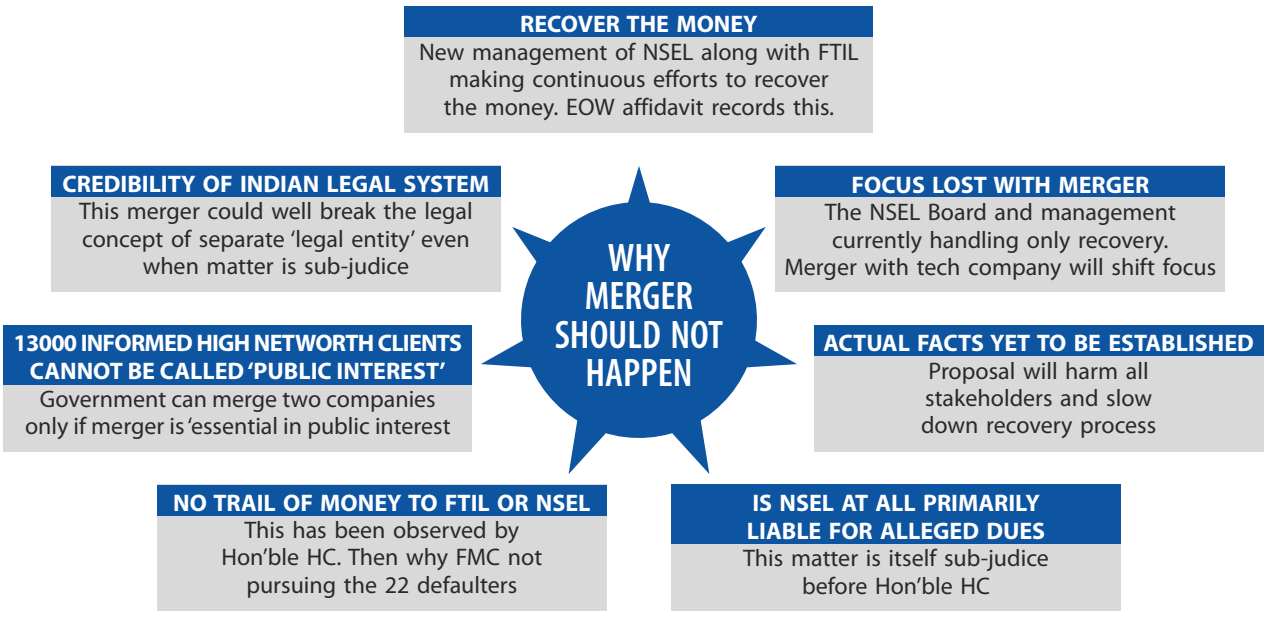
11 Contestable Proposals

Merger of NSEL with FTIL Proposed by FMC Not Consistent with Corporate Laws

The merger of NSEL with FTIL proposed by the Ministry of Corporate Affairs is in contravention and conflict with established conventions and principles of corporate law. In no previous instance, where the amount in dispute is available in the form of real assets and the company is extending full cooperation and has been making progress in recovery, has a company been subject to such extreme and harsh punishment.



Forward Markets Commission has forwarded to the Central Government a proposal to merge NSEL with FTIL to ensure speedy settlement of the trading clients claims. From the concept of good regulation, it is important that the Forward Markets Commission should work towards realizing the recovery from the assets frozen for the particular purpose of protection of the rights of trading clients rather than taking a measure that deprives the rights of investors in the parent company. From a regulatory point, the recommendation is most regressive in the sense that whatever assets that are available at the disposal of regulatory authorities are not used to settle claims and instead investors of the other company are made to pay for the same with the result being adverse to both the parties.

MOREOVER THE FMC PROPOSAL FACES SEVERAL OTHER LIMITATIONS, INCLUDING:

- The FMC does not have the power under the FCRA to recommend a merger and still they have decided to propose it.

- The FMC has various powers under the FCRA to act against defaulters but they have chosen not to do anything with regard to defaulters for recovery.

- NSEL is an exchange and the money has gone from paying brokers to receiving brokers. NSEL has done all that it could do under the bye-laws and the law of the land and now the matter is additionally subject to various judicial and investigative forums and NSEL is still vigorously pursuing its claim against the defaulters under every forum, however, NSEL cannot determine the process under these forums. Further, assets of the defaulters to the tune of over Rs 5,000 crore are already impounded by the EOW for recovery of dues from defaulters and the matter is sub-judice.

- The Board of NSEL has been meeting the FMC periodically and the FMC has never raised this issue of merger with the Board or sought any clarification or indicated on any specific issue that they are not satisfied with NSEL effort and so they would consider merger of NSEL with FTIL. NSEL have periodically kept FMC informed about all efforts of NSEL through its weekly report, monthly report and MAC (Monitoring & Auction Committee) meetings.

WHY MERGER SHOULD NOT BE ALLOWED TO HAPPEN

- The Board of NSEL comprising majority of independent directors and the new management of NSEL, with the support of FTIL, is making all efforts to recover the money from the defaulting members.

- It is incorrect for the FMC to cast an impression as if entire case is only under the jurisdiction of NSEL and it is lack of NSEL's effort which is delaying recovery, whereas the real fact is that there is a maze of legal and investigative activity happening simultaneously.

- The affidavit of EOW (March 7, 2014) in the MPID case No.1 of 2014 has recorded the assistance given by NSEL to EOW, Mumbai, and therefore it is incorrect to say that NSEL is not doing anything for recovery.

- The fact is that now as the recovery is centred in the Court, Competent Authority and the Hon'ble High Court appointed Committee, it is time-consuming exercise.

- Under the Companies Act, the Government can merge two companies only if such merger is "essential in the public interest". The interest of the 13,000 clients of the brokers who traded on NSEL platform for higher returns cannot be termed as "public interest" when 69 percent of the entire current

outstanding amount is being claimed by just six percent of the trading clients (i.e., by just 781 clients). This power was used in only one instance of merging two PSUs. If the provisions of this section is stretched to break the legal concept of separate "legal entity" even when the matter is sub-judice, it would be a huge set-back to the credibility of Indian judicial system, besides it may become unconstitutional as the very matter whether corporate veil is to be lifted at NSEL is sub-judice before the Bombay High Court.

- Further, the Hon'ble High Court of Bombay, in its order dated August 22, 2014, has questioned whether these trading clients are "genuine investors".

- The trading clients are neither creditors or depositors or shareholders of NSEL. Then how can they be called as investors. Their account books will more than adequately reveal this fact.

- The question whether NSEL is at all primarily liable for the alleged dues of Rs 5690 crore (or any part thereof) of the trading clients, is currently sub-judice in four civil suits filed before the Hon'ble High Court of Bombay.

- In fact, in Suit No. 173 of 2014, the Hon'ble High Court of Bombay, by its Order dated September 2, 2014 **(ANX-54),** has already constituted a high powered Committee under the Chairmanship of a former Judge of the Bombay High Court to ascertain the liability of each of the 22 defaulting members of the Exchange, who traded on NSEL's trading platform and failed to honour their pay-in obligations towards the brokers of trading clients and to recover all the money of the trading clients from such defaulters.

- No trail of the trading clients' money (whether direct or indirect) has been traced either to NSEL or to FTIL or to FTIL's management. The same has also been observed by the Hon'ble High Court of Bombay in its Order dated August 22, 2014. In view thereof, the focus of the FMC to extinguish NSEL by the device of merger instead of proceeding against the 22 defaulters for recovery, appears to be misconceived.

- In these circumstances, while investigations and various legal proceedings are pending where the actual facts are yet to be established, any action based on the FMC's recommendations towards merging NSEL with FTIL, will irreparably prejudice and harm all stakeholders and slow down the ongoing recovery process.

SUPERSESSION OF MANAGEMENT: DEPRIVING DUE CREDIT

The FMC's proposal of supersession at FTIL's management by the Government is against the tenets of the established norms of corporate conduct and in this instance, contradicts the order of the Hon'ble High Court on several aspects, which it considered regarding the case and the promoters.

ORDER OF THE HON'BLE HIGH COURT DATED AUGUST 22, 2014 ON MR. JIGNESH SHAH, PROMOTER, FTIL

NO MATERIAL TO ESTABLISH APPLICANT'S ALLEGED CONSPIRACY

An allegation that this has been done by the borrowers in conspiracy with NSEL – and consequently with the applicant – has been made. However, there is no material to show the same. There is no allegation that the applicant has acquired from the borrowers any part of the ill-gotten money earned by them, as

a consideration for making it possible for them to commit such frauds, or that, any part of the money earned by the borrowers in such a dishonest manner, has been received from them by the applicant. It is almost conceded that there has been no material to show any direct connection or link between the defaulting borrowers and the applicant. *(Ref: Page #18; Para # 20)*

NO DIRECT ALLEGATIONS; ARREST WITHOUT MATERIAL TO SUBSTANTIATE

Though there are direct allegations against the applicant in the FIR itself, the applicant was not put under any arrest. Five other accused were arrested and charge-sheeted. Three of them are the officials of NSEL and two, are the 'borrowers' who have made huge defaults. Thereafter, without any new material, the applicant came to be arrested. *(Ref: Page #21-22; Para # 23)*

BROKERS AND CLIENTS HAD THE KNOWLEDGE OF THE COMPLEXITIES OF TRADING

The fact remains that the persons who are raising the grievance about such fictitious trading's were themselves not genuine trading clients, and had entered into the transactions purely as financial investments. There is every reason to believe that a sizable number of so-called 'investors' whose transactions were being entered into through brokers, actually did not bother about the fictitious trades, and knowingly participated in such illegal activities, without raising any issue of illegality thereof. *(Ref: Page #14; Observation # 15)*

MOST TRADING CLIENTS WERE NOT "GENUINE TRADERS"; BROKERS HAD COGNIZANCE ABOUT THE FUNCTIONING OF THE COMMERCIAL MARKET

The persons, whose money is lost, including the First Informant, are apparently, not the genuine traders for whom NSEL was supposed to provide a platform. The very fact that these persons are, as also the Investigating Agency is, freely using the terms as the 'investors', 'borrowers', indicates that the transactions in question were not genuine transactions of sale or purchase was well known to the so-called buyers also, who now choose to describe themselves as 'investors'. It is clear that from their point of view, it was only an investment yielding high returns for their money. These investors are not middle class or lower class people, but are themselves businessmen. The transactions in question were being entered through brokers who had knowledge of the commercial market. Going by the broad probabilities of the case, it cannot be accepted that the persons who are now crying foul, were not aware of the fact that their transactions were not genuine. They were looking at these transactions clearly as an investment of their money yielding safe returns. *(Ref: Page #:12-13; Observation # 15)*

BROKERS WELL AWARE OF MARKET OPERATIONS AND LEGALITIES OF TRANSACTIONS

There is great substance in the contentions advanced by the learned counsel for the applicant that the brokers, through whom the so-called trade transactions were entered into, do have their own legal team and a full knowledge of how the market operates. The legalities of the transactions were quite expected to be known to the brokers and the trading clients who do not hesitate to term themselves as 'investors', and they were expected to assess the legalities of the transactions. The brokers being quite experienced, and the investors being informed persons, it is apparent that the issue of illegality of the transactions raised by them is not out of their concern to adhere to legalities, but in order to project the applicant as the main offender, rather than the defaulting parties. *(Ref: Page #:14; Observation # 16)*