BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved on : 11.7.2014
Date of Decision : 26.8.2014

Appeal No. 64 of 2013

M/s. Emkay Global Financial Services Limited
The Ruby, 7th Floor,
Senapati Bapat Marg,
Dadar (West),
Mumbai – 400 028 …Appellant

Versus

1. The National Stock Exchange of India Limited
   Exchange Plaza, Bandra Kurla Complex,
   Bandra (East),
   Mumbai – 400 051

2. Inventure Growth and Securities Limited
   Viraj Towers, 201, 2nd floor,
   Near Land Mark
   Western Express Highway,
   Andheri (East),
   Mumbai – 400 069

3. Prakash K Shah Shares and Securities Limited
   8B, Rajabahadur Motilal Mansion,
   1st Floor, 11/43, Tamarind Lane,
   Fort, Mumbai – 400 023

4. Labdhi Finance Corporation Private Limited
   Unit No. 104 – 111, 1st Floor,
   Bhaveshwar Market,
   M.G. Road, Ghatkopar (East),
   Mumbai – 400 077

5. Adroit Financial Services Private Limited
   401-402, 4th Floor, Angel Mega Mall,
   Plot No. 1CK-1, Kaushambi,
   Ghaziabad – 201 010, Uttar Pradesh

6. Religare Securities Limited
   D-3, P-3B, District Centre, Saket,
   New Delhi – 110 017

7. Mesh Stock Brokers Private Limited
   701, Samrock Apartments, Juhu Lane,
   C.D. Barfiwala Marg, Andheri (W),
   Mumbai – 400 058

8. Focus Shares and Securities Private Limited
   Forbes Building, 3rd Floor, East Wing,
   Charanjit Rai Marg, Fort,
   Mumbai – 400 001

9. CNB Finwiz Private Limited
   Office No. 1, Notting Hills, Opposite Pasco
   Old Delhi Road, Sector – 18, Gurgaon,
   Haryana – 122 001 …Respondents

Mr. Darius Khambatta, Senior Advocate with Mr. P. N. Modi and Mr. Shiraz Rustomjee, Senior Advocates, Mr. Ranjit Bhonsale, Mr. Somasekhar Sundaresan, Mr. Ravichandra Hegde, Mr. Abishek Venkataraman and Ms. Arti Raghavan, Advocates for the Appellant.

Mr. Iqbal Chagla, Senior Advocate with Mr. E. P. Bharucha, Senior Advocate, Mr. Cyrus Bharucha, Mr. Vikram Trivedi, Mr. Rashid Boatwalla and Mr. Amit Chouhan, Advocates for Respondent No. 1

Mr. Ravi Ramaiya, Chartered Accountant for Respondent Nos. 2 & 4.

Mr. Fredun De vitre, Senior Advocate with Mr. Ajai Achuthan and Mr. Shrivardhan Deshpande, Advocates for Respondent No. 3

Mr. Ankit Lohia, Advocate with Mr. Amit Dey, Advocate for Respondent Nos. 5 and 8

Mr. Hitesh Shah, Managing Director for Respondent No. 7

None for Respondent Nos. 6 and 9.

AND

Miscellaneous Application No.80 of 2014
&
Appeal No.86 of 2013

Prakash K Shah Shares & Securities
Private Limited
8/B, Rajabahadur Mansion,
11/43, Tamarind Lane, Fort, …Appellant

Mumbai – 400 023.

Versus

The National Stock Exchange of
India Limited
Exchange Plaza, Plot No.C/1, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai – 400 051. …Respondent

Mr. Zal Andhyarujina, Advocate with Mr. Ajai Achuthan and Mr. Shrivardhan Deshpande, Advocates for the Appellant.

Mr. Cyrus Bharucha, Advocate with Mr. Rashid Boatwalla and Mr. Amit Chouhan, Advocates for the Respondent.

AND

Miscellaneous Application No.81 of 2014
&
Appeal No.87 of 2013

M/s. Inventure Growth and Securities Ltd.
201, Viraj Tower, Near Land Mark,
W.E. Highway,
Andheri (East),
Mumbai – 400 069. …Appellant

Versus

The National Stock Exchange of
India Limited
Exchange Plaza, Plot No.C/1, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai – 400 051. …Respondent

Mr. Ravi Ramaiya, Chartered Accountant for the Appellant.

Mr. Cyrus Bharucha, Advocate with Mr. Rashid Boatwalla and Mr. Amit Chouhan, Advocates for the Respondent.

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

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

1. In these three appeals dispute relates to trades that were executed on National Stock Exchange on October 5, 2012, wherein these three appellants as well as respondent nos:4 to 9 are parties to the trades. Hence these three appeals are heard together and disposed of by this common judgment.

APPEAL NO. 64 OF 2013

2. Appellant herein is aggrieved by the decision of National Stock Exchange of India Limited ("NSE" for short) dated April 29, 2013 whereby, application made by appellant on October 7, 2012 for annulment of trades executed by appellant's dealer on October 5, 2012 has been rejected. Although appellant had claimed annulment of all trades executed by appellant's dealer on October 5, 2012, at the hearing of this appeal before us, counsel for appellant has restricted claim for annulment of only those trades wherein respondents no. 2 to 9 are counter parties to the trades.

3. Case of the appellant in nutshell is that the trades executed on October 5, 2012 constitute "material mistake in the trade" under Bye law 5(a) framed by NSE and hence those trades are liable to be annulled. NSE however, has rejected the claim on ground that if the appellant had complied with regulatory requirements by installing prudent risk management and order management system at the dealer's terminal, no

mistake could go unnoticed and even if any order was erroneously punched, remedial measures could be taken before erroneous order went out of dealer’s system and reached NSE’s trading system and therefore in the facts of present case, appellant being grossly negligent, trades in question cannot be considered as ‘material mistake in the trade’ and consequently the said trades cannot be annulled.

4. Facts relevant for purpose of this appeal are that appellant is a public limited company and is engaged in the business of providing financial services i.e., the business of stock- broking and advisory services. Appellant claims to have significant market share across all the market segments and claims that its average daily cash market turnover is approximately ₹ 139 crores.

5. Events that took place on October 5, 2012 and follow up action taken thereafter in relation to the trades in question have been summarized by the appellant as follows:-

A) At 08:30 A.M. appellant’s dealer Mr. Sagar Shah, reported to the appellant’s Information Technology Department (“IT Department” for short) that the operating system of his computer has crashed.

B) At 08:45 A.M. IT Department replaced Sagar Shah’s system with another system and installed a fresh copy of the OMNESYS Order Management Software (“Omnesys” for short), which is used for placing orders.

C) At 09:00 A.M. pre-market opens.

D) At 09:10 A.M. Sagar Shah logs into Omnesys system.

E) At 09:15 A.M. market opens.

F) At. 09:48:52 A.M. an order to sell 35 lakh value of Nifty Basket and 7 lakh value of Sensex Basket is received by Mr. Kalpesh Parekh (Head of cash dealing section of the appellant) from a client of appellant.

G) At 09:48:52 A.M. Mr. Kalpesh Parekh decides to execute the Nifty order in two tranches i.e., one of ₹ 17 lakh and other of ₹ 18 lakh as per regular practice and assigns it to Sagar Shah for execution.

H) At 09:50:54 A.M. Mr. Sagar Shah, places an order to sell 17 lakh NIFTY 50 units ‘based on quantity’ instead of ₹ 17 lakh value. As a result, sell order for ₹ 980 crores was entered into trading system of NSE.

I) At 09:50:58 A.M. the error was identified by Sagar Shah, immediately after substantial NIFTY Basket order got executed. Sagar Shah tried to cancel pending orders but could not do so as orders had already hit the exchange server.

J) At 09:50:58 A.M. Sagar Shah reported the error to Mr. Kalpesh Parekh and to the IT Department.

K) By 09:51:00 A.M., ₹ 650 crores worth of NIFTY Basket order got executed and cash segment of NSE halted.

L) At 09:54:00 A.M. Mr. Prakash Kacholia, Managing Director of appellant called the then Deputy Managing Director of NSE, Ms. Chitra to inform her about the error at the appellant’s end.

M) At 10:01:00 A.M. Mr. Sandeep Singal, Co-Head Institutional Equities with a view to mitigate the possible losses on account of error trades, gave necessary instructions to the dealing team to buy NIFTY futures and options at suitable strike prices to hedge short error position of NIFTY Basket as cash segment of NSE alone had halted and futures and derivative system of NSE was operational.

Thereupon the dealing team of the appellant bought:

i) 3,01,750 Qty. of Nifty Oct futures

ii) 50,000 Qty. of Nifty 5800 CALL

iii) 24,000 Qty. of Nifty 5900 CALL and

iv) 63,000 Qty. of Nifty 6000 CALL.

All these positions were squared off within an hour’s time. The appellant incurred financial loss of about ₹ 51.58 lakhs on account of these hedging trades.

N) At 10:05:00 A.M, as soon as the cash market of NSE resumed trading, some more orders worth approximately ₹ 5 crore got executed as they were pending in the system. These pending orders were converted into "limit orders" by NSE at prices which were the first traded price when the error took place. The appellant then cancelled the pending orders in the system from the admin terminal of the institutional desk. The appellant also started to buyback the NIFTY Basket in the cash segment with a view to square off the existing position.

O) At 11:45:00 A.M. Mr. Prakash Kacholia, Mr. Krishna Kumar Karwa and Mr. Anish Damania, Head of Institutional Equity's Business of the appellant went to NSE to explain exactly as to what transpired and also requested the officials of NSE including the then Deputy Managing Director to annul the error trades.

P) At 12:00:00 P.M. the appellant's system were put into square off mode. As orders were not going into the system even in square off mode, the appellant's trading terminals were reverted back from square off mode. NSE communicated the appellant to square off the error position into appellant's error account. Following these instructions, as the appellant started buying into its error account, it attracted, margin and the appellant's trading rights were disabled. On the appellant's request, the trading terminal was reactivated for about 10 minutes by NSE to square off the transactions in the same institutional code in which error trades got executed.

Q) At 01:00:00 P.M. there were still some nominal positions yet to be squared off and the appellant intimated via an e-mail to officials of NSE to square off the position to make the error trade net quantity NIL. On account of above error trades, appellant incurred loss of approximately of ₹ 51 crores.

R) On October 5, 2012 NSE issued a press release wherein it was categorically stated that the trades on October 5, 2012 executed by the appellant were outcome of an "erroneous order".

S) On October 5, 2012 NSE, conducted an immediate inspection of the systems and risk management controls of the appellant.

T) On October 6, 2012 a show cause notice was issued to the appellant. Appellant replied to the said show cause notice on October 8, 2012 and by an order dated October 29, 2012 the Disciplinary Action Committee ("DAC" for short) constituted by NSE imposed monetary penalty of ₹ 25 lakh by holding that the trades executed on October 5, 2012 were the outcome of an error.

U) On October 7, 2012 appellant made an application for annulment of erroneous trades executed on October 5, 2012 in terms of bye-law 5(a) of Chapter-VII of bye-laws framed by NSE inter alia on ground that the trades were outcome of a material mistake in the trade.

V) By impugned order dated April 29, 2013, NSE has rejected the annulment application made by the appellant.

Challenging aforesaid order of NSE, present appeal is filed.

6. Mr. Khambata and Mr. Modi, learned Senior Advocates appearing on behalf of appellant have submitted that the impugned order passed by NSE cannot be sustained for the following reasons:-

a) For determining the question as to whether a mistake is a material mistake or not, one has to look at the magnitude of the mistake as also the size/volumes and the scale of impact. In the present case, erroneous action of appellant’s dealer led to a basket order of 17 lakh NIFTY 50 units being placed as opposed to the intended sale of NIFTY 50 stocks worth ₹ 17 lakhs. Owing to the erroneous order placed by the dealer of the appellant, a single sell order worth ₹ 980 crores was placed. Such an order can never reasonably be expected as a trade in the ordinary course of business. Never in the past a single sell order worth ₹ 980 crores has been ever placed on NSE. Therefore, mistake on part of appellant’s dealer being manifest and no reasonable person would have placed a single basket order for sale of NIFTY 50 worth ₹ 980 crores, NSE ought to have annulled the trades in question.

b) NSE erred in holding that appellant was guilty of gross negligence by not installing requisite checks and balances in the computer at the dealer’s terminal. In fact in para 24 of the impugned order it is recorded that there were multiple checks and balances installed at the dealers terminal however, same was not followed by the dealer. In the present case, punching erroneous sell order was one off instance arising out of a human error and it was not a case of gross negligence. Moreover, the limited purpose inspection conducted by NSE immediately on execution of erroneous trades on October 5, 2012 revealed that it was a case of one off instance and not a systemic issue. Very fact that the trading rights of the appellant suspended on October 5, 2012 have been allowed to be resumed on October 10, 2012 bears testimony to the fact that the appellant’s risk management system were in place and it was only a one off incidence of an extra ordinary nature, requiring intervention as envisaged in Bye law 5(a) framed by NSE. In any event a negligent mistake not involving malafide intention would be material mistake in trade as per Bye law 5(a) and hence liable to be annulled.

c) Contracts in securities effected on the stock exchanges are special contracts to which the basic law of contracts under the Indian Contract Act, 1872 (“Contract Act” for short) as also the special provisions of the Securities Contracts (Regulations) Act, 1956 (“SCRA” for short) would apply. Section 10 of the Contract Act, inter alia, recognizes that ‘free consent’ is the foundational element of an enforceable bargain. Section 14 of the Contract Act defines consent to be free ‘when it is not caused by coercion or undue influence or fraud or misrepresentation or mistake’. In the present case, very foundation of the need for a contract not to have been vitiated by a mistake is missing for all the trades in question in view of the error in the placement of the order on part of appellant’s dealer. Therefore, such a contract being not enforceable, NSE ought to have annulled the trades in question.

d) Erroneous sell order led to execution of erroneous trades for approximately ₹ 660 crores within 6 seconds of the market opening, which is far in excess of the total daily turnover and trading in the first hour after the market opened. Thus, it is clear that there occurred an extraordinary substantial and material mistake and therefore the trades in question ought to have been annulled.

e) Committee on Model Bye-laws of Stock Exchanges constituted by SEBI way back in May 1997 had, inter alia, recommended in its report for annulment of trades initiated by mistake. In the present case, trades were outcome of a material mistake in the initiation of trade owing to a mistake by appellant's dealer in placing an order for sale of 17 lakh NIFTY 50 units instead of order for sale of ₹ 17 lakh worth of NIFTY 50 units and hence the trades executed thereunder were liable to be annulled under the Bye-laws framed by NSE.

f) Section 72 of the Contract Act provides for restitution of any money or property received by any person, as a result of a mistake. Such a person is obliged to return the money or property received, to the mistaken party. Therefore, the Bye-laws that are consistent with the basic law of the land governing formation and implementation of contracts ought to be given a full run by annulling the trades in question.

g) Annulment of trades in question is in the interest of the integrity of the market. The principle of protecting market integrity entails ensuring that erroneous trades are dealt with in accordance with the bye-laws and trades with manifest material mistakes are treated as if they were never executed. Integrity of the market would in fact be hurt adversely if the trades in question are not annulled because, all market players would have then to believe that regardless of how serious an error they may make, the market system would never follow the principle of annulment.

h) Respondents no. 2 and 3 who are the two largest beneficiaries of erroneous trades have admittedly violated the regulatory frame work by placing orders several times in excess of available margins. Margin requirements are mandatorily required to be met under the rules and regulations framed by NSE. In the present case respondent no. 3 had margin of only ₹ 2.88 crores which could have enabled it to take trade positions approximately worth ₹ 25 crores, whereas, respondent no. 3 had placed orders worth

₹ 416.71 crores and bought in stock position of more than ₹ 158 crores. Similarly, respondent no. 2 had a margin of only ₹ 4 crores which would have enabled it to take trade position of approximately worth ₹ 35 crores, whereas, respondent no. 2 had placed orders worth ₹ 1083.42 crores and bought in additional stock position of more than ₹ 220 crores. NSE had issued circulars on January 20, 2004 and February 22, 2005 cautioning trading members from placing orders at 'unrealistic prices which are far away from the market price/ theoretical price' since they 'lead to aberrations in the normal price discovery process'. Since the trades in question got executed on account of buy orders placed by respondents no. 2 to 9 in violation of the circulars, rules and regulations framed by NSE, the trades in question deserve to be annulled.

i) Erroneous sell order placed by appellant got executed to the extent of ₹ 660 crores, because the circuit breaker system of NSE failed to trigger market halt after the NIFTY 50 fell below 10%, which was in violation of SEBI Circular dated June 28, 2008. As a result whereof, loss caused to the appellant escalated to ₹ 51 crores from approximately ₹ 19 crores. Thus, in the facts of present case, where erroneous trades took place on account of respondent nos. 2 to 9 purchasing NIFTY 50 beyond their capital adequacy and on account of failure of NSE's trading system to halt the trading after NIFTY 50 fell below 10%, NSE is not justified in rejecting the annulment application of the appellant.

j) As per NSE Circular dated April 24, 2012 every broker has to confirm availability of adequate capital before proceeding with trades in excess of specified threshold. Since counterparty brokers in the present case that is, respondents no. 2 to 9 had confirmed about capital adequacy but in fact there was no capital adequacy for the trades, it is clear that respondents no. 2 to 9 had misrepresented and therefore, respondents no. 2 to 9 cannot be permitted to profit unjustifiably when the trades in question are vitiated on account of their willful misrepresentation.

k) Admittedly, SEBI has issued show cause notice to NSE on April 18, 2013 in relation to the trades in question wherein following deficiencies on part of NSE have been found:-

    i) the systems of NSE did not work as required under the securities laws as the trading system had not come to a halt when the index fell by 10%.

ii) NSE failed to keep the market system shut for two hours and decision of NSE to resume trading within a period of fifteen minutes was in violation of the norms laid down by SEBI.

iii) NSE failed to put in place order/ trade limit controls and risk management at its end and has rather put the onus for erroneous trades solely on the broker and

iv) the counter party brokers could enter large purchase orders at unrealistic market prices without even posting sufficient margins and thereby they could cause a systemic risk and the NSE did not have systems to prevent such market abuse.

l) In its reply to the above show cause notice NSE has admitted that the market fell below 10% due to the erroneous order from a single dealer of the appellant. NSE has further admitted in its reply that the system audit report of the appellant did not reveal any lapses. In these circumstances, it is contended that even the prima facie view of SEBI as also reply of NSE filed before SEBI supports the contention of appellant and therefore, it would have been just and proper for NSE to take a balanced view and annul the trades at least that of respondent nos. 2 to 9 who were also guilty of violating the norms laid down by SEBI/NSE, thereby ensuring that the loss caused to the appellant is minimized and counter parties are not unduly benefited from the erroneous trades executed on account of material mistake in the trades in question.

m) Decision of NSE in declining to annul the trades on ground that the appellant has squared off its position is wholly unjustified. Appellant squared off the position with a view to avoid bankruptcy arising out of erroneous trades. Where the erroneous trades are found to be vitiated by material mistake in the trade, annulment could not be denied merely because protective action was taken to save the entire market settlement system.

7. Mr. Chagla and Mr. Bharucha, learned Senior Advocates appearing on behalf of NSE, on the other hand submitted as follows:-

a) Admittedly dealer's computer which crashed on October 5, 2012 at 08:30:00A.M. was replaced at 08:45:00 A.M. with a standby computer. Part of sell order received from the client was placed into the NSE's trading system at 9:50:54 A.M. Thus, there was clear gap of more than one hour for appellant to set up on the said stand-by computer the checks and risk management measures which ought to have been necessarily set up on the computer used at the dealer's level. Moreover, no risk parameters were set up even on the CTCL Server level, NEAT CTCL USER ID level and at the Corporate Manager level of the appellant. Thus, apart from placing erroneous sell orders, appellant is guilty of gross negligence/ non compliance as the appellant failed to set up checks and risk management measures in to the trading system of the appellant before entering deals on the Exchange.

(b) When a dealer logs into the system of NSE to place a basket order, following procedure is followed-(i) The dealer has three choices for placing an order namely based on value, based on value (in lakhs) and based on quantity. Based on value is the first choice and based on quantity is the last choice. The dealer has to first select whether the order is "Based on Quantity" or "Based on Value". (ii) Having made the above selection, a dealer is then prompted to enter the quantity/ value based on the choice made and the total value of the contract in INR (whether dealer has selected the quantity tab or value tab) is displayed prominently at the bottom of the screen. (iii) Where the order comprises of more than one scrip, the value of each scrip is displayed prominently in actual figures against such scrip. (iv) The order of the dealer enters the NSE's system only if the "OK" button is pressed by the dealer. Thus, in the present case, the dealer could have prevented the transaction from going through/ corrected the same by (i) checking that he had chosen the correct tab viz. value instead of quantity; (ii) checking the abnormally high quantities of each scrip which appeared next to the name of the chosen scrips- this would have alerted him to the fact that the quantity tab had been chosen and not the value tab; (iii) checking the abnormally high total value of the entire transaction appearing at the bottom of the screen- this also would have alerted him that wrong tab had been chosen; and (iv) pressing "OK" button only after confirming all the above details. Ignoring these basic checks which permitted the dealer at 4-5 stages in the order placing process to cancel/correct the order, amounts to sheer negligence. It shows that the conduct of the Appellant/ its dealer was completely unlike the conduct of a reasonable or prudent man.

(c) Furthermore, it is an admitted fact that the Appellant had also not set limits at scrip level, value level and quantity level which would have prevented such a negligent order entering from the Appellant's terminal into NSE's trading system.

(d) It was not mistake but gross negligence on part of appellant and its dealer that led to the trades in question. Even if it is assumed that there was a mistake of fact qua the appellant, who is one of the parties to the contract, even then the trades executed on October 5, 2012 cannot be annulled because the counter parties to the contract were not under any mistake of fact or otherwise.

(e) Appellant has squared off the erroneous trades in question by buying NIFTY futures and options at suitable strike prices to hedge short error position of NIFTY Basket and thereby minimize the possible losses on account of erroneous trades. Even if erroneous trades in question are annulled, appellant's subsequent square off buy order will remain and the appellant may end up with a profit on the said square off buy order as the market rose subsequently. Thus annulment of trades in question, if granted, would benefit appellant who is guilty of gross negligence, which is undesirable in the interests of securities market.

(f) Bye-law 5(a) framed by NSE provides for annulment of a transaction on the Exchange only if the relevant authority i.e. NSE is satisfied that such transaction ought to be annulled on ground of fraud, or willful misrepresentation or material mistake in the trade. Any and every mistake made by a party cannot be classified as a material mistake in the trade. Failure to install adequate and required checks and balances before a computer is used for trade does not and cannot amount to a mistake and in any event cannot be considered as material mistake. Even after erroneous tab was selected, appellant’s dealer had 4 to 5 opportunities to rectify the error before placing the sell order, but the appellant’s dealer failed to utilize those opportunities. As per regulation 3.2.5 and 4.2.1(a) of the Capital Market Regulation (Part A) framed by NSE, trading members are required to establish, maintain and enforce procedures to supervise its business and supervise the activities of its employees and are responsible for the accuracy of the details of the trades entered in to the trading system including orders entered on behalf of its constituents. As per Circular dated July 15, 2005 issued by NSE, appellant ought to have incorporated suitable validation mechanism as part of the risk management system to avoid erroneous orders with large quantities being transmitted through CTCL system in to the NSE's trading system. As the appellant had violated the above provisions, NSE was justified in rejecting the annulment application.

(g) Each Trading Member including the appellant has submitted an undertaking in writing to NSE to abide and adhere to the bye-laws, Rules and Regulations framed by NSE and also abide by the Code of Conduct as laid down from time to time. By NSE Circular dated May 12, 2000, computer to computer link ("CTCL") facility was offered to members wherein the members could use their own software running on a suitable hardware/software instead of NEAT front end software. CTCL facility was made available only to approved persons after obtaining prior consent of NSE. Such approved persons were mandatorily required to have an inbuilt facility for online surveillance and risk management features like trade by trade position monitoring and various checks and controls in the front end application software used by them. Since these mandatory requirements were not followed, appellant was not justified in seeking annulment of trades.

(h) Allegation of appellant that the circuit breaker system of NSE did not shut down when the market fell by 10% is incorrect. On October 5, 2012, the NIFTY opened at 5815 points. Upon the entry of the grossly negligent order into the trading system, the NIFTY fell by 570 points (10%) at 09:50:58. Immediately upon falling 10%, the market halt process was triggered within the trading system of NSE. The market halt process involves stopping of (i) entry of fresh orders into the system (which was accomplished instantaneously) and (ii) Communication between the multiple trading engines and allied systems viz risk management system, index system and surveillance system. Thus, after triggering of the market wide circuit breaker, a minimum process time would be involved for halting the entire market. This is endemic to any computer system and even SEBI has acknowledged the same in its 'note on market halt' dated May 18, 2009. In the past, time lag between triggering the circuit breaker and complete halt was 13 seconds. However, in the present case, on circuit breaker triggering at 09:50:58 complete shutdown took place by 09:51:04 A.M. i.e., within just 6 seconds. In between circuit breaker triggering and complete shut down, executable and matchable orders existing within the system at that time got executed. Therefore, it is incorrect to state that market wide circuit breaker did not trigger at 10% NIFTY fall.

(i) Allegation that after circuit breaker system triggered, cash segment of the Exchange was erroneously halted for only 15 minutes and not for the period mandated by SEBI is also without any merit, because immediately on circuit breaker system triggering it was ascertained that (i) the fall in the market was only due to the negligent order emanating from the appellant (based on the communication received from the appellant) (ii) NSE's Equity derivative markets did not reflect a similar fall and were trading normally and (iii) the BSE Sensex was not affected by the above fall in the NSE'S market. In these circumstances, the NSE in consultation with SEBI and after informing BSE arrived at a conclusion that a market halt for two hours would lead to unnecessary panic and further fall in the market and accordingly the market was reopened within 15 minutes of the market halt. Therefore, in the facts of present case, NSE cannot be faulted for reopening the market within 15 minutes.

j) Disciplinary Action Committee (“DAC” for short) by its order dated October 29, 2012 had noticed various lapses on part of appellant and accordingly imposed monetary penalty of ₹ 25 lakh which the appellant has paid. Therefore, having accepted the findings of DAC that appellant has committed various violations, it is not open to the appellant to find fault with the decision of NSE in rejecting the annulment application of the appellant.

k) Reliance placed by appellant on the proceedings initiated by SEBI against NSE is devoid of any merit, because, firstly, the allegations set out in the show cause notice are only prima facie observations which are yet to be adjudicated in the light of replies filed by NSE. Secondly, expressing any opinion on the merits of the case pending before SEBI would seriously prejudice case of the appellant which is pending before SEBI.

8. Mr. F. Divitre, learned senior Advocate appearing on behalf of respondent no. 3, Mr. Ravi Ramaiya, Chartered Accountant, appearing on behalf of respondent no. 2 and 4, Mr. Hitesh Shah, Managing Director, appearing on behalf of respondent no. 7 and Mr. Ankit Lohia, Advocate appearing on behalf of respondent nos. 5 and 8, while

adopting the arguments advanced by counsel for NSE, submitted that the buy orders placed by them were in the ordinary course of business and therefore, they have every right to seek enforcement of the trades in question. Moreover having squared off all the trades in question, appellant is not justified in seeking annulment of the trades in question on ground that there is material mistake in the trade. The submission is that the buy orders placed by respondents no. 2 to 9 were within the permissible limits prescribed by the Stock Exchange and assuming that there was any shortfall in the margin money requirement in some cases, it did not invalidate the trades and wherever margin money violations were noticed, NSE has taken action against the respective respondents and in fact appeals filed against those orders are pending before this Tribunal. In any event appellant who has violated the mandatory norms laid down by NSE and has been grossly negligent in placing the sell orders cannot claim that there is material mistake in trade and consequently the trades in question cannot be annulled and the amounts due to the respondents which are withheld by NSE must be directed to be released to the respective respondents forthwith with interest at such rate as this Tribunal deems fit and proper.

9. We have carefully considered submissions made by counsel on both sides. We have also considered submissions made by applicants in Miscellaneous Application nos. 80 and 81 of 2014.

10. Since the dispute herein relates to interpretation of Bye-law 5, we may quote Bye law 5 framed by NSE which reads thus:-

*“ 5 **<u>Inviolability of Trade</u>***

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

(b) Notwithstanding anything contained in clause (a) above, the Exchange may, to protect the interest of investors in securities and for proper regulation of the securities market, suo motu annul deal(s) at any time if the relevant authority is satisfied for reasons to be recorded in writing that such deal(s) is/ are vitiated by fraud, material mistake, misrepresentation or market or price manipulation and the like.

(c) Any annulment made pursuant to clauses (a) and (b) above, shall be final and binding upon the parties to trade(s). In such an event, the trading member shall be entitled to cancel the relevant contract with its constituents.” (emphasis supplied)

11. Appellant seeks annulment of trades in question on ground that the said trades constitute ‘material mistake in the trade’ under Bye law 5(a) framed by NSE basically on three grounds:-

a) Punching erroneous order to sell 17 lakh NIFTY 50 units instead of punching order to sell ₹ 17 lakh worth NIFTY 50 units was an unintended error committed by the appellant’s dealer and such an error being one off error never committed by any Trading Member in the history of NSE, the trades in question ought to have been annulled as material mistake in the trade.

b) Erroneous sell order placed by appellant's dealer culminated into erroneous trades because respondents no. 2 to 9 had placed unrealistic orders to buy NIFTY 50 at a price far away from the market price and that too without adequate margin money which was in gross violation of the norms laid down by SEBI/NSE. As a result of unrealistic trades that took place, NIFTY 50 crashed by 15.5% within few seconds of punching erroneous sell order and the trading system halted. Since respondent nos. 2 to 9 were responsible for unrealistic trades, NSE ought to have held that the trades in question constitute material mistake in the trade and hence liable to be annulled.

c) As per SEBI circular dated June 28, 2001, the index based market wide circuit breaker system of NSE ought to have brought about a coordinated trading halt when NIFTY index fell below 10%. However, on October 5, 2012 the trading system of NSE failed to halt when NIFTY index fell below 10% but halted when NIFTY index fell by 15.5%. Apart from above failure, decision of NSE to resume trading within 15 minutes of the market halt was also erroneous and contrary to aforesaid SEBI circular dated June 28, 2001, which led to execution of some more erroneous trades. If the market halt was continued for the period specified under the aforesaid circular dated June 28, 2001, additional erroneous trades could have been avoided and erroneous trades to the extent of ₹660 crores would not have taken place. Therefore, the trading system of NSE being faulty and decision of NSE to resume trading within 15 minutes of the market halt being erroneous, it is just and proper to hold that the NSE was not justified in rejecting the annulment application of the appellant.

12. First question, therefore, to be considered is, whether appellant is justified in contending that mistake committed by appellant's dealer in punching erroneous sell order constituted 'material mistake in the trade' under Bye law 5(a) framed by NSE.

13. Expression ‘material mistake in the trade’ is not defined under Bye laws framed by NSE. Hence, that expression has to be understood by giving common parlance meaning and in the context in which that expression is used in Bye law 5(a).

14. Whether a mistake is a material mistake or a non material mistake is a question that would depend upon facts of each case. Bye Law 5(a) does not contemplate every mistake to be a material mistake.

15. Bye law 5(a) postulates that all dealings on the Exchange shall be inviolable. Expression ‘inviolable’ as per Oxford Dictionary of English (Second Edition) means ‘never to be broken, infringed or dishonoured’. Thus, Bye law 5(a) envisages that all dealings on the Exchange shall be honoured and shall not be broken. Bye law 5(a), however, carves out exception to the above inviolability by providing that the Exchange may annul trades which according to the Exchange are fit for annulment on account of fraud or willful misrepresentation or material mistake in the trade. Thus, reading Bye law 5(a) as a whole it is evident that all dealings on the Exchange shall have to be cleared and settled in accordance with Bye laws, Rules and Regulations framed by NSE except those trades which according to the Exchange are fit for annulment on account of fraud or willful misrepresentation or material mistake in the trade.

16. Since dealings on the Exchange are inviolable, it is obvious that both parties to the trade i.e., selling dealer as also the buying dealer have to enter into dealings on the Exchange with due care, caution and diligence. Where a dealer (whether selling dealer or buying dealer) fails to exercise due care, caution or diligence while entering into the dealings on the Exchange, then, consequences such failure may be disastrous. Regulation 3.2.5, 3.2.7 and 4.2.1(a) in Part A (Capital Market Segment) of NSE (Capital Market) Trading Regulations, 1994 specifically provide that the Trading Members shall be solely responsible for the accuracy of details of orders entered into the trading system including orders entered on behalf of his constituents and that the trades generated on the system are irrevocable and shall be 'locked in'. Thus, Regulations framed by NSE provide that in respect of all transactions executed on the Exchange (whether executed with due care, caution or diligence or not), the Trading Member shall be bound to fulfil the obligation arising out of those trades, unless the trades fall within the exceptions carved out under Bye law 5(a).

17. Object of Bye law 5(a) is to ensure sanctity of the dealings on the Exchange by making the trades inviolable. With a view to facilitate inviolable trades, NSE has inter alia issued a circular on July 15, 2005 requiring members using CTCL facility to incorporate suitable validation mechanism as part of risk management, if not already provided to avoid erroneous orders with large quantities being transmitted through CTCL system into Exchange's trading system. In the present case, it is not in dispute that the dealer's terminal did contain

risk management system, however it did not contain suitable validation mechanism as a part of risk management system. As a result, when one of the computer in the dealer's terminal crashed on October 5, 2012, IT Department of appellant installed a standby computer and when erroneous order for sale of 17 lac NIFTY 50 instead of Rs.17 lac worth NIFTY 50 was entered on the said standby computer, erroneous trades to the extent of Rs.660 crores took place. If suitable validation mechanism in the risk management system were installed such an error could have been avoided. Failure to install suitable validation mechanism within the risk management system was due to negligence on part of appellant and therefore, appellant is not justified in contending that the negligent mistake constitutes material mistake in the trade.

18. Had the appellant set up suitable validation mechanism as part of risk management system not only at dealer's computer level but also at the CTCL server level, NEAT CTCL USER ID level and at the Corporate Manager level, error if any at the level of the dealer's terminal would have been noticed at these levels and requisite steps for correcting the error could have been taken. Failure on part of appellant to install suitable validation mechanism as part of risk management system at all these levels was in violation of SEBI Circular dated 30th January, 2000 and NSE Circulars dated 12th May, 2000 and 15th July, 2005. Since erroneous trades took place not only due to mistake in punching erroneous sell order but also due to breach of duty in not installing suitable validation mechanism as part of risk management system on the

standby computer as also at various other levels, before dealing on the Exchange, appellant is not justified in contending that the mistake committed in punching erroneous sell order constitutes material mistake in the trade. Bye-law 5(a) does not permit annulment of trades executed by mistake, but permits annulment of only those trades where there is material mistake in the trade. Trades executed by mistake cannot be termed as material mistake in the trade merely because every mistake contains element of negligence in executing such trade. If trades executed due to negligence/breach of duty are treated as material mistake in the trade then it would amount to promoting breach of duty/negligence which is not the object with which Bye-law 5(a) is framed.

19. As rightly contended by counsel for NSE, apart from failure to install suitable validation mechanism in the risk parameter system before entering into dealing on the Exchange which constitutes breach of duty/negligence, appellant's dealer is also guilty of not exercising reasonable care and caution after punching erroneous sell order on the computer on October 5, 2012. In para 24 of the impugned order, NSE has recorded a finding that four to five level checks on the trading terminal were provided with a view to enable the trader to rectify any order erroneously placed by him. Ignoring these four to five level checks that were provided on the screen itself constitutes failure to exercise due care, caution or diligence. Para 24 of the impugned order reads thus:-

"24. The trading terminal that is used for placing a basket order, by design and default provides for the following checks for a basket order:-

a. As the first level check, in the order entry screen, there are three choices for placing an order namely based on value, based on value (in lacs) and based on quantity. Based on value is the first choice and based on quantity is the last choice.

b. As the second level check, while placing the order of Rs. 17 lacs the dealer had entered the figure "1700000" in the screen which shows- "Based on Quantity".

c. The third level check is that the quantity and value of the proposed order is shown at the bottom right corner of the screen. In this case, the screen shot provided by the Applicant during inspection, of a sample basket order of same quantity shows net quantity of 1,97,44,895 shares of all NIFTY scrips and net basket order of Rs. 9,74,28,72,733.55 at the bottom of the screen.

d. As the fourth level check, the screenshot further shows for all the scrips in the basket individually, the quantity and value for each of the scrip showing mindboggling figures against each scrips. For eg: against ITC the quantity shown is 2920767 and against Reliance the quantity shown is 889483.

e. Thereafter the dealer is required to approve the proposed order by clicking the "OK" button; only on clicking the "OK" the order *enters into the trading system of the NSE for execution.*

The Committee in this case, noted that

a. The dealer had used the last choice namely "Based on Quantity", when the first choice namely "Based on value" was actually the applicable choice.

b. Once the order is placed as such it still does not get into trading system leaving an opportunity for a second level check i.e., entering "1700000" in the tab wherein it is mentioned based on quantity.

c. The net quantity of the basket order showed "19744895" and net value of the basket order showed Rs. 9742872733.55 at the bottom of the screen.

d. The quantity and value for each of the scrip shows huge figures against each scrips and had been again ignored by the dealer.

e. The Committee also noted that only on clicking the "OK" the order enters into the trading system of the NSE for execution. This is the fifth check.

Inspite of all these checks and balances appearing on the order screen, the order was okayed and partly executed as explained above. The order could have been corrected at various stages. The dealer apparently has failed to exercise required care and skill and has been grossly negligent."

20. From aforesaid facts and findings recorded by NSE, it is apparent that apart from punching erroneous sell order, appellant is guilty of committing breach of duty by not installing suitable validation

mechanism before entering sell order and also guilty of negligently transmitting erroneous sell order from the dealer's terminal to the NSE's server by ignoring four to five level checks that were available in the system. Thus, in the present case, punching erroneous sell order is coupled with breach of duty/negligence. Before placing the sell order, appellant was aware of its obligation to install suitable validation mechanism in the risk management system and follow four to five level checks that were prominently displayed on the screen. By ignoring four to five level checks that were prominently displayed on the screen, appellant's dealer pressed 'OK' button thereby allowing erroneous order to hit the server of NSE. In these circumstances, having committed breach of duty by not installing risk management parameters before entering sell order and having been negligent in ignoring four to five level checks that were displaced on the screen before transmitting the erroneous sell order from dealers terminal to the trading system of NSE, appellant cannot escape liability arising out of such trades even if it amounts to incurring huge losses.

21. In a bid to overcome above difficulty, appellant claims that the trades in question, deserve to be annulled on ground that the mistake committed by appellant constitutes material mistake in the trade under Bye law 5(a). Under Bye-law 5(a) inviolability of trades is a rule and annulment of trades is an exception. Where a trading member entering erroneous order is guilty of breach of duty as well as negligence, annulling trades of such trading member would amount to defeating the object of inviolability of trades specified in Bye-law 5(a). Since Bye law

5(a) contemplates inviolability of dealings on the Exchange, it is evident that the expression ‘material mistake in the trade’ in Bye law 5(a) would be attributable to such trades which affect sanctity of the trade in spite of it being executed after exercising due care, caution and diligence. In other words, a trading member who is guilty of breach of duty and is also guilty of negligence cannot claim annulment of trades on grounds that erroneous trades constitute material mistake in the trade. No doubt that inadvertent mistakes may occur in spite of exercising due care and caution. To take care of inadvertent mistakes that may occur inspite of reasonable care, caution and diligence exercised by a Trading Member, NSE requires that every Trading Member shall install suitable validating mechanism in the risk management system before placing sell/buy orders and further, the system adopted by NSE ensures several levels of checks on the screen so that inadvertent error if any in placing the sell/buy order is rectified before the sell/buy order is transmitted into the trading system of NSE. In the present case, it is seen that apart from punching erroneous sell order, appellant is guilty of breach of duty/negligence and in such a case, appellant is not justified in contending that erroneous trades executed inspite of breach of duty/negligence ought to be treated as material mistake in the trade.

22. A mistake whether committed due to inadvertent error or not does not become material mistake merely because that mistake has led to huge financial losses. Bye-law 5(a) is not intended to give relief to a trader who is guilty of not exercising due care and caution and guilty of negligence. Bye-law 5(a) empowers the Stock Exchange to annul those

trades which are vitiated by fraud or willful misrepresentation or material mistake in the trade. Even if the expression 'material mistake in the trade' is to be construed widely, common thread passing through the expressions 'fraud' or 'wilful misrepresentation' or 'material mistake in the trade' in Bye-law 5(a) is to ensure sanctity of the trades executed on the Stock Exchange. Expression 'material mistake in the trade' would therefore be attributable to unforeseen circumstances which vitiate sanctity of the trades executed on the Stock Exchange. Breach of duty/negligence would not be unforeseen circumstance that can be said to vitiate the trades executed on the exchange.

23. It is contended on behalf of appellant that the question as to whether a mistake is a material mistake or not has to be determined on the basis of the magnitude of the mistake, size of the volumes and the scale of impact. There is no merit in the above contention as can be demonstrated from the following illustration. Suppose, a Trading Member by mistake enters sell order for sale of NIFTY 50 Basket worth ₹ 100 crores instead of an order for sale of NIFTY 50 Basket worth ₹10 crore. Similarly, suppose another Trading Member by mistake enters sell order for sale of NIFTY 50 Basket worth ₹1000 crores instead of an order for sale of NIFTY 50 Basket worth ₹10 crore. In such a case, if both sell orders gets executed on the Exchange, to hold that trades of the Trading Member who had erroneously entered sell order for ₹1000 crores are liable to be annulled on ground that there is material mistake in the trade in view of magnitude, size and scale of mistake and to hold that the Trading Member who has erroneously placed order to sell

NIFTY 50 Basket worth ₹ 100 crore must comply with his obligation would be wholly unjustified. Accepting such a contention of a Trading Member who has erroneously placed sell order for sale of NIFTY 50 Basket worth ₹1000 crores would mean that Bye-law 5(a) contemplates annulment of trades where the degree of negligence is higher. Under Bye law 5(a) it cannot be said that higher the degree of negligence higher the chance of annulment. Therefore, interpretation of Bye law 5(a) put forth by appellant which defeats the object with which Bye-law 5(a) is enacted cannot be accepted.

24. It is true that expressions used in Bye-law 5(a) being clear and unambiguous, it is unnecessary to refer to the provisions contained under the Contract Act. In a screen based trading system trades take place anonymously i.e., the party entering sell orders into the trading system does not know as to who could be the counter party whose buy order would get matched and the trades get executed. In such a case, there is no scope for the counter party to ascertain as to whether sell order is placed under mistake or not. That is why Bye-law 5(a) provides that the trades executed on the Exchange shall be inviolable except where the trades are liable to be annulled on ground of fraud or willful misrepresentation or material mistake in the trade. In other words, Bye-law 5(a) provides that the trades executed on the Exchange shall be inviolable irrespective of the fact there are inadvertent errors or grave errors unless trades are annulled on grounds set out therein. Fall in NIFTY Index by 15.5% on account of erroneous sell orders placed by appellant may be a ground to take penal action against appellant but not

a ground for annulment of trades on ground that there is material mistake in the trade. Admittedly, penalty of Rs.25 lac has been imposed upon appellant for placing erroneous sell order and that order has attained finality. Therefore, without going into the question as to whether the trade suffers from unilateral mistake or bilateral mistake, we hold that in the facts of present case, appellant who is guilty of breach of duty/negligence is not justified in seeking annulment of trades on ground that erroneous sell order placed by appellant which led to fall in NIFTY index by 15.5% and loss of Rs.51 crores constitute material mistake in the trade.

25. Reliance placed by appellant on the recommendations of the Committee on Model Bye laws of Stock Exchange constituted by SEBI way back in May in 1997 is also misplaced because, recommendation of that committee in so far as it relates to annulment of trades initiated by mistake, has not been adopted in the Bye-laws finally approved by NSE. In fact, in the Bye-laws finally approved by NSE, recommendation of the committee for suo motto annulment of trades initiated by mistake has been expressly omitted. In these circumstances, first contention of the appellant that punching erroneous sell order which led to fall in NIFTY index by 15.5% and consequent market halt constitute 'material mistake in the trade' under Bye-law 5(a) cannot be accepted.

26. Second contention of the appellant is that apart from erroneous sell order placed by appellant, erroneous trades took place because respondent Nos. 2 to 9 had placed unrealistic orders to buy NIFTY 50 at

a price far away from the market price and that too in some cases without adequate margin money which was in violation of the norms laid down by SEBI/NSE and therefore unrealistic trades executed would constitute ‘material mistake in the trade’ and hence liable to be annulled. Relying on notification dated 1st March, 2000 issued under Section 16(1) of SCRA, it is contended on behalf of appellant that the trades of respondent Nos. 2 and 3 executed in violation of margin money requirements specified under Bye-laws framed by NSE would constitute illegal transaction under Section 16(2) of SCRA and hence liable to be annulled.

27. We see no merit in the above contentions as such. Trades in the present case have been admittedly executed on Stock Exchange recognized by SEBI as mandated under above circular dated 1st March, 2000 and hence it cannot be said that there is violation of Section 16(1) of SCRA. Once it is held that there is no violation of Section 16(1), then question of declaring trades to be illegal under Section 16(2) of SCRA does not arise. Violating margin money norms would mean violating Bye-laws and/or circulars issued by SEBI or Stock Exchange. Violating Bye-laws would not amount to violating Section 16(1) of SCRA, because Section 16(1) of SCRA prohibits execution of trades in contravention of circular dated 1st March, 2000 and in the present case, it cannot be said that the trades are in violation of section 16(1). Hence argument of appellant that the trades in question are liable to be declared as illegal under Section 16(2) of SCRA cannot be accepted.

28. Question then to be considered is, whether the appellant is justified in contending that the sanctity of the trades in question are lost on account of violation of margin money norms and hence the trades in question are liable to be annulled. Annulling trades at the instance of trading members who are guilty of violating margin money norms would be unjustified as it would virtually amount to permitting trading members to trade by violating margin money norms and seek annulment wherever the trades are adverse to the interest of the trading members. In such a case annulment of trades would amount to frustrating the objects with which margin money norms have been framed. Thus, trades of a trading member who is guilty of placing erroneous order coupled with breach of duty/negligence cannot be annulled on ground of material mistake. Similarly trades of a trading member who is guilty of violating margin money norms cannot be annulled on ground of material mistake. In both such cases, trading members would be obliged to fulfill the obligation arising from the trades executed.

29. However, where, both parties to the trades executed on the stock exchange i.e. selling trading member as well as buying trading member are guilty of violating the norms and if the selling trading member who is guilty of violating the norms claims that the trades are vitiated on account of violations committed by the buying trading member and accordingly claims annulment of trades inter alia on ground of material mistake in the trade, whether the Stock Exchange can refuse to consider that argument is the precise question that needs consideration. In other words, in an unprecedented case like the present one, where NIFTY

index crashed by 15.5% and market halt took place within few seconds of market opening, can it be said that the trades have vitiated market sanctity due to violations committed by both parties to the trades and if so, whether, imposing penalty of Rs.20-25 lac on both parties to unrealistic trades and allowing respondent nos:2 and 3 who gained several crores of rupees from unrealistic trades to retain such gains, would act as deterrent or boost the morale of respondent nos:2 and 3 who admittedly have violated the norms laid down by SEBI/NSE regularly, is the question which deserves consideration.

30. In the present case, apart from seeking annulment of trades on ground that the trades are vitiated on account of erroneous sell order placed by the appellant, appellant had also claimed that the trades are vitiated on account of respondent nos:2 to 9 placing buy orders far away from the market price and in some cases in violation of margin money norms laid down by NSE. Although appellant had claimed annulment of all trades executed where respondent nos:2 to 9 were counter parties, at the hearing of appeal, claim for annulment was restricted to the trades on account of violating margin money norms where respondent nos.2 to 9 are counter parties to the trades.

31. For appreciating above argument of appellant it would be necessary to state facts relevant to the issue. According to NSE, on October 5, 2012 respondent No.3 had placed total buy orders worth Rs.416.71 crores which was 144 times the available margin provided by respondent No.3 with NSE. Out of the above buy orders, orders worth Rs.300.61 crores were placed on proprietary account and orders worth

Rs.116 crores were placed on client's account. Out of the buy orders worth Rs.416.71 crores, orders worth Rs.260.24 crores were placed 18.15% below the last traded price of shares. The buy orders exceeded respondent No.3's net worth of Rs.27.78 crores by approximately 11 times and client's net worth also exceeded multiple times. Out of the total buy orders worth Rs.416.71 crores, orders worth Rs.158.87 crores fructified into trades. This was against the deposited margin of Rs.2.88 crores thus leading to margin shortfall of 86%. Respondent No.3 had also placed sell orders worth Rs.305.40 crores out of which orders worth Rs.298.41 crores were placed 20.28% above the last traded price of the shares.

32. Similarly, on 5th October, 2012, Respondent No.2 had placed buy orders worth Rs.1083.42 crores against the available margin of Rs.4 crores which was 271 times the available margin. Respondent No.2's gross total income for the year 31st March, 2012 was Rs.57.53 lakhs whereas the buy orders were for Rs.1083.42 crores which is hugely disproportionate. Out of the buy orders worth Rs.1083.42 crores, buy orders worth Rs.596.81 crores were placed on behalf of Respondent No.2's client viz. Ankit Financial Services. Out of the buy orders worth Rs.596.81 crores placed on behalf of Ankit Financial Services, orders worth Rs.468.96 crores were placed 18.64% below the last traded price. Out of the total buy orders of Rs.1083.42 crores, orders worth Rs.214.82 crores fructified into trades. This was against the deposited margin of Rs.4 crores thus leading to a margin shortfall of 87%. Respondent No.2 had also placed sell orders on behalf of Ankit Financial Services for

Rs.555.81 crores out of which orders worth Rs.392.16 crores were placed 21.88% above the last traded price of the shares. The buy limits set on Respondent No.2's terminal was Rs.36 to Rs.71 crores and the sell limits set on the Respondent No.3's terminal was Rs.37 to Rs.75 crores. There was no link between the above set limits to the margin/collateral.

33. It is relevant to note that DAC of NSE in its orders both dated April 30, 2013 has held that respondent Nos. 2 and 3 are guilty of violating the margin money norms by committing breach of following Circulars/Regulations:-

(a) NSE Circular dated 9th May, 2005.
(b) SEBI Circular dated 23rd February, 2005.
(c) NSE Circular dated 23rd March, 2007.
(d) NSE Capital Market Segment Regulation 4.5.4.c(i) and 4.6.1
(e) NSE Capital Market Circular dated 21st January, 2004.
(f) SEBI Circular dated 18th January, 2006.
(g) Various circulars issued under the Prevention of Money Laundering Act.

34. NSE circular dated January 20, 2004 depricates the practice of trading members in placing orders far away from the normal market price and warns that disciplinary action may be initiated against those members who place orders far away from the normal market price. According to NSE, for violating margin money norms, laid down in the circulars/Regulations, trading members are liable for expulsion or suspension or withdrawal of all or any of membership rights and/or to pay fine and/or censure, reprimand or warning.

35. Thus, in the peculiar facts of present case, trades executed due to erroneous sell orders placed by appellant and buy orders placed by respondent nos:2 and 3 in violation of the norms laid down by NSE, NIFTY index fell by 15.5% and market halt took place within few seconds of the market opening. It is not in dispute that as a consequences of such violations appellant had to incur loss of more that Rs.51 crores and respondent nos:2 and 3 gained huge profits running into several crores of rupees.

36. On an application made by appellant seeking annulment of trades, NSE while rejecting claim for annulment on ground that there was inadvertent error in placing sell orders, rejected claim for annulment on ground that respondent nos:2 and 3 had placed buy orders far away from market price and in violation of margin money norms by recording that a) in an anonymous trading system counter parties do not know who is on the other side and their intention of placing buy or sell orders (b) orders of most of the counter party members (which includes respondent nos: 2 and 3) were already there in the system before the order of the appellant (c) respondent nos: 2 and 3 have represented that their trades were in ordinary course of business (d) argument of appellant that respondent nos. 2 and 3 have unlawfully gained has no merit and is not germane to the issue under consideration.

37. Since execution of trades in question had resulted in NIFTY index falling by 15.5% within few seconds of market opening and had brought the market to a grinding halt, NSE could not have brushed aside the

argument of appellant that there is material mistake in the trade due to violations committed by respondent nos:2 and 3 by merely recording that respondent nos:2 and 3 have represented that their trades were in the ordinary course of business and that they had placed buy orders even before appellant placed sell orders. If placing buy orders far away from the market price and in violation of margin money norms was the regular practice followed by respondent nos.2 and 3, then surely it was a case for taking more stringent action against respondent nos:2 and 3 as there was constant danger of their buy orders disturbing the market equilibrium as well as sanctity of trades compared to the erroneous sell orders placed by appellant by failing to install suitable validation mechanism in the risk management system and by ignoring four to five level checks displayed on the screen.

38. NSE ought to have appreciated that between the two violators who deserved to be more disciplined. In other words NSE ought to have appreciated that for violations committed by appellant whether imposing penalty of Rs.25 lac in addition to the loss of more than Rs.51 crores was appropriate or for violations committed by respondent nos:2 and 3 whether imposition of penalty of Rs.20-25 lac on respondent Nos:2 and 3 as against huge unauthorized profits running into several crores made by them would be appropriate. It is not in dispute that respondent nos:2 and 3 have made huge profits running into several crores of Rupees by selling NIFTY 50 purchased under unrealistic trades, on October 5, 2012, because, NIFTY 50 which fell by 15.5% on account of unrealistic

trades, bounced back immediately on reopening of the market after market halt on October 5, 2012.

39. In our opinion, violations committed by respondent nos. 2 and 3 were serious violations and since respondent nos.2 and 3 have admitted to have been committing such violations regularly, NSE, before imposing penalty against respondent nos.2 and 3 ought to have considered arguments of appellant that the trades were vitiated on account of violations committed by respondent nos:2 and 3.

40. NSE ought to have appreciated that imposing penalty of Rs.20-25 lac against respondent nos.2 and 3 as against profits running into several crores wrongfully earned by respondent nos: 2 and 3 by violating the norms, instead of acting as deterrent, in fact embolden respondent nos:2 and 3 to commit such violations regularly. Before passing any order NSE ought to have weighed gravity of the violations committed by appellant on one hand and respondent nos:2 and 3 on the other hand.

41. Since failure on part of NSE to consider aforesaid issues in its proper perspective has led to miscarriage of justice, we set aside the impugned order in so far as it relates to annulment of trades wherein respondent nos:2 and 3 are counter parties to the trade and remand the matter for fresh consideration in accordance with law.

42. We make it clear that whether in the fact of present case, it would be just and proper to annul all or some of the trades executed by and between appellant and respondent nos:2 and 3 or is it proper to take steps for expulsion or suspension or withdrawal of all or any of the membership rights of respondent nos.2 and 3 is a question to be decided

by NSE after hearing both parties viz. appellant and respondent nos:2 and 3.

43. In view of remanding the issue under consideration, it would not be necessary to go into various decisions relied upon by counsel on both sides including the decision of this Tribunal in case of Grisham Securities Ltd. vs. SEBI (Appeal no:151 of 2013 decided on 28/10/2013). Accordingly second contention raised by appellant is remanded qua respondent nos:2 and 3 for fresh consideration and in accordance with law.

44. Third contention of appellant is that the trading system of NSE was faulty because, firstly, contrary to SEBI guidelines, market halt did not take place when NIFTY index fell below 10% and secondly, decision of NSE to resume trading within 15 minutes after the market halt took place when NIFTY index fell by 15.5%, was in violation of SEBI circular dated June 28, 2001 and therefore trades in question are liable to be annulled.

45. No doubt that SEBI has issued a show cause notice to NSE on the above issues. NSE has replied to the said show cause notice and the matter is still pending adjudication before SEBI. Since the above issues are pending for decision before SEBI it would not be proper for us to comment on the merits of the issue raised herein. However, for the purposes of this appeal, we may consider the prima facie view of SEBI in the show cause notice as well as the reply filed by NSE before SEBI. In its reply, NSE has stated that on NIFTY index falling below 10% the circuit breaker system did trigger and entry of fresh orders into the

system was stopped instantaneously and it took 6 seconds to shut down the system completely and within that period executable/ matchable orders existing within the system got executed. It is further stated that when circuit breaker had triggered in the past on May 18, 2009 it had taken 13 seconds for the trading system to come to a complete halt, whereas in the present case it took 6 seconds for the system to come to a complete halt. It is also stated that trading was resumed within 15 minutes of the market halt, after ascertaining that the market fall was due to negligent order emanating from the appellant which did not affect other segments of the market in NSE as also BSE-Sensex. It is further stated that NSE in consultation with SEBI and after intimating BSE arrived at a conclusion that a market halt for two hours would lead to unnecessary panic and further fall in the market and accordingly the market was reopened within 15 minutes of the market halt. These factual statements are being investigated by SEBI and decision is awaited. Admittedly, pending adjudication of show-cause notice, SEBI has not restrained NSE from continuing with the existing trading system which clearly shows that SEBI has found that arguments of NSE cannot be summarily rejected and require deeper consideration. In these circumstances, in our opinion, it would not be proper on our part to pass any order based on prima facie view expressed by SEBI in its show-cause notice issued to NSE on April 18, 2013. Consequently, third contention of the appellant that the trading system of NSE being faulty, the trades in question are liable to be annulled, cannot be accepted.

46. For all aforesaid reasons we reject first and third contentions raised by appellant and to a limited extent remand second contention raised by appellant for fresh consideration in accordance with law.

APPEAL NO. 86 OF 2013
AND
APPEAL NO. 87 OF 2013

47. Both appellants herein are aggrieved by two orders passed by the Disciplinary Action Committee (DAC) of the NSE both on April 30, 2013 whereby penalty of Rs.20 lakhs and Rs.25 lakhs has been imposed upon appellants for placing buy orders on October 5, 2012 far away from market price and in gross violation of margin money norms laid down by NSE.

48. On perusal of impugned orders, it is seen that neither the provisions under which penalty has been imposed is disclosed nor the basis of quantifying penalty is disclosed. Similarly in the impugned orders without assigning any reasons it is held that the appellants have violated the circulars issued by NSE under the provisions of Prevention of Money Laundering Act and the Rules made thereunder.

49. Apart from above, since issue relating to taking action on account of respondent nos.2 and 3 placing buy orders far away from the market price and in violation of margin money norms is remanded for the reasons set out in paragraphs 33 to 43 above, without going into merits of rival contentions, we set aside the orders impugned in both appeals

and direct NSE to pass fresh order on merits and in accordance with law after hearing both parties.

50. In the result, all the three Appeals as well as Miscellaneous Application Nos.80 and 81of 2014 are disposed of in the following terms:

a) Appeal No.64 of 2013 is partially allowed by remanding the issue relating to annulment of only those trades in which respondent nos. 2 and 3 are counter parties to the trades. On remand, NSE shall rehear both appellant as well as respondent nos. 2 and 3 on the question as to whether the trades in which respondent nos.2 and 3 are counter parties are vitiated on account of respondent nos:2 and 3 placing buy orders far away from the market price and in violation of margin money norms laid down by SEBI/NSE and if so, pass order either to annul trades in which respondent nos. 2 and 3 are counter parties (in full or part) or take steps either for expulsion or suspension or withdrawal of all or any of the membership rights of respondent nos. 2 and 3 or take any other steps as deemed fit and proper.

b) Orders impugned in Appeal no:86 of 2013 and Appeal no:87 of 2013 are set aside by way of remand and NSE is directed to pass fresh order on merits after taking into consideration our decision in Appeal no:64 of 2013.

c) Till fresh orders are passed on all the remanded issues, amounts/payouts withheld by NSE shall continue to be withheld.

d) NSE is directed to pass fresh orders on the remanded issues as expeditiously as possible, preferably within a period of three months from today. Both parties shall co-operate in disposal of remanded issues expeditiously.

e) No order as to costs.

Sd/-
Justice J.P. Devadhar
Presiding Officer

Sd/-
Jog Singh
Member

26.8.2014
Prepared and compared by
PK/DDG/RHN

Appeal No. 64 of 2013

Per : A.S. Lamba

1. Present Appeal has been filed by M/s Emkay Global Financial Services Limited (Appellant) against National Stock Exchange of India Limited (Respondent No. 1) and others against order communicated under reference no. NSE/2013/202770-F dated April 30, 2013, inter alia, rejecting request of Appellant's for annulment of deals entered into by Appellant on October 5, 2012 amounting to Rs. 660 crore, with various parties, for sale of NIFTY amounting to 17,000 units of NIFTY, in terms of Bye-law 5(a) of Chapter VII of bye-laws issued by Respondent No.1.

2. It has been represented by Appellant that terminal in its office used by its agent, namely, Mr. Sagar Shah broke down at 8:30 a.m. on October 5, 2012 and IT Department of Appellant's office, replaced this dealers system with a stand-by system and "OMNEYS" trading system software, was installed on standby system. At 9:48:52 order to sell Rs. 35 lakh worth of NIFTY was received by Appellant from institutional client 'Templeton' and same was split into two tranches – of Rs.17 lakh and another of Rs. 18 lakh – to reduce impact cost. At 9:50:54, dealer placed basket order for sale of Rs. 17 lakh units of NIFTY, instead of NIFTY units worth Rs. 17 lakh, which resulted in placement of NIFTY sale order worth Rs. 980 crore. This error was identified at 9:50:58 and immediately at 9:51:00 after NIFTY basket order got executed to extent of Rs. 660 crore, Market halted due to fall in NIFTY index by 10%, necessitating market to shutdown.

3. At 10:05:00, when Respondent No. 1 resumed trading on NSE, some more orders worth, out of Rs. 980 crore sale order, Rs. 5 crore got executed,

since they were pending in the system, instead of being returned by trading system of Respondent No. 1 and rest of pending orders of Appellant were cancelled.

4. At 11:45:00 Appellant reached Respondent No. 1 office and explained what transpired, i.e. their version, and requested Respondent No. 1 to annul these “error” trades. At this juncture, it is stated that the term ‘error trade’ will be used subsequently also, since this term has been started by Appellant and all others are referring to these trades as ‘error trade’, but the undersigned will not be bound by ‘error trade’ as representing an actual error, at any point up now or in future.

5. At 12:00 noon, Appellant’s system were put on square off mode, but due to problems of margin, the trades could not be squared off and thereafter Appellant’s terminals were re-activated by Respondent No. 1 in institutional mode, which allowed squaring off of transactions of Appellant. Further at 01:00:00 p.m. Appellant was allowed to square off nominal open positions, to make error trade net quantity NIL and a loss of Rs. 51 crore was incurred, on account of all trades connected with placement of erroneous order.

6. Following facts, as per Appellant are noteworthy:

- Erroneous trades were executed by Appellant’s dealer on a standby computer, which did not contain specific checks and risk management measures.
- Dealer made punching error and placed order for 17 lakh units of NIFTY, worth Rs. 980 crore, instead of for Rs. 17 lakh worth of NIFTY and within 4 seconds dealer realized his mistake but could not rectify the situation since order had hit NSE trading system and within 6 seconds of placing order, i.e. at 9:51:00, orders worth Rs. 660 crore got executed and cash segment of Respondent No. 1 was halted.
- Circuit breaker system of Respondent No. 1did not halt market when NIFTY index fell by 10%, as required under relevant circular of SEBI, but trading halted when NIFTY had fallen by 15.5%. Trading halted for only 15 minutes – which was required

to be stopped for 1 hour, if NIFTY fell by 10% of opening mark or for 2 hours, if NIFTY fell by more than 15% of opening mark.

- Appellant took all possible mitigating measures to correct the situation, arising out of error trade, by buying futures and derivative NIFTY, selling them subsequently and again buying NIFTY to square off short position in NIFTY caused by sale of NIFTY worth 660 crore.

7. Press Releases: Appellant appraised Respondent No. 1 of error trade and thereafter Respondent No. 1 issued a press statement stating categorically that trades of October 5, 2012, executed by Appellant, were outcome of an "erroneous order". Press release did not mention of any fault in Respondent No. 1's system, although its systems failed to stop trading when NIFTY fell by 10% and stopped only when NIFTY had fallen by 15.5%.

8. Further, it is stated that relevant circular of SEBI, dealing with Market halting due to fall of 10%, 15%, 20% etc. mandate stoppage of trading for 1,2 or more hours, but this requirement was not met and trading continued when index fell beyond 10% and stopped when it was 15.5% and this caused enormous losses to Appellant. It may be pointed at this stage that Appellant has not quantified, value of trades which took place when NIFTY had fallen by 10% and what value trades occurred when it fell from 10 to 15.5% and how Appellant has concluded that fall of NIFTY from 10 to 15.5% caused it enormous loss, when it had been clarified by Respondent No. 1 that trading worth Rs. 5 crore only took place, between fall of NIFTY INDEX from 10% to 15.5% of opening mark.

9. It is also stated by Appellant that Respondent No. 1 conducted immediate inspection of system and risk management of Appellant and issued SCN, which was replied and Disciplinary Action Committee (DAC) of Respondent No. 1 imposed monetary penalty of Rs. 25 lakh on Appellant after

holding trades executed on October 5, 2012 was outcome of an error, vide order dated October 29, 2012.

10. On October 7, 2012, Appellant applied before Respondent No. 1 for annulment of trades of October 5, 2012 in terms of buy-law 5(a) of Chapter-VII of buy-laws of Respondent No. 1, on grounds that trades were outcome of a material mistake. Bye-law 5(a) reads:

> *"CHAPTER VII: DEALINGS BY CLEARING MEMBERS*
> *INVIOLABILITY OF ADMITTED DEALS*
>
> *(a) All the dealings in securities on the Exchange made subject to the Byelaws, Rules and Regulations of the Exchange shall be inviolable and shall be cleared and settled in accordance with the Byelaws, Rules and Regulations of the Exchange. However, the Exchange may by a notice annul the deal(s) on an application by a Trading Member in that behalf , if the relevant authority is satisfied after hearing the other party/parties to the deal(s) that the deal(s) is /are fit for annulment on account of fraud or willful misrepresentation or material mistake in the trade.*
>
> *(b) Notwithstanding anything contained in clause (a) above, the Exchange may, to protect the interest of investors in securities and for proper regulation of the securities market, suo motu annul deal(s) at any time if the relevant authority is satisfied for reasons to be recorded in writing that such deal(s) is/are vitiated by fraud, material mistake, misrepresentation or market or price manipulation and the like.*
>
> *(c) Any annulment made pursuant to clauses (a) and (b) above, shall be final and binding upon the parties to trade(s). In such an event, the Trading Member shall be entitled to cancel the relevant contracts with its constituents."*

11. It is further stated that jurisdiction of bye-laws arises, when a material mistake occurs and hence error in trade, as stated earlier by Appellant, transforms into a mistake and that too a material mistake or later significant mistake, considering magnitude of sell order (Rs. 980 crore), executed trade

(Rs. 660 crore) and loss of Rs. 51 crore of the appellant, to invoke provisions of bye-laws 5(a)(b)(c) of Chapter-VII of NSE.

12. Appellant's submissions before DAC of NSE were:

(i) Trades were outcome of material and manifest mistake (manifest in new addition);
(ii) Counterparties (Respondent Nos. 2 & 3) had acknowledged the error and consented Exchange in withholding pay-outs;
(iii) Counterparties (Respondent Nos. 2 and 3) undertook trades in violation of circulars issued by Respondent No. 1 and SEBI, relating to margin and capital adequacy and ought not to benefit as result of their non-complaint actions;
(iv) Counterparties willfully misrepresented that they were adequately capitalized to undertake the trade;
(v) Annulment of trade by a stock exchange is in accordance with how professional managed stock exchanges in India and abroad deal with such situations;

13. NSE called up counter party brokers to file their reaction to application of Appellant to cancel trade and Appellant was asked to file its response to counter-parties reaction. After hearing Appellant and all major counterparties, NSE, passed Impugned Order dated May 1, 2013, rejecting Annulment Application.

14. It is further submitted that SEBI has initiated proceedings against NSE, in regard to erroneous trade of Appellant on October 5, 2012, and issued show cause notice to Respondent No. 1 on following points:-

(a) systems of Respondent No. 1 did not work as required under the provisions of securities laws by not coming to a halt when the index fell by 10%;
(b) Respondent No. 1 erred in not keeping the market system shut for two hours, and instead resumed trading within a period of fifteen minutes;
(c) Respondent No. 1 failed to put in place order / trade limit controls and risk management at its end and has rather put the onus for the same solely on the broker; and
(d) counterparty brokers had been able to enter large purchase orders at unrealistic market prices without even posting margin, and therefore were able to cause a systemic risk and the Respondent No. 1 did not have systems to prevent such market abuse.

No order has yet issued by SEBI with respect to their SCN as above (dated April 18, 2013). .

15. Now coming to impugned order dated April 30, 2013 of DAC in NSE, main points arising of order are that erroneous trade of Appellants was with 665 trading members and 14,000 clients were counter parties, out of which 8 counter-parties were responsible for 70% of total trade. These 8 counter party trading members are:

1. Inventure Growth and Securities Limited
2. Prakash K Shah Shares and Securities Limited
3. Labdhi Finance Corporation Private Limited
4. Adroit Financial Services Private Limited
5. Religare Securities Limited
6. Mesh Stock Brokers Private Limited
7. Focus Shares and Securities Private Limited
8. CNB Finwiz Private Limited

16. Main submissions of Appellant before Respondent No. 1, are the same, as in above paragraphs, with following additions:-

(a) Usual checks and filters are usually in place to prevent such errors but were inadvertently missed out when trading software was replaced in Sagar Shah system, as his system had crashed in morning of October 5, 2012;
(b) NSE conducted inspection of terminals and has arrived at findings, which in turn, has led to imposition of penalty, by which Appellant has already been punished for the said mistake / error and therefore it would be totally un-justified and un-fair to force and to suffer trading losses also and reward counterparties with huge un-fair profits at its expense;
(c) Mistake was material, since erroneous order was of Rs. 980 crore and trade executed from this order was Rs. 660 crore and volume of trade during first hour also shot up abnormally, which shows that error / mistake / material mistake was extraordinary and substantial, resulting in market crash and closure;
(d) Counter party brokers became clearly aware that they made abnormal and windfall profit by buying at throwaway prices, only to sell, when impact on market become normalized immediately;
(e) Counterparties had, in advance, placed orders at unrealistic prices, in violation of NSE's circular, in hope of trapping anyone who made such a mistake. Such traps were without adequate margins / limits/capital adequacy;
(f) Bye-laws permit annulment of a trade on grounds of willful misrepresentation, since NSE circular require brokers to confirm

availability of adequate capital before proceeding with trade, in excess of specified threshold;

(g) If counterparty brokers have certified capital adequacy, without actually having adequate capital for the trades, it would amount to a misrepresentation, and such brokers ought not to profit unjustifiably from such orders placed;

(h) Counterparties ought not to be allowed to take advantage of their own wrong or to benefit or profit from the same would amount to unjust enrichment;

(i) October 5, 2012 is not peculiar to India and whenever human intervention is possible, there is possibly of human error and if error happens, stock exchanges may annul trades since these were patently erroneous;

17. Counter Party Trading Members (CPTMs) have submitted as follows:-

(a) Trading on stock exchange is faceless trading where Exchanges and its Clearing Corporations act as a counter to both buyer and seller and guarantee settlement of trades executed through its trading system;

(b) Business of dealing in stock markets is a business which carries inherent risk, which includes sudden increase or decrease of value of securities bought or sold. Entities transacting on stock exchange know that they carry this risk and are eligible to rewards of favourable movement in value of securities as and when it arises;

(c) At the time of execution of trades CPTMs clients were not aware, as to whether these trades are result of orders entered by a CP is erroneous as there is fall in market and CPTMs client did not know whether they will be able to sell these shares at a profit or loss. If markets had fallen further, clients would have suffered huge losses;

(d) There was no need for Appellant to place orders in a hurry, since market was bullish and in a rising markets, sellers are not in a hurry to place sell orders and dealer / Appellant had enough time to place sell orders;

(e) Default setting of OMNESYS is based on value of basket and it was changed to Quantity and placing of sell order for 17 lakh units of NIFTY scrip, was not erroneous;

(f) OMNESYS system gives detailed view of basket and shows total value and quantity of basket being entered. How did dealer of Appellant not see this, at time of entity of order;

(g) Limits of user are stored in server and all orders that are placed from any terminal are filtered and validated against risk parameters set by administrator. OMNESYS product description shows that it is role based authentication and dealer may log in from any existing computer or another standby computer; roles, privileges, limits and risk management parameters saved on server do not change. How Risk Management Parameters of dealer entered on the server, changed automatically just because dealer's mode had OS crash and was replaced with a new standby computer;

(h) Order that was un-intentionally placed was not from replaced computer that was logged at 09:10 which had IP address 192:168:54:155, but from another computer with IP address 192:168:54:221 where user ID INST19 was logged in at 09:37:55, which shows that PC which was used by INST19 at after 09:37:55 was a different PC than the PC that had a crash of operating system.

The argument proves beyond doubt that Appellant has only cooked up a story of PC crash, since order under discussion was not placed through it. The act is wilful misrepresentation which is even more grave than the fact of gross negligence and utter disregard to compliance requirements of SEBI and exchanges;

(i) CP's order can never be categorized as orders at unrealistic prices since orders were within permissible circuit filters and orders were in capital market segment and in most liquid contracts;

(j) Delivery of shares and issuance of contract note, in pursuance to trades of October 5, 2012, has been done and are complete contracts. Hence, annulment of trades would set very wrong precedent;

(k) All CP's trades, that got executed, were passive trades and in system of Respondent No. 1 and got executed, when sale order came into trading system. Hence, no un-intention benefit has been obtained from sell order of Appellant;

(l) Appellant has stated that it took all possible mitigating action, but one important such action for sending CP, trade cancellation request, was not undertaken;

(m) Locally and internationally, trades have been annulled due to fraud / misrepresentation / manipulation, and are differentiated from facts of present case, since present trade occurred due to an alleged error;

(n) Large number of trades in F&O segment are undertaken in a large number of cases to hedge their arbitrage position in cash segment and in case cash segment trades are annulled, there will be significant financial implications on concerned brokers and their clients;

(o) Risk Management and Surveillance Team and IT team of Appellant did not set limit from 8:45 am to 9:50 am on October 5, 2012, then how sell order was an error, since there was complete lack of seriousness towards risk management system;

(p) Appellant did not have documented and implemented process for a computer which is to be replaced including hardening and profiling process that needs to be carried out before putting a computer to use in live trading system and Appellant failed to ensure putting limits for orders placed by its dealers – thereby giving dealers unlimited access to place orders;

(q) In light of grave lapses by Appellant in basic controls as stipulated by NSE and failure to exercise due diligence, CPs object that negligent acts that put entire financial system to crises, cannot be categorized as an error or mistake;

(r) Conduct of Appellant in placing large and unrealistic order of Rs. 980 crore without any checks and gross negligence of risk management system, is not expected from any prudent broker and posed grave systematic risk to trading system and exchange and was in blatant non-compliance of Exchange / SEBI circulars, rules, bye-laws;

(s) Appellant's submission that risk parameters are set on dealers terminal only and no risk parameter were set on CTC server level, NEAT CTCL USER ID level and at corporate Manager level etc., displays level of gross negligence, non-compliance and lack of internal control system at its end;

(t) A series of errors and failure in diligence on multiple counts, which have potential of causing serious harm to entire market and disturb market equilibrium, cannot be termed as error;

18. After the impugned trade of October 5, 2012, Respondent No. 1 conducted inspection of Appellant regarding systems at Appellant workstation and found following:-

- Respondent No. 1 found large lapse at Appellant's end pertaining to risk management controls to be placed before starting new session;
- Limits claimed to be present and observed during inspection on few computers, were left to dealer concerned, without any checker mechanism in place;
- Lapse existed at Appellant's end in defining validation for dealer terminal;
- As per RMS log, there was no validation for user id "INST19";
- Appellant did not ensure to incorporate suitable validation mechanism as part of Risk Management System to avoid erroneous orders;
- There is no requirement of collection of Value at Risk (VaR) Margin on upfront basis from clients by broker in capital market segment, and collection of this margin to be as per internal policy of broker;
- Deficiency of margin is no reason for annulment of trade, since availability of margin of broker with exchange is dealt by NSE as per its own procedure of dealing with the situation and exchange dealt accordingly on that day as well;
- Exchange, on regular basis, put Members terminals on square off mode, due to insufficiency of margin and Members have to bring addition margin or square off trade to bring margin written limits and for this, Members are subjected to pre-defined penalty and interest for overnight shortfalls;
- Annulment request is frustrated from practical stand point by impossibility, since reversal of trade would impact across the market, since trades were squared off by them and have gone to buyers who might have taken delivery or further traded in market and to annul such trades would be impossible, since de-mated shares are fungible and it is virtually impossible to track the shares, pertaining to trade under reference;

19. Appellant have submissions on above submissions of Counter Party Trading Members, out of which the following, considered relevant, are mentioned:-

- Sagar Shah (the dealer)'s system had crashed and was replaced with a new system, which was allotted IP address, ending with 155 by system administrator as this IP address was listed as unused at that time. However, this IP was allotted to another computer when user tried logging on the system reported IP address conflict. Accordingly, the IP system was changed. Therefore, the allegation that Sagar Shah placed an order from a different system based on change in IP address is absurd and untenable. An IP address can be manually assigned to a computer system and therefore a change in IP address does not necessarily imply that the system had changed;

20. Findings of DAC of Respondent No. 1 on request of Appellant for cancellation of erroneous trade:-

- Regarding Appellant's allegation that CPTMs violated regulations of NSE, DAC was informed that disciplinary action proceedings have been initiated where violations were noticed. Outcome of these proceedings was not considered relevant to proceedings;
- If brokers (including CPTMs)do not comply with trades put through NSE system, such as capital inadequacy or margin requirements, it would be a matter of disciplinary action but will have no bearing on these proceedings. If trades have to be annulled on account of any possible violation of NSE bye-laws and regulations in respect of inadequacy of margin or capital inadequacy, it would lead to unintended consequences for innocent counterparty members and their clients;
- As per Appellant's submissions, risk parameters were set on dealer's terminal only and no risk parameters were set out CTCL Server Level or at corporate Manager Level, which displays gross negligence, non-compliance and lack of internal control systems at its end. There was conscious and consistent omission on part of Appellant to abide by regulations and adopt risk management tools and order management practices;
- More than adequate time was available to Appellant to set exposure limits at dealer's end, after replacement of crashed computer at 8:45 a.m. and receipt and placement of sell order at 9:48:52 and 9:50:54 respectively; which indicates gross negligence;
- Appellant was aware of all bye-laws, rules, regulations of Respondent and was bound to abide by these, but its conduct shows that Appellant did not show adequate regard for the regulations, requirements as well as prudent risk management practices;
- Appellant was obligated to abide by (i) Regulation 4.5.1. of NSE Capital Market Regulation Part A – to adhere to Code of Conduct – Regulation 4.2.1 of NSE Capital Market Regulation Part A-Trading Member shall supervise activities of its employees, Regulation 3.2.5 of NSE Capital Market Regulation Part A – Trading Member will be solely responsible for accuracy of details of orders; NSE's circular dated July 5, 2005 – incorporate suitable validation mechanism as part of risk management system to avoid erroneous order with large quantities and despite all this; Appellant did not comply with these regulations, and circulars of SEBI / NSE;
- Regarding mechanism of placing orders, DAC noted that dealer deliberately choose "Based on Quantity, entered 17 lakh in tab wherein it was mentioned based on quantity, net quantity showed 1,97,44,895 and net value at Rs. 9,74,28,72,733.55 – which was not noticed by dealer, quantity and value of each of the scrip showed huge figures against each scrip and was ignored by dealer, yet order enters trading system when dealer presses OK, which is fifth check and dispute all those checks and balances appearing on screen, order was okayed. Order could have been corrected at least 4 stages, with exercise of required care and skill but dealer was grossly negligent;
- If Appellant had complied with regulatory requirements, prudent risk management practices and order management practices, no mistake

would have arisen and any erroneously placed order would not have left CTCL and reached NSE trading system. Multiple checks are incorporated in order placement system, which provide ample opportunities to verify and rectify the order and erroneous orders could have been corrected but order was not remedied due to negligence, lack of vigilance and furthermore not corrected, at earliest opportunity, are not fit to be corrected, in retrospect by seeking annulment;

- Appellant claims that it worked hard for salvaging the situation and remedying the error and explored all possible measures to mitigate what transpired, but Appellant did not use trade cancellation facility provided by Exchange with consent of CPTM, as pointed by CPTMs.
- Going by sequence of events explained above, there was conscious and consistent omission of part of Appellant to abide by regulations and adopt even basic risk management tools and order management practices. While dealing with events such as this, proof of mistake has to be strong without gross negligence, in order to qualify for annulment, as same would have large implications on proper functioning of the market;
- CPTMs and CPTM client's have represented that they traded on the market without mala-fide intention and annulment will be subjected to undue hardship and losses, without any fault from their side. Committee noted that NSE's trading system is anonymous order matching system, where trading entities do not know counter-parties and do not know intention of counter-party in placing buy / sell order. Moreover, thousands of orders are placed every second and orders of most of CPTMs were already in trading system of NSE, before order of Appellant and orders of CPTM were in ordinary course of business. Regarding Appellant representation that CPTMs have gained unlawfully and committee finds no merit in the argument of above reasons. DAC has further stated that this argument is not germane to the issue under consideration.
- Appellant has submitted that there was material mistake since order size was Rs. 980 crore, appellant suffered loss of 51 crore, market fell drastically because of order leading to market halt but DAC needs to look at materiality in context of whole or significant part of market and not in context of one member. Appellant suffered loss due to his consistent gross negligence and his acts brought cash market to fall and had to be halted for some time. Market recovered within seconds of reopening and value of trade, arising out of Rs. 980 crore sell order constituted only 3.35% of trading value of cash segment of NSE and 0.33% total traded value of that day on NSE;
- Risk Management and control facilities provided in CTCL software, were not made use of by Appellant and Appellant tried to shift blame partially to dealer, but DAC finds this unacceptable. Since dealer is employee of Appellant and hence Appellant is responsible for all acts and omissions of the dealer, since Regulation 4.2.1 requires Trading Member (Appellant) to establish, maintain and enforce procedures to supervise its business and to supervise activities of its employees and Appellant has failed to do so;
- Appellant stated that it was already punished for his mistake / error and therefore, if his annulment application is not allowed, it will suffer trading losses and CPTMs will make unfair and huge profits, at

his expense. DAC noted that levying of penalty on Appellant, is not a mitigating circumstance and present annulment proceedings are completely different from earlier proceedings resulting in penalty. DAC has further stated, in case Appellant has suffered losses on account of these trades, the losses were caused by his own gross negligence and his least regard for regulations and risk management practices. DAC is of the view that annulling of trades would act as a perverse incentive for Applicant and also for other such members, who may disregard regulatory requirements and risk management practices, while placing orders;

- DAC also examined effect of annulment of trade, if carried out, on CPTM, their clients and market place; will effect 60,000 trades executed and 665 counter party trading members and more than 14000 clients in respect of first instance. CPTMs have also represented that they had closed out their positions, as soon as market reopens, which, in turn brought in around numerous innocent participants on the other side, who in turn would have closed out or taken delivery and closed out later on, thereby creating further third party rights in favour of numerous innocent investors. Annulment from practical stand point is frustrated by impossibility since reversal of trades, would have severe and unimaginable impact across market;
- DAC is of the view that market is not static but dynamic in nature, where scrips are bought or sold by thousands of entities, who then keep these scrip or square them off and hence it is not possible to accede to request of Appellant to annul their sale of Rs. 660 crore, out of sale order of Rs. 980 crore placed by them, which was result of an error; since these share sold and may have changed hands hundreds of time since occurrence of this event on October 5, 2012; and any annulment of his trade may put lakh of investors in first or subsequent resultant trades, who may have purchased / sold these shares in intervening period, at risk of monetary loss and losing confidence in inviolability of trade, which is allowed in very rarest of rare instances; when, most importantly, Appellant was negligent in placing erroneous order, in the first instance, when it did not place risk management measures in their ordering system and had put entire market at risk;
- DAC also stated that annulment has been resorted to in only few occasions, in entire history of 18 years of NSE and that too where cases were pertaining to manipulations. For this and all above reasons request of Appellant for annulment of trade as per bye-law 5(a) of NSE was not accepted;

21. Now the issues that arise are:-

- ❖ How authentic is the version of Appellant in narration of what happened in their work station, resulting in market fall and its consequences;
- ❖ Whether CPTM are justified in their claims that these orders were in conformity to NSE rules, bye-laws and circulars;
- ❖ Whether Appellant is justified in asking for annulment of trade arising due to their erroneous order of October 5, 2012;
- ❖ Whether decision of DAC / NSE i.e. Respondent’s refusal to request of Appellant for annulment of trade justified;
- ❖ Whether it is possible to annul the trade of October 5, 2012;

22. The first issue that requires examination is whether version of Appellant regarding happenings in their work station on October 5, 2012 can be believed at its face value. In this regard it may be mentioned that NSE conducted examination of Appellant's systems on October 5, 2012, later in the day, and what came out is Appellant's version and has to be examined.

23. In this regard events which took place on October 5, 2012 in Appellant work-station have been stated in paragraphs above and need not be repeated, but it will be worth mentioning that these are as per Appellant and have not been verified, in details, by an independent expert body. It may be stated that a few happenings are difficult to believe, which are:-

- Order for execution of 17 lakh units, based on quality, was placed at 9:50:54, instead of NIFTY BASKET of Rs. 17 lakh value, due to error on part of Sagar Shah and he realized his mistake at 9:50:58, when he tried to cancel pending orders, but could not do so, as orders had already hit the exchange server. In this connection, it has not been stated as to how Sagar Shah realized that he had made a mistake in placing orders within 4 seconds of placing orders. It was clarified by Learned Senior Counsel for Appellant that orders were executed, due to Sagar Shah's placing orders 4 seconds ago, started getting flashed on his screen. In this regard, it is not understood as to how a person, who did not look at what computer screen was telling him, when he placed order and committing a series of mistakes, which are five in number, i.e. he took pointer from based in value (default mode) to based on quantity, he entered 17,00,000 in the screen – based on quantity, did not check value of order at Rs. 9,74,28,27,733.55 or quantity at 1,97,44,896 shares, screen shot shows all the scrips in basket individually – quantity and value of each of scrip comprising NIFTY – showing mind boggling figures, dealer is required to approve proposed order by clicking OK button; and also did not check whether the replaced computer had limits placed or not, before starting his transactions; realized within 4 seconds that he had made a mistake in placing order and tried to cancel pending orders within the same 4 seconds; is not understood or appreciated by the undersigned.
- From page 8 of MOA it is seen that Sagar Shah logs into OMNESYS System at 9:10 a.m., which is almost corroborated from page 83 of MOA, where Sagar Shah with I.D. INST19 is shown log in at 9:11:24 in machine with IP ending 155, from where he logs out at 9:13:00 and logs in again 9:18:15 to log out at 9:37:37 and thereafter log in at 9:37:55 from machine with IP ending 221 and log out at 9:52:09 i.e. at the time order for 17 lakh units of NIFTY is placed at 9:48:52. It is

seen that Sagar Shah logs in machine with IP 221 at 9:37:55 after logging out of machine with IP 155 at 9:37:37 i.e. after 18 seconds and hence placed orders from a regular machine 221 and not from replaced machine 155. It is stated by Appellant that due to conflict of IP with 155, the replaced machine was given IP 221, but from opinion of experts, it can be inferred that to change IP of a machine, it takes at least 180 seconds and the same cannot be done in 18 seconds, which is the time shown in Sagar Shah switching from machine with IP 155 to machine 221. But this explanation of Appellant that IP of crashed replacement machine was changed from 155 to 221, due to conflict of IP and if did not allow dealer to log in from IP 155, but it has not been explained as to how dealer was working on IP 155 from 9:11:24 to 9:13:0, from 9:18:15 to 9:37:37, where dealer logged on and off twice before logging on from machine IP 221 at 9:37:55 when conflict of IP did not allow dealer to log in from machine IP 155. Statement of Appellant that order was placed from replacement machine and hence order checks, limits were not installed in machine with IP 155 become difficult to believe, which in other words means order was placed from a regular machine with IP 221, which also did not have order checks , limits on it. Consequences of such an eventuality happening will be very adverse to Appellant for his appeal before this Tribunal and possibility of such an happening should have been looked into during inspection by Respondent No. 1, but unfortunately inspection by Respondent No. 1 of Appellant after events of October 5, 2012, was misconceived and did not bring many material and important facts.

24. Now coming to inspection carried out by NSE of Appellant, in afternoon of October 5, 2012, it is not clear as to what emerged during inspection, whether NSE found the limits placed on all other terminals, except the replaced one. Since this inspection report is not available in records. Appellant has stated that NSE inspection revealed that everything in their work station was found in order, which is very doubtful but if this is the conclusion of Respondent No. 1, the undersigned has grave doubts of seriousness and relevance of inspection, in bringing out facts. There is no mention of NSE inspection in DAC’s findings.

25. Hence, to substantiate the claim of Appellant that limits were not set in replaced machine only and all other machines had these checks, in place, in doubtful; since if order was placed from machine with IP 221, which was not the replaced machine, then Appellant case falls flat in face of facts that “perhaps” other machines in Appellant work station also did not have limits,

in place. However, this would have been known, if NSE had conducted a thorough inspection of all that Appellant was required to do, in light of NSE and SEBI instructions; then NSE inspection report becomes very relevant, but the same has not been made available to this Tribunal, nor was placed before DAC of Respondent or relied by them.

26. In the circumstances, it is evident that facts assumed by all concerned have been what have been marshalled by Appellant and no competent, independent third party has gone into actual happenings and about what systems, limits etc. were found in Appellant's work station and what has been stated about these, is the version of Appellant and definitely there are in-consistencies in these, which have been brought about by CPTM, which have substance, but not dealt properly by Respondent No. 1; hence it has to be mentioned that facts are not properly known and hence taking inferred and rational decision, will be definitely affected.

27. Appellant has relied on Indian Contract Act, 1872 for canvassing his case to the effect that since mistake was on both parties to the contract, about the subject matter and hence contract was void, but this Contract Act cannot be imported to present case, since laws governed securities market are adequate to deal with the present case and Contract Act, 1872 came into existence, when present day securities market did not exist or were even contemplated and also since Appellant / CPTMs did not plead Contract Act before Respondent No. 1/ DAC and hence we may not take cognizance of pleadings of both the parties, based on Indian Contract Act, 1872.

28. Another fact that is canvassed by Appellant is that everyone, including Respondents and CPTMs had referred to disputed trades on October 5, 2012 as erroneous and hence they are bound for all times, in future, to term these

trades as erroneous. In this context, it may be stated that Appellant was most affected by these trades and were the first to call these as erroneous and wrote to all concerned with subject matter as regarding erroneous trade. Since all others were reacted to this and in their references called these as erroneous and hence no more significances should be placed on referring these trades as erroneous, by all concerned except Appellant. It may also be mentioned that Appellants have gradually shifted / changed to term the trades as mistake, significant mistake, material mistake, etc., depending on what usage will take their case forward. For instances, when it came to requesting for annulment of these trades, Appellant called these trades, as arising out of material mistake. Similarly, when it came to taking up their trades for purposes of Contract Act, they called these trades as arising out of a mistake, since that is the term used in Contract Act.

29. It may also be stated that Appellant have tried to impress, at every time and place, that their trades or placed order for sale of NIFTY arose due to one inadvertent punching error and maintained this consistently, while all others have termed placing of erroneous order as a series of errors and system from where order was placed, as not having limits and such limits not existing on CTCL as well – due to lack of managerial controls, and hence Appellant was negligent, to say in the least, in placing sell order to begin with.

30. It has already been brought out, above, that it is narration of Appellant only as to what wrong, how it went wrong, what was expected of other parties, how they went about retrieving the situation, what was expected of Respondents, when markets should have halted, how long the markets should have kept closed; how their one little punching error is solely responsible for everything and having been punished for same with imposition of penalty,

should not be subjected to another hardship, in not annulling trade, which will subject them to a loss of Rs. 51 crore and other parties which placed orders at unrealistic prices – far away from market price, without proper margins and inadequate margins, without taking margins from clients, giving undue exposure to their clients, exposing markets to risk, etc. etc.; are all versions of their own i.e. of one interested party not supported by an independent third responsible party and even Respondent No. 1 - who is also an interested party to quite an extent, as will be stated later – have conducted some enquiry / inspection, at Appellant's end, - during the day of happening, have not placed their inspection report before this Tribunal, which also has been quoted by Appellant only – that it did not find anything wrong with their system, represents a state of affairs, where this Tribunal has been called upon to take informed decisions, which will have serious repercussions on market and may give rise to further litigation; when actual facts of happenings on October 5, 2012, are not available before this Tribunal.

31. Another aspect that needs to gone into in details, is the stand taken by Respondent No. 1 in different situations, in this matter itself, while dealing with different aspects of this issue, while dealing with different parties.

32. The first important aspect that needs to be dealt is imposition of penalty of Rs. 25 lakh on Appellant vide Respondent's letter dated October 29, 2012, as per decision of Disciplinary Action Committee (DAC) of Respondent. In this it is only stated that Respondent conducted a limited purpose inspection of Appellant to verify facts of the case. Thereafter facts of the case, regarding crashing of computer, its replacement, replaced computer not having limits, etc., are narrated, as has been stated by Appellant – without any variations-, and violation observed are the same, as stated in paragraphs

above i.e. a series of errors and replaced computer not having limits. Thereafter various Respondents' circulars have been stated, which were violated by Appellant, followed by submissions of Appellant – not significantly or materially different from as in present proceedings, personal hearing, when same submissions are repeated. Thereafter conclusions of DAC are available to the effect that replaced computer did not have appropriate controls, validation processes and due diligence and that Appellant had left setting up of alerts of scrip level, value level, quantity level and that setting up limits is left to dealer without any maker checker mechanism and in case dealer omits to put limits or posts wrong limits – irreparable damage to system could be caused and that Appellant had not ensured installing software on new replaced machine (computer) – appropriate controls, validation processes undertaken with due diligence; Appellant had not exercised due skill, care and diligence in execution order, as per instructions of client, lapse at members end in defining validation for dealer terminal (computer).

33. Hence, Respondent No. 1 / DAC found flaws / lapses / lack of due diligence / system placing order not having appropriate limits / lack of supervision at Appellant's end, for which Appellant was penalized and it has to be noted that Appellant has paid the penalty and not preferred appeal against the same, which in other words means – Appellant has accepted the verdict of Respondent and in turn accepted the lapses and other flaws, narrated in above order of Respondent No.1.

34. It would have been interest to find out from which terminal impugned order was placed – whether from computer with IP end 221 or 155 and whether IP of crashed computer was changed from 155 to 221, as it is now been contended by Appellant or whether computer with IP 221 is different

from computer with IP 155. It would have very assuring if limited purpose inspection conducted by Respondent had been meaningful and set at rest the speculation of some counterparties that entire system of Appellant was flawed, with no limits on any machine, a dealer not tied to any terminal and one dealer operating from six terminals, one dealer shifting to another computer as a matter of routine, computer control assigning IPs without ensuring that same is not being used by another computer, terminals having or not have limits, limits left to dealers, i.e. no management controls or supervision, dealers not careful in placing orders and acting negligently; but Respondent No. 1 carried out a limited purpose inspection, not trying to find out of any relevance but reiterating what was dished out to them by Appellant, which in other words is a routine inspection, where nothing is reported or asked for, but undertaken to show that inspection was carried out for record purposes.

35. However, it may be stated that Respondent No. 1 have held, in brief, the Appellant of violative of various bye-laws, regulations and circulars of Respondent and imposed penalty on Appellant, which has been paid and not appealed against and case of Appellant is that when they have been penalized for this Act; they will be subjected to further penalty / double jeopardy if this request for annulment of trade with 655, counterparties, involvement 14000 clients, arising out of a erroneous order placed by them on October 5, 2012 resulting in loss of Rs. 51 crore to them, is not annulled by Respondent No. 1, who have already rejected this request and this decision of Respondent No. 1, not reversed in present appeal before this Tribunal.

36. It may be noted that Respondent No. 1 have not held counterparties, as violative of any provision contained in their bye-laws, regulations, circulars;

in their decisions, as decided by their DAC, vide letters dated October 29, 2012 – imposing penalty of Rs. 25 lakh on Appellant – and dated April 30, 2013 – rejecting Appellant's request for annulment of trade dated October 5, 2012, thereby not compensating them fully or partially for their loss of 51 crore suffered due to this trade.

37. Next important aspect of Respondent's version has to be seen from this Respondent imposing penalties on Respondent No. 2, cases against other Respondents is similar, in impugned appeal in Appeal No. 87 of 2013; as follows:-

- ❖ Trading Member exceeded its exposure by 740% by executing total buy trades wroth 214.82 crore against available collateral of Rs. 4 crore; in violation of Rule 5(i) of Chapter IV of Rules of Exchange and Exchange circular no. NSE/CMPT/6122 dated May 9, 2005;
- ❖ Income of client of Respondent No. 2 for year 2011-12 was Rs. 57.35 lakh, and buy and sale orders on its behalf on October 5, 2012 was Rs. 1083.42 crore, which is highly disproportionate with income of client. Exposure granted to client was arbitrary, reckless and with gross negligence, in violation of NSE circular reference no. NSE/CMPT/6122 dated May 09, 2005 and Exchange circulars on buy orders on October 5, 2012 for huge quantities were placed at price significantly away from market price were matched and led to steep market fall;
- ❖ Buy limits and sell limits placed on terminal used by Trading Member for placing orders pertaining to their client on October 5, 2012, was between Rs. 36 crore to Rs. 71 crore and Rs. 37 crore to 75 crore respectively, without collecting margin or considering client's capability, in violation of Rule 4(d) of Chapter IV of Rules of Exchange and Exchange circular reference no. NSE/CMPT/6122 dated May 09, 2005;

38. These cases will be dealt separately and, at this stage no conclusion need be drawn from above, but it will be sufficient to state that Respondent No. 1 found faults with trading of Respondent No. 2, in respect of trading margin, ordering in excess of client's work, placing orders significantly away from market price and allowing trading limits on terminals to place huge quantity of buy / sell orders for clients, without collecting margin or considering clients capability;

39. Now coming to third outlook of NSE on this matter, wherein SEBI issued show cause notice to NSE, on following counts:

(a) Systems of Respondent No. 1 did not work as required under provisions of securities laws by not coming to halt when index fell by 10%;
(b) Respondent No. 1 erred in not keeping the market system shut for two hours and instead resumed trading within a period of fifteen minutes;
(c) Respondent No. 1 failed to put in place / trade limit controls and risk management at its end and has rather put the onus for the same solely on its brokers;
(d) Counterparty brokers had been able to enter large purchase orders at unrealistic market prices, without even posting margins and therefore were able to cause a systemic risk and Respondent No. 1 did not have systems to prevent such market infer;

40. In reply to various counts in paragraphs above, it is stated with regards to member (broker) trading in excess of margin, that Respondent No. 1 generates broadcast alerts messages, in case members reach margin utilization as percent of his effective deposit from 70% onwards i.e. at utilization levels of 70%, 85%, 95% and 100%, but on several occasions, members overshoot collateral level above 100% on execution of big orders, because margins are calculated and levied after execution of these orders, as a result of which members is disabled, after execution of that order. It may be noted that NSE has a facility of voluntary close out to facilitate members who have been disabled owing to margins violations automatically, to close out their outstanding positions.

41. On October 5, 2012, consequent to placement of basket order by Appellant, all four members named in SEBI letter were disabled. Immediately they squared off their position or brought in required collateral before getting disabled for trading, and that there has been no margin default or settlement default arising out of the incident.

42. However, as per findings and decision of DAC of Respondent No. 1, Respondent No. 2 & 3 are alleged to have exceeded exposure by 740% and 718% by executing buy trades worth Rs. 214 crore and Rs. 158.87 crore, as against collateral available of 13% and 14% for execution of these transactions, which shows the trading member has evaded margin, which is violative of Rule 5(i) of Rules of Exchange and Exchange Circular Reference No. NSE/CMPT/6122 dated May 09, 2005.

43. NSE (Respondent No. 1) in reply to SEBI regarding “Counter party brokers entered large purchase orders without even posting margins” it is stated by Respondent No. 1 that there had been no margin default or settlement default arising out of the incident, and they had monitored risk management of the member, yet Respondent No. 2 and 3, have been charged penalty for evasion of margin and risk management policy, which in variance to their position in reply to SEBI show case notice.

44. Respondent No. 1 had relied on submissions of CPTMs to substantiate changes against Appellant and imposing penalty of Rs. 25 lakh on them for lapse at member end pertaining to risk management controls to be placed before starting a new system, which could cause irreparable damage to the system and has not ensured that on installing the software on the new machine after the crash of the system, appropriate control, validation process and due diligence were undertaken.

45. Hence, NSE (Respondent No. 1) has not taken an inconsistent stand in dealing with issues arising out of trade of October 5, 2012; wherein Appellant had put huge unintended order for sale for NIFTY scrip.

46. It may also be mentioned that placement of a huge single sale order of Rs. 980 crore for sale of 17 lakh units of NIFTY BASKET, gave rise to unparalleled and unprecedented situation of such humongous proportion, in such short span of time, that SEBI circular / NSE's circulars, bye-laws and regulations, which deal with normal situations arising on day to day basis in conduct of trade at exchange, proved inadequate to meet the abnormal situation and hence attempts of all concerned, including SEBI and NSE, to apply their regulations – which deal with ordinary situations – to such an unforeseen, unparallel and unprecedented situation, is giving rise to dissatisfaction to all concerned; especially when, as mentioned earlier also, when facts underlying placement of order, have not been gone into any depth by an uninterested third part, which has the requisite expertise and competence to deal with the situation, since NSE actions have been questioned by SEBI now and SEBI's decision / action against NSE, in yet to be received. However, it may be mentioned that shortcomings in NSE system had been questioned by Appellant and Respondent No. 2 & 3 earlier also, which have not be answered to satisfactorily by NSE.

47. It has been mentioned earlier that it is Appellant version of happenings on October 5, 2012 in placing of single order for sale of 17 lakh units of NIFTY BASKET worth Rs. 980 crore, which started process and Appellant version cannot be relied on since it is an interested party and secondly there are flaws in its version as to how the dealer came to know of his order placed at 9:50:54 as being erroneous, within 4 seconds of his placing the order i.e. at 9:50:58, whereas trade of Rs. 660 crore out of order for Rs. 980 crore sale order, was executed at 9:51:00. How dealer realized his mistake, within 4 seconds, was not answered by learned senior counsel for Appellant, who later withdrew this realization. However, whether trade for Rs. 660 crore was

completed at 9:50:58 or 9:51:00 is also not clear, since Appellant is saying it happened at 9:51:00, whereas NSE and other Respondent time it at 9:50:58.

48. Similarly, it is also not clear whether order was placed from replaced machine with IP 155 or other normally machine with IP 221, since there are problems, in accepting version of change in machine with IP 155 to IP 221 and NSE limited inspection does not bring out this fact and also does not brings out whether risk management i.e. putting limits, not existing on replaced machine, was not exist on other on machines also. Although, a copy of limited inspection of Appellant work-station is not available with this Tribunal, yet it has to be mentioned that when a problem, like existing one, arose with NSE and as with Member’s System, NSE should have conducted an exhaustive enquiry, instead of a limited purpose inspection, bringing out all possible aspect of working of Appellant, including observance of all their and SEBI’s circular applicable to a member. However, since SEBI has questioned the role of NSE in the matter and any decision not yet taken by SEBI on reply on SCN to NSE, it may be mentioned that NSE, is at present, an interested party and should not be sitting over adjudication where it has interest in projecting itself above board, when it’s conduct or functioning of its system is being questioned.

49. Now coming back to various events which took place on October 5, 2012, it appears that an order of Rs. 980 crore originated from Appellant, which was the single largest order in history of NSE and hit trading system of NSE at 9:50:54, and within 4 seconds order worth Rs. 660 crore got executed which resulted in fall of NSE index by 10% and, as per circular of SEBI, NSE cash segment stopped trading and system came to a halt at 9:51:04, when NSE

index had fallen to 15.5.%. Trade worth Rs. 660 crore, involved, Appellant, 660 counter-parties and 14,000 clients.

50. Out of 665 counter-parties to the trade, some eight had major contribution amounting to 70% of trade, and most of these eight counter-parties, who executed trade upto Rs. 462 crore or so, allegedly fell short of margin requirement, alleged to have also traded by placing orders far away from last traded price or realistic prices, allowed clients to trade with taking adequate margin, did not verify antecedents of their clients and allowed them, exposure far beyond their incomes, etc. and this destabilized the market.

51. We will deal with each of these allegations, along with rule position and prevalent practice of dealing with the situation, as and when it arose previously. Regarding margin, it has been brought out that trading member are required to put up VaR margin upfront and for this purpose SEBI had issued necessary guidelines to all stock exchanges and based on these guidelines, stock exchanges, (including Respondent No. 1) issued guidelines to their members. Instructions for collection of VaR margin, is that it will be collected on upfront basis, based on gross open position, no netting of position across different settlements, VaR margin rate of each security is disseminated at end of each trading day and applicable on position for next trading day, VaR margin so collected shall be released on completion of pay-in of settlement and most importantly VaR margin intends to cover largest loss that can be encountered on 99% of days.

52. There appears contradiction when two requirements of VaR margin are looked at closely that – VaR will be collected upfront i.e. before trading is allowed and that – it is based on gross open positions. Gross open positions are known after trade has taken place, but then VaR margin is required to be

put-up upfront – before trade. To solve this contradiction, it is stated that VaR margin intends to cover largest loss than can be encountered on 99% of days.

53. From practical view point, members put in margin, which is based on their daily average trading in a day i.e. expected gross open positions and put up that much of margin upfront. However, there are problems when members do trade in excess of margin and to take care of such possibilities, system generate alerts when margin upto 70%, 80%, 90% and 95% is traded and trading system of Respondent No. 1 is expected to stop taking up further orders from member when margin utilization is 100%.

54. To stop trading on exhausting 100% margin, SEBI had instructed NSE to have such a system in place, which will disable a member's terminal on reaching this limit, however, NSE has interpreted this in a different way - that members have been instructed to stop trading on reaching 100% utilization of margin. SEBI and NSE have to sort this out and it NSE had difficulty in implementing SEBI's instructions on this issue, they should have brought it to notice of SEBI or SEBI should have ensured that their instructions are implemented; but none of these two has happened.

55. Fact of the matter is that member's terminals do not get switched off automatically on reaching 100% utilization and NSE on realizing that a member has reached 100% margin limit, put off that members terminal and brings these in compulsory square off mode and at this member has option of squaring off his open positions to come within margin available or to bring an additional margins.

56. As per Respondent No. 1, trading of members does not stop at 100% utilization of margin, since when margin is on verge of crossing 100% margin

utilization level, if a large order of a member is under execution, the same will be completed and any action to put his terminals on compulsory square off made (mode that does not allows further trading); is taken thereafter and invariably results in members overshooting 100% margin in these cases.

57. In view of above imperatives of practicability, Exchanges (including NSE) have a system of imposing penalty of Rs. 5000 for first violation of margin, Rs. 10,000 on second violation, during the day and trades, being inviolable is allowed and penalty is with a view to deter members from violating margin requirement but at the same time allowing them to trade, when margin requirement is fulfilled, while allowing the trades which are executed when shortfall in margin exists but made good later.

58. Now coming back to what happened on October 5, 2012, margin upto normal was, in place, for all counter-parties, to see trading upto normal expectations; but on that day – with coming into existence of a huge sale order from Appellant – many trades were executed which were not foreseen by Appellant and counter-parties and which resulted in severe shortfall of margin of all counter-parties, but Appellant was not affected in this respect, since it had placed order for institutional client, requiring no margin.

59. It is only of academic interest, whether shortfall in margin was 760% or with available margin only 14% of trade was to be allowed, but fact of the matter is that NSE did not have a system in place – which will disable a member's terminal on reaching 100% margin utilisation or counter-parties had occasion to stop trading on reaching 100% margin limit. This Tribunal will not hesitate to say that even if NSE had system in place to stop members from trading on reaching 100% margin limit, the same would not have worked on October 5, 2012 since everything was over in 4 to 10 seconds of

Appellant's order hitting NSE trading system and market was to be halted after 4 seconds but halted after 6 seconds thereafter and hence even if NSE had tried to have a system to disable member's terminal on reaching 100% margin limit, the same would not have worked on that day, since everything took place at astronomical speed and nobody or no system could not controlled the events in the available time-span.

60. Coming back to allegation that counter-parties did not stop trading on reaching 100% margin limit, or bring in additional margins. First about stopping trading, it may be stated that this event were not in control of any person, due to everything happening within 4 seconds or since no one had foreseen such an happening and second about bringing in additional margin or squaring off their open positions, the counter-parties did exactly the same and some brought in some additional margin and/or squared off their open positions. Hence, counter-parties did what they are habituated to do, as per requirements of system and law and no fault / violation can be found, in this respect.

61. Another point stressed by Appellant that counter parties) i.e. Respondent Nos. 2 to 9) had placed orders worth hundred to thousand crore, without having capability and capacity to execute the same. In this respect Respondent No. 2 is a case in point, which had placed orders of Rs. 1083.42 crore, for both buy and sell side. As per Respondent Nos. 2 and 3 and others, who appeared before this Tribunal have stated that it was their practice to put orders in a similar manner which they did on October 5, 2012, before Appellant's sell order came in, from past for a long time and is part of their trading strategy and they have made money or lost on trading, based on this strategy, but have always fulfilled their commitments.

62. Since Respondent No. 1 has not refuted this statement that Respondent Nos. 2 to 9 were not placing such big orders in the past, hence it was an acceptable practice of Trading Members to place such order and as per Respondent Nos. 2 to 9, most of these orders are passive order and get deleted at end of the day, without execution and only 2% of their order get converted into trade on an average, on a normal working day. This has also not been refuted by NSE and hence may be accepted as a practice. Moreover, since NSE (Respondent No. 1) has not objected to placement of passive order, in the past, it should have no hesitation to these orders as per existing practice.

63. Respondents have stated; with regard to charge of bringing markets into disequilibrium, that by placing such orders which were layered, and brought stability in market since they placed some orders at 2% below market, some upto 5% below market, some below 7½% below market, some 10% below market and their last order was only 17½ % below market, which is allowed by NSE since it is within 20% bandwidth allowed by NSE for placing orders. It is further represented by Respondent Nos. 2 to 9 that it was Appellant order on October 5, 2012, placed in a negligent manner, which brought instability to market and their orders brought stability, since there were orders at various levels and did not allow market a free fall, which could have been steeper than what it was on that day. The undersigned accepts this arguments, since it was refuted only by Appellant, very vehemently but its arguments were not based on reason, but not by NSE or Respondent No. 1, who it must be stated did not go beyond it's oral submissions than what is stated in their written submissions and nothing much of substance exists in their written submissions and these written submissions, as already brought

out above, have many contradictions, which unfortunately, were not resolved during oral arguments or in reply to submissions of other Respondents.

64. Next, arguments raised by Appellant that Respondent Nos. 2 to 9 had not obtained requisite security from their clients, before providing them so large exposure, which definitely is not a good practice and not in interest of healthy functioning of securities market. This was represented to be the case of Respondent No.2, who had not obtained any security from their client, namely, Ankit Financial Services, but had provided it exposure of hundreds of crores, in matter of placing orders and executing trade on its behalf on October 5, 2012. As per circular of NSE dated May 9, 2005 regarding Cash Market – Risk Management Framework, 'Members should have a prudent system of Risk Management to protect themselves from client default. Margins are likely to be an important element of such a system. The same shall be well documented and be made accessible to the clients and the stock exchanges. However, the quantum of these margins and the form and mode of collection are left to discretion of Members'. As per this, Exchange is concerned with Members and clients of members are left to be dealt by member and if a member chooses to take small / insignificant / or no margin, it is his discretion, to be exercised with prudence Respondent No. 2 represented that this client has been with them for 20 years, has met all his obligation and has never defaulted and otherwise he is very solvent and his net profit is Rs. 57.53 lakh during 2011-12, which was wrongly stated at Rs. 57.53 lakh as income. Respondent No. 2 also stated that their client, AFS, has fulfilled all obligations arising out of trade all these years and by not taking any margin from this client, has been done after necessary due diligence. This argument, since based on reason, logic and on law, is accepted.

65. Next question dealt with is of placing orders at unrealistic price or far away from market, taken up by Appellant against Respondent Nos. 2 to 9. Rule position in this regard is contained in circular of NSE dated February 22, 2005 wherein members are advised to ensure due diligence while entering orders and these should not be far away from normal market price / theoretical price. It may be mentioned that NSE has left field wide open by issuing this circular, since no limit has been put in quantitative terms and leave matter to discretion of individuals. As a matter of fact NSE should have been more careful in issuing this important circular, by putting reasonable, unambiguous directions for everyone to understand and follow, but it seen that NSE has observed a mere formality by issuing this circular, without having much relevant to the subject matter and according this circular deserves only, as much respect, which everyone concerned has accorded, by interpreting as they can and doing the needful, in this regard.

66. In above context, it may be added that as per Detailed Consolidated Circulars, Item 3 relating to Market Parameters, Item 3 under heading No Price Bank, issued by NSE, it is stated that "There is no price band in respect of securities, for which derivative products are available in scrips, included in indices on which derivative products are available. However, in order to prevent members from entering orders at non-genuine prices in such securities and in pursuance of Regulation 2.5 of Part-A of Regulations of the capital market segment, the Exchange maintains dummy circuit filter / operating range) of 20% of such securities". Order for sale of NIFTY BASKET placed by Appellant on October 5, 2012 had no price band, since securities in NIFTY BASKET have derivative products and are included in indices, hence dummy price band of 20% will exist and hence placing order at 18% below or above of LTP of NFITY by Respondent Nos. 2 to 9, was in order and these

Respondents cannot be held violative of any NSE circulars, bye-laws, regulations, etc. in this regard.

67. Appellant in their submissions had held Respondent Nos. 2 to 9 of conducting prejudicial business and unwarranted business, which is defined as follows, in NSE Rules 4(d) and 4(f) respectively:-

- Prejudicial Business : If it makes or assists in making or with such knowledge is a party to or assists in carrying out any plan or scheme from the making of any purchase or sales or offers or offers of purchase or sale of securities for the purpose of upsetting the equilibrium of the market or bringing about a condition in which prices will not reflect market values;
- Unwarrantable Business: If it engages in reckless or unwarrantable dealings in the market or effects purchases or sales for its constituent's account or for any account in which it is directly or indirectly interested which purchase or sales are excessive in view of its commitments or his own means and financial resources or in view of the market for such security.

68. Although Appellant made a big issue of Respondent Nos. 2 to 9 acting in prejudicial business or unwarranted business, but this has to be seen in background of unforeseen events in NSE on October 5, 2012, where a single sale order of Rs. 980 crore shock the market, which was stabilized to quite an extent due to pre-existing orders of Respondents in a layered manner, which had been their strategy since a long time, where were in NSE's system for every single day since long and hence NSE was aware of these order and if NSE had any problem with Respondent's placing orders since long, NSE should have objected, and by not objecting or taking action on matters such on placing orders for buy / sell in layered manner since long time by Respondents, the same has becomes a practice and its legality and acceptance has to be recognized, but, however, if one day the same passive orders gets converted into trade, it cannot be held that entities placing such orders have indulged in Prejudicial Business or Unwarranted Business. Strangely, this

matter was not raised by NSE, but by Appellant and it can be presumed that NSE have no objection to such business by Respondent Nos. 2 to 9.

69. Another point raised by Appellant will be dealt now i.e. – Failure to provide margin deposit and / or Capital Adequacy Requirements, which reads "The relevant authority shall require a trading member to suspend its business when it fails to provide the margin deposit and / or meet capital adequacy norms as provided in these Bye-laws, Rules and Regulations….". Margin deposit and capital adequacy is defined in NSE's – Detailed Consolidated Circular Item No. 1, Para 1.1.8 such as "All orders received in pre-open session shall be validated at the applicable margin for sufficiency of available market prior to acceptance of orders. If available capital of member is insufficient to cover margin requirement of the order placed, the same shall not be accepted for pre-open session.

70. The above requirement of applicable margin and for sufficiency of available capital is for pre-open session, and capital adequacy is also in respect of margin sufficiency and in no other respect. In this context capital adequacy is required for sufficiency of margin and has nothing to do with capital adequacy of the member, in terms of its net worth, working capital, turnover, current assets, etc. and is in context of member's ability to put in sufficient margin.

71. During the pleadings, it was stated by Appellant, a number of times, that Respondent Nos. 2 to 9 and especially Respondent Nos. 2 and 3, placed orders, which resulted into trades, which were more than total net worth of their companies or that of their clients, on whose behalf orders / trade was carried out. In this context, the undersigned had specify requested Appellant to clarify as to what are requirements of capital adequacy and net worth of

members or their clients, as per NSE's circulars, rules and bye-laws, to which learned senior counsel for Appellant, stated that capital adequacy is required, as per above mentioned circular of NSE and hence capital adequacy and also net worth should also be sufficient to place orders or execute trade of the order placed by Respondent Nos. 2 to 9. The above has been quoted by Appellant, out of context, and has no relevance to trading on NSE and capital adequacy is in relation to sufficiency of margin and not in terms of net worth of members. This actually, was not clarified by NSE, on whose circular, rule, bye-law, Appellant was arguing and it is strongly felt that NSE, who was represented by its senior counsels / counsels / representative, throughout the discussions of relevant appeal, should have clarified the matters, which concerns them and are arising out of their directives.

72. As a matter of fact, NSE should be careful in drafting their circulars, regulations, bye-laws to make these clear and understandable by all concerned in an unambiguous manner, since these are required by all players in security market; but it is a matter of regret, that NSEs circulars, bye-laws, rules are drafted in a manner, which do not lead to clarity and un-ambiguity, since there was no requirement to bring in concept of capital adequacy while dealing with adequacy of margin, when what constituents margin had been spelt out explicitly. NSE, as a matter of fact, should not bring out new terms, without adequately defining them and 'material mistake' is one such term.

73. Most of the arguments, counter-arguments, pleading of Appellant and replied thereto, have been dealt, but what has not been dealt with, is most vital to the matter and goes to the root of the issue. The issue is "whether systems, rules, bye-laws, regulations of SEBI/NSE are adequate to deal with situations, which arose due to punching in of an order of Rs. 980 crore, due to error /

mistake / negligence of Appellant, when it wanted to sell Rs. 17 lakh worth of NIFTY BASKET at market rate but punched in sale order for 17 lakh units of NIFTY BASKET worth Rs. 980 crore.

74. Within 4 seconds of order for sale of Rs. 980 crore worth of sale order, trade worth Rs. 660 crore got executed, leading to 10% fall in NIFTY INDEX, necessitating halt in market for 1 hour and after 4 seconds of order, halt mechanism of NSE trading got triggered, but market stopped 6 seconds later, when NIFTY INDEX had fallen to 15.5%, since NSE's trading system stopped accepting orders for trade, but orders in trading system got matched and some trade worth additional Rs. 5 crore got executed.

75. A lot of time was spent on arguments / counter-arguments, whether NSE system should have stopped immediately on NIFTY INDEX falling 10% and no further time for stopping this should have been consumed / required by NSE's system. In this context, NSE reply to SEBI show-cause notice is relevant:-

On May 18, 2009	NIFTY			SENSEX		
	Time	Applicable points for triggering circuit filter	Points at which market actually halted	Time	Applicable points for triggering circuit filter	Points at which market actually halted
Circuit Triggered for first time	9:55:08	300 (10%)	531.65	9:55:11	975 (10%)	1789.88
Circuit Triggered for second time	11:55:17	600 (20%)	651.50	11:55:17	1950 (20%)	2110.79

	NSE	BSE
Market Start	9:55:00	9:55:00
Circuit Triggered for first time	9:55:08	9:55:11
Last order acceptance time	9:55:18	9:55:53
Last trade time	9:55:21	9:55:54

Market reopened after 2 hour halt	11:55:00	11:55:00
Circuit Triggered for second time	11:55:17	11:55:17
Last order acceptance time	11:55:19	11:55:32
Last trade time	11:55:25	11:55:33

76. In narration, it is stated that, in earlier instance of market-wide circuit filter triggered on May 18, 2009 and NSE system brought market to halt in 13 second, where BSE system took 43 seconds to halt market, with further falls in NSE and BSE, between trigger and halt. When markets resumed functioning, after halt on above triggers, markets had to be closed a second time and it took 7 second for NSE system to halt after trigger, while BSE system took 13 seconds to halt after trigger. This time BSE trading was not halted, after NSE system halted after 6 seconds of trigger. It further stated that time taken by system to bring market to halt, depends on level of activity on the market when triggered. SEBI have agreed to this contention and recorded, in this matter as : Difference between circuit trigger time and last order acceptance time on the exchanges as due to system taking finite time to complete their internal process of stoppage of acceptance of fresh orders from brokers terminals and shuttling down matching NSE further states that entire process of halting market is automated, with no human intervention.

77. Hence, the entire controversy of market taking time to shut down should rest with understanding that markets are active constituents and when ordered to stop will take time to settle and there will be gap between trigger and halt, which is inevitable. Hence, this settles the issue that market systems will not stop instantaneously and halt only after a small time gap, which is necessary to complete ongoing operations.

78. The other issue is counter-parties trades without adequate margin money, without capital adequacy, many time their net worth and hence these

entities had put the system to risk and accordingly gains / profits made by counter-parties (i.e. Respondent Nos. 2 to 9) and should not be allowed to be retained by them, but should be used to make good the loss, incurred by Appellate due to placing sale order due to punching error.

79. This aspect has been dealt, in details above, but it will be sufficient to state that NSE requires members to trade by putting margin expected to meet 99% of single largest loss and that NSE has a system to take care of shortfall in margin, as per extent instructions of NSE, and this has stood test of time and whenever, a member has exceeded its available margin, guidelines have ensured that margin requirements are met and system is not put to any risk.

80. Regarding counter-parties trade's having put market at risk, de-stabilization, disturbing equilibrium; the matter has been dealt above and each side alleging violation, by other side; but taking a balanced view, it may be held that none of the sides did anything deliberately and events happened of their own due to inadvertent placement of sale order by Appellant, matching with passive orders regularly placed by counter-parties, resulting in trade of Rs. 660 crore in 4 seconds; giving rise to analysis of margins, adequate capital, lack of due diligence, un-business like conduct and so on and so forth; but since none of these were done, by any party, deliberately, balance of equity lies in whether systems responded, in way at was intended and whether there is need for improvements, to meet any such eventuality, in future.

81. One thing must be mentioned that, as per SEBI's instructions to NSE, to disable members trading terminal when margin available is utilized to the extent of 100% and NSE passing this responsibility to members with instructions of not trading when margin is exceeded, whether NSE was

justified in pass the buck to members and whether it was possible to have a tab in their trading system, which will disable members, trading terminals on exhausting available margin. NSE is definitely not justified in passing the responsibility of stopping trading on exceeded available margin to members and should have tried to implement this in their trading systems and if it was not possible, due to some reasons, should have brought this to notice of SEBI. This was not done and to resolve this SEBI and stock exchanges should consider what has to be done to address this problem.

82. The last question to be considered is whether NSE is justified in turning down Appellant's request for annulment of trade of October 5, 2012, in terms of Chapter VII : Dealings of Clearing Members para (b) regarding cancellation of impugned trades allegedly vitiated by fraud, material mistake, misrepresentation or market or price manipulation.

83. Before we deal with this, let us consider, as to what is being asked for by Appellant. Appellant are asking for cancellation of trade between Appellant and 665 counter-parties, involving 14,000 clients, which happened more than one year and nine months and these trades were mostly either reversed on the same day or in few cases delivery took place. These shares being fungible must have been traded several dozen times and would have been dealt by lakh of trades and hence locating these traded securities, for reversal of trade, will be an impossible task and NSE had admitted this, in so many words.

84. In case, Appellant wants first of the trade to be reversed, the same will put counter-parties to a huge loss, since they will have to give back securities bought from Appellant and they will get back Rs. 660 crore. Since counter-parties are not holding these shares, these trades were reversed the same day

to so many other unknown members / clients, counter-parties, will be required to actually buy these securities which will cost them 892 crore and will put all these counter-parties to a loss of Rs. 232 crore, as against their combined gain of Rs. 36 crore (70% of Rs. 51 crore). Hence this cannot be agreed to, in all fairness.

85. Since, as per NSE regulations, only annulment of trade is contemplated, and the same cannot be agreed to also due to the fact that from all reasonable considerations, Appellant were negligent in putting sale order of Rs. 980 crore, in place of sale order of Rs. 17 lakh; since it was not one simple punching mistake, but a series of mistakes, when the dealer did not care to see limits on its terminals, bringing pointer from default position (order in value term) to order by quantity deliberately, putting in value when blank to be filled was for quantity, not caring to see value of order and quantity of order and okaying everything, which even a novice would have known is wrong, not to talk of a seasoned dealer placing the order.

86. It is also be mentioned that despite an event of such magnitude taking place, shaking securities market in India to its foundations, NSE choose to conduct a limited purpose inspection, not bringing out anything of relevant or confirming that it was a one off mistake and system of Appellant are firm and reliable and not bringing out, inter-alia -, whether how dealer within 4 seconds realized that he had made a mistake when – as per Appellant – all the trade happened in 6 seconds before market halt got triggered, whereas as per NSE all the trade happened in 4 seconds before market halt got triggered and from which computer order was placed, whether it had address end 221 or 155 – the replacement of crashed computer and whether explanation of Appellant , is plausible, that IP 155 of computer was changed to IP 221;

without change of computer, which was done in 18 seconds, when experts say this will take at least 180 seconds.

87. Since this Tribunal has take a view whether request for annulment is justified and practical, it can be held in equity that such a request is not justified, in given circumstances, since it is not possible to believe that buy order of Appellant was result of one punching error and that it is not possible, at this juncture, to annul the trade, due to practical difficulties that will arose and may put counter-parties to grave loss, for no fault on their party and will enrich Appellant, who created all the problem, due to its negligence.

88. Towards the end may be mentioned that modified request of Appellant to give them the pay-out of Respondent Nos. 2 to 9, kept with NSE, to compensate them to extent of 70% of their loss of Rs. 51 crore in the trade of Rs. 660 crore; is not possible or even desirable since NSE's rules permit annulment of trade, which has become practically impossible, and NSE's rules do not permit withdrawing profits from counter-parties to compensate Appellant to the extent possible.

89. In view of above appeal does not succeed.

Sd/-
A.S. Lamba
Member

26.08.2014
Prepared and compared by
msb

Appeal No. 87 of 2014

Per : A.S. Lamba

1. This appeal has been filed by M/s. Inventure Growth & Securities Ltd. (Appellant) vs. National Stock Exchange of India Limited (Respondent) against imposition of penalty of Rs. 25,00,000/- vide letter of Respondent No. NSE/INVG/2013/202780-K dated April 30, 2013; for evasion of margin, violation of Rule 5(i) of Respondent's Circular No. NSE/CMPT/622 dated May 09, 2005, un-businesslike conduct as defined in Rule 4(f) of Chapter IV of Respondent Circular No. NSE/CMPT/6122 dated May 09, 2005, violation of spirit of advise to trading members vide Respondent's Circular NSE/INVG/2007/65 dated March 23, 2007, violation of Rule 4(d) of Chapter IV of Respondent's Circular No. NSE/CMPT/6122 dated May 09, 2005, KYC analysis and financial details of clients not in accordance with Respondent Circular Reference No. NSE/INVG/7102 dated January 25, 2006, NSE/INVG/7307 dated March 24, 2006, NSE/INVG/223 dated December 22, 2008, NSE/INVG/11928 dated January 22, 2009, NSE/INVG/12996 dated September 2, 2009, NSE/INVG/13784 dated December 30, 2009, NSE/INVG/14117 dated February 17, 2010, NSE/INVG/14994 dated June 17, 2010, NSE/INVG/16703 dated January 5, 2011 and relevant Prevention of Money Laundering Act, 2002 (PMLA Rules), setting Terminal limits not in accordance with NSE/CMPT/6122 dated May 9, 2005 and Rule 3,4,5 of Chapter IV of Rules of Exchange, Margin Collection process and risk management policy as per Respondent's Circular No. NSE/CMPT/6122 dated May 9, 2005.

2. This penalty has been imposed for violation of various above mentioned Circulars, on basis of inspection of books, registers, records and other relevant documents, undertaken on October 12, 2012 by Respondent and a show cause notice dated November 1, 2012, was issued to Appellant for un-businesslike conduct, unprofessional conduct, adverse impact on market and investors at large. Various alleged violations (V), reply of Appellant (R) and decision of Disciplinary Action Committee (D) of Respondent are enumerated below, ad seriatim:-

(i) (V) Appellant placed, on behalf of his client, orders worth Rs. 1083.42 crore on Respondent; as against margin of Rs. 4 crore, on October 5, 2012 between 9:05:00 a.m. to 9:50:59 a.m.;

(R) Regarding placing orders and applicable margin in trading system, of Rs. 1083.42 crore, VaR margin shall be collected on gross open position of the member, as per Clause 11.52 of Circular No. 541/2011 (Download Ref. No. NSE/CMPT/19139 dated October 14, 2011; which in effect means that during Rolling Market, requirement of margin is applicable on open position and not on pending orders entered by members (brokers) in trading system of exchange;

Exchange levies margin on pending orders in pre-open session, which means Exchange has mechanism to levy margin based on pending orders, but exchange has not applied this to Rolling Market Session and that requirement of margin is upon execution of trade in Rolling Market Session – and this facility has been extended by this Members to its clients;

Member did not enter these kinds of orders for first time on October 5, 2012, but has adopted similar strategy for years and Respondent has records of such orders placed on its system and not once, such question has not been raised by Respondent in the past and further Respondent has not prescribed any limit or prohibition on placement of orders on its trading system;

All orders were placed using direct terminals of Respondent, which allowed order placement as it is well within framework of Respondent;

Respondent may appreciate market wide order-trade ratio is between 30 to 300 orders per trade and as a result under normal circumstances orders worth Rs. 1000 crore, would have resulted in trade of Rs. 3 crore to 30 crore (both buy + sell and net position will be much less as buy and sell trades would have been knocked out, as member's client carries out inter-day trades, predominantly);

Business on Respondent is done based on precedence and probability of trades being executed in normal course and this one-off order, claimed to be erroneous by Respondent, placed by some member, got matched with passive orders of Appellant. No request for trade cancellation was received, which generally comes up if transactions are executed, due to placement of erroneous order.

(D) No mention of this charge in Finding & Decision;

(ii) (V) You on behalf o your client – Ankit Financial Services – placed total of 6713 buy orders (for Rs. 596.81 crore) in NIFTY scrips, out of which 4288 orders (for a value of 468.96) were placed at prices significantly below Last Traded Price (LTP) upto 18.64%; on October 5, 2012 between 9:00:05 and 9:50:39. Further, on same during this day and time, you – on behalf of your client – placed total of 7159 sell orders (for Rs. 555.81 crore) on NIFTY scrips, out of which 4430 orders (for Rs. 392.16 crore) were placed at prices significantly above Last Traded Price upto 21.88% and, therefore, it is apparent that you, on behalf of your client, placed orders away from the market on buy and sell side;

(R) It may be noted regarding placement of orders away from market price; orders for this client are placed at various points to average out buying / selling within established framework of Respondent. Clause 'C' of Item 3 of Capital Market Consolidated Circular Ref. No. 034/2012 (Download Ref. No. NSE/CMTR/20616) dated April 24, 2012, quotes;

There is no price band in respect to securities for which derivative products are available and scrips included in indices on which derivative products are available. However, in order to prevent members from entering orders at non-genuine prices in such securities and in pursuance of Regulation 2.5 of Part - A of Regulation of Capital Market Segment, Exchange maintains dummy circuit filter (operating range) of 20% of such securities;

This in effect means Respondent generally recognizes that orders placed within range of 20% of LTP are not non-genuine and orders placed by Appellant were well within the parameters stipulated by Exchange. Comparison of order price with LTP, which is as per Respondent's letter is 18.64% of some buy orders and 21.88% of some sell orders form LTP is also within framework of 20% price band to previous close, as stipulated by Respondent;

(D) Buy orders for huge quantities placed, at a price significantly away from market price were matched and led to steep market fall. Appellant has represented that it had placed all its orders within permissible limits and no order was placed beyond limits set by Exchange and client has always being adopting this strategy of trading in the past. DAC noted that members are advised by Circular No. NSE/INVG/2007/65 dated March 23, 2007 to exercise due diligence and caution, at time of placing of orders, which are away from market price and also advised to put in place appropriate internal system and procedures for ensuring that such orders are not entered and Appellant has violated the spirit of said circular;

(iii) (V) On October 5, 2012 your buy orders for huge quantities, placed at price significantly away from market price, were matched and led to steep market fall. Placing of orders away from market price, violated Regulation 4.5(1)(1) Part A (Capital Market Segment) of Trading Regulation , wherein it is stated that A Trading member will not make bids and/or offers for securities with an intention of creating a false or misleading appearance with respect to the market for, or the price of any security.

(R) Appellant has been applying similar strategy since years and why Respondent never before pointed out violation of this regulation. Whenever obligation to pay-in was generated due to execution of orders, Appellant's client fulfilled obligation and intention being non-genuine is unwarranted. Client had paid huge amounts of several occasions, when suffered losses. Orders were placed much before these got converted into trades and these passive orders got matched with active orders of counter-party Appellant's orders prevented market from falling even further.

(D) Same as in point (ii).

(iv) (V) Regulation 4.5.4(c)(i) of Trading Regulation in Circular No. NSE/INVG/2007/65 dated March 23, 2007, drawn attention of Members non-compliance with requirement specified regarding "member making bids and/or offers for securities with an intention of creating false or misleading appearance with respect to the market for, or the price of any security", shall attract disciplinary action, and that members were advised to put in place appropriate internal systems and procedures for ensuring that such orders are not entered.

(R) Appellant has put in strong mechanism of Risk Management System and Risk Management options provided by Exchange on Corporate Manager Terminal, and has feature of Margin Limit for voluntary close out – wherein lower and upper limit of "Margin Limit" % as 85 and 91 respectively - which means pending orders should have deleted and terminals gone into close out mode, as soon as voluntary limit of 91% is crossed – which was not enacted by Respondent. Over and above that, the orders placed by Appellant, after reach 100%, Respondent puts the members (including Appellant) into a compulsory square off mode.

(D) Does not deal with this specifically but, “perhaps”, assumes that decision in (ii) will apply.

(v) (V) As per income proof submitted by client, gross total income for year ended March 3, 2012, was Rs. 57.53 lac and total value of orders, in all scrips for buy / sell, was Rs. 1083.42 crore on October 5, 2012, which shows Appellant provided exposure to client which was hugely disproportionate, with income of client. This exposure was arbitrary, reckless, grossly negligent for exceeded known capabilities of client.

(R) Client’s net profitability for FY 2011-12 was Rs. 57.53 lac, erroneously shown as gross total income, which is appreciative, considering adverse market conditions in previous FY. Partners of client are High Net Worth Individuals and deal in securities market through Appellant only. Combined financial capability of the client group is much over Rs. 100 crore. Client places such orders on daily basis and all orders placed on trading system do not get executed and hence placement of orders is not allowing exposure. Special case where passive orders of this client got matched with active orders placed by counter-party if fructification of allegations against Appellant, then since Appellant had deposited only Rs. 4 crore as margin money with Respondent, exposure to client beyond Appellant deposit, was effectively given by Respondent.

(D) Income proof of client, shows his gross total income as Rs. 57.53 lac for FY ending March 31, 2012 and total buy/sell orders on behalf of client amounting to Rs. 1083.42 crore on October 5, 2012, show that exposure provided to client was highly disproportionate with his income and exposure granted to client was arbitrary, reckless and with gross negligent and hence conduct of Appellant indicates un-businesslike conduct;

(vi) (V) Vide Circular No. NSE/CMTR/4749 dated January 21, 2004, members are urged to ensure that they collect adequate and proper margins from the investors and do not fall prey to any possible temptation to find margins / pay-in for their investing clients. It is again reiterated that members must exercise due diligence in assessing financial capacity of clients for whom they are executing orders to ensure that their clients’ market activity is commensurate with their financial ability.

(R) This has been dealt with Appellant’s submission to point numbers (iv) and (v) above.

(D) No findings.

(vii) (V) As per Respondent’s record, buy limits and sell limits placed on terminals used by Appellant for placing orders pertaining to client on October 5, 2012 was between Rs. 36 crore to Rs. 71 crore for buy and between Rs. 37 crore to Rs. 75 crore for sell. It seems no care and caution had been exercised in setting limits for dealers or by linking same to margin / collateral. Such conduct, evidently, led to disturbance in normal functioning of securities market and also consequent withdrawal of your trading faculty on that buyer.

(R) Appellant appreciates observation that they had set limits on terminals which ranged from Rs. 35 crore to Rs. 75 crore, which itself substantiates that Appellant were using RMS facilities, provided by Respondent and did not leave terminals without limits. Appellant want Respondent to also acknowledge Appellant's use of Voluntary Closeout Parameter for terminals wherein limits set were in range of 85% to 91% of deposit consumption for executed orders limits were set up with adequate care and caution and looking at general trend in market i.e. very small % of orders get executed and result into trade.

(D) Buy limits and sell limits placed on terminals used by trading member on October 5, 2012 of between Rs. 36 crore to Rs. 71 crore for buy and between Rs. 37 crore to Rs. 75 corre for sell, without collecting adequate margins or considering client's ability. Therefore, no care and caution had been exercised in setting the limits for the dealers or by linking the same to margins / collateral and such conduct resulted in disablement of Member, which is in violation of Rule 4(d) of Chapter VI of Rule of Exchange and Exchange Circular Reference No. NSE/CMPT/6122 dated May 09, 2005.

(viii) (V) Non adherence to prescribed risk management policy and providing high exposure without adequate margins is not in accordance with the Exchange Circular (NSE/CMPT/6122) dated May 09, 2005 and also constitutes violation of the provisions of Prevention of Money Laundering Act, 2002 ("PMLA") as informed to you vide various circulars issued by the Exchange from time to time including Circular (NSE/INVG/7102) dated January 25, 2006, Circular (NSE/INVG/7307) dated March 24, 2006, Circular (NSE/INVG/11798) dated December 22, 2008, Circular (NSE/INVG/11928) dated January 22, 2009, Circular NSE/INVG/12996) dated September 02, 2009, Circular (NSE/INVG/13784) dated December 30, 2009, Circular (NSE/INVG/14117) dated February 17, 2010, Circular (NSE/INVG/14994) dated June 16, 2010 and PMLA Master Circular (NSE/INVG/16703) dated January 05, 2011 and relevant PMLA Rules.

(R) Alongwith Risk Management System, Appellant also follow proper policy framework, as per guidelines of anti-money laundering measure's – the overriding principle is that their management have taken all proper precaution and have implemented all safeguard measures initiated by them, which are adequate, appropriate and follow spirit of these measures and requirement, as enshrined in PMLA.

Appellant's internal mechanism ensure compliances with policies, procedures and controls relating to prevention of money laundering covers broadly the customer acceptance policy and customer due diligence measures, including requirements for proper identification, maintenance of all records, compliance with relevant statutory and regulatory requirements and with regard to client AFS – he is known to our management and company officials, along with his other business interest, his place of work and residence client nor any of its partners are involved in any criminal activity and their impeachable record on honouring obligations, along with their financial standing, has resulted in their categorization as low risk clients.

Since, in interest of our stakeholders, Appellant pursue policies which are in longer public interest, transparent and accountable to all regulatory bodies and competent authorities. Accordingly, any violation of PMLA is denied. Clients prompt payments, whenever, called upon has given us confidence about his credibility and suitability of his profile.

(D) Conduct of Appellant in providing Rs. 1083.42 crore exposure to client, namely, AFS on October 5, 2012, against his gross total income, for FY 2011-12, at Rs. 57.53 lac, was highly disproportionate with income and was arbitrary, reckless and with gross negligent and far exceeded known capability and hence violative of Exchange Circulars on PMLA;

(ix) (V) From observation from 1 to 9, as above, your conduct indicates mis-conduct (Rule 3 of Chapter IV of Rules of Exchange) un-businesslike conduct (Rule 4 of Chapter IV of Rules of Exchange and Unprofessional Conduct (Rules 5 of Chapter IV of Rules of Exchange);

(R) As explained above, Appellants have not violated any Regulations of exchange and deny violation of Rule 3, 4 and 5 dealing with misconduct, un-businesslike conduct and unprofessional conduct;

(D) Deals with gross income of client "AFS" for FY 2011-12 at Rs. 57.53 lac, against exposure of Rs. 1083.42, in placing buy and sell orders by Appellant on behalf of client on October 5, 2012; which was considered arbitrary, reckless, and with gross negligence and far exceeded known capabilities of client and since no margin was collected by Appellant from client, conduct of Appellant indicates un-businesslike conduct;

3. From scrutiny of 'alleged violations', 'reply' of Appellant and 'Finding and Decision'; it is seen that matter has been dealt by Respondents and DAC of Respondent in a unprofessional, un-businesslike and ad-hoc

manner, without going into any depth of the problem and in a perfunctory manner, not expected of exchange of national level competing with best in India and abroad and most importantly has not done any justice to Appellant or brought out any violation on part of Appellant in any meaningful manner or with a view to taking action for correction for any violation or for future guidance of Appellant or similarly placed members as Appellant.

4. The less said the better about conduct of Respondent, in conducting inspection of Appellant by a team of officials on October 12, 2012, pursuant to sudden fall in NIFTY on October 5, 2012. Presumably this should have in context of finding the reasons for what happened on that fateful day, who was at fault, whether system of exchange and of members worked properly to meet surge of activity fuelled by erroneous order and how the system responded to same and if any corrective / upgradation of systems / improvements of Appellant or Respondent were required to meet such occurrences in future, but Respondent choose, in their wisdom, to conduct a standardized inspection of all big players, who played some important part in events of October 5, 2012 and found same fault with all concerned and fined everyone of these, irrespective of whether it was Appellant’s rational or justified conduct or not, as per Respondent’s regulations;

5. Now coming to findings of inspection against Appellant, Appellant’s response to findings and proceedings of Disciplinary Action Committee. It is seen that inspection was conducted, in haste, found what Respondent wanted to find - as if it had pre-decided its findings before inspection since inspection and show cause notice to all CPs of erroneous trade is more or less the same and similarly worded. Matter was placed before DAC for decisions, based on findings of inspection and reply of Appellant, oral submissions of

Appellant, etc. but surprisingly finding and decision of DAC are same as findings during inspection by Respondent and DAC has not considered the replies of Appellant but come to same conclusions which were alleged in SCN. DAC's finding and decision are stated in 4 paras on pages 4 and 5 of Respondent's communication dated April 30, 2013 and thereafter 4 sub-paras on page 5 state some observations, which concludes violation by Appellant of various rules, bye-laws, regulations and circulars of Respondent, followed by imposition of penalty of Rs. 25 lac and deposit another Rs. 25 lac to monitor compliance.

6. Thus a nine point charge sheet of Respondent has been dealt in 4 paras of findings by DAC of Respondent to hold Appellant violative of 21 circulars of Respondent and one PMLA master circular and relevant PMLA rules and 3 rules of Chaper IV of Rules of exchange, etc.. It is not clear as to how 9 alleged violations have been dealt in 4 para findings by DAC, without giving any credence to reply of Appellant, let alone indicating why replies of Appellant were not considered satisfactory or how these replies did not rebut allegations and why some of the alleged violations in SCN have been accepted or why some of these overlooked / not mentioned.

7. In fairness, it must be admitted that though inspection carried out by team of officials of Respondent was not conducted in a satisfactory manner and had other deficiencies, but still brought out nine violations on part of Appellant in clear terms, but same cannot be said of conduct of DAC of Respondent, which met in all solemness, conducted appropriate proceedings, took oral evidence of Appellant and after examining their written submissions, made some findings in 4 paras for 9 alleged violations, without indicating which para of findings deals with which violations, and on what

basis DAC concluded in 4 sub paras of observations, that follow these 4 paras, for holding Appellant violative of so many circulars, bye-laws and rules of Respondent. Appellant has been held guilty of evasion of margin, as per first para under heading 'FINDING AND DECISION' This change did not exist in SCN. However, Appellant explained that margin can be evaded by (i) showing a general client as institutional client, who is not required to pay margins, and (ii) trading on behalf of more than one client from one client's account, so that margin requirement gets reduced. Hence, change of Evasion of Margin does not get substantiated.

8. The most important alleged violations relating to fall in market states, which is also repeated in decisions of DAC; states- buy orders for huge quantities placed at a price significantly away from market price were matched and led to steep market fall. This statement has to be seen at what is 'price significantly away from market price'. From summary of order analysis, provided by Appellant and available in reply to 2nd alleged violation, as in Table below:

Distance from Previous Close	No of Buy Orders	% of Buy Orders	Value of Buy Orders	% of Buy Value	No of Sell Orders	% of Sell Orders	Value of Sell Orders	% of Sell Value
00% to 05%	2909	43.33%	1794480527.75	33.75%	3076	42.97%	2009218840.60	32.79%
05% to 10%	1893	28.20%	808474123.50	15.21%	1287	17.98%	611706161.85	9.98%
10% to 15%	1445	21.53%	1608988946.55	30.26%	2007	28.03%	2483482093.30	40.53%
15% to 20%	466	6.94%	1105083688.85	20.78%	789	11.02%	1023287488.45	16.70%
Total	6713	100.00%	5317027286.65	100.00%	7159	100.00%	6127694584.20	100.00%

- The above table reflects that 43% of the buy sell orders amounting to 33% of the total order value were placed within 5% of the Previous Close Price.
- Only 7% of the buy orders were placed at the price that was in the range of 15% to 20% of the Previous Close Price.
- No orders were placed at the upper or lower price band.
- The average distance of buy and sell orders from the previous close price was 10%, which is placed as per a predefined trading strategy of the client.

- The same system of order placement where the average distance of all orders is around 10% from the previous close price is being applied since a very long period of time.
- The Exchange has quoted some figures, selectively taking into account a few orders that are far away from the extreme ends of order log without taking into account the law of averages that is applied in all business.”

9. It can be seen from table that orders for purchase of Rs. 531.7 crore were placed by Appellant on October 5, 2012, at different levels, for purchase of NIFTY Scrip and these orders got converted into trades of Rs. 214.83 crore. It may be seen from data in above table and finding that buy orders worth Rs. 214.83 got converted into trade, it will be safe to conclude that all buy orders which got converted into trade, were from 0-5% and 5 to 10% range of buy order of Appellant. Hence, what buy orders got converted into trade, were placed at 0 to 10% of previous close, which is also supported by Appellant’s contention that their average profit from trades on October 5, 2012 was 7½ % only.

10. Now, it is not understood, as to why Appellant is being faulted for steep fall in market, when only buy orders got converted into trade were placed in range of 0-10% of previous close and majority of these trades were in range 0-5% of previous close. Hence, it is not understood as to why Appellant’s orders, placed significantly away from market price, are being held responsible for steep fall in market, which were not converted in trades. It may also be mentioned that if buy orders by 8 parties (including this Appellant), were not existing in Respondent’s trading system, when order for sale of Rs. 980 crore in NIFTY Scrip was placed by M/s. Emkay, fall would have been much more steep and hence orders of 8 major parties supported the market and provided some equilibrium. How these buy and sale orders of

some 8 parties (including Appellant) are being held responsible for steep fall in market, is not appreciated.

11. Regarding allegation that client AFS had income of Rs. 57.53 lac for FY 2011-12 and he was allowed to place orders worth Rs. 1083.42 crore and hence action of Appellant was arbitrary, reckless and grossly negligent; has been clarified that Rs. 57.53 lac was not the income but net profit in 2011-12, which is appreciable since 2011-12 was a bad year and that partners of client 'AFS' are people of High Net Worth and have met their obligation in most difficult circumstances and are known to Appellant for long and hence orders of Rs. 1083.42 crore placed on behalf of client on not only October 5, 2012 and long before that and also after that, is a well conceived and time tested client appreciation policy and has not been refuted by DAC but yet DAC have come to same conclusion as alleged in SCN.

12. It is not worthwhile dealing with Respondent's or their DAC's conduct in any further details, but to state that SCN contained nine allegations, which were put to Appellant to explain, Appellant gave their submissions in writing and orally and it is not revealed by DAC whether these submissions were considered or but DAC repeated some of these nine allegations in four para, without stating which ones are substantiated which are not, consistently not providing any clue why some of allegations are repeated in findings and some not specified in findings; but at the same time Appellant has been found violative of 23 circulars, PMLA master circulars, etc. and how these circulars, rules, master PMLA circulars apply in individual violations, has not been clarified.

13. In other words, DAC totally failed on all counts for what it was constituted. It may also be stated that imposition of penalty on so many entities by Respondent, included Appellant, for occurrences of October 5,

2012; has proved an opportunity in disguise for Respondent to make money by imposing penalty to extent of lac of rupees, know-beat everyone concerned by being held violative of so many of its rules, buy-laws, circulars; without explaining , let alone advising, anyone how to conduct themselves in matters of trading, confusing everyone as to how trade at Respondent's trading system is to be conducted and engaging lots of entities in lot of meaningless litigation.

14. Before concluding, it may also be stated Respondent was asked by the undersigned as what the allegation were, how the Appellant violated its regulations etc. and how the trading on its system was to be conducted, but representatives of Respondent did not clarify any such matters but stated, in brief, what was contained in SCN or in findings of DAC and hence did not make the undersigned, any wiser, to understand the case.

15. Hence, in conclusion it is held that impugned order imposing penalty of Rs. 25 lac and for providing Rs. 25 lac for withholding to ensure compliance of order impugned dated April 30, 2013, is set aside and quashed. Appeal is accordingly allowed with no order as to costs.

Sd/-
A.S. Lamba
Member

26.08.2014
Prepared and compared by
msb

Appeal No. 86 of 2014

Per : A.S. Lamba

1. This appeal has been filed by M/s. Prakash K. Shah Shares & Securities Private Limited (Appellant) vs. National Stock Exchange of India Limited (Respondent) against imposition of penalty of Rs. 20,00,000/- vide letter of Respondent No. NSE/INVG/2013/202779-S dated April 30, 2013; for margin collection process, in violation of Respondent's Circular No. NSE/CMPT/622 dated May 09, 2005, NSE/INVG/7102 dated January 5, 2006, NSE/INVG/7307 dated March 24, 2006, NSE/INVG/223 dated December 23, 2008, NSE/INVG/11928 dated January 22, 2009, NSE/INVG/12996 dated September 2, 2009, NSE/INVG/13784 dated December 30, 2009, NSE/INVG/14117 dated February 17, 2010, NSE/INVG/14994 dated June 16, 2010; PMLA Master Circular No. NSE/INVG/16703 dated January 5, 2011 and relevant PMLA Rules; Risk Management Policy not in accordance with circular no. NSE/CMPT/6122 dated May 9, 2005; order inflow process and order analysis not in accordance with circular no. NSE/INVG/2007/65 dated March 23, 2007 and trading in proprietary account not in accordance with Rule 3, 4 and 5 of Chapter IV of Rules of Exchange.

2. This penalty has been imposed for violation of various above mentioned Circulars, on basis of inspection of books, registers, records and other relevant documents, undertaken on October 12, 2012 by Respondent and a show cause notice dated November 1, 2012, was issued to Appellant for misconduct, un-businesslike conduct and unprofessional conduct. Various

alleged violations (V), reply of appellant (R) and decision of Disciplinary Action Committee (D) of Respondent are enumerated below, ad seriatim:-

(i) (V) Appellant placed orders worth Rs. 416.71 crore on Respondent; as against margin of Rs. 2.88 crore, on October 5, 2012 between 9:02:44 a.m. to 9:50:52 a.m.;

(R) Regarding observation pertaining to value of orders vis-à-vis available margin – orders placed in respect of our own account and that of our clients -, the said orders were placed in normal course of day trading transactions and were placed at various price levels in various scrips – all within price circuit limits stipulated by NSE. Margin calls are not based on order placement, whereas same is based on actual executed trades. Further, Appellant did not default on their obligations as a broker.

(D) Trading Member has exceeded its exposure by 718% by executing total buy trades worth Rs. 158.87 crore, as against total available collateral of Rs. 2.88 crore i.e. collateral available was 14% of required collateral for execution these transactions. Thus Member has evaded margin in violation of Rule 5(i) of Chapter IV of Rules of Exchange and Exchange Circular ref. no. NSE/CMPT/6122 dated May 9, 2005.

(ii) (V) You placed total of 2381 buy orders (for Rs. 264.38 crore) in NIFTY scrips, out of which 2026 orders (for a value of 260.24 crore) were placed at prices significantly below Last Traded Price (LTP) upto 18.15%; on October 5, 2012 between 9:02:44 and 9:50:10. Further, on same during this day between 09:04:30 and 09:50:53 you placed total of 2675 sell orders (for Rs. 305.40 crore) on NIFTY scrips, out of which 2291 orders (for Rs. 298.41 crore) were placed at prices significantly above Last Traded Price upto 20.28% and, therefore, it is apparent that you placed orders away from the market on buy and sell side;

(R) Buy orders cannot result in falls in price of scrip. Top 5 orders in respect of scrip (in terms of price) are visible on system of NSE and Appellant's pending orders could not have created any misleading appearance in market or that of price of respective scrip, since all pending orders were not visible on NSE's system.

Appellant's orders were purely in nature of jobbing transactions and were placed within circuit limits of NSE. Initiation of sale of NIFTY by Emkay triggered market fall. Appellant had placed orders, on behalf of its clients and under proprietary account in NSE's system in normal course of business. Appellant has exercised due diligence and caution at the time of entering orders and have adequate internal systems to ensure that such orders are well within the circuit limits of NSE.

(D) Member in its proprietary account placed buy orders with NSE in many scrips on October 5, 2012 for total value of Rs. 300.61 crore, which is 11 times of members Net Worth, which conduct of Member indicates unprofessional conduct as defined in Rule 5(i) of Chapter IV of Rules of the Exchange.

(iii) (V) On October 5, 2012 your buy orders for huge quantities, placed at price significantly away from market price, were matched and led to steep market fall. Placing of orders away from market price, violated Regulation 4.5(1)(1) Part A (Capital Market Segment) of Trading Regulation , wherein it is stated that A Trading member will not make bids and/or offers for securities with an intention of creating a false or misleading appearance with respect to the market for, or the price of any security.

(R) Same as against (ii).

(D) On October 5, 2012 the buy orders for huge quantities placed at a price significantly away from the market price were matched and led to steep market fall. However, the member has represented that it has placed all its orders within the permissible limits and no order has been placed by him beyond the limits set by Exchange. However, the members are advised by the circular no. NSE/INVG/2007/65 dated March 23, 2007 to exercise due diligence and caution at the time of placing of orders which are away from market price and also advised to put in place appropriate internal system and procedures for ensuring that such orders are not entered and the member has violated the spirit of the said circular.

(iv) (V) Trading regulations is also expressly included by reference in an Exchange circular (NSE/INVG/2007/65) dated March 23, 2007, wherein attention of members was drawn to Regulation 4.5.4(c). Further it was also stated in the said exchange circular that non-compliance with the requirement specified in Trading Regulation shall attract disciplinary action. Additionally, members were advised to exercise due diligence and caution at the time of entering orders which are far away from market price and also advised to put in place appropriate internal systems and procedures for ensuring that such orders are not entered.

(R) Same as in (ii).

(D) Same as in (iii)

(v) (V) You, in your proprietary account placed buy orders with the exchange in all the scrips during the period 09:02:44 and 09:50:52 of a total value of Rs. 300.61 crore, which is 11 times your net worth as on March 31, 2012 i.e. Rs. 27.78 crore.

(R) Trades in proprietary account were jobbing transactions and orders were placed in normal course of business. Observation that buy order exceeded 11 times net worth is based on incomplete appreciation of facts, since margin calls are not based on order placement, but on executed trades. Appellant was well within financial net worth and admittedly not in default in respect of trading obligations, vis-à-vis, trades executed.

(D) The member in its proprietary account placed buy orders with the Exchange in many scrips during the period 09:02:44 a.m. and 09:50:52 a.m. for a total value of Rs. 300.61 crores which is 11 times (approximately) of the member's Net Worth as on March 31, 2012 i.e. Rs. 27.78 crores (as per records available with the Exchange). This conduct of the Member also indicates unprofessional conduct as defined in the Rules 5(i) of Chapter IV of Rules of the Exchange.

(vi) (V) Income range specified by your clients, in client registration forms, was in the range of Rs. 1 lac to Rs. 10 lac. Total buy orders placed by your clients on October 5, 2012 was Rs. 116 crore. Thus, exposure provided to clients was highly disproportionate with income source / range declared by your clients and was arbitrary, reckless, grossly negligent and far exceeded known capabilities of client. No margin / collateral was collected by you from your clients.

(R) Denied that exposure granted to clients was arbitrary, reckless, grossly negligent and that it far exceeded known capabilities of clients and not violated circular NSE/CMTR/4799 dated January 21, 2004. Margin collected from clients is based on prudent system of risk management so as to protect itself from client default and Appellant has robust risk management system based on which margin calls for clients are made. Net worth of respective clients was adequate to cover value of net pay-in obligations. Exposure to individual clients is decided based on past experience about probability of execution of trades and promptness of client to honour his pay-in obligations. Clients are with Appellant for years and have fulfilled their financial obligations.

(D) The income range specified by the clients in the client registration forms and as per the periodic financial review was in the range of Rs. 1 lac to Rs. 10 lac. The total value of the buy orders placed by the clients in all the scrips during the period between 09:23:44 a.m. and 09:50:10 a.m. on October 5, 2012 is Rs. 116 crore (approximately). Thus, it is observed that exposure provided to the clients on October 5, 2012 is highly disproportionate with the income sources / range declared by the clients at the time of registration or periodic financial review. The exposure granted to the clients by the member was arbitrary, reckless, with gross negligent and far exceeded the known capabilities of the clients. Further, no margin was collected by the trading member from the clients. The

Committee noted that the said conduct of the trading member indicates unbusinesslike conduct as defined in the Rule 4(f) of Chapter IV of Rules of the Exchange, Exchange circular reference no. NSE/CMPT/6122 dated May 9, 2005 and Exchange circular on PMLA.

(vii) (V) As per exchange circular no. NSE/CMTR/4749 dated January 21, 2004 – Members are urged to ensure that they collect adequate and proper margins from the investors and do not fall prey to any possible temptation to fund margin / pay-in for their investing clients. It is again reiterated that members must exercise proper due diligence in assessing the financial capacity of clients for whom they are executing orders to ensure that their clients market activity is commensurate with their financial ability.

(R) Same as in (vi).

(D) Same as in (vi).

(viii) (V) Buy limits placed on terminals used by you for placing orders, pertaining to your clients on October 5, 2012 was Rs. 200 crore, Further, the buy and sell limits set for the terminals used by you for placing orders for your proprietary account was between Rs. 60 crore to Rs. 100 crore and between Rs. 75 crore to Rs. 115 crore, respectively. It appears that no care and caution had been exercised in setting the limits for the dealers or by linking the same to margins / collateral. As is evident, such conduct has led to disturbance in normal functioning of the securities market and also the consequent withdrawal of your trading facility on October 5, 2012.

(R) Limits on client's terminal are set cumulatively for all clients put together and Rs. 200 crore limits was for more than one client. Denies that no care was exercised in setting limits for dealers or by linking the same to margins / collateral. Denied that Appellant conduct led to disturbance in normal functioning of securities market.

(D) As per the Exchange records, the buy and sell limits placed on the terminal used by the trading member for placing orders pertaining to their clients on October 5, 2012 was at Rs. 200 crore. Further, the buy and sell limits set for the terminals used by the trading member for placing orders for its proprietary account was between Rs. 60 crore to Rs. 100 crore and between Rs. 75 crore to Rs. 115 crore, respectively. It appears that no care and caution had been exercised in setting the limits for the dealers or by linking the same to margins / collateral. As is evident, such conduct has resulted in disablement of the Member. The said conduct of the trading members in violation of Rule 4(d) of Chapter IV of the Rules of the Exchange and Exchange circular reference no. NSE/CMPT/6122 dated May 9, 2005.

(ix) (V) Non adherence to prescribed risk management policy and providing high exposure without adequate margins is not in accordance with the Exchange Circular (NSE/CMPT/6122) dated May 09, 2005 and also constitutes violation of the provisions of Prevention of Money Laundering Act, 2002 ("PMLA") as informed to you vide various circulars issued by the Exchange from time to time including Circular (NSE/INVG/7102) dated January 25, 2006, Circular (NSE/INVG/7307) dated March 24, 2006, Circular (NSE/INVG/11798) dated December 22, 2008, Circular (NSE/INVG/11928) dated January 22, 2009, Circular NSE/INVG/12996) dated September 02, 2009, Circular (NSE/INVG/13784) dated December 30, 2009, Circular (NSE/INVG/14117) dated February 17, 2010, Circular (NSE/INVG/14994) dated June 16, 2010 and PMLA Master Circular (NSE/INVG/16703) dated January 05, 2011 and relevant PMLA Rules.

(R) Appellant has robust and well documented margin collection and risk management system, which has been implemented and reviewed frequently and past inspections by NSE have not questioned Appellant Risk Management System. Appellant, on behalf of itself and of its client, did not default in their obligations to Exchange and violation of PMLA 2002 is denied.

(D) No mention.

(x) (V) From the above, your conduct indicates Misconduct (Rules 3 of Chapter IV of Rules of the Exchange), Unbusinesslike Conduct (Rule 4 of Chapter IV of Rules of the Exchange) and Unprofessional Conduct (Rule 5 of Chapter IV of Rules of the Exchange).

(R) No reply.

(D) Same as in (v).

(xi) (V) Considering the seriousness of violation involved and the adverse impact that it has created on market and investors at large and the systemic risk it posed, you are hereby called upon to show cause as to why disciplinary action should not be initiated against Prakash K Shah Shares & Securities Pvt. Ltd. for violation of Rules 3, 4 and 5 Chapter IV of Rules of the Exchange, violation of Regulation 4.5.4(c)(i) of the Trading Regulation and Exchange circular (no. NSE/INVG/2007/65) dated March 23, 2007.

(R) Denies violation of provisions of rule 3, 4 and 5 of Chapter IV of rules of Exchange Appellant has been in business of very long time and has built very strong reputation.

(D) Same as in (v).

3. From scrutiny of ‘alleged violations’, ‘reply’ of Appellant and ‘Finding and Decision’; it is seen that matter has been dealt by Respondents and DAC of Respondent in a unprofessional, un-businesslike and ad-hoc manner, without going into any depth of the problem and in a perfunctory manner, not expected of exchange of national level competing with best in India and abroad and most importantly has not done any justice to Appellant or brought out any violation on part of Appellant in any meaningful manner or with a view to taking action for correction for any violation or for future guidance of Appellant or similarly placed members as Appellant.

4. The less said the better about conduct of Respondent, in conducting inspection of Appellant by a team of officials on October 12, 2012, pursuant to sudden fall in NIFTY on October 5, 2012. Presumably this should have in context of finding the reasons for what happened on that fateful day, who was at fault, whether system of exchange and of members worked properly to meet surge of activity fuelled by erroneous order and how the system responded to same and if any corrective / upgradation of systems / improvements of Appellant or Respondent were required to meet such occurrences in future, but Respondent choose, in their wisdom, to conduct a standardized inspection of all big players, who played some important part in events of October 5, 2012 and found same fault with all concerned and fined everyone of these, irrespective of whether it was Appellant’s rational or justified conduct or not, as per Respondent’s regulations;

5. Now coming to findings of inspection against Appellant, Appellant’s response to findings and proceedings of Disciplinary Action Committee. It is seen that inspection was conducted, in haste, found what Respondent

wanted to find - as if it had pre-decided its findings before inspection. Matter was placed before DAC for decisions, based on findings of inspection and reply of Appellant, oral submissions, etc. but surprisingly finding and decision of DAC are same as findings during inspection by Respondent and DAC has not considered the replies of Appellant but come to same conclusions which were alleged in inspection. DAC's finding and decision are stated in 5 paras on pages 5 and 6 of Respondent's communication dated April 30, 2013 and thereafter 6 sub-paras on page 6 and 7 state some observations, which concludes violation by Appellant of various rules, bye-laws, regulations and circulars of Respondent, followed by imposition of penalty of Rs. 20 lac and deposit another Rs. 20 lac to monitor compliance.

6. Thus a 10 point charge sheet of Respondent has been dealt in 5 paras of findings by DAC of Respondent to hold Appellant violative of 18 circulars of Respondent and one PMLA master circular and relevant PMLA rules and 3, 4 and 5 rules of Chaper IV of Rules of exchange, etc.. It is not clear as to how 10 alleged violations have been dealt in 5 para findings by DAC, without giving any credence to reply of Appellant, let alone indicating why replies of Appellant were not considered satisfactory or how these replies did not rebut allegations and why some of the alleged violations in SCN have been accepted or why some of these overlooked / not mentioned.

7. In fairness, it must be admitted that though inspection carried out by team of officials of Respondent was not conducted in a satisfactory manner and had other deficiencies, but still brought out 10 violations on part of Appellant in clear terms, but same cannot be said of conduct of DAC of Respondent, which met in all solemness, conducted appropriate proceedings, took oral evidence of Appellant and after examining their written submissions

but made some findings in 5 paras for 10 alleged violations, without indicating which para of findings deals with which violations, and on what basis DAC concluded in 6 sub paras of observations, that follow these 5 paras, for holding Appellant violative of so many circulars, bye-laws and rules of Respondent. Appellant has been held guilty of evasion of margin, as per first para under heading ‘FINDING AND DECISION’ This change did not exist in SCN.

8. It is not worthwhile dealing with Respondent’s or their DAC’s conduct in any further details, but to state that SCN contained 10 allegations, which were put to Appellant to explain, Appellant gave their submissions in writing and orally and it is not revealed by DAC whether these submissions were considered or but DAC repeated some of these 10 allegations in 5 para, without stating which ones are substantiated which are not, consistently not providing any clue why some of allegations are repeated in findings and some not specified in findings; but at the same time Appellant has been found violative of 18 circulars, PMLA master circulars, etc. and how these circulars, rules, master PMLA circulars apply in individual violations, has not been clarified.

9. In other words, DAC totally failed on all counts for what it was constituted. It may also be stated that imposition of penalty on so many entities by Respondent, included Appellant, for occurrences of October 5, 2012; has proved an opportunity in disguise for Respondent to make money by imposing penalty to extent of lac of rupees, know-beat everyone concerned by being held violative of so many of its rules, buy-laws, circulars; without explaining , let alone advising, anyone how to conduct themselves in matters of trading, confusing everyone as to how trade at Respondent’s trading system

is to be conducted and engaging lots of entities in lot of meaningless litigation.

10. Before concluding, it may also be stated Respondent was asked by the undersigned as what the allegation were, how the Appellant violated its regulations etc. and how the trading on its system was to be conducted, but representatives of Respondent did not clarify any such matters but stated, in brief, what was contained in SCN or findings of DAC and hence did not make the Tribunal, any wiser, to understand the case.

11. Hence, in conclusion it is held that impugned order dated April 30, 2014 imposing penalty of Rs. 20 lac and for providing Rs. 20 lac for withholding to ensure compliance of order impugned, is set aside and quashed. Appeal is accordingly allowed with no order as to costs.

Sd/-
A.S. Lamba
Member

26.08.2014
Prepared and compared by
msb