rs.258,556 crores till February 2012 with an average daily volume of Rs.904 crores and on March 26, 2012, NSEL recorded the highest ever turnover of Rs.2482.88 crores. It is also mentioned in the Minutes that the Board opined that it was a good turn around as compared to last year's performance and applauded the performance of the Company and congratulated Shri Anjani Sinha and his team for the same. This clearly shows that the Board of Directors were aware of the activities of the NSEL that resulted in such a dramatic turnaround and supported the performance of the management.

8.1.3.2 In the presentation made by Shri Jignesh Shah, Director of NSEL in the presence of Secretary, DCA on 10th July, 2013, he had mentioned that trading on NSEL is a safe and smooth economic activity, as over 100% stock are held as collateral (managed by independent collateral manager), 10 – 20% as margin money and backed by 100% of Post Dated Cheques from participants offering highest level of safety for participants. He further informed that the functioning of the NSEL is one of the biggest inclusion stories in India, even better than the AADHAR scheme. This presentation made by Shri Jignesh Shah turned out to be not only factually incorrect and false but was also misleading as would be clear from the facts/events discussed in this document. This shows that the promoter of FTIL took full responsibility for the functioning of NSEL and was actually promoting the cause of NSEL before the Government and the Commission and taking responsibility for the same.

8.2. It is observed from the Minutes of the Meeting of Board of Directors of NSEL that the approval of the Board of Directors was taken from time to time for providing Corporate Guarantee in favour of Banks like HDFC Bank and financial companies like Karvy Financial Services Ltd (KFSL), for providing credit facilities to some of the buyers like M/s NK Proteins & Aastha Minmet (India) Pvt. Ltd. It is also observed from the Minutes that blanket approval was being taken from the Board of Directors for providing guarantee in favour of HDFC Bank up- to Rs175 crores and for guarantee in favour of M/s. KFSL up to Rs.100 crores. It is also observed from internal audit report of NSEL for the period 01.10.2012 to 31.12.2012 that NSEL had entered into legal agreement on 10th October, 2012 with NCS Sugars Ltd, for the procurement of 7800 MT sugar at the rate of Rs. 2975/- per MT to be delivered by the latter party at the agreed dates. Company paid an advance of Rs. 20 crores on 18th October, as per the clause 2 of the agreement. The total value of transaction as per the agreed terms, rate and quantity with the NCS Sugar Limited came to Rs. 2,32,05,000/- (7800 MT & 2975 per MT). However, the advance paid by the company on 18th October, 2012 was Rs. 20 crores, which is around 8.62 times more or 861% higher than the total value of sugar to be procured. It is also observed from the internal audit report that NCS Sugar Ltd would give post dated cheques (PDC) to NSEL as security towards the total value of procurement. However, on verification it was found by the internal auditor that NSEL has not taken any PDC from the NCS Sugars Limited. This clearly shows that connivance between the buyers / management and the Board of Directors of NSEL.

8.3 Trading by IBMA on MCX platform: IBMA was incorporated in the financial year 2007-08. NSEL is the holding company as on date. As on 31st March, 2012 and 31st March, 2013, NSEL was holding 60.88% (8851725 shares of Rs. 10 each) of the equity shares of IBMA. FTIL is the ultimate holding company of IBMA as on date. IBMA carried on business as a buyer, seller and commission agent in the physical market as well as through future and spot exchanges in gold, silver, base metals and agricultural commodities. It also offered facilities to its members, their authorized agents, constituents and other participants to hedge, transact, clear and settle trades done on the Exchange(s) in different types of contracts in bullion, silver and various agricultural and other commodities. Mr. V Hariharan, Mr. Shreekant Javalgekar and Mr. Devang Neralla were mentioned as the directors/ key management personnel for the first two years. The financial statements for financial year 2011-12 and 2012-13 were signed by Mr. Anjani Sinha (who was MD and CEO of NSEL until recently) and Mr. Shreekant Javalgekar (who is also MD and CEO of MCX). The earlier financial statements were signed by Mr. V. Hariharan and Mr. Shreekant Javalgekar.

8.3.1 The Board Meetings where the Resolution relating to registration of IBMA as a client of M/S Sarita Prem Singhal (dated August 3rd, 2009) and as a client of Karvy Comtrade (22nd February, 2010) for trading in MCX was approved had the following directors present:-

1) *Mr. Manish Ranjan*
2) *Mr. Anjani Sinha*
3) *Mr. V. Hariharan*
4) *Mr. Devang Naralla*
5) *Mr. Shreekant Javalgekar.*

8.3.2 IBMA was trading in MCX in the capacity of a client through Karvy Comtrade and Sarita Prem Singhal which was in contravention of Clause 5.2 of the Guidelines of the Commission dated 14th May, 2008 and Clause 3.5 of the Guidelines dated 29th July, 2009, wherein it is provided that the Exchange shall have a demutualised structure, i.e., the share holders of the Exchange shall not have any trading interest either as a trading member or as a client at the Exchange. This stipulation restricts the participation of entities which have an equity stake in the exchange from trading as members or as clients on the Exchange. The principle behind the aforesaid stipulation of demutualised exchanges is to reduce the potential for conflict of interest and to ensure good governance. The trading by IBMA on MCX is in gross violation of Government's directives. The resolution for IBMA to trade as client on MCX platform was approved in the meeting of the Board of Directors of IBMA where Mr. Devang Neralla (Founder Director, FTIL) and Mr. Shreekant Javalgekar were present. Mr. Devang Neralla along with Mr. Jignesh Shah and La-Fin Financial Services Pvt. Limited are promoters of FTIL which is ultimate holding company of IBMA. FTIL is also promoter of MCX. Therefore, approving trading by IBMA in MCX clearly indicate that FTIL was aware of the conflict of interest and has violated Government's directive in this regard.

8.3.3 The Commission vide its letter dated 30th August, 2013 (Copy enclosed at Annexure-XXII) had directed Mr. Shreekant Javalgekar, Managing Director & CEO of MCX to submit an explanation to the Commission with regard to the above violation of Guidelines dated 14th May, 2008 and 29th July, 2009. In its response, MCX in its letter dated 6th September, 2013 (Copy enclosed at Annexure-XXIII) has stated that the MD and CEO holds merely one share of NSEL and that MCX was not aware of the change in shareholding of NSEL in IBMA and that it deals only with its members. It is evident from the Board

Resolutions dated August 3rd 2009 and 22nd February, 2010 and the attendance of the Board meeting of IBMA that the concerned directors of FTIL were aware and a party to the decision of IBMA registering as client at MCX. Further, in its response, MCX has itself acknowledged the lapses in surveillance at the Exchange, which failed to detect such a trading pattern. This is a very serious violation of the guidelines by FTIL and its common Directors with IBMA which erodes the confidence of market participants in the integrity of MCX as a trading platform.

8.4 Trading by IBMA on NSEL platform: The following are the key facts:

a. *IBMA was trading at NSEL.*
b. *IBMA has regularly obtained loan from NSEL e.g. in the financial year 2011-12 it has obtained loan of Rs. 166.80 Cr and repaid Rs. 111.80 Cr Similarly in the financial year 2012-13, IBMA has obtained loan of Rs. 882.25 Cr and repaid Rs.937.25 Cr. As per Board minutes of 21 May, 2012, the IBMA Board approved availing a loan of Rs. 882.25 Cr from NSEL. The purpose of the loan was for the purpose of working capital of the Company.*
c. *Similarly IBMA has entered into various transactions with NSEL like purchases and sales, payment of warehousing charges, payment of turnover transaction charges, receipt and procurement fees, receipt of share of revenue, receipt of business development and promotion services charges.*
d. *IBMA, a subsidiary of NSEL, has been an actively trading counterparty of the NSEL. A daily margin of exemption of Rs. 2 crore was granted to IBMA on 9th February, 2010. This was further increased by additional Rs. 3 crores on 2nd April, 2013. Further, over and above there were 125 instances where additional margin limit exemption approval was granted.*

   The above facts indicate that the Directors and Promoters of FTIL, which is the ultimate holding company of IBMA have knowingly allowed trading by IBMA on NSEL which is a very serious case of conflict of interest.

8.4.1. Failure of the Board to constitute its Committees: The Rules and Bye-laws of the Exchange mandated the formation of various Committees to effectively manage the operations. The details of these Committees are given below:

Committee	***Objective***	***Incorporation***
Membership Committee	*Functions to include, approve / reject the admission of members and other aspects related to membership management*	*BoD meeting minutes dated 7 April 2008*
Trading Committee	*Functions to include, review and recommend Rules for automated trading; specification of price limits for each contract month; specification of position limits for each contract held by members; Review and recommend risk management systems; etc.*	*Not Incorporated*

Committee	***Objective***	***Incorporation***
Clearing House Committee	*Functions to include, recommend margin structure applicable for each commodity and contracts; recommend action in the event of a default by members; to determine losses, damages and penalties resulting from any defaults including delivery defaults; to recommend action against defaulting members, etc.*	*Not Incorporated*
Arbitration Panel	*To give arbitration award in cases preferred for arbitration*	*Not Incorporated*
Vigilance Committee	*Functions to include, set out the procedure relating to checks, inspections, enquiries and investigations in order to discover, prevent and monitor, as the case may be, price manipulation, price distortion, trading malpractices, etc.*	*Not Incorporated*
Executive Committee	*Functions to include, day to day management of the Exchange and for the implementation of the provisions of Articles, Bye-Laws, Rules and Business Rules of the Exchange, etc.*	*Not Incorporated*
Commodity specific advisory board	*Advisory Board shall be responsible to recommend the contract specification for such commodities as well as the Rules relating to delivery and settlement in such commodities*	*Not Incorporated*
Other Committees/ Panels/Advisory Boards, as it may desire.	*As required*	*Not Incorporated*
Standing Committee	*Committee constituted for the management of the business and regulatory affairs of the Exchange.*	*Not Incorporated*
Dispute Resolution Committee	*Dispute between the Exchange members arises, in whole or in part, on one or more of matters, the decision on such matter or matters shall be referred to the arbitration of a Dispute Resolution Committee or Officer or Conciliation, as may be provided in Bye-Laws and the relevant Rules and Regulations of the Exchange in force from time to time.*	*Not Incorporated*

The Board failed to constitute 9 out of the 10 such committees.

8.4.2. The Board of Directors of NSEL had failed to constitute the Vigilance Committee, whose functions included setting out the procedure relating to checks, inspections, enquiries and investigations in order to discover, prevent and monitor, as the case may be, price manipulation, price distortion, trading malpractices, etc. Constitution of such a Committee would have monitored and prevented the events that led to the suspension of private market license by the Directorate of Marketing, Maharashtra State Government and could have addressed the issues of price manipulation to provide assured returns.

8.4.3. The Clearing House Committee was also not constituted. The functions of this Committee included recommending margin structure applicable for each commodity and contracts, action in the event of default by members, to determine losses, damages and penalties resulting from any defaults including delivery defaults; to recommend action against defaulting members. If such a Committee had been formed, it would have clearly indicated the lapses in risk management. The non-constitution of such an important Committee indicates that the Board did not discharge its responsibility as its intention was not to supervise properly the functioning of the NSEL.

8.4.4. The Trading Committee was also supposed to look into issues of risk management. The Board of NSEL has undermined the governance of NSEL and not performed their duties by not forming this Committee.

*8.5. The forensic auditors have observed that "**the Board Meeting minutes regularly (e.g. 11 June 2008, 15 June 2009, 25 May 2011) stated that the audit committee had detailed discussions on the Annual Financial Statements, the Internal Control Systems, reviewing the scope of Internal Audit functions, the performance of the statutory and internal auditors, the scope of work for the internal auditors, the planning of the statutory audit for the current financial year, the payment of audit fees, the observations by the auditors in the draft Auditor Report etc. Upon review of the corresponding Audit Committee minutes there is no reference to discussions on Internal Control Systems, reviewing the scope of Internal Audit functions, performance of internal auditors and scope of work for the internal auditors. Common members of the Board and the Audit Committee were:***

Mr. Jignesh Shah
Mr. Joseph Massey
Mr. V. Hariharan
Mr. Shreekant Javalgekar

Similarly it is also observed from the Directors report forming part of the financial statements of NSEL that Shri Jignesh Shah, Director, had been a member of the audit committee of NSEL from the beginning till the middle of FY 2011-12. One of the items on the agenda of the audit committee had been to ensure that internal control systems are in place apart from recommending the annual accounts to the Board of Directors for its adoption. Inspite of observation made by internal auditor, no corrective measures were taken by the Board of Directors/Committee Members.

8.6. The following are the key observations of the Forensic Auditor's Report on Board Minutes of NSEL:

*8.6.1. **"The Board Meeting Minutes regularly contained a comment on the Noting of Minutes of Membership Committee "The list of members admitted was noted and confirmed". The full Board was generally present at such meetings including:***

Mr. Shankarlal Guru	***-***	***Chairman***
Mr. Jignesh Shah	***-***	***Director/ Vice-Chairman***
Mr. Anjani Sinha	***-***	***CEO and Managing Director***
Mr. B.D. Pawar	***-***	***Director***
Mr. Joseph Massey	***-***	***Director***
Mr. V. Hariharan	***-***	***Director***
Mr. Shreekant Javalgekar	***-***	***Director"***

The Board of NSEL was thus fully aware of the membership issues at NSEL.

8.6.2. ***"The Board Meeting minutes of 31 March, 2010 state that the Company approached Karvy Financial Services Limited (KFSL) to extend credit facilities to a member,*** *specifically* ***N.K. Proteins. Further, the Board granted and approved for issue of a guarantee to KFSL, to the extent of Rs.14 crores, in respect of credit facilities to N.K. Proteins. The attendees at this Board Meeting were:***

Mr. Shankarlal Guru	***-***	***Chairman***
Mr. B.D.Pawar	***-***	***Director***
Mr. Jignesh Shah	***-***	***Director***
Mr. Joseph Massey	***-***	***Director***
Mr.V. Hariharan	***-***	***Director***
Mr. Anjani Sinha	***-***	***CEO"***

8.6.3. ***"The Board Meeting minutes of 26 May 2010 state that the Company approached HDFC Bank Limited with an arrangement where the Company would act as a Service Provider for the Bank and would source the borrowers for providing credit facilities to an aggregate amount of Rs. 50 crores. The Company would be required to issue guarantee to secure the timely payment of all dues and obligations of the borrowers sourced by the Company."***

8.6.4. ***"The Board Minutes of 11 August, 2010 state that the NSEL approached KFSL to extend credit facilities to a member, specifically N.K. Proteins. Further the Board granted and approved for issue of a guarantee to KFSL, to the extent of Rs. 14 crores, in respect of credit facilities extend to N.K. Proteins. The attendees at this Board Meeting were:***

Mr. Shankarlal Guru	***-***	***Chairman***
Mr. B.D.Pawar	***-***	***Director***
Mr. Jignesh Shah	***-***	***Director***
Mr. Joseph Massey	***-***	***Director***
Mr.V. Hariharan	***-***	***Director***
Mr. Anjani Sinha	***-***	***CEO"***

9. ***<u>Summary of Observations:</u>***

The factual matrix and observations on the conduct of business affairs of NSEL establish the fact that the entire governance of the company including planning, directing and controlling of its activities was utterly lacking in transparency, integrity, competence, compliance with law, and most importantly an honesty of intent to meet its stated objectives of offering a platform for genuine trading in commodities .The FTIL, in which Shri Jignesh Shah and his entities hold controlling stake and which in turn, has complete control over NSEL, deliberately allowed NSEL Board to admit, nurture and incentivise unworthy members to continuously trade and default on its platform thereby circumventing the company's bye-laws, risk-management system and canons of corporate governance, and at the same time, continued to allow short-selling and forward contracts having long term settlement periods in total defiance of the conditions stipulated in the notification dated 5.06.2007 issued by the Central Government. The afore-said observations would further become evident from the point-wise illustrations of the conduct of affairs of NSEL made in the following paragraphs.

9.1. TRADING IN FINANCING CONTRACTS :

i) NSEL was granted exemption under Section 27 of the FCRA to trade on one day forward contract in commodities; however, from the year 2009 onwards, with the approval of the Board, it started trading in paired contracts in commodities in such a manner that it would generate an assured return of 13% to 18% per annum, akin to financial transactions under the garb of commodities trading.

ii) The paired trades were neither backed by actual physical delivery of commodities nor were discovering the market price of the commodity traded. In fact, this was just like a financial transaction and no spot trading in commodities was done.

iii) Despite being aware that the transactions taking place on its platform are violating the primary conditions of exemptions granted to them u/s 27 of FCRA, the Board of Directors allowed short selling with no system in place to verify physical possession of goods by sellers before allowing them to trade and launched contracts with long term settlement instead of ensuring the settlement of all contracts within a period of 11 days, in contravention of the provisions of FCRA.

9.2. ABSENCE OF GOVERNANCE :

i) The Board of Directors completely failed to provide any effective governance over the Management of NSEL; specifically, it failed to put in place a risk management system at NSEL, effective audit of the internal control process, warehouses, accounts and other business of the Company and total apathy to take follow-up action to address the serious concerns that existed in these areas.

ii) The failure of the Board of Directors to constitute 9 of the 10 Committees in complete violation of the rules of NSEL smacks of a deliberated design to avoid any oversight of the NSEL's activities so that the gross irregularities and malpractices being committed in the NSEL could continue unabated and the Board could feign ignorance of these fraudulent activities.

iii) The NSEL Board ought to have at least constituted the Vigilance Committee, Clearing House Committee and Trading Committee etc which are essential to monitor the integrity of its trading platform.

iv) The credibility of reporting by the management was abysmally poor, devoid of consistency and the Board of the company continuously misrepresented facts before the Commission. It was extremely irresponsible to say the least, of the Board of Directors to have failed in their basic duty to provide governance to the Company as per the rules laid down by them for the purpose.

9.3. NO RISK MANAGEMENT SYSTEM :

i) The Board of Directors ignored the repeated defaults by a number of members (borrowers) of NSEL like N. K. Proteins Ltd , a company promoted by the son-in-law of the Chairman of the Board of NSEL- Shri Shankar Lal Guru and Lotus Refineries Pvt Ltd since the year 2011 and instead of debarring such defaulters from trading and initiating default

proceedings against them, NSEL showered charity on them with margin exemptions & facilitated Loans to them from Banks/Finance companies by extending Corporate Guarantees .

ii) Large sum of funds were taken from borrowers for the benefit of its group company IBMA and a related company where wife of Mr. Anjani Sinha was the Managing Director thereby exposing the nefarious nexus between the Board and Management of NSEL and these borrowers.

iii) The admission made by the former Managing Director, Mr. Anjani Sinha in an affidavit that the borrowers were allowed trading even after committing a series of defaults confirms that the Board was fully aware that NSEL was basically running a finance scheme where the pay-in obligations of the borrowers could not be met even partly without giving them fresh funds by mobilizing the same from the investors by floating attractive assured return schemes in the market.

iv) Such a connivance between the Board and management of NSEL and the borrowing members was further aggravated by the fact that the largest borrower, M/s N.K. Proteins was promoted by the son-in-law of the Chairman of the Board of NSEL- Shri Shankar Lal Guru.

v) The Board of NSEL misutilized the margin money account and withdrew money from SGF for its own business needs which is not permissible.

vi) The Board of Directors of NSEL was bound to be aware of the order of the Directorate of Marketing, Government of Maharashtra passed on 26.12.2012 suspending the private market license issued to NSEL with directions to NSEL to ensure transparency in transactions at the Electronic Platform operated by them and the same is bound to be in the knowledge of its controlling company FTIL as well as its promoter, Shri Jignesh Shah. However, such an adverse development of suspension of license was not brought to the knowledge of the Central Government or the market participants by NSEL.

vii) Suspension of the private market license to carry out commodities trading in a state where the locus of electronic trading platform is situated is a grave business setback which is bound to be brought to the knowledge of the Board of Directors, the promoters and other stake holders of the company by the management. However the Board did not display any concern, did not take any action in this regard and willfully kept the public in dark about this important development.

9.4. <u>NO CONCERN FOR INVESTORS:</u>

i) Since the NSEL's Board, Management and its prominent borrowers continuously acted in complicity whereby borrowers were allowed to default and roll over their outstanding debts, the investors got dragged into dangerously high risk exposures; ultimately it helped the borrowers to misuse and defraud the investors of their money. It is not surprising that the post dated cheques taken as security from the borrowers were not honoured by the Bank on presentation.

ii) While the bye-laws of NSEL proclaim that the company as an exchange, is responsible for ensuring the settlement of the counter

parties, NSEL has reneged on its obligation by blaming the borrowers for not meeting their pay-in obligations. The fact however remains that many of these defaulting borrowers were allowed to continue trading on NSEL despite defaulting several times and instead of debarring them from trading, the Board and management went all out in gross violation of their bye-laws and rules, to allow them to trade for extended periods often years as pointed out earlier.

iii) It is clear from the above that in the name of trading in commodities, NSEL was running its platform for an impermissible business of financial transactions in collaboration with a few borrowing members in an organised manner with the approval of the Board. NSEL was also promoting the scheme among brokers and investors and submitted false information in this respect to the Commission as well.

iv) On the one hand, NSEL enrolled members with extremely doubtful credentials, did not put in place any risk management systems and violated its own rules/bye-laws to favour the borrowers thereby misusing the funds of investors for its own purpose; on the other hand, the management of NSEL violated the conditions of notification, ignored various show-cause notices & directives issued by Government Authorities and also kept the investors in the dark about its wrong and illegal activities.

v) The defiant and irresponsible attitude of NSEL Board is further evident from the fact that after issue of show cause notice to NSEL in April 2012, instead of exercising caution, taking corrective measures to comply with the conditions notification dated 05.06.2007 and strengthen risk management systems, it allowed the exposure of the members (borrowers) to be increased sharply in the next 15 months. As per the information provided by the then MD of NSEL on 13th September, 2013 the exposure of the borrowing members went up from Rs.2009 cr on 31st March 2013 to Rs.6762 cr on 30th June 2013.

vi) Thus, despite continuing defaults, written warnings from their internal auditor, suspension of license order by Director of Agriculture Marketing, Government of Maharashtra and show cause letter issued by the Government, the Board of NSEL turned a deaf ear to all these alarms thereby putting thousands of investors under high risks of losing money who had invested their money with an expectation of assured return given the very nature of paired contracts they had executed.

vii) Such a callous approach and conduct on the part of an entity that called itself an exchange and which boasts of a reputed listed company like FTIL as the controlling holding company and Directors of repute including Shri Jignesh Shah, the promoter of FTIL as Key Management Personnel on its Board, is highly reprehensible and makes an explicit portrayal of dishonesty and lack of integrity whose actions were driven by vested self interest without any regard for their duty towards the thousands of investors to provide a reliable trading platform with adequate risk management system.

9.5. The chain of events which took place at NSEL, report of the forensic auditor and the information gathered by the Commission and all the circumstantial evidence raise a strong pointer to the fact that Shri Jignesh Shah despite having full knowledge of the financing activities being undertaken at

NSEL, absence of stock as collateral, waiver of margins/default in payment of margin money as well as several defaults by the buyer members and non-sanctity of post dated cheques, had deliberately painted an impression in his presentation on 10th July, 2013 before the Secretary, DCA in the presence of the entire Commission that trading on NSEL is a safe and smooth activity offering highest level of safety for participants. This fact casts serious doubts on the reputation, credibility, honesty and integrity of Shri Jignesh Shah who is director on the Board of MCX and promoter having controlling stake in FTIL, which is the holding company of NSEL. The Board members who were on the Boards of other Exchanges such as MCX and MCX-SX could not have been unaware of the best practices and mandatory practices such as KYC documentation, risk management etc but deliberately took advantage of regulatory gap with respect to NSEL and violated these practices including the Exchange's own laws/bye-laws.

9.6. As would be evident from the foregoing, throughout its existence NSEL has exhibited very poor record in terms of corporate governance. Its Key Management Personnel allowed members/ buyers of very dubious record to be registered without proper due diligence or fulfilling KYC norms prescribed in their own laws/bye- laws. There were related party transactions by IBMA with MCX and NSEL. The connivance of NSEL with IBMA and defaulting borrowers like NK Proteins, the largest defaulter in NSEL, in extending credit facilities to them despite their repeated defaults sums up their unacceptable conduct. NSEL and IBMA, being subsidiaries/ step-down subsidiaries of FTIL have been mentioned in the financial statements of FTIL as companies over which it has management control. The manner in which the business affairs of NSEL were conducted despite FTIL being in full control and in full knowledge of its Directors who themselves misled the Government and the public about the functioning of NSEL, have cast grave aspersions on the reputation, integrity, honesty and credibility of FTIL and its directors in controlling and providing direction to the Board of NSEL or IBMA who jointly with the management of these companies conspired in their nefarious pursuit to defy Government notification, provisions of FCRA, rules/bye-laws of the exchange and ultimately to de-fraud the investors.

9.7. A Commodity exchange is supposed to be a responsible, self regulatory institution which ought to inspire trust and confidence of the people who invest in the trading on its platform. Apart from business related operations, it is entrusted with the task of regulatory functions and is tasked to perform the role of counter-guarantor. FTIL, as a listed company which is credited with promoting a number of exchanges, has along with its directors, grossly failed in discharging these functions in a fair, judicious and honest manner in the way it has allowed its subsidiary, ie. NSEL under its total control to perpetrate such fraud on its platform and conspired to cheat the investors of thousands of Crores of rupees. The fact that statutory auditors of FTIL, M/s. Delloitte Haskins & Sells have withdrawn their Audit Report for FY 2012-13 subsequent to exposure of NSEL affairs, has further put a question mark on FTIL's financial integrity apart from severe erosion of its reputation ."

9. Keeping the above factual observations in view, the Commission, at paragraph no.9.8 of the SCN recorded its strong reason to believe that FTIL, as the anchor shareholder in MCX, which is also 99.99% stake holder of NSEL and the Directors of NSEL, viz Shri Jignesh Shah, Shri Joseph Massey and Shri

Shreekant Javalgekar who have also been serving on the Board of MCX, being jointly as well as severally responsible for the unlawful, irregular, and fraudulent activities as well as poor governance in NSEL, have suffered serious erosion in their general reputation, honesty, and integrity as also credibility to operate in the Commodities Derivatives Markets in any capacity. Their record of fair conduct was also in serious doubt. Hence, the Commission directed FTIL to explain as to why it should not be declared as not fit & proper to remain as a share holder and the other three persons named above were directed to explain as to why they should not be declared as not fit & proper to be Directors of a recognised commodity exchange like MCX.

10. The Show-Cause Notices (SCNs) as mentioned above were duly served upon the persons concerned on 5th October, 2013. On receiving the SCNs , FTIL, vide its letter dated 11.10.2013 , citing various reasons , requested for a further period of four weeks' time for submission of its reply to the SCN. Similarly, Shri Jignesh Shah and Shri Joseph Massey vide their respective letters dated 14.10.2013 and Shri Shreekant Javalgekar, vide his letter dated 11.10.2013 made similar requests for four weeks time for submission of their replies to the SCN. After considering their requests, the Commission vide letter dated 18th October 2013 extended the time limit for submission of reply to 31st October, 2013. The Commission has received replies to the SCN from FTIL and the other three persons, viz: Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar on 31st October, 2013.

11. On a perusal thereof, it was observed that all the four noticees requested for a personal hearing before the Commission. Having due regard to their requests and in accordance with the principles of natural justice, the Commission granted them an opportunity of personal hearing on 12.11.2013. Accordingly, on 12.11.2013, Shri Somasekhar Sundareshan, Legal Counsel and Partner, J. Sagar & Associates (herein after 'counsel') and his associate lawyers, duly authorised by all the four noticees, viz: FTIL, Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar, appeared before the Commission. Two noticees, viz: Shri Joseph Massey and Shri Shreekant Javalgekar also personally appeared before the Commission with their afore-named authorized counsel. Shri

Somasekhar Sundareshan made a detailed oral presentation of arguments on behalf of all the four noticees and explained their respective versions of the points/issues raised in the SCN pertaining to their role and responsibilities in the affairs of NSEL. The counsel also submitted to the Commission a written note containing a summary of the arguments/explanations which were orally presented by him before the Commission. In their reply to SCN and also during the proceedings the counsel made a request to the Commission to allow the noticees to cross-examine the forensic auditor, M/s. Grant Thornton India LLP (herein after GT), whose report has also been relied upon by the Commission in the SCNs issued to the noticees. The Commission heard at length the counsel and all the noticees present during these proceedings. The Commission acceded to the request of the counsel to allow the noticees to question Grant Thornton on their findings about NSEL affairs which is relied upon in the SCNs so as to enable the noticees to find out further facts, if any, relevant to their own interest. The opportunity given to the noticees for examining Grant Thornton and the outcome of such examination etc. have been discussed in subsequent parts of this order.

12. The explanation offered and the arguments made by the counsel on behalf of all the four noticees, viz; FTIL, Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar during afore-said hearing as well as in their respective written submissions referred to above, have been carefully examined and considered. In this connection, from the written replies received from Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar, it is observed that all of them have enclosed, a copy of the written reply addressed by FTIL to the Commission, and have taken a common stand at Para No.2 of their respective replies to the effect that "*FTIL has provided me copy of its reply dated October 31, 2013 ("FTIL Response"), in response to the Show Cause Notice issued to it. Upon a review of the same, I am fully in agreement with the contents thereof and I hereby adopt the response furnished in the FTIL Response. In the interest of brevity, I am not reproducing the contents here, and hereby adopt the same as if they are reproduced herein."*

13. Since all the above-named three persons have primarily and substantially relied upon the reply submitted by FTIL in response to the SCN issued to the

Company, for the sake of brevity, it is felt necessary to first deal with the reply given by FTIL vide its letter dated 31.10.2013, before attending to other specific personal explanations offered by the above-named three persons in their respective submissions / presentations. As a logical consequence and keeping in view that the FTIL's reply has been fully relied upon by the other three individuals, the Commission deems it appropriate to pass a consolidated order in the captioned matter thereby together disposing of the submissions and arguments of FTIL and other three persons, viz: Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar.

14. The Commission has perused the entire submission of the FTIL very carefully and due regard has been accorded to its arguments and explanations in response to various points raised in the SCN issued to the noticees. The presentations made by the counsel of FTIL during his appearance have also been carefully considered. To begin with, it is observed that the promoter and anchor investor of MCX have raised a number of technical and legal objections to the show-cause notice, before offering its explanations on the factual contents of the SCN containing the observations made by the Commission with regard to their role in the governance and business affairs of NSEL. The sum & substance of such technical and legal arguments put forth by FTIL have been summarised under relevant heads and are dealt with, in the subsequent paragraphs:

14.1 ***Need for reasonable time:*** *-On receiving the show cause notice, FTIL vide letter dated 11th October, 2013, sought further time for responding to the SCN issued by the Commission. In response, the Commission vide letter 18th October, 2013 had granted time only until 31st October, 2013. FTIL had pointed out that the Commission has not given it a reasonable time on the "pretext" of the urgent need for taking action proposed in SCN to address public interest. According to FTIL, there is no emergency of any nature and the hurry is not warranted.*

14.1.1 The Commission issued a show cause notice (SCN) on 4th October, 2013 which was served on FTIL and other three persons on 5th October, 2013 affording them two weeks' time to furnish their explanation and replies. The SCN primarily raised a question with regard to their respective status as 'fit and proper

person' in view of the role played by them and / or expected to be played by them in the management and governance of NSEL affairs which are / were prima facie within their personal knowledge and control. Therefore, the Commission considered two weeks' time as a reasonable period for a person / entity to clarify his / its own position and to explain as to why it / he should not be declared as not fit and proper person to become a director / shareholder of MCX. Nevertheless, considering the request made by them and in the interest of natural justice, the Commission extended the time till 31st October, 2013, for submission of the replies. In any event, as all the noticees have responded and furnished their explanation within the extended time period, the question of time granted as being inadequate is liable to be viewed as merely a technical objection. Moreover, the Commission has also accepted their requests for personal hearing and heard them in person on 12th November, 2013, at length. Subsequently, the Commission granted them an opportunity to examine the Forensic Auditor, Grant Thornton on 3.12.2013 which was availed of by one of the noticees. Further, on 6.12.2013, the Commission received another written submission from each of the noticees updating their previous submissions. Subsequently on 16.12.2013, the Commission received one more written submission dated 13.12.2013 from Mr Joseph Massey which is perused and considered .Thus, this order is being passed after due and careful consideration of all the written and verbal submission put forth by all the four noticees.

14.2. ***Show Cause Notice is Premature****:- According to FTIL, the facts / allegations in SCN relate to NSEL which is a distinct and separate legal entity, and not against the FTIL. It was further submitted by FTIL that various agencies were investigating into the events at NSEL and pending adjudication which established a nexus between the events and circumstances at NSEL and the FTIL for such occurrences, it would be inappropriate, unfair and unjust to initiate proceedings upon FTIL. The SCN is premature and unwarranted, pending completion of investigation that are currently underway. Further, FTIL itself is a listed entity with its own Board of Directors and large body of public shareholders and there is no basis for levelling allegations against FTIL in connection with the occurrences at NSEL. There is no indication that there is any need / urgency in issuing the SCN or taking any action pursuant thereto.*

14.2.1 It is not disputed that subsidiary and holding companies are ordinarily regarded as separate legal entities. However, this does not logically lead to the conclusion that NSEL, by virtue of being a separate legal entity, can be said to be independent from the control of the holding / parent company, i.e., FTIL which hold 99.998% of its share capital. As regards the contention that the SCN is premature in view of pendency of adjudication and ongoing investigations into the NSEL matters, the Commission considers that this argument does not hold good for the reason that the investigation / adjudication proceedings are distinct and separate from the instant proceedings in respect of the 'fit and proper person' status of FTIL. One proceeding operating in a different sphere does not affect the validity of the other proceeding or require it to come to a halt and vice versa. Moreover, the subject matter of on-going investigations being carried out by investigation agencies such as Economic Offences Wing, Enforcement Directorate etc., is reportedly inter alia to book the defaulters for their default and attach their properties / assets to safeguard the interest of over 13000 investors who have lost their money on the exchange platform of NSEL. Similarly, the prayers and grounds in the Public Interest Litigations and the Writ Petitions which are currently being pursued by various market participants before the Hon'ble Bombay High Court are mainly aimed at seeking directions from the Court to NSEL and other Government agencies to recover the dues from the defaulters and make FTIL, being the holding company, own up to its responsibility and return money to investors. Thus, the focus of the ongoing adjudication and investigation proceedings are primarily geared towards the recovery of dues from the NSEL and the defaulting borrowers and also to examine from the point of view of taking action on the criminal charges, if any. Under these circumstances, the present proceedings relating to declaration on the status of 'fit and proper person' of FTIL and the three other directors of MCX is not and cannot be said to be contingent upon the outcome of the ongoing investigations / adjudication proceedings as claimed by FTIL. Moreover, it would amount to great risk to large number of market participants if persons who may have lost their general reputation and trust of market participants are allowed to continue to manage market infrastructure institutions like Commodity Exchanges, where over 40 lakhs

clients are registered to trade and thousands of crores of value of trades take place on every working day.

14.2.2 It needs emphasis here that the present proceedings relating to the 'fit and proper person' status of the four noticees stand independently on its own merit based upon facts, and credible information pertaining to the misconduct of business affairs of NSEL. These include trade data showing violations of Government Notification, internal audit reports, report of Collaterals Inspecting Firm, M/s. SGS India Pvt. Ltd. (SGS), minutes of Board Meetings of NSEL, lack of funds in Settlement Guarantee Fund , report of the forensic auditor like Grant Thornton and such other documents / records indicating utter mis-management of NSEL affairs by its Board. The facts coming out of the aforementioned sources constitute compelling evidence for initiating in the public interest, proceedings on the matter of 'fit and proper person' of FTIL – (the anchor investor of MCX) and the other three NSEL directors named above who also are / were serving on the MCX Board. The recent unfortunate events at NSEL have exposed how the poor governance and mis-management of the company has the potential to inflict irreparable injury to the interest of thousands of market participants in the commodity market. Hence, as a regulator entrusted with the task of observing the forward market and taking such action in relation to them as may be necessary, the Commission, in public interest and in the interest of thousands of market participants who regularly trade on the exchange platform of MCX, is duty bound to examine as to whether FTIL, which is the anchor investor in MCX and the other three directors named above, can be said to be 'fit and proper persons' to continue as share-holders or/and Directors of the largest regulated Commodity Exchange of India . The Commission would be failing in its primary mandate of safeguarding the interest of market participants if, despite witnessing how the poor management of NSEL have led over 13000 investors to risk losing their money, it failed to initiate urgent measures to protect the interests of thousands of market participants who trade on MCX platform. Therefore, the arguments of FTIL that the SCN itself is premature, is dismissed as being completely misconceived.

14.3 ***Firm Findings already made:-*** *It has been submitted by FTIL that the SCN, while purporting to direct FTIL to show cause, has in reality recorded firm findings on* the *alleged conduct/role of FTIL even before culmination of investigations into the allegations against NSEL. This approach, according to FTIL deprives it of a fair opportunity to present its case. In support of its argument FTIL has referred to paras 7.1.6, 9, 9.2 (i), 9.2 (ii), 9.2 (iv) 9.5, and 9.6 of the SCN wherein, in its view, firm findings have been recorded and definite conclusions arrived at FTIL, while referring to the Commission's letter dtd. 18th October, 2013 wherein it has been stated inter alia, that 'the volume of trade at MCX platform has been adversely affected since NSEL crisis which is also an indicator of erosion of public confidence' has submitted that there is no cogent data or evidence linking the alleged defaults at NSEL with alleged adverse effect on the volumes at MCX. According to FTIL, the Commission's letter dtd. 18th October, 2013 also gives an impression that 'the alleged non-qualification of FTIL as a 'fit and proper person' is seen as a foregone conclusion.*

14.3.1 At the outset, the Commission would like to state that there are certain facts about the mismanagement and poor governance of NSEL that the Commission has incorporated in the SCN. The notable ones are reiterated as follows:

i. NSEL conducted its business not in accordance with the conditions stipulated in the notification dated 05.06.2007 granting it exemption from the operation of FCRA, 1952, with regard to the one-day forward contracts to be traded on its exchange platform. As noted in the SCN, the condition of 'no short-sell' and 'compulsory delivery of outstanding position at the end of the day' stipulated in the notification were violated by NSEL.

ii. NSEL Board allowed launching of paired back-to-back contracts on its exchange platform comprising a short-term buy contract (T+2 settlement) and a long-term sell contract (T+25 settlement) with pre-determined price and profit for the buyer and seller, which violated the very concept of spot market of commodities and the transactions ultimately were in the nature of financial transactions.

iii. The Directorate of Marketing, Government of Maharashtra passed an Order on 26.12.2012 suspending the private market licence issued to NSEL with directions to them to ensure transparency in the transactions on the electronic platform.

iv. NSEL suspended abruptly its trading in all the contracts (except e-Series contract) leaving thereby an outstanding default of Rs.5,500 crores (approx.) from a group of 24 borrowers with poor credentials who owed the money to a large multitude of over 13,000 investors.

v. The management of NSEL provided inconsistent figures about the fund availability in Settlement Guarantee Fund which, from a stated position of Rs.738.55 crores on 01.08.2013 came down to a figure of only Rs.62 crores on 04.08.2013.

vi. Within a few weeks, 19 out of 24 borrowers were declared defaulters and the management had no risk management tools at their disposal to recover any money from them.

vii. The management of the NSEL formulated a Settlement Plan to pay to the investors through equated weekly disbursements of Rs.174.72 crores for 30 weeks, but till date have not been able to meet the said target for any single week.

viii. The NSEL engaged a collateral management firm, named SGS to make a detailed assessment of the stock of commodities lying in their accredited warehouses. As mentioned at paragraph No.7.3 of the SCN, SGS has pointed out in their interim report that from their inspection of 16 warehouses, physical verification revealed that as against stock of Rs.2389.36 crores supposed to be lying in these warehouses as per the records, stock worth only Rs.358 crores was found. Moreover, the inspecting firm was prevented from inspecting 22 warehouses despite the fact that they were engaged by NSEL for carrying out inspection on their own stock lying in their accredited warehouses. The survey conducted by the Income-tax Department on 23.05.2013 at M/s ARK Imports Ltd, a member of NSEL, wherein gross discrepancies in the stock of raw wool was found, has also been set out at paragraph no.7.4 of the SCN.

ix. The Commission directed NSEL to engage a forensic auditor to inspect their books of accounts, records maintenance etc. Accordingly, NSEL engaged a forensic auditing firm, M/s. Grant Thornton who have submitted their report to NSEL. From the report of the forensic auditor and other information collected by the Commission in course of dealing with NSEL, various facts about lack of due diligence and control over warehouses, gross irregularities in risk management by allowing repeated defaulters to trade without margin money or collaterals, poor clearing and settlement system, mis-utilisation of margin utilisation account, financing of defaulters by NSEL, allowing related party like IBMA (a group company) to trade on the platform of NSEL and MCX etc., have come to the knowledge of the Commission which have been elaborately addressed at paragraph 6 to 8 of the SCN issued to FTIL and the other three directors.

x. The Board of NSEL failed to constitute 9 out of 10 committees mandated under the rules and bye-laws of the Company which included important Committees such as Vigilance Committee, the Clearing House Committee and the Trading Committee etc., as a result of which there was absolutely no oversight over the risk management system in place at NSEL.

14.3.2 The aforesaid factual findings are only illustrative and have been discussed in great detail in the SCN. In the light of these facts pertaining to such gross irregularities practised by the management of NSEL which is a wholly owned subsidiary of FTIL, the Commission has made certain observations in the SCN. The noticees were required to meet the case made out in the SCN either rebutting the facts or accepting the facts and observations made therein. The FTIL erroneously sought to label the observations of the issues as pre-judgements under consideration. In their written submissions, FTIL has not disputed the basic factual positions set out in the SCN or presented its alternative version of facts and instead, has resorted to hypothetical statements at various paragraphs of their submissions, some of which are cited below:

a) Para No.10: *'It would well be possible that investigations that are currently underway may lead to the FMC gathering information which would support FTIL's case.'*

b) Para No.11: '*It is likely that NSEL would be in a position to effectively respond to the allegations against it. It is likely that upon adjudication of the facts, no wrong-doing is proved against NSEL'.*

c) Para No.33: *'It is likely that NSEL may be in a position to demonstrate that the forensic auditor did not appreciate the data in the correct perspective that may have* been *presented by NSEL to them.*

d) Para No.61: *'It is submitted that the alleged defaults stated in the Show Cause Notice could only have been committed by the employees of NSEL. It is submitted that even the Board of Directors could not have known about such alleged defaults in the event they are indeed committed.*

14.3.3 The afore-cited statements made by FTIL show that instead of rebutting the basic factual positions set out in the SCN in a straight-forward manner, they have chosen to paint some of the prima facie observations which are based on such facts as being pre-judged and prejudiced against them. The objective of issuing SCN to FTIL and other persons was to elicit their explanations as to why they should not be declared as not 'fit and proper person' in view of their role played by them as the parent company and directors of NSEL, given the fact that the management of the business affairs of NSEL have been conducted in a manner whereby rules, regulations, notifications etc., were routinely violated and the business was conducted without any concern for risk management, corporate governance and even to protect the interest of the thousands of investors who have participated in its trading platform. The SCNs were issued on the basis of tangible information and concrete facts. FTIL has not controverted those facts and appears, instead to be resorting to technical objections.

14.3.4 We have carefully considered the observations of the Hon'ble Supreme Court of India in the case of **'Oryx Fisheries Private Limited v. Union of India & Others** (2010) 13 SCC 427' cited by FTIL in their reply. However, there is no reason for FTIL to conclude that the SCN is in defiance or deviation from the

observations of the Supreme Court. The SCN has summarised the observations of the Commission on the basis of facts and information as discussed above and the circumstances under which, the Commission has reason to believe that the reputation, credibility, integrity, honesty and record of fair conduct of FTIL and other three directors, are in serious doubt. The SCN contains only allegations and no pre-judgements against the parties concerned. The allegations in the SCN are based on the facts set out therein and are not fanciful or made in the air. Under the circumstances, the citing of the decision of the Hon'ble Supreme Court (supra) has no relevance in the present case. Similarly, the observations of FTIL that the SCN is prejudiced or carrying pre-judgement against it and the Commission is working under apparent regulatory pressure are baseless and hence are liable to be dismissed.

14.4 ***FTIL neither unfit nor improper:-*** *According to FTIL, there is no adjudication in relation to NSEL or its management by a Court or any competent authority and there is no basis for any allegation of any wrong doing on the part of FTIL to support the levelling of such allegations. The SCN issued to FTIL narrates conclusive statements about NSEL, which themselves have not been adjudicated. The allegations would have to be first adjudicated in an appropriate forum and only after a conclusive adjudication of facts and law vis-a-vis NSEL can any action, if at all, even be contemplated against FTIL. Even at that stage, proceedings may be initiated against FTIL, if and only if, any such findings show any credible and reasonable cause of action against FTIL for any involvement and participation in any of the alleged misdemeanours of NSEL.*

14.4.1 As observed earlier, the contentions of FTIL that the proceedings pertaining to the declaration of 'fit and proper person' have to wait till the allegations against NSEL are adjudicated in an appropriate forum is devoid of any merit for the fact that each of them is a separate proceeding and the outcome of one is not dependent on the other. Moreover, NSEL has till date, not been able to rebut any of the afore-stated facts pertaining to mis-management of its affairs before the Commission. In fact, these are the facts on the basis of which various petitions have been filed by the aggrieved investors before the Hon'ble Bombay High Court and the settlement crisis involving Rs.5,500 crores has

primarily emanated from the same. As stated earlier, the ongoing adjudications of the pending petitions before the Hon'ble Bombay High Court and also the proceedings pending before different investigating agencies are primarily oriented towards examining the angle of criminality in action and recovery of dues from the assets of the NSEL and the defaulting borrowers, for the purpose of compensating the investors. Further, the standard of proof in each of these proceeding is different. Hence, these are distinct proceedings, each being capable of being pursued separately without depending on the outcome of the other.

14.4.2 The point to note here is that the present proceeding before the Commission involves the issue of whether FTIL and the other three former directors of MCX have actually suffered erosion in their general reputation, integrity and honesty which affects their status as 'fit and proper persons'. In considering this issue, the Commission shall be primarily guided by the role played / ought to have been played by them as a parent company and / or director of the Board, in the governance / management of conduct of business affairs of NSEL. This will again be based upon the facts and other supporting documents as narrated above, which provide a clear picture about the actual affairs and events that happened at NSEL. FTIL contends that the Commission should wait for years till such time all the adjudication/investigation proceedings get concluded and only thereafter initiate the proceedings of 'fit and proper person' status if at all there is any court decision implicating the persons concerned for their role in the affairs of NSEL. Thus in effect, FTIL wants the Commission to remain oblivious to its statutory responsibility of protecting the interest of thousands of market participants who are trading in the exchange platform of its regulated exchanges such as MCX. This proposition of FTIL, if accepted would, undermine the public interest. It also militates against the legislative trust reposed by FCRA, 1952 in FMC.

14.5 ***Guidelines not* violated:**- *FTIL while referring to the criteria for a person to be deemed to be a 'Fit and Proper Person' as provided in the note 2 enclosed to the guidelines on the Equity Structure of National Commodity Exchanges after five years of operation issued by Ministry of Consumer Affairs, Food & Public*

Distribution, Department of Consumer Affairs, (DCA) on July 29, 2009, has mentioned with respect to clause (i) of the criteria that FTIL has, since inception, never defaulted in meeting any of its financial obligations. It has been submitted that there is nothing in the SCN or otherwise to allege or to demonstrate that FTIL is not financially sound. There is no notice / suit/ claim received / filed by any of its stakeholders that could lead to any doubt about its financial integrity, reputation, character or honesty. There is nothing to show that any alleged default in NSEL was on account of deceit or fraud on the part of FTIL or the shareholders of FTIL. It has been submitted that FTIL would be able to demonstrate that it was itself in the dark about the exact alleged default at NSEL as the FTIL Board relied bona-fide on duly adopted board and corporate processes in order to professionally review and monitor process of NSEL. No such overview at NSEL's operations revealed anything amiss about its functioning to FTIL. It has been submitted by FTIL that this reply is being formulated as a preliminary response and it reserves its right to supplement the same at an appropriate stage.

FTIL has submitted *that the Minutes of NSEL's Board Meetings were tabled and noted at FTIL Board Meeting and such minutes never contained any cause for worry much less alarm for the Board of Directors of FTIL. FTIL has taken a view that from a plain reading of Clause (ii) of the Guidelines, the disqualifications may be applied only upon a final determination of the situations set out therein. Mere accusation of any wrong doing by a shareholder of any commodity exchange cannot automatically lead to action for disqualification under 'fit and proper criteria'. Even the discretion accorded to the Commission in the guidelines needs to be exercised reasonably and only in the event of an ambiguity in a situation leading to two views about a disqualification and in the present case, prior and conclusive disqualifications are required and exercising the discretion by the Commission would lead to unreasonableness and arbitrariness. FTIL has submitted that the Mumbai Police as well as the NSEL have initiated investigations / proceedings against some of the employees of NSEL and pending culmination of these proceedings, the proceedings under SCN need not be continued and kept in abeyance.*

14.5.1 A perusal of the concluding observations at Para No.9.8 of the SCN as referred in para 9 of this Order would show that the Commission has a prima facie reason to believe that FTIL and the other named three directors, by virtue of their nexus with the mis-management of the affairs of NSEL, have failed to fulfil the first and foremost criteria of 'fit and proper person' prescribed under Clause (i) of the criterion provided under the guidelines issued by the Central Government and the Commission from time-to-time. Clause (i) of the criterion states as under:

> '**such person has a general reputation and record of fairness and integrity, including but not limited to –**
>
> (a) financial integrity;
> (b) good reputation and character; and
> (c) honesty'

14.5.2 Thus, the criterion prescribes that before complying with any other specific qualifications, the person / entity concerned should possess the first and foremost eligibility of carrying 'a general reputation and record of fairness and integrity', which would also include financial integrity, good reputation and character and honesty. Therefore, the claim of FTIL that it is a financially sound company and has not defaulted in meeting its financial obligations is irrelevant. What is relevant for the Commission to consider is whether in the aftermath of the unfortunate events at NSEL exposing its poor management and unlawful business conduct, its holding company, i.e. FTIL which is also the anchor shareholder in MCX, can be said to be possessing the basic attributes of general reputation, and record of fairness and integrity or not. FTIL has contended that it was in the dark about the defaults at NSEL. It is claimed that the FTIL board relied *bona fide* on the board of NSEL and no reviews of NSEL's operations revealed anything amiss about its functioning to the board of FTIL. FTIL has argued that there is no illegal profit or gain that can be attributed to FTIL in relation to the alleged defaults at NSEL. Additionally, it goes on to state that NSEL has itself initiated criminal proceedings against some of its employees and hence, NSEL could be a victim of fraud by its own employees. Statements like these display how a parent company is attempting to evade its responsibilities

with regard to its wholly owned subsidiary company over which, it has absolute control. Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar are / were very much serving as directors of NSEL right from its inception. The afore-said three noticees are also the original promoters of NSEL when the company was incorporated on 18.05.2005 and out of total 50,000 shares, Shri Jignesh Shah and Shri Joseph Massey subscribed to 5,000 shares each while Shri Shreekant Javalgekar subscribed to 24,900 shares on behalf of MCX. Amongst other individual shareholder, Shri V. Hariharan also subscribed to 5,000 shares on behalf of MCX. Thus, since the time of incorporation, the majority stake in the company was held by MCX to the extent of 59.8% through Shri Shreekant Javalgekar and Shri V. Hariharan. Subsequently, in September 2005, 5,00,000 equity shares were issued to the FTIL by the company and all the existing shareholders, except for NAFED holding only 100 shares, transferred their stakes in favour of FTIL, thereby making FTIL 99.99 % holder of stakes in NSEL. The shift of control over NSEL from MCX to FTIL with effect from 30.09.2005 is also evident from schedule 10 (6) of Annual Report of NSEL for FY-2005-06. The Articles of Association of NSEL confers effective powers to the shareholders for appointment of shareholders' Directors (Clause 30). Since FTIL is effectively the only shareholder of NSEL, the constitution of the Board of Directors of NSEL is entirely under its control. In terms of Articles of Association, the Board of Directors has all the powers to frame the bye-laws or regulations of the Exchange (Clause 48) and is vested with all the powers starting from admission of members to conduct of business of exchange in all manners as well as amending bye-laws, rules and regulations of Exchange (Clause 49, 50 & 51). Thus, FTIL through the Board of Directors of NSEL constituted by it possesses effectual and absolute control over its subsidiary company, i.e., NSEL. Such control is further amplified and accomplished by the fact that Shri Jignesh Shah, the Promoter and Chairman-cum-Managing Director of FTIL has been on the Board of NSEL and functioning as Vice-Chairman of the company since its inception. Shri Joseph Massey was also a common Director both on the Board of FTIL and NSEL, while Shri Shreekant Javalgekar continued to be a Director of NSEL till he resigned from the post in July, 2013. Moreover, Shri Jignesh Shah was also the Vice-Chairman of NSEL and a part of Key Management Personnel

(hereinafter 'KMP') of NSEL till F.Y 2011-12. The year-wise information about KMP of NSEL has been furnished at paragraph no.8.1 of the SCN.

14.5.3 The meetings of NSEL Board were generally attended by all the Directors and its minutes regularly contained, inter alia, a discussion on the minutes of Membership Committee of NSEL. It is on record that all the minutes of Board meetings of NSEL were regularly tabled at the Board meetings of FTIL. References to some such minutes of NSEL Board meetings which ought to be in the knowledge of the FTIL Board have been illustrated at paragraph nos.7.6.4, 8.2, 8.3.1, 8.5, 8.6.2, 8.6.3 and 8.6.4 of the SCNs. Similarly crucial and sensitive matters like the observations of Internal Auditor on higher risk of credit default as mentioned at paragraph no.6.5, suspension of NSEL's licence by Directorate of Marketing, Maharashtra as discussed at paragraph no.6.14, insufficient stock of commodities at warehouses referred to at paragraphs nos. 7.3 & 7.4, mis-utilisation of margin money by NSEL as pointed out at paragraph no. 7.5.6, admission of members without due compliance with KYC norms as pointed out at paragraph no.7.6.2, trading by IBMA on MCX as well as NSEL exchange platform discussed at paragraph nos.8.3 and 8.4 and favours shown to defaulting members as indicated at paragraph nos.7.5.4, 7.5.8, 8.1.2 and 8.2 etc. of SCN were all matters which were supposed to be in the knowledge of the Board of Directors and through it, in the knowledge of FTIL as well. FTIL kept itself apprised about the affairs of NSEL and also approved/ratified the actions of NSEL in its Board meetings on a regular basis. Therefore, all the noticees, viz, FTIL and the three individuals named above can be said to have knowledge about all the NSEL's management issues notwithstanding any posture by them to the contrary. Even assuming for the sake of argument that this was not so, and that FTIL did not care to keep itself informed of these matters, it can hardly be contended that an abdication of FTIL's duties and obligations can come to its rescue. As a matter of fact, the noticees' claim of having no knowledge of the events at NSEL over a long period of 4 years reflects poorly on their ability and competence to govern and/or manage the affairs of an important market infrastructure institution such as commodity exchange.

14.5.4 On the one hand, FTIL had actual control over the management of NSEL, inter alia, through common directors on NSEL Board, appointment of personnel, scrutiny of all the minutes of the board meetings of NSEL tabled before its own board, consolidation of financial reports etc., while on the other hand, FTIL claims that it was itself in the dark about the alleged defaults at NSEL, which is belied by the material on record as stated above. FTIL is unjustifiably distancing itself from what has transpired at NSEL and their responsibilities in this regard. The criminal proceedings initiated by NSEL against some of its employees cannot absolve the NSEL Board / management or the Board / management of parent company FTIL of their responsibility for good governance/management of the company.

14.6 ***Application to cross-examine forensic auditor:*** *- FTIL while referring to the instances of* conclusions *drawn by the forensic auditor in their report with reference to paras 6.4, 7.1.1, 7.1.2, 7.5 and 7.5.4 have requested the Commission to summon the forensic auditor for cross examination by FTIL. In support of their request for such cross-examination of the forensic auditor, FTIL has referred to certain case law and has submitted that FTIL will file its detailed reply to the allegations in the SCN within a reasonable time from conclusion of such cross-examination.*

14.6.1 As pointed out earlier, the Commission directed NSEL to appoint a forensic auditor for inspection of their books of accounts, review of their maintenance of records and other housekeeping activities of the company so that on the basis of report of an expert agency further corrective measures can be taken by the Company to set their house in order. On the basis of this direction, it is NSEL who have appointed a forensic auditor, viz M/s. Grant Thornton India LLP (GT) for carrying out the aforesaid audit and review as per the terms of its appointment mutually agreed between them. Since the forensic auditor was commissioned by NSEL, the auditor examined all the documents, books of accounts etc., as presented to them by the Company and based on their examination and periodic discussions with the management and employees of the Company, the auditor submitted the report on 23rd September, 2013 in which, serious irregularities and gross anomalies in different spheres of functioning of

NSEL have been pointed out which have also been largely supported by facts and figures in various annexures enclosed to the report. Needless to say, FTIL being the parent company of NSEL which has appointed the forensic auditor was aware of the appointment of M/s. Grant Thornton, and its Directors, who are also Directors of NSEL were reportedly keeping a close watch over the audit work being carried out by the auditor. As stated by Grant Thornton, the audit report was finalised after due consultation with and review made by the NSEL management, including Shri Jignesh Shah and Shri Joseph Massey. It is also not the case of FTIL that it was not aware of the contents of the report submitted by Grant Thornton. FTIL has also not raised any objection to the findings made in the final report submitted by Grant Thornton.

14.6.2 Since the report of an expert agency specialising in forensic auditing has thrown up a host of facts pertaining to the actual working of NSEL and the manner in which the management of the Company carried out its business affairs, it is but natural for the Commission to take cognizance of and attach serious importance to such findings for the purpose of the instant proceedings.

14.6.3 The forensic report was germane and impinged directly on the issues under consideration and, therefore, the same could not be disregarded. As pointed out above, FTIL has not rebutted the aforesaid expert report nor has it fundamentally questioned the facts raised in the SCNs. The proceedings before the Commission are purely based on the facts which are available in the reports of NSEL, the collateral management firm SGS, the forensic auditor (GT), the minutes of the Board Meetings of NSEL and FTIL, the internal auditors report and all such documents to which both NSEL and FTIL (as the parent company) have access for the purpose of referring to and examining the report and seeking to clarify their position if they felt necessary.

14.6.4 The noticees not having disputed the facts set-out in the Grant Thornton report, it was not really necessary to grant them cross-examination of Grant Thornton. The rules of natural justice do not require that an opportunity to cross-examine be given where a party does not dispute or question the correctness of the facts alleged by the persons of whom cross-examination is sought. It is also

relevant to note here that Grant Thornton has not been examined as a witness by the Commission in the present proceedings.

14.6.5 Nevertheless, having regard to the requests made by the noticees, the Commission thought it fit to grant an opportunity to the noticees to question the authors of the Forensic Report, i.e. GT in its presence. Accordingly, the date for the cross-examination of GT was fixed on 25.11.2013 in the Commission's office. This was intimated to the noticees and to GT vide separate communications. However subsequently on 22.11.2013 Grant Thornton requested for an adjournment of the afore-said proceedings on the ground that their senior partners who would necessarily have to be present during the proceedings, would be travelling on the appointed day, i.e. 25.11.2013. Since the presence of officials of GT was crucial to the proceedings, the Commission had to adjourn it by a week and the same was re-fixed on 3.12.2013 and the noticees as well as GT were intimated about the re-schedulement of the proceedings on 26.11.2013 by fax, followed by despatch of a letter to them. On 29.11.2013, the Commission received a letter from FTIL sating that its counsel had to attend a part-heard matter at the Securities Appellate Tribunal (SAT), and hence could not attend the cross-examination. FTIL requested that the proceedings be postponed to one of five alternative dates selected by it on or after 11.12.2013. None of the other three individual noticees made any request for adjournment.

14.6.6 The request made by FTIL for adjournment lacked merit and justification. FTIL or its advocate could have immediately informed the Commission on 26.11.2013 itself that the date was not convenient so that the proceedings could have been re-scheduled accordingly. Now, just 3 days before the proceedings, FTIL approached the Commission with its request for adjournment thereby upsetting the schedule of the current proceedings for unwarranted reasons. Needless to point out here that, it is the noticees who were keen to cross-examine GT and it was on their repeated requests that the Commission made Grant Thornton available to them for questioning even though GT has not been examined by the Commission as a witness. Therefore, it was in the interest of the noticees that they should have attached utmost importance to the proceedings and use the opportunity to the fullest. Moreover, none of the three individual

noticees had made any request for adjournment of the proceedings. Since the three individual noticees were serving on the board of NSEL and are completely seized of the NSEL matters but have not requested for postponement of the proceedings, the Commission concluded that the three individual noticees, are prepared to confront GT with their questions. One of the three individual noticees, Shri Jignesh Shah who was Vice-Chairman of NSEL is also the Chairman and MD of FTIL. Under the circumstances, the request made by FTIL appeared to be a dilatory tactic aimed at prolonging the proceedings. Therefore, the request for adjournment made by FTIL was not accepted and the same was communicated to FTIL vide a letter dated 29th November, 2013.

14.6.7 On the scheduled date, i.e. 03.12.2013, 8 officials duly authorized by Grant Thornton presented themselves before the Commission for questioning by the noticees. However, only one noticee, viz: Shri Joseph Massey attended the proceedings. As the Commission did not accept the adjournment request of FTIL and the other remaining two noticees did not ask for adjournment in their personal capacities, the Commission, expecting the attendance of all the noticees, waited for thirty minutes more from the scheduled time of 10:30 a.m, but when none of the remaining three appeared till 11:00 a.m, there was no option left but to continue with the proceedings in the presence of one noticee, Shri Joseph Massey.

14.6.8 At the outset of the proceedings, Shri Joseph Massey made a statement before the Commission that he had many questions to ask but would be able to do it through his counsel and he would request the Commission to grant him time. In view of the aforesaid response from Shri Massey who, despite being present, did not wish to avail the opportunity granted to him to cross-examine Grant Thornton, the Commission deemed it fit to utilise the proceedings to elicit the responses of Grant Thornton at least on the points of arguments raised by the noticees' counsel during his oral presentations before the Commission on 12.11.2013. As mentioned earlier, the counsel of the noticees had submitted a written note on his arguments during his oral presentations which contained inter-alia, ten questions / objections pertaining to the forensic audit report of Grant Thornton. Those ten issues primarily raised fingers at the reliability, methodology,

validation process etc., of the forensic audit report. Since these issues were categorically raised by the counsel before the Commission, Grant Thornton was asked to give their replies to these ten specific issues during the proceedings. The responses of Grant Thornton have been duly recorded in the presence of Shri Joseph Massey. During the proceedings, Shri Joseph Massey intervened at different stages and posed some specific queries to Grant Thornton and also raised three additional queries which were responded to by Grant Thornton. All the questions and answers were duly recorded and authenticated by Shri Joseph Massey and the authorised personnel of Grant Thornton. Towards the conclusion of the proceedings, Shri Joseph Massey reiterated his request for one more opportunity to cross-examine Grant Thornton. However, objecting to such request, the authorised officials of Grant Thornton stated that '*the Noticee No.3 (Shri Joseph Massey) has subsequently participated fully in the process of cross-examination and has asked all questions that he wanted to. The process of cross-examination should therefore be declared as closed and the witness should be discharged. It should also be taken into consideration that the entire team has kept itself present for any information as required*.'

14.6.9 Keeping in view the foregoing discussions and narration of events pertaining to the request made by the noticees for cross-examination of GT, it can be concluded that, despite the Commission granting opportunity to the noticees to question Grant Thornton in the manner they liked, to muster all the facts as they deemed necessary for defending their cause, except for Shri Joseph Massey, the remaining three noticees chose to remain absent on the scheduled day when the entire team of Grant Thornton was available before the Commission for questioning by the noticees.

14.6.10 The forensic audit report submitted by Grant Thornton contains a number of adverse findings of fact with regard to the management of NSEL which till date, have not been contested by any of the noticees. The objections and issues so far raised by the counsel of the noticees primarily relate to the technical, procedural and reliability aspects of the audit report which have been substantially rebutted by Grant Thornton during the above proceedings as would be evident from their replies as reproduced below:-

1. *"The scope of work of Grant Thornton is set out in Para 2 of their report ("Report"), which was essentially in the nature of reviewing the settlement system, quantifying the outstanding liabilities and commenting on the settlement plans.*

***GT's Response**: The scope of work is as defined in our Engagement Letter dated 27th August, 2013 addressed to NSEL and confirmed by FMC. The scope is adequate in our opinion for a forensic audit. We confirm that we have carried out our engagement in accordance with the agreed scope of work in clause 2 of the engagement letter. The report does not go beyond the agreed scope of work.*

2. *The methodology and process of work done is set out in Para 3 of the Report, emphasises how it was a commercial methodology, not founded on principles of natural justice or quasi-judicial processes that would ensure the rule of law.*

***GT's Response**: Our work was carried out in accordance with the agreed methodology which was agreed by NSEL and FMC. The draft report was shared on 17th September, 2013 with Shri Jignesh Shah, Shri Joseph Massey, Shri P. R. Ramesh, Shri Anjani Sinha, Shri Shashidhar Kotian, Shri Bharat Tripathi for their views, comments and confirmation. The report was finalised thereafter.*

***At this juncture**, Shri Joseph Massey took the permission of the Commission to intervene to state that 'that the meeting that took place was for an hour during which the executive summary was presented to us and we did not get time to go through the report and give our comments and nor did we know the end use of the forensic report for which we should have commented. No specific questions were posed to us and we were not witness to the entire process that was undertaken by them.'*

***Response of GT**: We reiterate the position that the entire draft report consisting of approximately 45 pages including the executive summary was reviewed by the NSEL team and made and clarified specific issues on every page and the GT team provided clarifications as required. One copy of the draft report was provided to NSEL which was then discussed by their team.*

***Shri Joseph Massey**: The GT **report** was not given to me by the GT team and was shown to me during the meeting through a power point presentation. I don't even recollect whether all the people referred above were present during the entire presentations which focussed only on the executive summary as we were told that the essence of the entire report is captured in the executive summary.*

3. *Para 4.1 of the Report, in fact, makes it clear that Grant Thornton has not "independently verified or validated" any information.*

***GT's Response**: This is as per the mandate given to us contained in clause 6.4 of our engagement letter which reads 'Our findings shall be based on the information made available to us and we have not independently verified or validated the information. Our report shall be conclusive at the time of signing the report. Should additional information or documentation become available which impacts upon conclusions reached in our reports, we reserve the right to amend our findings accordingly.' The engagement letter referred to above is the contract for the forensic audit executed between GT and NSEL and confirmed by FMC.*

4. *Paragraph 4.2 of the Report states that Grant Thornton's Report "did not constitute an audit" and therefore "cannot be relied upon to provide the same level of assurance as a statutory audit." Therefore, Grant Thornton's Report can hardly be said to be a "forensic audit report" much less even an 'audit report'.*

***GT's Response**: The **engagement** was not for a statutory audit but for a forensic purpose. We have followed well-accepted methodology for conducting this forensic audit. We have provided supporting documents which was the basis of our findings from the study. This was also stated in our engagement letter clause 6.6 which states 'Under these arrangements, Grant Thornton has not been retained to conduct a statutory audit under any generally accepted accounting principle, hence it cannot be relied upon to provide the same level of assurance'. The level of assurance for forensic audit is based on reporting all the evidence based on the procedures carried out and does not limit itself to materiality like in a statutory audit.*

5. *Paragraph 5.1 of the Report states that the Report is "not intended for" being "quoted or referred to in whole or in part" without Grant Thornton's prior consents in each specific instance.*

6. *The notices hereby call upon FMC to provide a copy of such consent from Grant Thornton for their report to be relied upon in a SCN for these proceedings.*

***GT's Response to 5 & 6**: GT has given its consent to FMC on 27th September by email and on 28th September, 2013 by a letter.*

7. *Even Grant Thornton has said that "should additional information or documentation become available, which impacts upon conclusions reached in our report, we reserve our right to amend our findings and reporting according."*

8. *Therefore, even Grant Thornton Report is preliminary, premature and unworthy of any reliance for regulatory proceedings either of the nature contained in the SCN or at all.*

***GT's Response to 7 & 8**: We have not received any additional information subsequent to our report which would impact our conclusions. The report is final and the findings are true and correct.*

9. *In fact, Grant Thornton has categorically asserted that its comments "are not intended, nor should they be interpreted to be legal advice or opinion".*

***GT's Response**: It is neither a legal advice or a legal opinion but a finding of facts.*

10. *Consequently, the credibility of Grant Thornton's report and the findings contained therein are unreliable and unworthy of any dependence by a regulatory that cares for the rule of law, particularly when Grant Thornton itself says its processes can give no assurance of being even in the nature of a statutory audit much less it being regarded as a forensic audit to support investigations.*

***GT's Response**: This is covered by our responses in the previous paragraphs.*

Shri Joseph Massey sought the permission of the Commission to put some more questions to GT. His questions and the answers given by GT are recorded as under:

Q1. If GT knew that their report would be used or relied upon for issuance of the show cause notice for which they gave their consent on September 28th, 2013 would their dealing with directors of NSEL would have been different than the process that was adopted currently ?

GT : No.

Q.2 Why was the entire board of NSEL not formally met or why a meeting was not considered necessary for the purpose of the GT report?

GT : We did not deem it necessary and there was no request from NSEL for such a meeting.

Q.3 Did GT know that there was a fraud / loss committed by key management persons in NSEL and if yes, then what precaution was taken to verify the data from board / new officials of the exchange?

GT: The question is objected to as being beyond the scope of the work undertaken by GT and the purpose of cross-examination that has been permitted by this Commission. The report and the correctness of its contents can be made the subject-matter of cross-examination. The report is self-contained and self explanatory. There is no question raised about the correctness of its contents."

14.6.11 The Commission in one of its communications to the noticees on 20.11.2013, had already tried to emphasise the fact that the proposed cross-examination of GT should be primarily viewed as a fact-finding exercise and the Commission is eager to have all the facts made available to it before a judicious and informed decision is taken in the matter. Accordingly, the Commission sincerely desired the noticees to attach utmost seriousness to avail the opportunity to extract all the facts that are relevant for the purpose of a judicious conclusion of the proceedings. However, the noticees, chose instead to raise various technical objections and FTIL did not avail of the opportunity to confront GT on the factual content of their forensic report. In any case, Grant Thornton has already answered all the points of objections/questions raised by the counsel of the noticees in his submissions before the Commission and a copy of the record of the proceedings has been handed over to Mr Joseph Massey immediately after conclusion of the proceedings. Under the circumstances, the request of Shri Joseph Massey or FTIL to offer one more opportunity for cross-examination which has been seriously objected to by GT, was not accepted.

14.6.12 It is seen that each of the four noticees have, on 6th December, 2013 filed another written submission calling the same as updated and restated memo of their submissions post the personal hearing held on 12.11.2013. On a careful perusal, it is found that the contents of all the submissions are identical, touching upon the same issues. Further, most of the issues raised in these written submissions are reiterations of their earlier submissions made before the Commission, hence discussion of the same would amount to repetition. The only additional point made in this written submission pertaining to their objections to the manner in which the cross-examination of Grant Thornton was conducted on 03.12.2013. The noticees have alleged that the approach of the Commission to cross-examination was unfair, coercive and arbitrary in so far as they were not allowed a fair opportunity to participate with their legal counsel and the Commission asking Grant Thornton to reply on the noticees' submissions behind their back, has deviated from the principles of natural justice and the due process of law. The noticees have also argued that the proceedings on 03.12.2013 cannot be called a cross-examination and can, at best, be called the examination-in-chief of Grant Thornton.

14.6.13 The objections and arguments of the noticees in the aforesaid written submissions dated 06.12.2013 have been carefully considered in the preceding paragraphs. The facts and circumstances under which the cross-examination of Grant Thornton was completed as per its schedule on 03.12.2013 has been discussed at length. Only FTIL sought deferment of the proceedings to certain selected dates which was not feasible given the pre-occupations of the Commission with other matters. It has also been stated that none of the three individual noticees made any specific request for postponing the date of cross-examination. In fact, Shri Joseph Massey, on his own volition attended the proceedings and also put forward his questions to Grant Thornton in the manner he wanted, which were replied to by Grant Thornton. The questions / issues raised before Grant Thornton were purely based upon the written notes of arguments submitted by the counsel before the Commission and this fact has not been contested by the noticees. The Commission did not ask any question, *suo moto*, beyond the list of issues / questions which were raised by the Counsel

during personal hearing of the noticees on 12.11.2013. The only objective behind presenting those questions / issues before Grant Thornton was to elicit their responses to the issues raised by the noticees themselves, in the presence of one of the four noticees. This cannot be considered a proceeding conducted behind the back of the noticees. In view of the aforesaid, the grievance of the noticees regarding the approach or conduct of cross-examination by the Commission has no merit.

14.6.14 In this connection, it is worth noting that the warehousing fraud committed at NSEL is an admitted fact. NSEL itself has declared 22 of its borrower members as defaulters and has filed criminal cases against them. The audit firm SGS appointed by NSEL has found stocks missing in most of the NSEL's warehouses that it inspected, which has not been contested by NSEL or FTIL. The criminal investigations being undertaken regarding this scam are being reported in the media everyday. The forensic auditor, Grant Thornton has only relied upon the documents and information provided by NSEL and such information as provided by NSEL has revealed the system failures at NSEL that have led to this massive fraud. Therefore, the noticees' questioning the report of Grant Thornton does not stand to reason since the fact of a massive fraud having been committed has been established beyond any doubt by now.

14.7 ***Guidelines without jurisdiction:*** *It has been submitted by FTIL that the Commission has no jurisdiction or power to initiate any action contemplated under the SCN since the Forward Contracts (Regulation) Act 1954 does not confer on the Commission any powers to enforce the Guidelines. In this regard, FTIL has referred to the Forward Contracts (Regulation) Amendment Ordinance 2008 and mentioned that the Guidelines were issued when the ordinance was in force and that the Ordinance lapsed thereafter. It has also been submitted by FTIL that the Guidelines have been issued much later than the time when MCX was set-up in 2003 and such guidelines cannot apply retrospectively.*

14.7.1 The aforesaid allegations made by FTIL regarding lack of jurisdiction and about retrospective application of guidelines are based upon an erroneous appreciation of the facts and a flawed appreciation of law. First of all, the

contention of FTIL that the present statute, i.e. the FCRA, 1952, does not confer on FMC any power to enforce the guidelines and that it is only the Forward Contracts (Regulation) Amendment Ordinance, 2008 (FCRA Ordinance, 2008) which vested in FMC the regulatory power to issue guidelines for regulating the composition of Board of Directors of National Exchanges, is erroneous. A careful perusal of the two guidelines issued by the Ministry of Consumer Affairs, Food & Public Distribution, Government of India, viz the **Commodity Exchange Guidelines** dated 14th May, 2008 as amended on 17th June, 2010 and the subsequent **Post *5*-year Guidelines** dated 29th July, 2009 as amended from time to time*,* would reveal that these two guidelines have not referred to the FCRA Ordinance, 2008 or any special regulatory power being vested by such Ordinance under which, these guidelines have been issued, as claimed by FTIL. The objectives and scope of these guidelines have been delineated in the preamble of these guidelines where no reference to the aforesaid ordinance has been made. Further, the fact that these guidelines have been subsequently amended even long after the lapse of the FCRA Ordinance, 2008 and complied with by all exchanges including MCX, itself establishes that they were issued independent of the said Ordinance. These two guidelines were issued under the provisions of existing FCRA, 1952 and stand on their own by virtue of powers conferred upon the Central Government and the Forward Markets Commission under the existing FCRA, 1952. As the title of the first guideline would suggest, the same was issued in connection with the grant of recognition to new Commodity Exchanges under section 6 of FCRA, 1952. The relevant provisions for grant of recognition under FCRA, 1952, is Section 6 (1) which reads as follows '***Grant of recognition to association:-*** *If the Central Government, after making such inquiry as may be necessary in this behalf and after obtaining such further information, if any, as it may require, is satisfied that it would be in the interest of the trade and also in the public interest to grant recognition to the association which has made an application under Section 5, it may grant recognition to the association in such form and subject to such,* ***conditions as may be prescribed or specified,*** *and shall specify in such recognition the goods or classes of goods with respect to which forward contracts may be entered into between members of such association or through or with any such member.* **(Emphasis supplied).**

14.7.2 The aforesaid provisions may also be read with Rule 7 of Forward Contracts (Regulation) Rules, 1954 which reads as under:

> ***"7. Grant of Recognition.*** *(1) Before granting recognition to an association under Section 6 of the Act, the Central Government may besides making such inquiry and obtaining such further information as is referred to in that Section, also consider the advice of the Forward Markets Commission. (2) The recognition granted to an association shall be in Form B, specify the goods or the classes of goods with respect to which, in which forward contract may be entered into between the members of such association or through or any such member and be subject to the following conditions, namely:*
>
> *I. that the recognition granted shall be for such period not less than one year as may be specified in the recognition;*
> *II.* ***that the association shall comply with such directions as may from time to time be given by the Forward Markets Commission."*** (Emphasis supplied).

14.7.3 The authority to issue the Commodity Exchange guidelines pertaining to equity structure of the nation-wide multi Commodity Exchanges were derived from the provisions of section 6 of FCRA, 1952. Similarly, the guidelines issued by the Commission containing comprehensive directions to the National Commodity Exchanges relating to the constitution of the Board of Directors, nomination of independent directors as well as appointment of Chief Executives of such National Commodity Exchanges, have been issued and revised from time-to-time in exercise of powers conferred under Rule 7 (2) (ii) of FCR, Rules. It is pertinent to note that recognition to any nation-wide National Commodity Exchanges can be granted subject to any conditions which not only can be prescribed but also can be specified as provided under Section 6 (1) of FCRA, 1952. Moreover, the Commission also has power to issue directions under the Certificate of Recognition, and such directions of the Commission are enforceable by entities such as MCX which are recognised under FCRA, 1952.

In this matter also, the decision of the Commission is applicable and directed at its regulated entities. Therefore, as a regulator, the Commission is adequately vested with such power from the provisions in the Act and the relevant rules pertaining to the grant of recognition, to issue any directions either in the form of guidelines or otherwise, to the nation-wide Commodity Exchanges who are under obligation to comply with such directions as part of the compliance of the conditions stipulated to them while granting them recognition.

14.7.4 Even otherwise and independent of the aforesaid, the Commission is of the view that the requirement that the promoters of an association should be fit and proper person to run the same is a basic and fundamental requirement in the grant or continuance of recognition under Section 6 of the FCRA, 1952. The appropriate authority always has the power and jurisdiction to inquire into this fundamental aspect and to take appropriate action in that regard. It is untenable to suggest that the appropriate authority must not concern itself with the fitness and conduct of the Promoters of the association even if that conduct has a bearing on their fitness to be promoters.

14.7.5 The promulgation of the Ordinance is an unrelated event which was not determinative of the power of the Commission or Central Government to issue directives in the form of guidelines to the nation-wide multi Commodity Exchanges. None of these guidelines makes a mention of such Ordinance which is erroneously claimed to be the source of their authority. There is no denying the fact that the Ordinance referred to by FTIL sought to enhance the existing powers and authority in a comprehensive manner touching upon all aspects of Commodity Market Regulations; but at the same time, it is incorrect on the part of FTIL to claim that but for the Ordinance, which was promulgated and remained in force for a limited period, the Commission does not have the regulatory power, under the existing FCRA, 1952 to issue directions or guidelines to the recognised Exchanges. At the risk of repetition, the Commission would like to state that it is a statutory body created under the FCRA, 1952, for regulation of Forward Contracts Market. The title of the FCRA, 1952 adequately evidences the fact that the FCRA, 1952 is meant for regulation and therefore, the functions of the Commission cannot but be regulatory in nature in satisfaction of the legislative

intent of FCRA, 1952. In fact, section 4 (b) of FCRA, 1952, makes it abundantly clear that one of the primary functions of the Commission is to '*keep the Forward Market under observation and to take such actions in relation to them as it may consider necessary',* in exercise of powers assigned to it by or under this Act. Therefore, the contention of FTIL that Commission lacks jurisdiction under FCRA, 1952 to issue guidelines is not only an unfounded allegation but also an attempt to thwart the present proceedings before the Commission at the cost of larger public interest in particular and interest of Commodity Market in general. **It may be noted that FTIL, at Para No.9 of its submission has admitted that it has diluted its stake in MCX by reducing the same to 26% so as to achieve compliance with FMC's <u>regulatory mandate</u> to bring down promoter holding in Commodity Exchanges.** Thus, by their action and conduct in compliance with the guidelines issued by the Central Government, FTIL has been accepting all these years that the directives given under these guidelines carry a regulatory mandate under FCRA, 1952. However, at Para No.40 it has taken a contradictory posture by claiming that FMC has no jurisdiction to enforce guidelines under the present FCRA, 1952. This shows the palpable confusion in the mind of FTIL about the true import of provisions of law under FCRA, 1952. Under these circumstances, the contentions of FTIL including the decision of the Hon'ble Supreme Court in the case of '*State of Tamil Nadu v. Paramsiva Pandian (2002) (I) UC 91'* which has been referred to by it is out of context and does not advance its case at all.

14.7.6 FTIL has also claimed that the aforesaid guidelines operate and apply only to the setting up of new Commodity Exchanges and that since MCX was already in existence at the time of promulgation of the guidelines, the same cannot be invoked against them. It has further submitted that subordinate legislation such as guidelines cannot operate retrospectively. On this basis it contends that the stipulations regarding 'fit and proper persons' in the Guidelines cannot be made applicable to it. The Commission has carefully considered these contentions, but finds them untenable.

14.7.7 To begin with, as mentioned above, the requirement of being a 'fit and proper person' to run an exchange is a basic and fundamental one which

attaches to all promoters / shareholders by virtue of their very position and which runs throughout the lifetime of the exchange. It is untenable to suggest that a person need not be 'fit and proper' to run an exchange and that the market regulator is powerless either to look into this aspect of the matter or to take the necessary action if the concerned party is found not to be a 'fit and proper person'.

14.7.8 Further, the criteria for 'fit and proper persons' which are stipulated in the Guidelines only make explicit factors which have always been implicit and relevant in determining whether a person is 'fit and proper' to be a promoter. Surely it cannot be suggested that a person who does not have a record of financial integrity, good reputation or character or honesty should be considered a 'fit and proper person' to run an exchange. Similarly, it is untenable to suggest that an entity which is insolvent or a person who is of unsound mind should be considered 'fit and proper'.

14.7.9 Notwithstanding this position, MCX's contention that neither of the Guidelines issued by the Central Government are applicable to it, is incorrect. The Guidelines dated 14th May, 2008, though specifically covering the grant of recognition to new exchanges, clearly support the argument that the criteria stipulated in Annexure-I thereof were intended to apply to existing exchanges as well as new exchanges. The Guidelines specifically provide that the promoters of a proposed exchange must be a 'fit and proper person' and list the criteria in that regard. As mentioned above, the criteria are unremarkable insofar as they are factors which are, in any case, applicable on a basic determination of a person's 'fit and proper status'. Clearly the intent of the Guidelines is that all promoters / shareholders of exchanges must be 'fit and proper persons' and that the evaluation of that 'fit and proper status' should be as per the criteria therein.

14.7.10 Now, coming to the Guidelines dated 29th July, 2009, they clearly apply to existing exchanges which have completed five years of operation. The criteria for 'fit and proper persons', incidentally, are identical in both Guidelines. The Guidelines dated 29th July, 2009 are therefore clearly applicable to MCX and the promoters of MCX are required to comply with the stipulated requirements

regarding 'fit and proper persons'. Again, the fact that specific reference is made to the 'fit and proper' criteria in Clause 4, which requires a confirmation by the exchange that the investors in whose favour the divestment / fresh issue of equity is made fulfill the criteria, does not alter the position that the Guidelines contemplate that promoters of an exchange must fulfill the 'fit and proper' criteria. In fact, the stipulation that a confirmation be provided that the fresh investors fulfill the criteria itself affirms that it was taken as a given that the existing promoters must fulfill them.

14.7.11 To accept noticees' contentions would be to accept a position where promoters of a new exchange are required to be 'fit and proper persons' as per reasonable and logical criteria, but promoters of an existing exchange are not. This would be an anomalous and irrational situation and one which was clearly not contemplated under the FCRA and the Guidelines referred to in this regard.

14.7.12 The observations made above would also apply to the Guidelines issued by the Commission with regard to the constitution of Board of Directors, etc. These Guidelines are applicable to all exchanges and not only to exchanges coming into existence after the issue of the guidelines. The criteria stipulated are the same as those in the Central Government Guidelines. Again, it is incorrect to contend that directors appointed after the date of the Guidelines are required to fulfill the 'fit and proper' criteria, but those who are already on the Board do not.

14.7.13 In the light of the discussion made above, the Commission does not accept and dismiss the contentions with regard to the non-applicability of the Guidelines and the lack of jurisdiction of the Commission.

14.8 ***Fully segregated management, control and operations:*** *The shareholding of MCX has no relevance to its management and since FTIL has only one director nominated on the board of MCX, there is no control of FTIL in MCX. Thus, no benefit is caused by removal of FTIL from the shareholding of MCX or any loss on account of its continuation. FTIL, while referring to the List of members of Board of Directors of MCX and the key managerial personnel (KMP) of MCX has submitted that the directors of FTIL cannot be said to have any*

control or influence over the working of MCX and none of the KMP of MCX are nominated by, or are associated with FTIL. Therefore, the status quo in relation to FTIL's interest in MCX ought not to be disturbed. FTIL has submitted a list of various exchanges in India and abroad promoted by them and has submitted that all the exchanges are legal entities and declaring FTIL as unfit would have an effect on other exchanges as well.

14.8.1 One cannot lose sight of the fact that MCX is a listed company answerable to not only the public shareholders but also requires to be compliant with the regulations prescribed under the FCRA, 1952. It is important to note that MCX, in addition to being a corporate entity, is an Exchange. It is a trading, clearing and settlement platform recognised by Government under section 6 of FCRA, 1952. It is a self-regulatory organisation (SRO) which regulates the day-to-day trading on its Exchange platform involving thousands of crores of rupees of investments by numerous market participants. In that sense, it is a highly sensitive public institution in which trust and faith is reposed by the public at large. Therefore, the shareholders of such a sensitive institution need to conduct themselves impeccably and possess an unsullied general reputation and record of fairness and integrity. The guidelines issued by the Central Government dated 29th July, 2009 explains an '**Anchor Investor' as an investor who plays the lead role in managing the National Commodity Exchange**. Here, in the case of MCX, FTIL is the 'Anchor Investor' possessing the largest stake of 26%, thereby holding the most pivotal role in managing the affairs of MCX. In the case of MCX, the role of FTIL becomes much more critical as it is also the technology provider for MCX and holds the source code of its trading platform. This necessitates public trust of a higher order than a normal shareholder of an exchange. Keeping the immense importance attached to the existing and prospective shareholders of nation-wide multi Commodity Exchanges in mind, all the investors / shareholders have to fulfil the criteria for 'a fit and proper person' as defined in Note 2 of the said guidelines.

14.8.2 Under these circumstances, the criteria of a 'fit and proper person' demand strict and mandatory compliance by every shareholder of a recognised nation-wide Exchange such as MCX. The grounds taken by FTIL that MCX is a

demutualised Commodity Exchange and that FTIL, which had earlier two directors, now has only one director on the Board of MCX and it does not have control over the management, and that it has promoted a number of overseas Commodity Exchanges which are running independently under professional management etc., would not affect the determination of 'fit and proper person' status of FTIL as a shareholder of MCX in the facts and circumstances of the present case. FTIL, as an anchor shareholder of MCX, cannot claim that it was unaware of the directives issued by the Central Government and the Commission under the aforesaid guidelines from time-to-time. The fact remains that FTIL was required to safeguard its general reputation, record of fairness and integrity as a shareholder. That position is not affected by the factors mentioned by FTIL.

14.9 ***No cause to suspect wrong-doing:-*** *It has been submitted that there were no circumstances that could lead to FTIL being aware of any such alleged developments at NSEL since the information in relation to the working of NSEL was available only by way of the minutes of the meetings of the Board of Directors of NSEL provided to FTIL's board and by way of financial statements of NSEL and the various minutes of the meetings of the Board of Directors of NSEL that were placed before the Board of FTIL do not contain any item that could have led to any direct inference at the relevant time of any wrong-doing occurring at NSEL.*

14.9.1 It is undisputed that NSEL was an Exchange in which FTIL had ownership interest to the extent of 99.9998% leaving a negligible 0.0002% stake to NAFED. The Articles of Association of NSEL confers authority to its shareholders to appoint Directors. As the single largest share-holder, it is FTIL which has nominated all the directors on the NSEL board. As a wholly-owned subsidiary, NSEL is completely under the control of FTIL, including financial control over the affairs of NSEL. FTIL, which had the responsibility of managing the affairs of NSEL, cannot claim to be unaware of the wrong-doings and fraud committed by the management of NSEL. Interestingly, on the one hand, FTIL claims complete ignorance of any irregularities in NSEL despite having its own Directors on the Board of NSEL and despite receiving minutes of NSEL's Board Meetings for consideration by its Board and on the other hand, it has alleged that the fraud in

NSEL could have been perpetrated by the employees of NSEL. This is obviously with a view to safeguard the interest of its own Promoters and Directors who were on the Board of NSEL. While it argues that it would not be in a position to prove or dis-prove the allegations since those have never been brought to its knowledge, in the same breath, it contends that the Board of Directors of NSEL were not aware of the defaults. The statements of FTIL are, therefore, replete with contradictions and lack merit.

14.9.2 The Board of Directors of a Company is duty-bound to be aware of the manner in which the affairs of the company are being conducted. The facts of mis-management and ill-governance of the affairs of NSEL have been detailed in the SCN. It is difficult to conceive that the Board could be unaware of trading by unworthy members who were awarded margin relaxations and fund assistance, and consistent flouting of regulation by the management. Since the Board of Directors of NSEL included Shri Jignesh P. Shah as Vice-Chairman and Shri Joseph Massey as a Director who were also on the Board of FTIL, FTIL cannot plead ignorance of the affairs of NSEL. Under these circumstances, the arguments put forth by FTIL that there was no cause for it to suspect the alleged wrong-doings by NSEL defies common sense.

14.10 ***Regulatory Response Disproportionate****:- It has been argued by FTIL that penalising FTIL for the alleged wrongs of NSEL, especially when there has been no conclusive adjudication of the allegations against NSEL and the role of FTIL in relation to the same, would amount to inflicting a grossly disproportionate injury on FTIL and other exchanges.*

14.10.1 FTIL has not adequately appreciated that the present proceedings are to decide as to whether, as the anchor investor of MCX, it continues to meet the criteria of 'fit and proper person' as prescribed under the guidelines issued by the Central Government. For deciding the same, the shareholder has to pass a litmus test of the criteria prescribed in the guidelines keeping in view the facts and circumstances surrounding the conduct of a shareholder of a recognised Commodity Exchange. The fact, with regard to FTIL vis-a-vis NSEL, remains that NSEL is effectively a wholly-owned subsidiary of FTIL. FTIL has complete

control over the appointment of Board of Directors of NSEL, and through them effective control over the functioning of NSEL. The NSEL Board has the authority to frame the bye-laws, rules and regulations of the Company and has all the powers with regard to admission of members, conduct of the business of the Members of the Exchange with other Members or Non-Members of the Exchange, prescribing maximum open positions, deciding on procedures to be followed on the suspension or expelled or declared defaulters and all other powers relating to the risk management and trading in the Exchange platform.

14.10.2 Independently of the above, it appears to the Commission that the principle of *res ipsa loquitur* or similar principles would apply in the present case. The magnitude and nature of the break-down in the present case tells its own story. The failure of the management of NSEL, which lay in the hands of FTIL, is clear from the events on record.

14.10.3 After having considered the various objections raised by FTIL, the Commission now adverts to the contentions of FTIL as appearing at Paragraph No.63 to 106 in its written submission. A majority of them are repetition of what have already been raised and which the Commission has already considered in the preceding paragraphs. Therefore, for the sake of avoiding repetition, the explanations offered by FTIL by way of para-wise reply to the SCN are dealt with together.

14.10.4 Most of FTIL's contentions pertaining to its role vis-a-vis NSEL are repetitions of what it has already stated under the technical / legal objections made by it and have already been discussed at length in earlier paragraphs of this order. FTIL's main argument is that it does not conduct the day to day operation of NSEL and the information provided by NSEL was assumed to be correct by FTIL. It further argues that it had no knowledge of the alleged defaults in NSEL and that just because it is the promoter holding company the alleged defaults cannot automatically be attributed to FTIL without adjudication of the alleged default of the subsidiary company. According to it, even the Board of NSEL was not privy to or responsible for the events at NSEL, which was being handled by the management. FTIL identifies the management of NSEL as the

Managing Director and other subordinate officials and contends that it does not include the Board of Directors. It has argued that neither the FTIL Board nor the NSEL Board had any knowledge of the defaults at NSEL. FTIL further goes on to state that Shri Jignesh Shah was not the Key Management Personnel (KMP) of NSEL as he was not its permanent employee, and hence cannot be held responsible for the affairs of NSEL. It has also argued that Shri Jignesh Shah was not responsible for the day to day business of NSEL and was not directing and controlling the activities of NSEL. It has been submitted that NSEL Board would have been misled by the management of NSEL and assumed the facts and figures provided by management to be correct.

14.10.5 The Commission has already analysed most of the above arguments made by FTIL and has found them to be wanting both on facts and law. FTIL has repeatedly tried to project that it had no knowledge about the alleged affairs at NSEL, without any supporting material to justify their stand. It is a fact that Shri Jignesh Shah along with his closely held company is the promoter and is the Chairman-cum-M.D of FTIL. It is also observed from the Memorandum of Association of NSEL that Shri Jignesh P. Shah alongwith Shri Joseph Massey, Shri Shreekant Javalgekar and 3 others, were the initial promoters of NSEL on 18th May, 2005 and are signatories to the Memorandum of Association of NSEL. Shri Jignesh P. Shah and Shri Joseph Massey are the first directors of NSEL. Soon after that, by September, 2005, FTIL owned 99.99% of its shares, making NSEL its wholly-owned subsidiary. By virtue of its share-holding of 99.99% in NSEL, FTIL has complete control over the affairs of NSEL enabling it to appoint all the Directors on the Board of NSEL. The Articles of Association of NSEL vest in the Board of Directors of NSEL all the powers including the authority to formulate the bye-laws of the Company. Throughout the existence of NSEL, Shri Jignesh P. Shah who is also the Chairman-cum-MD of the parent company, remained as Vice-Chairman from March, 2008 onwards and a 'key management person' (as shown in the Annual Report of NSEL from inception to FY-2011-12) of NSEL. It is a matter of record that Shri Jignesh Shah, Shri Joseph Massey and Shri Sreekant Javalgekar were Audit Committee members of NSEL. In effect, the NSEL Board, in terms of its bye-laws not only depended on FTIL for its constitution but also derived all their powers including the power to formulate and

administer the bye-laws of NSEL, from the Board of FTIL. Moreover, with the presence of FTIL in the Board of NSEL, it can be logically concluded that the control over management of NSEL by FTIL was complete.

14.10.6 As pointed out earlier, no matter what FTIL may state to express its ignorance and innocence about the affairs of NSEL, it cannot shy away from its role and duty as a parent company to take reasonable care and exercise prudence in management and governance of the subsidiary company. With the presence of the key directors of FTIL and MCX in the Board of NSEL, one of them being the main promoter of the entire group having substantial interest in day-to-day running and management of all the group companies, FTIL cannot forsake its accountability when confronted with the hard facts of mis-management of NSEL affairs which have resulted in settlement default of Rs.5,500 crore of investment made by over 13,000 participants on its exchange platform.

14.10.7 It is also observed that apart from attempting to distance itself from the affairs of NSEL, FTIL has made hypothetical statements that the NSEL Board may not have been aware of the irregularities in the management of the Company and that Shri Jignesh Shah was not part of the Key Management Personnel (KMP) of the Company as he was not its permanent employee, and hence cannot be held responsible for the affairs of NSEL. These arguments put forth by FTIL are nothing but an attempt to carve out an escape route for itself and also for the Directors of NSEL appointed by it. Shri Jignesh Shah is the face of FTIL and NSEL and has control over NSEL through FTIL. He has made several assurances and presentations in different forums regarding the business model of NSEL on the basis of which, the market participants have substantially traded on the platform of NSEL Exchange. Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar have been serving on the Board of NSEL since its inception. Incidentally, Shri Anjani Sinha who has been accused of the entire fraud at NSEL by the noticees, was a CEO under the control & superintendence of the Board of Directors from June, 2006 continuously for five years and only from July, 2011 he was elevated to the post of MD-cum-CEO. Thus, the Board of NSEL has always been responsible for management decisions ever since its inception. Under these circumstances, FTIL's claim that

neither it nor the Board of NSEL nor even the promoter Shri Jignesh Shah had any knowledge of, or can be held accountable for any wrong-doings on the part of NSEL, defies common sense and logic, let alone the principles of settled law on Corporate Management.

14.10.8 In its submission, FTIL has cited various clauses of the bye-laws to oppose the contention made at Para No.6.16 of the SCN holding that NSEL is not solely responsible for settlement of trades. Referring to Bye-Laws 3.11, 3.13.1, 5.21, 5.26, 6.4, 7.9.1, 7.2.2, 7.9.3, 7.9.4, 7.9.5, 9.4, 9.6, 12.2.3, 12.6 – 12.8 & 12.9.2, FTIL has argued that NSEL is not fully responsible for settlement of trades as these Bye-Laws cast responsibilities on various members, participants and clients etc, trading on the Exchange. Such an argument by the parent company only smacks of its evasive attitude when it comes to shouldering the responsibilities of settling the outstanding trades which is the primary onus of an exchange on the platform of which thousands of participants have reposed faith while trading in its contracts. FTIL is not denying the fact that the bye-laws of NSEL have provisions casting responsibilities on the Exchange to provide counterparty guarantees to the members and clients as pointed out by the Commission in the SCN. FTIL has not furnished any explanation as to what steps have been taken by NSEL or by it as a parent company to honour the commitment of assuring safety and risk-free trading to the members and clients who have traded on their platform purely on the basis of an explicit assurance that the Exchange shall step into the shoes of counter parties should there be any default by any participant. However, FTIL has instead, indulged in cherry-picking of a number of other provisions in the bye-laws thereby trying to wash their hands off their responsibilities as the promoter of a nation-wide Commodity Exchange.

14.10.9 One point to note here is that NSEL is neither a registered nor a recognised association / Exchange under FCRA, 1952. It has never been regulated by any regulator and has conducted its function only as a corporate entity. Therefore, the bye-laws of NSEL have never been reviewed or regulated or monitored by any authority thereby leaving it a free-hand to add, amend or modify any provision as it suits its need. Making provision for certain escape

clauses and hiding behind them after causing huge losses to the members / clients because of its fraudulent activities indicates that the motives of the management of NSEL have been suspect from the very inception of the Company. As pointed out in SCN, as late as on 10th July, 2013, Shri Jignesh Shah made a presentation in the office of the Forward Markets Commission in the presence of Secretary, DCA making a strong case for the on-going business operations of NSEL, declaring that trading on the NSEL platform was backed by 100% stock as collaterals, apart from 10-20% as margin money and 100% post-dated cheques thereby offering the highest level of safety to the participants. Ironically, NSEL was standing on the brink of a collapse of its trading platform on the same day when Shri Jignesh Shah made these statements. This is further evident by the fact that FTIL hosted an advertisement in its website refuting the allegations against NSEL for not having storage capacity of around 1 lakh M.T for castor seed at Kadi Village, Gujarat only on 21.07.2013. Under these facts and circumstances, the reliance on bye-laws of NSEL by FTIL does not advance its cause.

14.10.10 FTIL has further argued that having common directors between FTIL and NSEL is not relevant. It further states that in any event, the only Director that was common between the Boards of NSEL and FTIL was Shri Jignesh Shah, who has been inadvertently shown as a KMP of NSEL although it was the Managing Director who planned, directed and controlled the Company. These contentions of FTIL are again an attempt to pass on the accountability to the Managing Director and to insulate Shri Jignesh Shah, the Board of NSEL as well as FTIL itself from owning up the responsibilities for the affairs of NSEL. In the light of observations made in the preceding paragraphs, such contentions of FTIL are not acceptable.

14.10.11 FTIL also referred to the constitutional right under Article 19 (1) of the Constitution and has submitted that any adverse action would affect the interest of about 70,000 shareholders of FTIL and, indirectly, 1200 employees of FTIL. It is further argued that in the light of revised guidelines issued by Commission, FTIL has the right to appoint only 1 director on the MCX board and for all practical purposes, MCX would be run by an Independent Director and thus no

regulatory intervention is warranted. FTIL has also made a without prejudice submission stating that it was withdrawing Shri Jignesh Shah as a nominee director on the Board of MCX. With this resignation, and the fact that Shri Joseph Massey and Shri Shreekant Javalgekar have already resigned from the Board of MCX, FTIL has submitted that the captioned proceedings deserve to be kept in abeyance if not withdrawn, until a final adjudication of all facts relating to NSEL is available.

14.10.12 At the outset, the reference to Article 19 (1) of the Constitution and the apprehension about the shareholders and employees of FTIL are not founded on any factual support and have no nexus with the present proceedings pertaining to declaration of 'fit and proper status' of FTIL. As regards FTIL's present right to appoint only one Director on the Board of MCX, the same also has no bearing on these proceedings. Moving on to the resignations submitted by Shri Jignesh Shah, Shri Joseph Massey and Shri Shreekant Javalgekar from the MCX Board, the same would not alter the conclusions rendered regarding fit and proper status of the noticees. It is not the case of the aforesaid three individuals that after receiving the SCN from the Commission, they have conceded that they do not continue to be 'fit and proper persons' for continuing as Directors of MCX. None of them has made any statement to the effect that his resignation is pursuant to the issue of the SCN. Therefore, their resignations do not have to be linked with the present proceedings. The probity and competence of the Board officials of a nation-wide Commodity Exchange are critical to the achievement of the objectives of regulation under FCRA, 1952. It is therefore necessary that the directors and shareholders whose holdings are above specified thresholds or who exercise a material influence on their operations ("key shareholders") meet the fitness, propriety or other qualification to be deemed as 'fit and proper person' in terms of regulatory norms. Therefore, irrespective of the fact that the above-mentioned three individuals have resigned from the Board of MCX, the declaration / decision about their present status as 'fit and proper person' is of importance which will decide if these three individuals are / would be eligible to take key managerial positions in any other regulated associations under FCRA, 1952. These decisions will be based on their conduct, general reputation, record of fairness and integrity as on date.

15. **Summary Observations and Conclusion:-** After having accorded due consideration to all the objections and arguments raised by the noticees vide their written submission as well as oral presentations through their counsel, we now proceed to conclude our observations by taking a final view on the status of the four noticees as 'fit and proper persons' in the succeeding paragraphs.

15.1 **Noticee No.1:- Financial Technologies (India) Limited (FTIL):** We have discussed the equity structure of NSEL, which is wholly owned by FTIL. We have also pointed out that Shri Jignesh Shah, Chairman-cum-Managing Director of FTIL has been a Director on the Board and also functioning as Vice-Chairman and a key management person of NSEL since its inception. Similarly, Shri Joseph Massey and Shri Shreekant Javalgekar have been Directors of the said company from its very beginning till the settlement crisis at NSEL first came to light in July, 2013. The facts establishing the fraud involving a settlement default over Rs.5,500 crores at NSEL have been discussed at length in the SCNs issued to the noticees as well as reiterated, albeit illustratively by us at Para No.14.7 of this Order. The responsibility of FTIL as the holding company possessing absolute control over the governance of NSEL has also been highlighted. The control of FTIL over NSEL becomes further crystallized from the responses given by M/s. Grant Thornton before the Commission on 03.12.2013 stating that Shri Jignesh Shah, Mr. Joseph Massey and a host of other officials of FTIL reviewed the forensic audit report and it was only after obtaining their clearance, the forensic auditor finalised its report.

15.1.1 The violation of conditions prescribed in the exemption notification, trading in paired contracts to generate assured financial returns under the garb of commodity trading, admission of members who were thinly capitalised having poor net worth and giving margin exemptions to those who were repeatedly defaulting in settling their dues, poor warehousing facilities with no or inadequate stocks, no risk management practices followed, non-provision of funds in SGF, consciously appointing Shri Mukesh P. Shah as statutory auditors for F. Y. 2012-13 who was related to Shri Jignesh Shah, and apparent complicity with the defaulters to defraud the investors, etc., lead to an inescapable conclusion that a huge fraud was perpetrated by NSEL while having the presence of two Board

members of FTIL on the Board of NSEL, one of whom was the Vice-Chairman of the company.

15.1.2 The facts of the case and the manner in which the business affairs of NSEL were conducted leaves no doubt in our minds that FTIL, notwithstanding its contentions that it was ignorant of the affairs and conduct of NSEL, exerted a dominant influence on the management, and directed, controlled and supervised the governance of NSEL. In the face of a fraud of such a magnitude involving settlement crises of Rs.5,500 crores owed to over 13,000 sellers / investors on the trading platform of NSEL, FTIL, cannot seek to take refuge behind the corporate veil so as to unjustifiably isolate itself from the fraudulent actions that took place at NSEL resulting in such a huge payment crisis.

15.1.3 FTIL has its principal business of development of software which has become the technology platform for almost the entire industry engaged in broking in shares and securities, commodities, foreign exchange etc. As has been demonstrated by FTIL in their written submission, FTIL has floated a number of regulated exchanges – both for securities and commodities derivates – in India as well as abroad. NSEL was incorporated to provide a trading platform of commodity spot exchange on a pan-India basis for the purpose of which apparently it sought and was granted exemption from the operation of the FCRA, 1952. Since the objective of the NSEL was promoting spot trading in commodities on an electronic platform, its business model did not contemplate venturing into trading in forward contracts. FTIL had already promoted MCX, a regulated exchange under FCRA, 1952, for the purpose of trading in forward contracts. Therefore, having secured an exemption from the purview of FCRA, 1952 on the ground that it was intended to promote spot trading, NSEL was not authorised to allow trading in forward contracts through the scheme of paired contracts, thereby defying conditions stipulated in the exemption notification granted to it. The motive behind allowing trading in forward contracts on the NSEL platform in a circuitous manner on NSEL which was neither recognized nor registered under FCRA, 1952 indicates *mala fide* intention on the part of the promoter of FTIL to use the trading platform of its subsidiary company for illicit gains away from the eyes of Regulator. The fact that FTIL promoted NSEL sought exemption from FCRA, 1952 provisions even before they had started any

trading or operation, points to their intention from the outset. In this manner, it misinterpreted the conditions stipulated in the exemption notification in collusion with a handful of members, which ultimately culminated in a massive fraud involving Rs.5,500 crores, which has the potential effect of eroding trust and confidence in exchanges and financial markets.

15.1.4 Keeping in view the foregoing observations and the facts which reveal misconduct, lack of integrity and unfair practices on the part of FTIL in planning, directing and controlling the activities of its subsidiary company, NSEL, we conclude that FTIL, as the anchor investor in the Multi-Commodity Exchange Ltd., (MCX) does not carry a good reputation and character, record of fairness, integrity or honesty to continue to be a shareholder of the aforesaid regulated exchange. **Therefore, in the public interest and in the interest of the Commodities Derivatives Market which is regulated under FCRA, 1952, the Commission holds that Financial Technologies (India) Ltd (FTIL) is not a 'fit and proper person' to continue to be a shareholder of 2% or more of the paid-up equity capital of MCX as prescribed under the guidelines issued by the Government of India for capital structure of commodity exchanges post 5-years of operation.** It is further ordered that neither FTIL, nor any company/entity controlled by it, either directly or indirectly, shall hold any shares in any association / Exchange recognised by the Government or registered by the FMC in excess of the threshold limit of the total paid-up equity capital of such Association / Exchange as prescribed under the commodity exchange guidelines and post 5-year guidelines.

15.2 **Noticee No.2: Shri Jignesh P. Shah:** In the show cause notice dated 4th October, 2013 issued by the Commission the active involvement of all the Directors including Shri Jignesh Shah in the settlement crisis at NSEL was discussed at length at Para No.8.1.3. As discussed in detail in the show cause notice and also in other paragraphs of this Order, Shri Jignesh Shah has been the man behind promoting FTIL and also promoting NSEL. He has been described in the official website of FTIL, as the 'Founder-Chairman and the Group CEO of FTIL' and by virtue of his controlling interest of more than 45% in FTIL through his personal holding of shares as well as holding of his family members and his Private Limited Company, viz La-fin Financial Services Private

Limited, Shri Shah always exercised effective control over NSEL not only through his control over FTIL but also through the position held by him in the management structure of NSEL. Shri Jignesh Shah has been serving as the Chairman-cum-Managing Director of FTIL and Vice-Chairman on the Board of NSEL. Shri Jignesh Shah, as a promoter of FTIL and also NSEL has remained the public face and indeed the head and brain of the entire group and through a number of presentations and assurances made by him in public fora about the business model and products including the paired contracts launched by NSEL, he has been successful in attracting public / clients to participate in the contracts traded on the exchange platform of NSEL. Under the circumstances, Shri Jignesh Shah had complete knowledge of the bye-laws, rules / regulations of NSEL and was an active participant in managing the affairs of NSEL. Therefore, it can be logically concluded that behind the corporate veil, the management and governance of NSEL was practically carried out by Shri Jignesh Shah through the vehicle of FTIL. This also points to the fact that Shri Jignesh Shah was aware of the contracts being traded on NSEL Exchange outside the regulatory oversight and the adverse fall-out of such trading which was being conducted without any risk management system in place.

15.2.1 It is noted that Shri Jignesh Shah has been named as one of the key management personnel in all the annual reports of NSEL until financial year 2011-12. Curiously enough, in the balance-sheet of NSEL for the financial year 2012-13, Shri Jignesh Shah has not been shown to be one of the key management personnel. Such an exclusion of his name from the list of key management personnel coincides with the exit of the former statutory auditor M/s. S. V. Ghatalia & Co., and induction of Shri Mukesh Shah, who happens to be the maternal uncle of Shri Jignesh Shah as the statutory auditor for FY 2012-13. The appointment of Shri Mukesh Shah as statutory auditor of NSEL was inappropriate and questionable in the prevailing circumstances. It appears that Shri Jignesh Shah has got himself excluded from the list of key management personnel ostensibly to distance himself from NSEL when continuous defaults by members had thrown the company completely out of gear during this period.

15.2.2 In his submissions, FTIL and Shri Jignesh Shah have tried to shift the entire blame on the former Managing Director, Shri Anjani Sinha for committing

the fraud on the investors, thereby abdicating his responsibility as the Vice-Chairman as well as promoter of the company. Strangely enough, it is the Board of Directors of NSEL who had showered praises on Shri Anjani Sinha in the Board Meeting held on 30.03.2012 for the performance of the company in FY 2011-12 and had congratulated him. This shows that Shri Jignesh Shah and other Directors were aware of the activities of NSEL that resulted in such a dramatic turnaround and supported the performance of the management and the business model and practices that were being followed by NSEL management. During the hearing before the Commission, the counsel of Shri Jignesh Shah referred to an affidavit filed by Shri Anjani Sinha and, relying thereupon, argued that Shri Sinha has taken the entire responsibility of mis-management of NSEL affairs on to himself and therefore Shri Jignesh Shah cannot be said to be having any knowledge about the happenings at NSEL. The argument is lacking in merit. It is not known under what circumstances and with what motive such a self-implicating affidavit was made by Shri Anjani Sinha and whether the affidavit, which prejudices his own interest has been corroborated by supporting documentary evidence. In any case, the Commission has learnt that Shri Anjani Sinha has retracted his statements given in the abovesaid affidavit and has filed a fresh affidavit giving contrary statements and accusing the Promoters, Directors and the key management personnel for the poor governance and fraud committed on the exchange platform of NSEL. Keeping this in view, no significant value can be attached to the earlier affidavit.

15.2.3 It is also pertinent to mention here that Shri Jignesh Shah was practically the highest beneficiary of the fraud perpetrated at the NSEL Exchange. It is because of the huge profit of Rs.125 crores (approx.) earned by NSEL during FY 2012-13 that the value of the shares of Shri Jignesh Shah in FTIL shot up manifold giving him the benefit of a spectacular market capitalization of his investment in FTIL running into thousands of crores of rupees. Shri Jignesh Shah, as the promoter of FTIL and NSEL has misused his position to create a confidence in the minds of the participants regarding the legitimacy of the business and its operations in the exchange platform of NSEL. Shri Shah consciously used his position to represent to the public at large about the attractive features of the contracts being traded on NSEL platform while taking no

steps to introduce any effective governance mechanism including risk management, due diligence, assured collaterals etc., to ensure the legitimacy of his claims and to prevent frauds.

15.2.4 Keeping the foregoing discussions and observations in view including the discussions made in the context of FTIL at para No.15.1, the Commission is of the view that the general reputation and character, record of fairness, honesty and integrity of Shri Jignesh Shah has been substantially eroded in view of his role in the affairs of NSEL as its Vice-Chairman & Director and also as the Chairman of the holding company of NSEL. Therefore, in the public interest, **the Commission holds that Shri Jignesh P. Shah, former Director of MCX is <u>not</u> a 'fit and proper person' in terms of the directions issued under the Board Composition Guidelines issued by the Commission and as amended from time to time.** Accordingly, it is ordered that Shri Jignesh P. Shah is not a 'fit and proper' person to hold any position in the management and the Board of any Exchange recognised or registered by the Government of India / Forward Markets Commission under FCRA, 1952. It is further ordered that neither Shri Jignesh P. Shah individually, nor any company/entity controlled by him, either directly or indirectly, shall hold any shares in any association / Exchange recognised by the Government or registered by the FMC in excess of the threshold limit of the total paid-up equity capital of such Association / Exchange as prescribed under the commodity exchange guidelines and post 5-year guidelines.

15.3 **Noticee No.3: Shri Joseph Massey:** As pointed out earlier Shri Joseph Massey was the Director on the Board of FTIL as well as the Board of NSEL. He has been associated with the management of NSEL since its inception. The foregoing discussions and observations made in relation to the FTIL and Shri Jignesh Shah leads to a natural conclusion that Shri Joseph Massey was jointly as well as severally responsible for the poor governance, fraudulent activities as well as mis-management of NSEL and despite his knowledge of the happenings at NSEL he has not made any effort to improve upon the management of the company. The contentions of Shri Massey in his written submissions that he was kept in the dark about the NSEL affairs as he was working in a non-executive capacity and that there was no regulatory clarity about the operations of NSEL

including the T-25 contracts are entirely devoid of merit. Shri Massey was the promoter of NSEL and has been associated with the Company as Director on its Board right from the day of its inception, and also being a common Director on the Board of FTIL, cannot resort to such pleas about his ignorance of affairs of NSEL. His statement about lack of regulatory clarity is also not borne out of facts since NSEL was exempt from the regulatory oversight by virtue of the exemptions granted to it under FCRA, 1952 hence, there is no ambiguity about such facts about NSEL.

15.3.1 Under the circumstances, his conduct through the series of events that led to the settlement crisis at NSEL has certainly eroded his general reputation, record of fairness, honesty and integrity which has adversely affected his status as a 'fit and proper person' to be a Director on the Board of a regulated exchange in terms of the directives issued under the **Board Composition Guidelines** issued by the Commission as amended from time to time. As observed by us in the case of Shri Jignesh P. Shah, his resignation from the post of Director, MCX shall not render the instant proceedings irrelevant since his continuation or association with the Commodities Derivatives Market in any key management position of any registered and / or recognised entity which is regulated under FCRA, 1952 shall not be in the interest of the market. Therefore, applying all the arguments and reasoning made in this Order in connection with FTIL and Shri Jignesh Shah, **the Commission holds that Shri Joseph Massey, former Director of MCX is <u>not</u> a 'fit and proper person' in terms of the directions issued under the Board Composition Guidelines issued by the Commission and as amended from time to time**. Accordingly, it is ordered that Shri Joseph Massey is not a 'fit and proper' person to hold any position in the management and the Board of any Exchange recognised or registered by the Government of India / Forward Markets Commission under FCRA, 1952. It is further ordered that neither Shri Joseph Massey individually, nor any company/entity controlled by him, either directly or indirectly, shall hold any shares in any association / Exchange recognised by the Government or registered by the FMC in excess of the threshold limit of the total paid-up equity capital of such Association / Exchange as prescribed under the commodity exchange guidelines and post 5-year guidelines.

15.4 **Noticee No.4: Shri Shreekant Javalgekar:** Shri Shreekant Javalgekar has been the Managing Director of MCX till he resigned from the post in the month of October, 2013. Shri Javalgekar has been serving as a Director on the Board of NSEL from the very beginning of the company and has been an active functionary in the affairs of the company. Apart from his association with NSEL, in a display of conflict of interest Shri Javalgekar was also on the Board of Indian Bullion Merchants Association Ltd. (IBMA) which was also trading on the platform of NSEL as well as on the platform of MCX. Such association by the Managing Director of a regulated exchange with group entities of FTIL which was also participating on the trading platform of the same regulated entity of which he was the Managing Director displays a lack of honesty and integrity of the individual. In view of the aforesaid and in the light of the conclusions arrived at by the Commission with respect to the status of 'fit and proper person' of FTIL, Shri Jignesh Shah & Shri Joseph Massey, **the Commission holds that Shri Shreekant Javalgekar, former Director of MCX is <u>not</u> a 'fit and proper person' in terms of the directions issued under the Board Composition Guidelines issued by the Commission and as amended from time to time**. Accordingly, it is ordered that Shri Shreekant Javalgekar is not a 'fit and proper' person to hold any position in the management and the Board of any Exchange recognised or registered by the Government of India / Forward Markets Commission under FCRA, 1952. It is further ordered that neither Shri Shreekant Javalgekar individually, nor any company/entity controlled by him, either directly or indirectly, shall hold any shares in any association / Exchange recognised by the Government or registered by the FMC in excess of the threshold limit of the total paid-up equity capital of such Association / Exchange as prescribed under the commodity exchange guidelines and post 5-year guidelines.

Sd/17.12.2013	Sd/17.12.2013	Sd/17.12.2013
(Ramesh Abhishek)	**(M. Mathisekaran)**	**(Nagendraa Parakh)**
Chairman	**Member**	**Member**

Place : Mumbai

Date : 17th December, 2013