

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Appeal No.84 of 2008

Date of Decision: 13.1.2009

Rusoday Securities Ltd.

.....Appellant

Versus

The National Stock Exchange of India Ltd.
The National Securities Clearing Corporation Ltd.
Securities and Exchange Board of India

.....Respondent no.1
.....Respondent no.2
.....Respondent no.3

Mr. Zal Andhyarujina Advocate with Joby Mathew Advocate for the Appellant.

Mr. E.P. Bharucha Senior Advocate with Mr. Cyrus Bharucha and Ms. Parina Talsania
Advocates for Respondent nos.1 & 2.

Mr. Mihir Mody Advocate with Ms. J.P. Durve Advocate for Respondent no.3.

Coram : Justice N.K. Sodhi, Presiding Officer
Utpal Bhattacharya, Member

Per : Justice N.K. Sodhi, Presiding Officer

Challenge in this appeal is to the communication dated January 5, 2006 from the National Stock Exchange of India Ltd., (for short NSE) informing the appellant that the former had decided to expel the latter from the trading membership of the Exchange with immediate effect. The order passed by the committee of NSE on Declaration of Defaults containing the detailed reasons for the expulsion has also been impugned.

2. The appellant before us was a stock broker and a trading member of NSE and registered with the Securities and Exchange Board of India in November, 1994. The Bye-laws, Rules and Regulations of NSE require a trading member to retain with the Exchange an interest free security deposit, bank guarantee as security deposit, margin money in cash and margin money in the form of bank guarantee. The sum total of these constitutes the base capital of a trading member. Some time in the year 1996 NSE transferred its clearing functions to its newly formed subsidiary company called the National Securities Clearing Corporation Ltd., (for short NSCCL) which is the second

respondent before us. As required under the Bye-laws, Rules and Regulations of NSE, the appellant deposited a sum of Rs 45 lacs as interest free deposit, furnished a bank guarantee in a sum of Rs 25 lacs as security deposit, margin money in cash to the extent of Rs 25.45 lacs and margin money in the form of bank guarantee of the value of Rs 33.75 lacs. In all, the appellant deposited in October, 1997 a sum of Rs 1,29,20,000/- with NSE and this became its base capital. As per the circular dated May 19, 1997 issued by NSCCL and circulated by NSE to its trading members, every trading member is subject to gross exposure limits not exceeding seven times the base capital. Gross exposure is the total of the net outstanding positions (purchases or sales) in each security of the trading member at any time. If a member desires to exceed the limit, margins in the form of additional deposit by way of cash or bank guarantee have to be submitted to NSCCL in advance and such additional margins once furnished cannot be withdrawn for a period of three months. However, if a member in the course of trading were to exceed the gross exposure limit, he shall be required to restrict his dealings on the Exchange to his exposure limit or else to bring in margins in the form of additional deposit equivalent to one seventh of the amount exceeding the gross exposure limit and for this he may be given a maximum time of 15 days. Where a member neither brings in additional deposits nor restricts his trading to his permissible limits, the relevant authority in its discretion may suspend that trading member. However, if a member while trading exceeds the gross exposure limit by 10 per cent or more, he shall not be permitted to trade with immediate effect until the margin deposits required are paid or the gross exposure is reduced to below five times the base capital. Where a trading member exceeds the gross exposure limit by ten per cent or more, his trading facility shall be withdrawn forthwith and if he were to opt for reducing the gross exposure to below five times the base capital, he is required to make a written request to NSE. If no such request is made upon the withdrawal of trading facilities, the Exchange may at its discretion close out the outstanding positions of the trading member. In pursuance to the power given by section 9 of the Securities Contracts (Regulation) Act, 1956, NSE has framed its Bye-laws and Bye-law 17 in chapter IX provides for closing out of any deal in securities made on the

Exchange. Closing out means completing an unexecuted sale contract in securities. If the selling trading member were to default in giving delivery on due date, the exchange steps in to complete the contract by purchasing the relevant securities from the market and giving delivery of the same to the buying member(s). Again, closing out could be restored to if the buying member were to default in making payment for the securities purchased. In that event also the Exchange steps in and makes payment to the selling member(s) and receives the securities. In case of closing out, the loss, if any, suffered by the exchange has to be borne by the defaulting trading member.

3. On October 13, 1997 the market opened as usual at 9.30 a.m. and the appellant as a stock broker placed its orders on behalf of its constituents in the normal course of business and within minutes thereof, it exceeded its gross exposure limit by more than ten per cent. Having regard to the base capital of the appellant, its gross exposure limit was Rs 9,04,40,000 (being seven times the base capital of Rs 1,29,20,000). It is common ground between the parties that by 9.33 a.m. the gross exposure of the appellant was Rs 11,89,04,547 which was far in excess of its permissible gross exposure limit. In terms of the aforesaid circular, the trading terminals of the appellant were disabled by NSE which prevented the former from trading any further. This action was taken by NSE because the appellant had exceeded the permissible exposure limit by more than ten per cent. This being so, the appellant could restart the trading either by bringing in more margin deposits as required or it could request the NSE in writing to reduce its gross exposure to below five times its base capital. The appellant did not exercise either of these options.

4. NSCCL addressed a letter to the appellant on October 13, 1997 informing the latter that if it wanted to exceed the gross exposure limit, an additional deposit equivalent to one seventh of the amount in excess of the gross exposure limit had to be deposited with the corporation in advance in the form of cash or bank guarantee. The appellant was informed that the additional deposit worked out to Rs 40.70 lacs which it was required to deposit by October 27, 1997. It appears that after sending this letter to the appellant, NSCCL realised that not only the amount of Rs 40.70 lacs was due from the appellant by way of additional deposit, it had also to pay a sum of Rs 29.10 lacs towards margin for

the trades executed by it on October 10, 1997 and a further sum of Rs 41,48,838/- towards short and bad delivery of securities during some of the previous settlements. To allow such a broker to trade would be exposing the securities market and the investors to a potential risk. Having realised this fact, NSCCL addressed another letter to the appellant on the same day i.e. October 13, 1997 advising it to deposit all the aforesaid amounts before 10.30 a.m. on October 14, 1997 failing which the open positions in various securities traded by it would be closed out at the cost of the appellant without any further notice. The appellant did not deposit these amounts as a result whereof NSE closed out all the open positions in various securities traded by the appellant. The appellant was further informed that this action would be in addition to any other action that may be initiated by it in this regard. By letter dated February 16, 2005 NSE informed the appellant that since it had failed to deposit the interest free security deposit and other amounts as demanded, the relevant authority had decided to suspend the appellant from the trading membership of the exchange with effect from the date of the letter. It is pertinent to mention here that after October, 1997 the appellant instituted several proceedings, both civil and criminal, against NSE and its officers and due to the pendency of those proceedings, NSE took no action though the appellant remained debarred from trading in the market. Detailed reference is not being made to these proceedings as those are not relevant for deciding the present dispute. After giving the appellant sufficient notice, NSE by its letter dated January 5, 2006 expelled the former from trading membership of the Exchange with immediate effect. The appellant was informed that a detailed communication will be forwarded to it in due course. NSE then communicated on March 14, 2008 the minutes of the meeting of its committee on Declaration of Defaults which contained the detailed reasons. The reason as mentioned in the minutes of the committee is that the appellant as a member of the Exchange had failed to replenish the deficit of Rs 34,28,289 in the interest free security deposit which is a part of the base capital and thereby failed to fulfill the requirements of continued admission norms for membership of the Exchange.

5. We have heard the learned counsel for the parties and are of the view that the appeal deserves to be dismissed. The primary argument of the learned counsel for the appellant is that NSE had no power to close out the open positions held by the appellant before the due date. Reference was made to Bye-law 17 of the Bye-laws framed by NSE and it was contended that the power of closing out could be exercised only on failure of the trading member to complete delivery or pay the amount due on the due date strictly in terms of this Bye-law and not otherwise. Since the argument is based on the provisions of Bye-law 17, it is necessary to reproduce the same for facility of reference. It reads as under :

“Closing out :

Subject to the regulations prescribed by the relevant authority from time to time any dealing in securities made on the Exchange may be closed out by buying in or selling out on the Exchange against a trading member and/or Participant as follows :-

(a) in case of the selling trading member/Participant, on failure to complete delivery on the due date; and

(b) in case of the buying trading member/Participant, on failure to pay the amount due on the due date, and any loss, damage or shortfall sustained or suffered as a result of such closing out shall be payable by the trading member or participant who failed to give due delivery or to pay amount due.”

The grievance of the appellant is that NSE closed out the open positions before the due date. In order to understand the grievance of the appellant, it is necessary to know that at the relevant time the system of weekly settlement of trades was in vogue according to which trades executed during a particular week were required to be settled during the following week. What the appellant contends is that NSE was bound to wait till the due date of settlement and that it could not close out the open positions prior to that date as the appellant could not be said to have defaulted either in payment or in delivery prior thereto. We have given our thoughtful consideration to the contention of the learned counsel for the appellant but are unable to accept the same. Bye-law 17 permits closing out of outstanding transactions only on failure to complete the same by the trading member by the due date. However, this Bye-law is not exhaustive and does not preclude

closing out the dealings in securities under other circumstances. We say so having regard to the provisions of Bye-law 18 of the Bye-laws which reads as under :

“Closing out of contracts or dealings in securities and settlement of claims arising therefrom shall be in such manner within such time frame and subject to such conditions and procedures as may be prescribed from time to time by the relevant authority.”

It is a cardinal rule of interpretation that these provisions have to be read harmoniously and one cannot be read in isolation without appreciating the import of the other. Bye-law 18 clearly permits closing out of contracts or dealings in securities in such manner and **within such time frame** and subject to the conditions and procedures as may be prescribed from time to time by the relevant authority. Closing out the contracts and the conditions and procedures subject to which it could be done under Bye-law 18 is in addition to the closing out under Bye-law 17. As already observed, Bye-law 17 permits closing out only on the failure of a trading member to settle the transaction by the “due date” where as under Bye-law 18, closing out could be resorted to for any other reason subject to such conditions and procedures as may be prescribed by the relevant authority. If Bye-law 17 is read to mean, as was argued by the learned counsel for the appellant, that its provisions are exhaustive and that under no other circumstances can NSE close out the open positions of a trading member, then Bye-law 18 becomes otiose. Where was then the need to provide in Bye-law 18 that closing out of contracts “shall be in such manner within such time frame and subject to such conditions and procedures” when all these have been prescribed in Bye-law 17. Obviously, Bye-law 18 contemplates reasons and circumstances for a close out other than that mentioned in Bye-law 17. Relevant authority has been defined in the Bye-laws to include NSE. The word ‘prescribed’ as used in Bye-law 18 has not been defined and the conditions and procedures as contemplated by this Bye-law could be prescribed in any manner including through a circular. It is not in dispute that NSE adopted the circular dated May 19, 1997 which was issued by NSCCL (which is also a relevant authority) and circulated the same to its trading members for compliance making it clear that non-compliance would be treated as a breach of Rules, Bye-laws and Regulations of the Exchange. This

circular undoubtedly provides for a closing out of outstanding positions of the trading members even before the due date in the event of withdrawal of their trading facilities and that too, without any further notice to the trading member. In other words, withdrawal of trading facilities of a trading member as contemplated by the circular furnishes yet another ground to the NSE to close out the outstanding positions or dealings in securities. Admittedly, in the case before us the trading facilities of the appellant were withdrawn on 14.10.1997 at 11.45am on account of its failure to enhance the base capital to the required extent or for its failure to bring down the gross exposure to below five times its base capital. In this view of the matter, we are of the opinion that NSE had the power to close out under the circular and no fault could be found with the impugned order(s) in this regard. We cannot lose sight of the fact that a stock exchange which is a primary level market regulator has also a duty to protect the interest of the investors and the integrity of the securities market. The conclusion that we have arrived at based on the interpretation of Bye-laws 17 and 18 would advance that object. We are also of the view that it is essential that a stock exchange should have the power to close out the open transactions of a trading member when it finds that he (the trading member) is trading recklessly beyond his gross exposure limit as such limits, backed as they are by requisite margins, are prescribed with a laudable objective of investor protection. Such a power is essential to discipline the recalcitrant trading members. In the absence of such a power, the market and the investors would be exposed to a serious threat and the stock exchange would be reduced to the position of a mute spectator.

6. At this stage we may notice another aspect of the aforesaid argument advanced by the learned counsel for the appellant. He referred to the ten letters addressed by the appellant to NSE/NSCCL all of which were written on 14.10.1997 in which the appellant had made a request to both NSE and NSCCL to buy some specified equity shares from the market on its behalf as the appellant's trading terminal had been disabled. The learned counsel took us through these letters and strenuously urged that the request made to NSE/ NSCCL in these letters amounted to a request on behalf of the appellant to bring down its gross exposure in terms of the circular of May 19, 1997. We cannot accept this

contention. As already observed, the only request made to NSE and NSCCL was to buy specified shares on behalf of the appellant. Why should NSE purchase shares which are specified by the trading member and in quantities which have also been specified by him, as if NSE were a broker of the trading member? We have not been able to appreciate this request made by the appellant to the NSE. Not a word has been stated in any of these letters except in one to which a reference will shortly be made requesting for the reduction of the gross exposure. This apart, the request made in the letters can by no stretch of reasoning be understood to mean that the appellant wanted to bring down its gross exposure in terms of the aforesaid circular.

7. This brings us to the letter dated 14.10.1997 addressed by the appellant to NSCCL and referred to above in which the following request was made:

“Today being the last day of the current Clearing/Settlement and since our terminals are not active, we request you now to square-off all our outstanding positions immediately.

Please note that any loss incurring (sic) due to non-implementing of our request due to timing of transactions will be solely at your risk and responsibility.”

This letter, as is clear from the other letters of the same date, was dispatched in the later half of the day that is, after 13:46 hrs. Since NSE had not acted upon the requests made by the appellant in the earlier part of the day for the purchase of specific shares, the appellant then through the aforesaid letter stated that “**we request you now to square-off all our outstanding positions immediately.**” This request of the appellant literally means that it wanted all its outstanding open positions to be closed out and, quite understandably, because otherwise the appellant would have been declared a defaulter as the settlement was to close on that day. Having made this request sometime after 13:46 hrs on 14.10.1997 and the NSE having actually closed out the appellant’s transactions at 11.45 hrs. on the same day, we see no reason for the appellant to have any grievance at all. Loss, if any, suffered by the appellant due to the difference in timing of actual close out and the request for close out is not a grievance made in the appeal. In this view of the matter, we are clearly of the opinion that the appellant is not a person

aggrieved because its request for close out had been acceded to by NSE and the appeal deserves to be dismissed on this ground alone.

8. Faced with this situation, the learned counsel for the appellant then contended that the circular of May 19, 1997 runs counter to Bye-law 17 inasmuch as it enables NSE to close out the open positions even prior to the “due date”. We are not impressed with this argument. We have already held that Bye-law 17 is not exhaustive and there can be other circumstances in which NSE can resort to the close out of the open positions. Those circumstances are prescribed by the aforesaid circular which supplements Bye-law 17 and are protected by Bye-law 18. The present case is squarely covered by the circumstances prescribed by the circular and, therefore, we are of the view that it was open to NSE to close out the open positions of the appellant.

In the result, we find no merit in the appeal and the same stands dismissed leaving the parties to bear their own costs.

Sd/-
Justice N.K. Sodhi
Presiding Officer

Sd/-
Utpal Bhattacharya
Member

13.1.2009
rhn/bk/ddg