

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% *Judgment Reserved On :February 23, 2017*
Judgment Delivered On : March 01,2017

+ **CO.APP.16/2013**

NATIONAL STOCK EXCHANGE OF
INDIA LTD.

.....Appellant

Represented by: Mr.Arvind Nigam, Sr.Advocate
instructed by Mr.Sanjay Bhatt,
Mr.Abhishek Anand, Mr.Mikhil
Sharda and Mr.Akshay Bhandari,
Advocates

versus

OFFICIAL LIQUIDATOR OF M/S GANGA
YAMUNA FINVEST PVT.LTD.

.....Respondent

Represented by: Mr.Rajiv Bahl, Advocate for
Official Liquidator

CORAM:

HON'BLE MR. JUSTICE PRADEEP NANDRAJOG

HON'BLE MR. JUSTICE YOGESH KHANNA

PRADEEP NANDRAJOG, J.

1. The present appeal impugns the order dated January 23, 2013 passed by the learned Company Judge, allowing Co.App.(C) No.4/2011 filed by the Official Liquidator and dismissing Co.App.No.401/2012 filed by the appellant in C.P.No.42/2009, and directing the appellant to deposit the amount of ₹1.10 crores with interest, if any, with the official liquidator.
2. The applications came to be filed before the learned Company Judge in the undernoted facts.

3. A company : M/s.Ganga Yamuna Finvest Pvt. Ltd. (hereinafter referred to as the company) was admitted to the trading membership of the appellant in the year 1995. As a condition of admission, to be a member of the appellant, the company made a deposit of ₹1.1 crores, in terms of the bye-laws of the appellant.

4. On July 27, 2009 the company defaulted upon its obligations and accordingly was expelled by the appellant from membership. Accordingly, on the event of default happening, the deposit of ₹1.1 crores came to be vested with the Defaulters Committee of the appellant, under the bye-laws, for disbursement to the persons whose claims were found admissible by the Defaulters Committee.

5. On July 29, 2009 the Defaulters Committee invited claims in respect of the company. It received 151 claims and found 68 claims to be admissible for payment, and finally in its meeting dated June 30, 2011 the Defaulters Committee approved 68 claims found to be admissible for payment of ₹1,07,82,122.11. Out of ₹1,07,82,122.11, as on February 10, 2012, claims to the extent of ₹81,96,954.59 were settled from out of the Investor Protection Fund Trust and the balance from the deposit of ₹1.1 crores of the appellant. It further resolved for setting aside of balance ₹83,91,000/- from the deposits of the appellant, as in the meanwhile on September 06, 2010 the company had been ordered to be wound up by the Company Court and the official liquidator appointed as provisional liquidator. On November 10, 2010 the official liquidator asked the appellant to remit to the official liquidator the deposit of the company with the appellant in the sum of ₹1.1 crores. On February 23, 2011 the appellant responded by asserting that no amount was due from the appellant to the company.

6. The official liquidator reiterated his request and on November 21, 2011 filed Co.App.No.4/2011 for a direction against the appellant. The appellant thereupon filed Co.App.No. 401/2012 for permission from the Company Court for the Defaulters Committee to deal with the amounts lying with the Defaulters Committee as per the bye-laws of the appellant.

7. These applications were heard and decided by the learned Company Judge. The application of the official liquidator was allowed and that of the appellant was dismissed with a direction to deposit ₹1.1 crores along with interest, if any, with the official liquidator.

8. In the course of hearing of this appeal, on April 10, 2013, a direction was issued to the official liquidator to invite claims qua the company in order, inter-alia, to ascertain whether there are any other claimants or not. The advertisement for the same was directed to be published in 'The Statesman' (English Edition) and 'Dainik Jagran' (Hindi Edition) and thereafter the official liquidator was directed to file a status report.

9. Pursuant to the above, the official liquidator invited claims and filed a report dated May 10, 2013, wherein the official liquidator reported to have received 2 claims only and that too by the investors. Relevant would it be to highlight that no workman filed any claim.

10. Thereafter, the official liquidator filed another report dated July 01, 2013 wherein the official liquidator stated that in addition to the 2 claims, he had received 6 more claims from the investors. The Eight (8) Claims received by the official liquidator were detailed as under:-

(i)	Mr. Neeraj Singla	Not admitted by NSEIL
(ii)	Mr. Manish Gupta	Not admitted by NSEIL
(iii)	Mrs. Urmila Gupta	Not admitted by NSEIL

(iv)	Mr. Kamlesh Aggarwal	Not admitted by NSEIL
(v)	Mr. C.K. Aggarwal	Not admitted by NSEIL
(vi)	Neeraj Singla (HUF)	Not admitted by NSEIL
(vii)	Mr. Anil Kumar Gupta	Not admitted by NSEIL
(viii)	Mrs. Uma Rani Gupta	Admitted by NSEIL

11. Evidently, till date, the official liquidator has received only 8 claims by the investors and no claim by any workman has been received by the official liquidator.

12. Thereafter, the official liquidator was permitted to scrutinize the claims received by the appellant and pursuant thereto has filed reports dated May 13, 2015 and August 13, 2015 along with clarifications from a Chartered Accountant with regards to a report filed by the Chartered Accountant appointed to scrutinize the claims received by the appellant.

13. Mr.Arvind Nigam learned senior counsel on behalf of the appellant contended that the capital markets require and hence provide the certainty for conclusion of transactions on the stock exchange. Learned senior counsel explained that the manner in which the appellant functions is that the National Stock Exchange through its clearing corporation guarantees the clearing and settlement for all deals executed on its platform, including deals executed in the Futures and Options (F&O) segment through novation in accordance with statutory requirement. Since NSE operates an anonymous order driven market, all trades executed in the capital market, Futures and Options and Currency Derivatives segments are novated by the appellant.

14. As per the learned senior counsel, the appellant therefore becomes the buyer for every seller and seller for every buyer and acts as a legal counterpart to all deals on its platform. In this manner, the appellant

assumes the counterpart risk of each member and guarantees settlement through a fine-tuned risk management system. Hence, if any counterpart to a trade fails to fulfill its obligation to settle the trade, the appellant is required to settle the trade in accordance with its bye-laws, rules and regulations. The inability of clearing corporation to carry out novation and eliminate counter-party risk will directly result in investors losing in capital markets, and the credibility of the capital market itself being eroded.

15. Learned senior counsel for the appellant further contended that appellant's functioning is wholly regulated by SEBI and under the Securities Contracts (Regulation) Act, 1956 and the Rules made thereunder. Under the Securities Contract (Regulation) Rules 1957, the Central Government has, in Rule 8 notified the qualifications for membership of a recognized stock exchange. Reference was made to Rule 8(1)(f) to contend that no person shall be eligible to be a member if he is engaged in any other business and must undertake to sever his connection with such other business, on admission. Under Rule 8(4A) a company as defined under the Companies Act 1956 shall also be eligible to be a member of a stock exchange if it complies with sub-Rules (i) to (v) thereof.

16. Extending the argument further learned senior counsel contended that in terms of the bye-laws of the Exchange, which have statutory flavour, by virtue of the same having been approved by the Central Government/Securities & Exchange Board of India (SEBI) under Section 9 of the Securities Contract (Regulation) Act, 1956 (SCRA), the Exchange admits trading members in accordance with the bye-laws, rules and regulations that may be framed from time to time in accordance with

the SCRA and SEBI Act. Section 9 of the Securities Contract (Regulation) Act, 1956 (SCRA) which reads as under was cited :-

“Power of recognized stock exchanges to make bye-laws

9. (1) Any recognized stock exchange may, subject to the previous approval of the Securities and Exchange Board of India, make bye-laws for the regulation and control of contracts.”

17. Learned senior counsel drew attention to Chapter V of the Bye-laws of the appellant which deal with the trading members. In terms of Bye-law 1(c) of Chapter V, the fees, security deposits, other monies and any additional deposits paid, whether in the form of cash, bank guarantee, securities or otherwise, with NSEIL, by a trading member from time to time are subject to a first and paramount lien for any sum due to the appellant and all other claims against the trading member for due fulfillment of engagements, obligations and liabilities of trading members arising out of or incidental to any dealing made subject to bye-laws, rules and regulations of the appellant. Bye-law 1(c) which reads as under was highlighted:-

“(c) The trading member shall pay such fees, security deposits and other monies as may be specified by the Board or the relevant authority from time to time, **on admission as trading member and for continued admission.** The fees, security deposits, other monies and any additional deposits paid, whether in the form of cash, Bank Guarantee, Securities or otherwise, with the Exchange, by a trading member from time to time, **shall be subject to a first and paramount lien for any sum due to the Exchange and all other claims against the trading member for due arising out of or incidental to any dealing made subject to the Byelaws, Rules and Regulations of the Exchange.** The Exchange shall be entitled to adjust or appropriate such fees, deposits and other monies for such dues and claims, to the exclusion of the other claims against the trading

member, without any reference to the trading member.”
(emphasis supplied)

18. In this connection it would be relevant to highlight that Chapter V of the Bye-laws of the appellant stipulates that the trading member shall adhere to the bye-Laws, rules and regulations of the Exchange. Bye-law 2(a) reads as under:-

“Conditions

2(a) Trading members shall adhere to the Bye Laws, Rules and Regulations of the Exchange and shall comply with such operational parameters, rulings, notices, guidelines and instructions of the relevant authority as may be applicable.”

19. Chapter X of the Bye-laws of appellant deals with the provisions relating to the rights and liabilities of members and constituents, which provides that all contracts are subject to the bye-laws, rules and regulations.

“All contracts subject to Byelaws, Rules and Regulations

All contracts relating to dealings permitted on the Exchange made by a trading member shall in all cases be deemed made subject to the Bye Laws, Rules and Regulations of the Exchange. This shall be a part of the terms and conditions of all such contracts and shall be subject to the exercise by the relevant authority of the powers with respect thereto vested in it by the Bye Laws, Rules and Regulations of the Exchange.”

20. Chapter XII of the Bye-laws of NSEIL deals with the provisions relating to the declaration of a trading member as defaulter and its consequences. Upon a trading member being declared a defaulter, his assets stand vested with the Defaulters Committee and on being defaulter, the defaulter member loses his right until the same be dealt in accordance with Bye-law 23. The Defaulters Committee of NSEIL is

required to disburse with the money in accordance with Bye-law 23 of Chapter XII of the Byelaws of NSEIL.

“Declaration of Default:-

(1) A trading member may be declared a defaulter by direction/circular/notification of the relevant authority of the trading segment if:-

(d) he failed to pay any sum due to the Exchange or to submit or deliver to the Exchange on the due date, delivery and receive orders, statement of differences and securities, balance sheet and such other clearing forms and other statements as the relevant authority may from time to time prescribe;

(IA) Without prejudice to the foregoing, if a trading member is either expelled or declared a defaulter by any other recognized stock exchange on which he is a member or if the registration certificate is cancelled by SEBI, the said Trading Member may be expelled from the Exchange after providing an opportunity of being heard to such Trading Member.

Notwithstanding anything contained in this Byelaw, the trading facility of the member shall be withdrawn immediately after the receipt of information of expulsion/default by any other stock exchange or cancellation of registration certificate by SEBI.

(11) Vesting of assets in the Exchange:-

*The Defaulters Committee shall call in and realize the security deposits in any form, margin money, other amounts lying to the credit of and securities deposited by the defaulter and recover all moneys, securities and other assets due, payable or deliverable to the defaulter by any other Trading Member in respect of any transaction or dealing made subject to the Bye-laws, Rules and Regulations of the Exchange **and such assets shall vest ipso facto on declaration of any trading member as a defaulter, in the Exchange** for the benefit of any dues of the Exchange,*

National Securities Clearing Corporation Limited, Securities and Exchange Board of India, other trading members, Constituents and registered sub-brokers of the defaulter, approved banks and any other persons as may be approved by the Defaulters' Committee and other recognized stock exchanges.

Application of Assets

(23) The Defaulters Committee shall apply the net assets remaining in its hands after defraying all such costs, charges and expenses as are allowed under the Rules, Bye-laws and Regulations to be incurred by the Exchange, in satisfying the claims in the order of priority provided hereunder:-

(a) Dues to the Exchange, National Securities Clearing Corporation Limited, Securities and Exchange Board of India

The payment of such subscriptions, debts, fines, fees, charges and other moneys due to the Exchange, National Securities Clearing Corporation Limited, Securities and Exchange Board of India, in the order in which their names appear herein;

(b) Dues to other Trading Members and to Constituents and registered sub-brokers of the defaulter

The payments as may be admitted by the Defaulters Committee, as being due to other Trading Members and Constituents and registered sub-brokers of the defaulter for debts, liabilities, obligations and claims arising out of any contracts made by the defaulter subject to the Rules, Bye-laws and Regulations of the Exchange, shall, if the amount is insufficient, be distributed pro rata amongst other Trading Members, all the Constituents and registered sub-brokers of the defaulter. The other Trading members in turn share the amounts so received with their Constituents on pro rata basis.

(c) Dues to the Approved Banks and claims of any other persons as approved by the Defaulters' Committee

After making payments under Clause (b) above, the amounts remaining, if any, shall be utilised to meet the claims of the approved banks and of any other person as may be admitted by the Defaulters' Committee. The claims of the approved banks should have arisen by virtue of the Exchange or National Securities Clearing Corporation Limited invoking any bank guarantee issued by the bank concerned to the Exchange or National Securities Clearing Corporation Limited as the case may be on behalf of the defaulter to fulfill his obligation of submitting bank guarantee, guaranteeing discharge of obligations under the Byelaws, Rules and Regulations of NSEIL/NSCCL. The claims of other persons should have arisen out of or incidental to the transaction done on the Exchange or requirements laid down by the Exchange, provided that if the amount available be insufficient to pay all such claims in full, they shall be paid pro rata, and

(d) Dues to any other recognized stock exchange:

After meeting the claims under (c) above, the remaining amounts, if any, shall be disbursed to any other recognized Stock Exchange for the purpose of meeting the obligations of the defaulter as a member of that Exchange. If the defaulter is a member of more than one recognized stock exchange, then the remaining amounts shall be distributed amongst all such recognized stock exchanges and if the remaining amount is insufficient to meet the claims of all such stock exchanges, then the remaining amount shall be distributed pro rata among all such stock exchanges.

(e) Surplus assets:

Surplus assets, if any, may be released to the defaulter after a period of at least one year from the date of declaration of the trading member as defaulter or after satisfying the claims falling under Bye-law 23, whichever is later."

21. Attention of the Court was also invited to Chapter XIII of the Bye-laws of the appellant to show that the Stock Exchange also has created an Investor Protection Fund, '*...to make good claims for compensation*

which may be submitted by a trading members constituent who suffers loss arising from the said trading member being declared as a defaulter by the exchange under Chapter XII...'. In the event the deposits of a defaulting trading member fall short, the Exchange has at its disposal, these sums of monies to make good on its counter party risk and to assure the credibility of the capital markets.

22. With reference to the above provisions of the bye-laws of the appellant, it was submitted that evidently the said mechanism is a complete code in itself so far as dealing with a defaulter member is concerned.

23. Learned senior counsel for the appellant also brought to the attention of the Court the provisions of the Bombay Stock Exchange (BSE), Rules, Bye-laws and Regulations, 1957, which came for interpretation before the Supreme Court in various decisions, and which are almost *pari-materia* except for an additional aspect of the issuance of 'membership card' to each member, which does not exist in NSE framework.

24. The said Rules, Bye-laws and Regulations of BSE have also been framed with the approval of the Central Government and the rules so framed govern the relationship of the member and the exchange.

Rule 5 Membership – a personal privilege-

“The membership shall constitute a personal permission from the Exchange to exercise the rights and privileges attached thereto subject to the Rules, Bye-laws and Regulations of the Exchange.”

Rule 9 Right of Nomination of Deceased or Defaulter Member -

“On the death or default of a member his right of nomination shall cease and vest in the Exchange.”

Rule 10 Forfeited or lapsed right of membership-

“When a right of membership is forfeited to or vests in the Exchange under any Rule, Bye-law or Regulation of the Exchange for the time being in force it shall belong absolutely to the Exchange free of all rights, claims or interest of such member or any person claiming through such member and the Governing Body shall be entitled to deal with or dispose of such right of membership as it may think fit.”

25. Rule 16 of the Bombay Stock Exchange, Rules, Bye-laws and Regulations, 1957, which deals with the order of priority as under:-

“Allocation in Order of Priority:-

16. (1) When as provided in these Rules the Governing Board has exercised the right of nomination in respect of a membership vesting in the Exchange the consideration received therefor shall be applied to the following purposes and in the following order of priority namely:

Dues of Exchange and Clearing House

(i) first-the payment of such subscriptions, debts, fines, fees, charges and other monies as shall have been determined by the Governing Board to be due to the Exchange, to the Clearing House or to the Trade Guarantee Fund by the former member whose right of membership vests in the Exchange.

Liabilities relating to Contracts

(ii) second-the payment of such debts, liabilities, obligations and claims arising out of any contracts made by such former member subject to the Rules, Bye-laws and Regulations of the Exchange as shall have been admitted by the Governing Board:

Provided that if the amount available be insufficient to pay and satisfy all such debts, liabilities, obligations and claims in full they shall be paid and satisfied pro rata; and

Surplus

(iii) third-the payment of the surplus if any to the funds of the Exchange: Provided that the Exchange in general meeting may at its absolute discretion direct that such surplus be disposed of or applied in such other manner as it may deem fit.

Rule 37 Form of Security –

The security to be furnished by a member shall be provided either by a deposit of cash or it may be provided in the form of a deposit receipt of a bank approved by the Governing Board or in Securities approved by the Governing Board subject to such terms and conditions as the Governing Board may from time to time imposed. Deposits of cash shall not carry interest and the securities deposited by a member valued at the market price of the day shall exceed the sum for the time being secured thereby by such percentage as the Governing Board may from time to time prescribed.”

26. Rule 43 of the Bombay Stock Exchange, Rules, Bye-laws and Regulations, 1957 deals with Lien on Security is as under:-

“Lien on Security-

43. The security provided by a member shall be subject to a first and paramount lien for any sum due to the Exchange or to the Clearing house by him or by the partnership of which he may be a member and for the due fulfillment of his engagements, obligations and liabilities or of the partnership of which he may be a member arising out of or incidental to any bargains, dealings, transactions and contracts made subject to the Rules, Bye-laws and Regulations of the Exchange or anything done in pursuance thereof.”

27. Similarly, in the Bombay Stock Exchange, Rules, Bye-laws and Regulations, 1957, Rule 53 and 54 deals with respect to Default and Lapse of Membership of Right as under:-

“Default

53. A member who is declared a defaulter shall at once cease to be a member of the Exchange and as such cease to enjoy any of the rights and privileges of membership but the rights of his creditor members against him shall remain unimpaired.

Lapse of Membership Right

54. A member’s right of membership shall lapse to and vest in the Exchange immediately he is declared a defaulter.”

Rule 67 Lien on margin deposits –

*“The monies, bank deposits receipts and other securities and assets, deposited by a member by way of margin under the provisions of these Bye-laws and Regulations shall be subject to **a first and paramount lien for any sum due to the Exchange** or to the clearing house by him or by the partnership of which he may be a member and for the due fulfillment of his engagements, obligations and liabilities or of the partnership of which he may be a member arising out of or incidental to any bargains, dealings, transactions and contracts made subject to the Rules, Bye-laws and Regulations of the Exchange or anything done in pursuance thereof.”*

28. Learned senior counsel for the appellant had also drawn our attention to the fact that Rules 16, 53 & 54 of Bombay Stock Exchange Rules, 1957 came to be considered by the Supreme Court in the decision reported as (1999) 6 SCC 215 Vinay Bubna vs Stock Exchange of Mumbai & Ors wherein the Supreme Court held as under:-

*“9. A bare perusal of the aforesaid and other rules clearly shows that the said **rules provide that the membership of the Exchange constitutes personal permission from the Exchange to exercise the rights and privileges attached thereto subject to the rules, bye-laws and regulations of the Exchange.** According to Mr. Ashok H. Desai, learned Senior Counsel for the respondents, every contract notice issued to a constituent contains a specific provision that “the contract is made subject to the rules, bye-laws and regulations and usages of the Stock Exchange, Bombay.” The members of the Stock Exchange, namely, the stockbrokers are permitted to buy and sell the shares for their clients like the appellant. To secure due performance of his obligations the Exchange; takes security from each member upon which it has lien as provided by Rule 43. A member is declared defaulter if he fails to meet his obligation and the rules further show that thereafter his right of membership and nomination ceases and vests in the Exchange and belongs to the Exchange. The vacancy thus created by the termination of the membership is filled by the admission of another person, who generally is a person who offers to pay the highest amount.*

10. The order of priority laid down by the aforesaid Rule 16 ensures that dues to the Exchange or to the Clearing House have first to be met before the balance amount can be utilized for payment of debts, liabilities, obligations, etc. arising out of any contract made by the firmer member. If the amount available is insufficient to pay all such debts, liabilities, etc. then the payment is to be made pro rata. If, however, any surplus still remains the same is to be disposed of or applied in such manner as the Exchange in general meeting may decide.

*11. The High Court in our opinion was, therefore, right in coming to a conclusion **that on default being committed the share broker ceases to be a member of the Exchange and all his rights, privileges etc. as a member comes to an end.** If he does not clear the dues within six months the Governing Body then has the right of nomination in respect of such membership. It will be incorrect to state that on the stockbroker ceasing to be a member, he still retains any*

right or interest in the permission which has been granted to him by the Exchange to carry on business as a member. **The membership card of a shareholder is not his personal property which, on default being committed by him and his ceasing to be a member, can be sold and the proceeds distributed amongst his creditors.** Rules 53 and 54 leave no matter of doubt that **the member's rights of membership vests in the Exchange after he is declared a defaulter.** This view, namely, that the defaulting member can claim no interest in the membership and can pass none in consonance with the decision of **the Privy Council in Official Assistant of Bombay v. K.R.P Shroff, AIR 1932 PC 186.** In that case a member of the Stock Exchange had lost his membership for being a defaulter. The main question that arose for determination there was whether a card or right of membership of share broker or the proceeds of sale thereof, when sold, would pass to the membership for being a defaulter. After referring to the rules of the Stock Exchange in this connection it was observed at p. 190 as follows:

*“But although the rules are badly drawn and not in uniform phraseology their **result in the case of a member who has lost his membership for being a defaulter clearly enough is that he loses all interest both in the property of the Association and in his card.** In such a case no interest is reserved in the defaulter's card except to members of the Association who have suffered by his lapse- in the rules sometimes called his creditors- or to the Association itself. This seems to their Lordships to be the result of Rules 18, 56, 57, and 62. The defaulting member himself has no interest in the result of the sale provided for under these rules nor can he require a sale to be made. The rules are there for the benefit of his 'Exchange creditor' and are doubtless enforceable at their instance”*

In that case also a contention was sought to be raised that if the proceeds of the sale of the insolvent's card are not given to the official assignee the same would be regarded as being contrary to the law of insolvency. It was rightly observed that when the defaulting member is expelled from

the exchange no interest in his membership card remains in him and none can pass to his assignee. Once the membership card ceases to be an asset of the shareholder the question of Rule 16 being contrary to the insolvency law does not arise.

12. As we see it not only Rule 16 is not illegal, arbitrary or unjust but the same is, on the other hand, framed in such a manner that the hardship which may be caused by the default committed by the erstwhile member is mitigated. There is nothing unfair or unjust in Rule 16 providing that the first priority from out of the sale proceeds would be towards the amounts due to the Exchange itself. The second priority is given to the debts, liabilities, obligations and claims arising out of the contracts made by the erstwhile member. Even though at the time when the nomination is made by Stock Exchange of the vacancy in law therein, nevertheless Rule 16 makes provision by providing for payments being made for clearing the debts etc. of the erstwhile members. But for Rule 16, in other words, creditors like the appellant would not have a ray of hope receiving any money realized by the Stock Exchange on the vacancy being created by reason of default of the stockbroker. In view of this it is not possible to accept that the said rules in any way bad in law.” (emphasis supplied)

29. Learned senior counsel for the appellant also drew attention to the decision reported as AIR 1932 PC 186, Official Assignee of Bombay v K.R.P. Shroff, wherein the Privy Council, whilst answering the question as to whether a card or right of membership of one Virji Madhavji in the Bombay Native Share and Stock Brokers' Association or the proceeds of sale thereof, when sold, pass to the appellant as the assignee in insolvency of his estate and effects, held as under:-

At Page 187 ...At all times material to these claims of the appellant, the relations between the Association and its members were regulated by a deed of association, dated

December 3, 1887 and by rules subsequently made and adopted pursuant to its provisions.

At Page 188.... Rules of the Exchange in that case were:

DISPOSAL OF AN INSOLVENT BROKER'S CARD

“18. If any of the brokers goes away from the market without paying the moneys claimable by another certified broker or is unable to pay the same, his card shall be sold and the sale proceeds thereof shall be distributed amongst the creditors.

21. If any broker does not pay the subscription in respect of his card of the deceased for two consecutive years, his name shall be struck off the roll of the member, his card shall be forfeited.

22. If the card of the broker has been forfeited for any reason, whatever, no certified broker shall dealing with him in any way, and if any broker will be found so dealing with him, his card also shall be forfeited.

62. On account of his having become a defaulter his card shall be cancelled in accordance with the rules of the association. If he fails to pay in full his creditors within a period of six months then his card shall be sold and the amount realized on the sale thereof shall be distributed among his creditors in proportion (to their claims) and if on such distribution being made any balance remains over then the same shall remain credited to the account of the fund in respect of the hall”

*@Page 190... But, although the rules are badly drawn and not in uniform phraseology **their result in the case of a member who has lost his membership for being a defaulter-clear enough is that he loses all interest both in the property of the Association and in his card** except to members of the Association who have suffered by his lapse- in the rules sometimes called his creditors- or to the Association itself. This seems to their lordships to be the result of rules 18, 56, 57 and 62. The defaulting member itself has no interest in the result of the sale provided for*

*under these rules nor can be require a sale to be made. **The rules are there for the benefit of his “exchange creditors” and are doubtless enforceable at their instance.** In this case the learned trial judge was of opinion that rule 62 was enforceable by the appellant and he directed the sale of the insolvent’s card and the application of the proceeds as by that rule prescribed. There has been no appeal by the respondents against the part of the order and therefore as against them it must stand. But it must not suppose that their Lordships think it justified. In their view, so far as the appellant’s case was one under the rules, his suit ought to have been dismissed.*

*At Page 191...But their Lordships find the real answer to this contention of the appellant **in the nature and character of the Association as they have described it whereby in the case of a defaulting member who is expelled from the Association no interest in his card remains in himself and none that can pass to his assignee whether his expulsion does or does not take place prior to the commencement of his insolvency.** (Emphasis supplied)*

30. Learned senior counsel for the appellant further contended that above position of law as laid down by the Privy Council has been consistently been followed by the Supreme Court in the undernoted decisions:-

- (i) (1999) 6 SCC 215 Vinay Bubna vs. Stock Exchange of Mumbai & Ors
- (ii) AIR 2001 SC 1071 The Stock Exchange, Ahmedabad vs. Asstt. Commissioner of Income Tax, Ahmedabad
- (iii) (2004) 1 SCC 160 Bombay Stock Exchange vs. Jaya I Shah
- (iv) (2015) 2 SCC 1 Bombay Stock Exchange v V.S. Kandalgaonkar & Ors.

31. Accordingly, it was the submission of the learned senior counsel for the appellant that under the bye-laws, on a trading member being

declared a defaulter, the security deposits in any form, margin money, other amounts lying to the credit of and securities deposited by the defaulter member and all moneys, securities and other assets due and payable or deliverable to the defaulter member by any other trading member ipso facto vest with the Defaulters Committee for the benefit and on account of any dues of Exchange, National Securities Clearing Corporation Limited, Securities and Exchange Board of India, other trading members, constituents and registered sub-brokers and other recognized stock exchanges and only upon satisfaction of claims under Bye-law 23 of the surplus assets, if any are to be released to the defaulter member. In the instant case only in the event of any surplus being found would the same be liable to be made over to the official liquidator.

32. Conversely, the learned counsel for the official liquidator placed reliance upon Section 446 of the Companies Act 1956 to contend that the Company Court alone under Section 446(2)(d) of the Companies Act, 1956 has the requisite jurisdiction to decide the question of priorities.

33. Further, with reference to Section 456 of the Companies Act, learned counsel for the official liquidator contended that the provisional liquidator shall take into his custody or control '*all the property*' to which the company is or appears to be entitled.

34. With reference to Section 468 of the Companies Act, the learned counsel for the official liquidator contended that, any property of the company that prima-facie appears to be the property of the company is liable to be delivered to the official liquidator and the Court may direct the delivery of such property at any time.

35. It was the further submission of learned counsel for the official liquidator that upon a provisional liquidator being appointed or winding up order being passed, a secured creditor is not entitled to utilize the

security available to it for its own dues. The said security is subject to a *pari passu* charge with workers and workmen dues and secured creditors dues are *pari passu*. Learned counsel referred to Section 529A of the Companies Act which came into effect from May 24, 1985 and provides for overriding preferential payments.

36. The learned counsel for the official liquidator further submitted that under the Companies Act, it is the duty of the official liquidator to collect and sell the assets of the company.

37. On facts the learned counsel for the official liquidator fairly stated, with reference to the record, that pursuant to the directions of the Court it had invited claims; it has scrutinised the claims as were filed before the Defaulters Committee of the appellant and those reports have been filed before the Court. He states that from a perusal of the record it is evident that there are no claims of any workman that has been filed with the office of the official liquidator pursuant to the public advertisement issued in terms of the previous orders passed in this appeal.

38. Learned senior counsel for the appellant, in response to the contentions raised by the official liquidator with regards to Section 456 of the Companies Act that the provisional liquidator shall take into his custody or control 'all the property' to which the company is or appears to be entitled, submitted that admittedly, the Company under liquidation being a trading member was bound by the Bye-laws, Rules and Regulations of NSEIL. Even, in the event of its winding up the contractual obligations undertaken by it prior to liquidation do not get obliterated. In terms of its obligation under the bye-laws, it is evident that pursuant to the member having been declared as a defaulter, if as on date the said defaulter member itself was not entitled to touch the deposit by virtue of the same being automatically vested in the Defaulters

Committee of the appellant, it was not available to the official liquidator. It was therefore submitted that the amount upon vesting was not an asset of the company in liquidation as on that date and therefore, the official liquidator is not entitled to lay its hands on the same without culmination of the entire process qua settlement of the liabilities of the company in liquidation by the Defaulters Committee in terms of the bye-laws, rules and regulations of the appellant.

39. Counsel for the appellant emphasizes the fact that capital markets require the certainty of settlement of claims of defaulting members within the time as prescribed by the byelaws for conclusion of transactions. This self-operating mechanism has withstood the test of time and has added robustness to the credibility of the capital markets. It is this certainty that creates confidence in the capital markets. The self-operating mechanism is a statutorily recognized complete code in itself and ought not to be set at naught.

40. Counsel for the appellant reiterated that the manner in which the appellant functions is that the National Stock Exchange through its clearing corporation guarantees the clearing and settlement for all deals executed on its platform, including deals executed in the Futures and Options (F&O) segment through novation in accordance with statutory requirement. Since NSE operates an anonymous order driven market, all trades executed in the capital market, Futures and Options and Currency Derivatives segments are novated by the appellant. Thus, the appellant becomes the buyer for every seller and seller for every buyer and acts as legal counterpart to all deals on its platform. In this manner, the appellant assumes the counterpart risk of each member and guarantees settlement through a fine-tuned risk management system. Hence, if any counterpart to a trade fails to fulfil its obligation to settle the trade, the appellant is

required to settle the trade in accordance with its bye-laws, rules and regulations. The inability of clearing corporation to carry out novation and eliminate counterparty risk will directly result in investors losing in capital markets, and the credibility of the capital market itself being eroded. Appellant contends that this appeal deserves to be allowed and with a direction that post completion of the process of settlement of claims by the Defaulters Committee, if any surplus remains with the Defaulters Committee the same shall be handed over to the official liquidator.

41. We propose to decide the appeal keeping in view the facts of the instant case of there being no workman who has filed any claim before the official liquidator and therefore the question of the official liquidator protecting the interest of any workman does not arise. On facts, it is not a case where workmen's dues would be required to be treated at par with a secured or a charged asset. It is not a case where a security is subject to a *pari passu* charge with the workers and thus on the facts of the instant case Section 529A of the Companies Act, 1956 is not attracted.

42. The legal position qua the appellant would be that its functioning is regulated under the Securities Contracts (Regulation) Act, 1956 and the Rules made thereunder. Under the Securities Contracts (Regulation) Rules, 1957 the Central Government has notified Rules and Rule 8 prescribes the qualifications for membership of a recognized stock exchange. As per Rule 8(1)(f) a member of the Exchange has to sever all connections with other businesses upon being enrolled a member. The bye-laws of the appellant are statutory and deposits made by a member with the appellant is subject to a first and paramount lien for any sum due to the appellant or other trading member or to a third party for discharge of the liability of the member towards the third party. Chapter XII of the

Bye-laws of the appellant make it apparent that deposits by a defaulting member are vested with the Defaulters Committee and has to be applied by the Committee as per Bye-law 23 of Chapter XII.

43. In the decision reported as AIR 2001 SC 1071 The Stock Exchange, Ahmedabad vs. Asstt. Commissioner of Income Tax, Ahmedabad, the Supreme Court whilst dealing with similar rules of the stock exchange held as under:-

*“9. The Stock Exchange Rules, Bye-Laws and Regulations have been approved by the Government of India under the Securities Contracts (Regulations) Act, 1956, there is no challenge to these rules. **The question whether right of membership confers upon the member any right of property is, therefore, to be examined within the framework of the Rules, bye-laws and Regulations of Exchange.** On a plain and combined reading of the Rules, it is clear that **right of membership is merely a personal privilege granted to a member**, it is non-transferable and incapable of alienation by the member or his legal representatives and heirs except to the fulfillment of conditions provided therein. The nomination wherever provided for is also not automatic. It is hedged by Rules. On right of nomination vesting in the Stock Exchange under the Rules, that right belongs to the Stock Exchange absolutely. The consideration received by the Stock Exchange on exercise of the right of nomination vesting in it, is to be applied in the manner provided in Rule 16.” (emphasis supplied)*

44. In the decision reported as (2004), 1 SC 160, Bombay Stock Exchange v Jaya I. Shah & Anr. the Supreme Court whilst dealing with rules of the Bombay Stock Exchange held as under:-

*“36. Rules, bye-laws and regulations are made by the Exchange. They, although are not made under a statute but having regard to the scheme as also the purport and object thereof, **have a statutory flavor.** Bye-laws are required to*

be made for regulation and control of contracts, whereas rules relate in general to the constitution and management of a stock exchange.

*37. A contract has been defined to mean a contract for or relating to purchase or sale of securities. A contract note, however, in terms of Bye-law Note 219 includes a contract between a member and non-member. **It is not in doubt or dispute that membership conferred upon a person is a personal privilege.** He holds such privilege so long as he complies with the Rules, Bye-laws and Regulations framed by the Exchange. **In the event of a default committed by a member, having regard to Rule 53 as also Bye-law 316, he would ceased to enjoy any right as such. His right in terms of Rule 54 lapses and vests in the Exchange immediately upon a declaration that he has become a defaulter.** His right of nomination in view of Rule 9 ceases upon default and vests in the Exchange. In terms of Rule 10, the membership belongs absolutely to the Exchange free of all rights, claims or interests in such manner as it may think fit. Rule 16 provides for the order of priority in terms whereof dues of the Exchange and clearing house would have priority, whereafter all the liabilities relating to the contract are required to be discharged. Rule 16, however, does not make any distinction between claim of a member or a non-member. In the event there being any surplus, the amount collected by the Exchange by auctioning the right of membership is to be dealt with in such a manner as the Exchange may think fit and proper.*

*39. **How the card money is to be dealt with has been provided under the Rules. A dichotomy, however, has been created under the Rules and Bye-laws as regards the amount received by sale of membership card and amount recovered from the defaulters other assets. On a plain reading of the Rules and Bye-laws it appears that the authority to deal with the card money and the liability of the members by the Defaulters' Committee is different, but having regard to the scheme of distribution of the liabilities of the Exchange, clearing house, members and non-members, all the assets shall be placed at the hands***

of the Defaulters' Committee. But as would appear from the discussions made hereinafter the application thereof would be separate and distinct.

46. Vesting of such assets of the defaulter in the Defaulters' Committee is not absolute. The Defaulters' Committee is merely a trustee. It holds the amount vested in it for the benefit and on account of the creditor members. Once the liabilities of the creditors from the defaulters are paid to the members, in terms of Rule 44, the assets devolve upon the Defaulters' Committee in terms of Bye-law 326 for a limited purpose and as contradistinguished from the Rules in terms whereof the card may best in the Exchange, do not vest in it absolutely." (emphasis supplied)

45. In the decision reported as (2015) 2 SCC 1 Bombay Stock Exchange v V.S. Kandalgaonkar & Ors, the Supreme Court was dealing, inter-alia, with a notice issued by the Income-tax Department to the Bombay Stock Exchange under Section 226(3) of the IT Act, 1961 directing that the various deposits of one defaulting member, Suresh Damji Shah, under various Heads such as Security Deposit, Margin Money, Securities deposited by Members and Others, was liable to be attached, and the money realized was to be appropriated towards outstanding income-tax dues of Suresh Damji Shah. The issue that arose for consideration was whether the claims of the Income Tax Department would have priority over all debts owed by a defaulter member, including the deposits made in favour of the Stock Exchange. The Court proceeded to consider as to who would be a secured creditor or a person having a lien; whether any lien or charge with respect to the deposits has been created in favour of the Stock Exchange, and if yes, whether the Stock Exchange would be a secured creditor qua the deposits; whether the lien if found has a statutory flavor; and whether the Stock Exchange would

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have a right superior to the income-tax dues. The Court perused the definition of a secured creditor under the Provincial Insolvency Act, 1920 and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, and noted that Rule 43 of the Bombay Stock Exchange creates a '*first and paramount lien*' in favour of the Stock Exchange. The Court further noted that Subsection (3) of Section 30 of Securities Contracts (Regulation) Act, 1956 would require every rule made by the Stock Exchange under the said Act to be laid before Parliament, making it clear that the said rules are statutory in nature. As a consequence, the Court was of the opinion that the Stock Exchange would be a '*secured creditor*' in light of the statutory flavor of the bye-laws and rules. Further, the Court observed that the common law doctrine of priority of crown debts would be still applicable to India by virtue of Article 372 of the Constitution, which would make crown debts subservient to the debts owed by secured creditors. Therefore, the Court concluded that the lien possessed by the Stock Exchange would make it a secured creditor by virtue of which, it would have priority over Government dues.

46. The position therefore would be that in the instant case there would be a lien of the appellant on the money deposited by the respondent company in liquidation when it became a member of the appellant and since there are no workmen dues the official liquidator has not to watch the interest of any workman. As a matter of fact other than persons who used the services of the respondent company to act as a broker on the stock exchange no one has any claim against the company. Therefore the manner of adjudication of the claims and disbursement in the instant case has to be as per the bye-laws of the appellant.

47. The appeal is accordingly allowed. Impugned order dated January 23, 2013 is set aside. Co.App.(C) No.4/2011 filed by the official liquidator is dismissed and Co.App.No.401/2012 filed by the appellant is allowed with a clarification. Should after settling the claims of investors any money remains surplus in the hands of the appellant the same shall be paid over to the official liquidator.

48. No cost.

(PRADEEP NANDRAJOG)
JUDGE

(YOGESH KHANNA)
JUDGE

MARCH 01, 2017
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