IN THE HIGH COURT OF DELHI AT NEW DELHI

OMP. 46/2005

Reserved on: November 30, 2011
Decision on: January 10, 2012

TREXIM CORPORATION ..... Petitioner
Through: Mr. C.M. Oberoi with
Ms. Surekha Raman, Advocates.

versus

FORTIS SECURITIES LTD. ..... Respondent
Through: Mr. Rohit Puri with
Mr. Amandeep Bawa, Advocates.

CORAM: JUSTICE S. MURALIDHAR

JUDGMENT
10.01.2012

1. The challenge in this petition under Section 34 of the Arbitration and Conciliation Act, 1996 ('Act') is to an Award dated 28th October 2004 passed by the Arbitral Tribunal constituted under the Bye Laws, Rules and Regulations of the National Stock Exchange of India Ltd. ('NSEIL'). By the impugned Award the Arbitral Tribunal allowed the claims of the Respondent and directed that the Petitioner would pay to the Respondent a sum of Rs. 43,15,797.06 together with simple interest @ 12% per annum from 1st April 2000 till the date of the payment.

The stand of the parties

2. The Petitioner Trexim Corporation ('Trexim') states that it had certain transactions with the Respondent Fortis Securities Ltd. ('Fortis') in sale and purchase of shares from December 1997 onwards. The dealings between the parties were in accordance with the Contract Notes that were duly acknowledged and confirmed in writing. Trexim and its partner Mr. Arvind

Kapur appended signatures to a Member-Constituent Agreement dated 11th February 1998. While the case of Trexim was that the parties stopped transacting after December 1999, barring a few transactions in January 2000, Fortis maintained that the transactions continued in February and March 2000. Fortis' claim before the Arbitral Tribunal of the NSEIL was that for the transactions between January and March 2000, Trexim owed it a sum of Rs. 80,16,602.83 together with interest at 24% per annum with effect from 22nd March 2000 till the date of payment. Trexim on the other hand denied that the transactions for which the claim was raised were entered into on its behalf by Fortis.

3. Trexim's preliminary objection to the constitution of the Arbitral Tribunal was rejected by it by an order dated 18th January 2002. In the final Award dated 28th October 2004 the Arbitral Tribunal negatived Trexim's further preliminary objections to its jurisdiction to entertain Fortis' claims. It held that inasmuch as Bye Law 1 (a) of the NSEIL's byelaws provided that all dealings on the NSE were automatically subject to arbitration under the NSEIL Bye Laws, Rules and Regulations, and the MCA between Trexim and Fortis also mentioned that all dealings between them on the NSE shall be subject to its bye laws, there was in effect an arbitration agreement between the parties. Trexim's contention that the disputes could only pertain to transactions on the NSE was accepted by the Arbitral Tribunal. It was however observed that if Fortis was prepared to give credit to Trexim for any money due to Trexim even though arising outside NSE transactions, there could be no objection as Fortis was voluntarily giving up its claim by way of adjustment.

Validity of the constitution of the Arbitral Tribunal

4.1 One of the principal grounds of challenge by Trexim to the impugned Award is based on Section 34 (2) (v) of the Act, viz., that the composition

of the Arbitral Tribunal was not in accordance with the agreement between the parties. The facts relevant to this ground are that Trexim received a communication dated 24th November 2000 from NSEIL enclosing a notice dated 21st September 2000 in Form I along with documents received from Fortis. Trexim was asked to submit its defence in Form III within 15 days and also submit within seven days a list of five persons from the list of eligible persons, which list was enclosed, to act as Arbitrators in the order of Trexim's preference.

4.2 On 2nd December 2000 Trexim wrote to the NSEIL pointing out that without prejudice to its reply dated 16th October 2000 to Fortis' legal notice dated 18th September 2000 and without prejudice to incompetency of the purported reference, the list of eligible persons furnished by the NSEIL was not in accordance with its Bye-laws and Regulations and did not contain sufficient number of eligible persons from whom choice was required to be indicated. It called for an additional list with the requisite number in conformity with the Rules and Regulations of NSEIL. Trexim submitted a response in Form-III on 12th December 2000 without prejudice and by way of abundant caution.

4.3 On 22nd December 2000 Trexim received a communication from the Assistant Manager of NSEIL requiring certain rectifications to be carried out to its reply, for further copies to be furnished and to deposit Rs.12,000 towards cost of arbitration. Trexim responded on 11th January 2001 pointing out that the NSEIL had no jurisdiction to entertain the dispute and that therefore it would not be able to pay for the arbitration. On 27th February 2001 NSEIL sent Trexim a list of persons eligible to act as Arbitrators and required Trexim to indicate its choice of five persons within seven days. It is stated by Trexim that this list contained names of 10 persons and was different from the list earlier sent which contained the

names of 10 persons, two out of whom were shown as having resigned.

4.4 On 16th April 2001 NSEIL informed Trexim of the appointment of a panel of Arbitrators comprising Justice P.R. Handa (Retired), Col. Gujral G. Singh (Retired) and Shri Sudhir Kumar Singhal. The first hearing of the Arbitral Tribunal was fixed for 15th May 2001. By a letter dated 30th April 2001 addressed to NSEIL Trexim asked for a copy of the Form-II containing the list of Arbitrators as furnished by Fortis to NSEIL. By its letter dated 10th May 2001 NSEIL referred to Regulation 5.6 (e) of the Capital Market Regulations ('CMR') of NSEIL but did not furnish the list of Arbitrators in Form-II as requested. Trexim reiterated its request on 12th May 2001. By a letter dated 14th May 2001, NSEIL informed Trexim that any challenge to the appointment of the Arbitrators had to be made before the Arbitrators.

4.5 Trexim raised an objection to the constitution of the Arbitral Tribunal on 15th May 2001 before the Arbitral Tribunal. It reiterated the objection at the hearing before the Arbitral Tribunal on 23rd July 2001. The Arbitral Tribunal left the decision on the issue to the relevant authority and adjourned the case. NSEIL by a letter dated 7th August 2001 informed Trexim of the appointment of Justice B.L. Yadav as Arbitrator in place of Col. Gujral G. Singh. When the Arbitral Tribunal met on 3rd September 2001 it transpired that Fortis had made an application to NSEIL against the propriety of the constitution of the Arbitral Tribunal and also made allegations against the Presiding Arbitrator. These were rejected by the Arbitral Tribunal as baseless. However, the entire panel resigned.

4.6 On 24th October 2001, Trexim received a communication from NSEIL informing it that a panel consisting of Justice V.V. Vaze, Presiding Arbitrator, and Shri Shiban Dudha and Shri Ajay Bahadur had been

appointed in place of the earlier Arbitral Tribunal and the case was fixed for 1st November 2001. Trexim wrote to the NSEIL on 20th October 2001 requesting for the list of Arbitrators as nominated by Fortis while submitting its statement of claim. A copy of the decision of the relevant authority was also requested for.

4.7. By a letter dated 10th December 2001 NSEIL informed Trexim of the resignation of Justice V.V. Vaze (Retired) on 1st November 2001 and the appointment of Justice P.K. Jain (Retired) in his place. Justice Jain expressed his inability to take up the matter and Justice R.P. Gupta (Retired) was appointed in his place. The Arbitral Tribunal fixed the hearing for 24th December 2001. Trexim on 12th December 2001 wrote to Fortis, *inter alia*, asking it to furnish a copy of Form-II containing the names of Member/Non-Members who had been nominated by Fortis or a list of order of preference indicated and also copies of the orders passed by the relevant authority concerning constitution of the Arbitral Tribunal. Trexim also addressed a communication dated 18th January 2002 to the Board of Directors of NSEIL requesting for being provided with the copies of the requisite orders/information.

5. At the hearing on 18th January 2002, the Arbitral Tribunal negatived Trexim's objection as to the validity of its constitution and took the view that it has been properly constituted under Regulations 5.6(f) and 5.7 of the Regulations. After setting out the events that had transpired till then, the Arbitral Tribunal noted that out of the ten names proposed only three remained since "the rest have either resigned from the tribunal or expresses their inability to act as arbitrators to the tribunal." The Arbitral Tribunal proceeded to hold as under:

> "Under the peculiar circumstances, it becomes irrelevant as to whose names were proposed by claimant in their form II. The respondent had not made any choice of names from

> the panel intimated to them. The process of constitution of Arbitration Tribunal in this case from time to time has been such that ultimately no choice was left for the relevant Authority except the present three Arbitrators.
>
> The respondent has raised no objection to any member of this tribunal in regard to their independence qua both the parties.
>
> In view of the facts and circumstances discussed above, both the demands and objections raised by respondent are irrelevant. Their objections are therefore rejected. We hold that we are properly constituted Arbitration Tribunal in this case and have jurisdiction to proceed with the Arbitrators."

6. Chapter 5 of NSEIL's CMR deals with Arbitration. Regulation 5.5 deals with the criteria and procedure for selection of persons eligible to act as arbitrators. Regulation 5.5 (a) inter alia states that the list of eligible persons shall consist of 40% Trading Members and 60% non-Trading Members. Regulation 5.6 sets out a detailed procedure for appointment of arbitrators. Regulation 5.6 (a) requires both the Applicant (in this case Fortis) to submit in Form II along with its claim in Form I a list of five names, in the order of descending preference, from among the list of eligible persons specified by NSEIL. Thereafter within seven days of receipt of notice the Respondent (in this case Trexim) had to send its list of five persons in Form II. Regulation 5.6 (c) details the procedure to be followed by NSEIL in constituting the Arbitral Tribunal from among the preferences indicated in the two lists submitted to it by the parties. Regulation 5.6(e) states that "if the Applicant submits Form II and the Respondent fails to submit the same, then Relevant Authority shall select an arbitrator from the balance lists of eligible persons excluding, the persons selected by the Applicant." Regulation 5.7 (f) envisages a situation where the arbitrator chosen is unable to act as such. In that case the 'Relevant Authority shall select an arbitrator from the remaining names on the list of eligible persons

excluding the persons selected by the Applicant and/or the Respondent." Resort is to be had to the names on the lists of either the Applicant or the Respondent only if the arbitrator chosen by the Relevant Authority fails to act.

7. In the present case, despite repeated requests from Trexim, it was not provided with the copy of the Form II submitted by Fortis to NSEIL. This was important in the context of the observation of Arbitral Tribunal in its order dated 18th January 2002 that Trexim's objections had become "irrelevant" since only three members from NSEIL's list of eligible arbitrators were available. This explanation of the Arbitral Tribunal without actually disclosing the names of Arbitrators as suggested in Form II by Fortis is not understandable since it makes it impossible to verify whether the procedure outlined in Regulation 5.7 (e) was in fact followed by NSEIL. Even to verify if the NSEIL was justified in resorting to the procedure under Regulation 5.6 (f) not only was a disclosure of the list suggested by Fortis in Form II was necessary but the decision of the Relevant Authority as demanded by Trexim had to be disclosed. The Arbitral Tribunal was expected to explain why the objection of Trexim had become 'irrelevant'. It is difficult to believe that there were no arbitrators available except the three that constituted the Arbitral Tribunal. If that were true, then the 'Relevant Authority' was duty bound to draw up a fresh list of eligible persons if the spirit of Regulation 5.7 was to be complied with. How else could it be ensured that the Arbitral Tribunal would have a representation of Trading and non-Trading Members in the ratio of 40:60? The failure to disclose the decision of the Relevant Authority meant that there was no material available with the Arbitral Tribunal to conclude that its constitution was 'inevitable'. Fortis has not been able to show how the order dated 18th January 2002 of the Arbitral Tribunal can be supported in law. In the circumstances, the reasons given by the Arbitral Tribunal in its

order dated 18th January 2002 rejecting the challenge to the validity of its constitution are contrary to the CMR of NSEIL and in particular the very purpose and spirit of Regulation 5.7. The said order is accordingly held to be unsustainable in law.

8. While the above conclusion is by itself sufficient to set aside the impugned Award under Section 34 (2) (v) of the Act, even on merits it is found, as will be discussed hereafter that the Arbitral Tribunal's conclusions are contrary to law and the evidence placed on record by the parties.

Margin money requirement was mandatory

9. Trexim had raised several objections to the claims of Fortis before the Arbitral Tribunal. One of them was that Fortis had not taken margin money from Trexim for the transactions it claimed to have entered into on the NSE on behalf of Trexim and that this was contrary to the mandatory requirement of the NSE Regulations.

10. The Arbitral Tribunal in the impugned Award has itself noticed that the Bye Laws 19 to 22 of Chapter IX of the Bye Laws of NSEIL requires margins to be placed by the Member with the NSE and Bye Law 26 sets out the effect of the failure by a Member to deposit the margin with the NSE. Bye Law 26 states that a trading Member failing to deposit the margins as provided in the Bye Laws and Regulations shall be required by the relevant authority "to suspend its business forthwith." Further its states that "a notice of such suspension shall be immediately placed on the trading system and the suspension shall continue until the margin required is duly deposited."

11. Regulation 3.9 (a) CMR deals with the obligation of the constituent to

deposit margin with the Member. It mandates that "The Trading Members shall buy securities on behalf of the constituent only on the receipt of margin of minimum such percentage as the relevant authority may decide from time to time, on the price of the securities proposed to be purchased, unless the constituent has already **an equivalent credit** with the broker". Regulation 3.9 (b) spells out the consequences of the constituent failing to make the full payment to the Trading Member for the execution of the full contract within two days of the contract note having been delivered for the cash shares or before the pay-in-day (as fixed by NSE for the concerned settlement period), whichever is earlier unless "the constituent has already an equivalent credit with the Trading Member." The loss, if any, would be met from the margin money of the constituent. Further, where a Member purchases or sells for the constituent without margins as prescribed, the Member could entail penalties that can be levied at that time by the NSE.

12. A plain reading of Regulation 3.9 CMR makes it clear that unless the constituent has credit with the Member which is "equivalent" to the value of the shares purchased, the deposit of margin money by the constituent is a must before the Member can buy shares on behalf of the constituent. Also, the delivery of contract notes concerning the purchase of shares by the Member to the constituent is mandatory for determining the two day period within which the constituent has to make full payment. The only exception again is if the constituent already has an equivalent credit with the Member. A breach of the requirement by the Member, i.e. a Member proceeding to buy shares without the constituent depositing with the Member the margin money entails penalties for the Member. There can, therefore, be no mistaking of the mandatory nature of the requirement of both the margin money being deposited by the constituent and the making of full payment by the constituent within two days of delivery to it of the concerned contract notes. This Court fails to appreciate how and on what basis the

Arbitral Tribunal concluded that "The wording of Regulation 3.9 is at best directory against the Broker/Member but not totally prohibitory in the sense that a violation would make an Order of purchase/sale as non-est. Even the extent of requirement of margins is a fluid situation." In the view of the Court, the above conclusion is patently erroneous and based on an incorrect reading of the relevant CMR provisions. The very edifice of the transactions in a stock exchange would be rendered weak if the requirement of margin money deposit and settlement of accounts within a short period after the transaction is entered into are not strictly enforced.

13. The error in the impugned Award in this regard is apparent when the transactions claimed by Fortis to have been entered into by it on behalf of Trexim in February and March 2000 are considered. Fortis claimed that it had purchased 21,400 shares of HFCL on 5th January 2000 at a price of Rs. 1,65,93,771.50. There was a requirement of payment of 20% margin money. Since the transactions in the said shares were considered volatile an additional margin of 105.28% was required. This worked out to nearly Rs. 68 lakhs. Admittedly Trexim made no payment of margin money for this transaction to Fortis. Also, clearly Fortis had no 'equivalent credit' in the account of Trexim to permit the purchase by Fortis of such a large tranche of shares of HFCL on behalf of Trexim. Also, surprisingly despite the requirement of settling the payment within two days of delivery of the contract, Fortis appears not to have made any written demand against Trexim in relation to the above transactions at any time between January and March 2000 and till such time it filed a claim before the NSEIL. According to the Respondent the said shares were sold on 11th January 2000 at a value of Rs. 1,53,11,048.50 at a loss of Rs. 12,82,723/-. The original contract notes in respect of the said transactions were not produced by Fortis before the Arbitral Tribunal. There is considerable force in the submission of Trexim that it was not possible that a broker earning a

brokerage of Rs. 19,260/- in respect of a transaction of 21,400 shares should have invested amounts aggregating to Rs. 68,00,000 in providing margin to the NSEIL and run the risk of such a considerable loss.

14. Another transaction is the purchase of 65,000 shares of MTNL on 25th February 2000 in the value of Rs. 1,88,32,103.15. These were allegedly sold on 29th February 2000 for Rs. 26,68,402.47. Even in relation to the aforesaid purchase no margin was provided by Trexim. Further, another 1,00,000 shares of MTNL were claimed to have been purchased by Fortis on 2nd March 2000 for a sum of Rs. 3,20,12,307.57. During the period from 8th to 10th March 2000, 3,80,000 shares of MTNL for a value of Rs. 9,53,32,884.20 were purchased. Again, for these transactions no margin amount was paid by Trexim. Fortis also did not produce contract notes, signed in duplicate by Trexim, evidencing the placing of an order by Trexim on Forits for these purchases. It is unbelievable that transactions worth crores of rupees could have entered into by Fortis without any margin money being deposited by Trexim.

15. Fortis claimed before the Arbitral Tribunal that there was 'sufficient credit' in Trexim's account in relation to the settlement period 8th to 14th March 2000 and even earlier. Fortis claimed that there was credit for a settlement between 5th January and 11th January 2000 and up to December 1999 of Rs. 8.59 lakhs approximately. The Arbitral Tribunal failed to note that these credits were too meager when compared to the actual value of the transactions concerning the HFCL and MTNL shares. In any event this did not constitute 'equivalent credit' as mandated by the Regulations. This was too obvious for the Arbitral Tribunal not to have noticed. It seems to have gone by the fact that in the past for certain transactions in September 1999 involving sale and purchase of MTNL shares Fortis had remained exposed for a liability of Rs. 1 crore approximately. That still did not explain how

Fortis could possibly have purchased shares for several crores of rupees on behalf of Trexim, and that too for two months in succession, without Trexim paying it any margin money. The Arbitral Tribunal also overlooked the fact that apart from not paying any margin money, Trexim also did not settle the 'full payment' in respect of the above purchases within 'two days' as required by the CMR. Yet Fortis had not raised any written demand for the said payment against Trexim at any time soon thereafter. Fortis itself had not deposited with NSE the margins for these transactions. These factors lend credence to the submission of Trexim that the transactions were indulged in speculatively by Fortis and it was trying to somehow recover the shortfall. The Arbitral Tribunal's conclusion that the margin money requirement was not mandatory is contrary to the Regulations and the conclusion that there was sufficient credit available in Trexim's account with Fortis is contrary to the evidence on record.

Non-production of contract notes

16. On the question of non-production of contract notes, the factors that weighed with the Arbitral Tribunal were that the order number and unique number were generated by the NSE system and these could not be manipulated by the broker. The Arbitral Tribunal compared the contract notes filed by Fortis on 8th, 9th, 10th and 14th March 2000 with the Trade Done Reports (TDRs) filed by Fortis under hard and softy copy for the period from January to March 2000 covering all the transactions executed through the NSE. According to the Arbitral Tribunal this showed that the trades done followed one another within seconds/sub seconds in logical sequence. The Arbitral Tribunal noted that the contract notes gave all the matching details relating to order number, trade number, trade time, quantity for the relevant dates. Although Fortis had not produced the acknowledged copy of the contract note (duly signed by Trexim) it was explained by the fact that the contract note was not prepared at the moment

of the trade transaction but after completion of the days' trading. Further, the offices of Fortis and Trexim were physically in the same area and, therefore, Fortis' assertion of delivery of contract notes through messenger was acceptable. Even Trexim's witness Shri Arvind Kapur admitted that contract notes used to be delivered by messenger and by courier. It was, however, noted by the Arbitral Tribunal that Trexim "has no proof of returning the signed copies of contract notes to the Claimant (Fortis) for the admitted transactions." The Arbitral Tribunal accepted Fortis' submission that there was a general practice between the parties of delivery/receipt of contract notes through messenger with neither maintaining a peon book/dispatch register. Shri Arvind Kapur's denial of being present at Fortis' office on 25th February and 14th March 2000 was held to be false. As regards the non-production of the order books the Arbitral Tribunal held that "substantially all the factors required to be detailed in an Order book were available" in the TDRs in which the code TC representing Trexim was used by Fortis. Therefore it was held by the Arbitral Tribunal that the placement of order by Trexim on Fortis was proved.

17. There are several problems with the above conclusions of the Arbitral Tribunal. The impugned Award itself notes that under Regulation 3.5.1 for trades executed in the format prescribed by the NSE, every Trading Member "shall issue a contract note to his constituents." In terms of Regulation 3.5.2 such contract note "shall be signed by a Trading Member or his Authorised Signatory or constituted Attorney." Under Regulation 7.1.17 every Trading Member is required to keep copies/duplicates of the contract notes and details of the statements which are required to appear on the contract notes. These cannot but be considered to be mandatory requirements of the Regulations.

18. The Arbitral Tribunal itself noted in the impugned Award: "True, the

Claimant (i.e. Fortis) has not produced the acknowledged copy of the contract notes (duly signed by the Respondent)" i.e Trexim. It also noted the SEBI Circular dated 18th November 1993 that required Member brokers to insist on the clients returning the "duplicate copy of the contract notes duly signed by them in token of their having received the contract notes." Also, the Arbitral Tribunal noted that the contract notes produced by Fortis were "photocopies of copies kept at the Claimant's (Fortis) office" and that "the copies kept at the office were not produced in spite of notice to produce during evidence (on) the plea that these were not traceable then." Yet, the Arbitral Tribunal seems to have excused this abject failure on the part of Fortis to produce credible proof of the transactions having been entered into upon orders placed on it by Trexim on the specious reasoning of there being a 'general practice between the parties'.

19. The mere presence of Shri Arvind Kapur in Fortis' office, or the proximity of the offices of Trexim and Fortis, could not make up for the lack of proof of the transactions running into crores of rupees having been entered into on behalf of Trexim by Fortis without the mandatory requirements of the NSE Regulations being complied with. The TDRs were documents prepared by Fortis and they required to be corroborated by contemporaneous documents evidencing the authorization of those transactions by Trexim. There was no such credible documentary corroboration in the evidence produced by Fortis before the Arbitral Tribunal.

20. Given the nature of the transactions and their value, the Arbitral Tribunal ought to have insisted upon submission of proper documentary proof by the claimant Fortis including proof of deposit of margin money by Trexim, originals of contract notes signed by way of acknowledgment by Trexim as available in the records of Fortis, and order books maintained in

the regular course of business by Fortis strictly in accordance with the requirements of the Rules, Bye Laws and Regulations of the NSE. Absent these essential pieces of evidence, Fortis' claim was liable to be rejected by the Arbitral Tribunal. The conclusion reached by the Arbitral Tribunal in the impugned Award that Fortis had proved the placing of orders on it by Trexim for the transactions in question is based on no credible evidence. It is therefore not possible to legally sustain the impugned Award.

Conclusion

21. Although there were other grounds urged on behalf of Trexim to assail the impugned Award, the above conclusions of the Court are by themselves sufficient to set aside the impugned Award on the grounds of patent illegality.

22. The order dated 18th January 2002 and the impugned Award dated 28th October 2004 of the Arbitral Tribunal are accordingly set aside. The petition is allowed with costs of Rs.10,000 which will be paid by the Respondent to the Petitioner within four weeks.

S. MURALIDHAR, J.

JANUARY 10, 2012
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