

HARINARAYAN G. BAJAJ
v.
RAJESH MEGHANI AND ANR.

DECEMBER 6, 2004

[RUMA PAL, ARIJIT PASAYAT AND C.K. THAKKER, JJ.]

Securities Contract (Regulation) Act, 1956; Ss. 3(2), 8, 9/National Stock Exchange Rules and Byelaws; Rule 33, Byelaws 1, 1-C, 2 and 23 of Chapter XI and Byelaws 19, 26 and 28 of Chapter XII :

Trading in shares—Purchaser defaulted in making payment—Broker declared defaulter by National Stock Exchange—Claim—Arbitration—Arbitral Tribunal awarded certain amount in favour of defaulter/broker—Right of defaulting member/broker in filing claim—Held : Ex-trading member/defaulters remains party to the arbitration agreement and Byelaw 1-C does not restrict the right of the defaulter to refer the claim for arbitration—Defaulter’s Committee precludes from referring defaulters claim to arbitration—Since amount which may be realized by defaulter must be made over to Defaulter Committee, purchaser’s apprehension of misappropriation of the amount by the defaulter is without any basis—More so, Defaulter Committee competent to take action independently against the defaulter or his debtor or both—Further protection, if any required, could be provided by the Exchange by framing on appropriate Bye-law—Arbitration and Conciliation Act, 1996; Section 34—Interpretation of Statutes.

Maxims :

Maxim “expressio unius est exclusio alterius”—Applicability of.

Words and Phrases :

‘Parties to the arbitration agreement’—Meaning of.

Appellant started trading in shares through the respondent, a share-broker, however, he allegedly did not make payment to the broker. National stock Exchange (NSE) declared the broker defaulter.

A Respondent referred his claim against the appellant to Arbitration under the Byelaws of NSE. The Arbitral Tribunal passed an award in favour of the respondent. Challenging the award, the appellant filed an application under Section 34 of the Arbitration and Conciliation Act in the High Court. The High Court directed the Arbitral Tribunal to give

B a finding on the issue as to whether the respondent was in a position to deliver the shares to appellant when he was declared defaulter by NSE and appellant was directed to deposit the awarded amount in the Court. Division Bench of the High Court set aside the direction of the Single Judge relating to the deposit of the awarded amount and directed that

C any amount which may be recovered by the respondent as a result of the arbitration proceedings be made over to the Defaulters' Committee to be dealt with in accordance with the Rules/Byelaws of NSE. Hence the present appeal.

D It was contended by the appellant that although the dispute relating to a defaulter member survived, he loses his right to refer the dispute to arbitrator in terms of Rule 33 of the NSE Rules; and that the dispute could only be raised by the Defaulter's Committee in terms of Bye-law 11 of Chapter XI since estate of the defaulter could be represented by the Defaulters' Committee.

E Respondent submitted that Rule 33 of the NSE Rules could not be construed to cover the right to go to arbitration since the right is not part of the privileges of membership but arises out of the contract between the respondent and the appellant and, therefore, the respondent could not be deprived of this right under the Rules; that Rule 1-C of the Rules clearly indicates that the disputes arising out of a transaction

F prior to a trading member being declared a defaulter survived and could be referred to arbitration only by the parties to the arbitration agreement; that there was limited vesting of certain assets of the defaulting members in the Defaulters' Committee which did not cover contractual rights of

G a defaulting member against a non-member and that neither the Defaulters' Committee nor NSE had ever asserted the right to refer the disputes of a defaulting member to arbitration or had they questioned the *locus standi* of the respondent to do so.

Dismissing the appeal, the Court

H HELD : 1.1. Under the NSE Byelaws, the parties to the reference

are the parties to the agreement. This is also what is what is provided under Section 2(h) of the Arbitration and Conciliation Act and a 'party' is defined as "a party to an arbitration agreement". [730-B-C]

1.2. Byelaw 1-C envisages claims, differences, disputes between the parties mentioned in Byelaws (1), (1A), (1B) in respect of dealings, contracts and transactions entered into prior to the date on which a Trading Member was either declared defaulter or expelled or has surrendered his trading membership. The parties remain parties to the arbitration agreement despite the fact that as far as the Trading Member is concerned, he may have ceased to be a Member when the reference is made. Byelaw 1-C of NSE Rules does not in any way indicate that an arbitration agreement between an ex-Trading Member and its constituent cannot be enforced at the instance of the ex-Trading Members, or that a defaulter member ceases to the party to be a arbitration agreement. [730-C-D-E]

2.1. Rule 33 of the NSE Rules does not provide for the vesting of any rights in the Defaulters' Committee. The Exchange and the Defaulters' Committee are not the same. It cannot be said that all the rights of a Trading Member who has been declared to be a defaulter vests in the Defaulters' Committee including the right to go to arbitration. By expressly providing for the powers in the Committee, it would follow that other powers are excluded on the principle "*expressio unius est exclusio alterius*". Thus the assets which may be called in or realized or recovered by the Defaulters' Committee do not include monies payable under a contract with a third party nor monies the recovery of which are yet to be made. [731-B; 730-E-F; 731-H; 732-A-B]

2.2. Doubtless, the Defaulters' Committee has been given the power to distribute the monies collected according to the priorities mentioned in Byelaw 23 after defraying its expenses. But it is a very different proposition to infer this that it is the Defaulters' Committee which is responsible for or entitled to recover all such amounts that too by a reference to arbitration under Byelaw 1-C of Chapter XI. On the other hand the Defaulters' Committee is expressly empowered under Byelaw 28 of Chapter-XII to initiate proceedings in a Court of law in name of the Exchange or in the name of the defaulter for the recovery of the dues of the defaulter. The words do not convey any intention to permit the Defaulters' Committee to also refer disputes in the name of the defaulter

A to the arbitrator under Byelaw 1-C. [732-C-D-E-F]

B 2.3. The effect of the express empowerment of the Committee “to initiate action in Courts of law” cannot be read as implying initiating a reference to arbitration. Had the intention behind the Byelaws been to similarly authorize the Committee for the purposes of Byelaw 1-C, it would have been expressly so provided. The plain language of the Byelaw precludes the Defaulters’ Committee from referring defaulters’ claims to arbitration. Additionally, the Defaulters’ Committee may take action independently against the defaulter or his debtor or both under Byelaw 28 in the name of the Exchange. If any further protection is required by the Exchange it is a need that must be met by the Exchange by framing an appropriate Bye law under Section 9 of the Securities Contracts (Regulation) Act, 1956 and not an exercise for the Courts to undertake by convoluted construction. [732-E-F-G; 733-D]

D *Vinay Bubna v. Stock Exchange, Mumbai, [1999] 6 SCC 215, distinguished.*

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 7890 of 2004.

E From the Judgment and Order dated 17.10.2003 of the Bombay High Court in A. No. 571/2003 in Arbitration Petition No. 366 of 2002.

R.F. Nariman, Dhruv Mehta, Anurag Jain, Sriraj, Mohit Chaudhary and P.N. Puri for the Appellant.

F S. Ganesh, C. Mukund, Ms. Sudha Sharma, G.K. Singh, Neeraj Kaseva and Bijoy Kumar Jain for the Respondents.

The Judgment of the Court was delivered by

RUMA PAL, J. : Leave granted.

G The first named respondent is a share broker and was a member of the National Stock Exchange of India Ltd. (referred as the ‘NSE’). The NSE which was initially named as the second respondent has been deleted from the array of parties at the instance of the appellant. We will therefore refer to the first respondent as the respondent. The appellant started trading in shares through the respondent. In March, 2001 three separate transactions

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were entered into between the appellant and respondent for purchase of three separate lots of shares of Amara Raja Batteries Ltd. The respondent's allegation is that the appellant did not make payment for the shares bought by the respondent for and on behalf of the appellant and that by reason of the non-payment for the shares, the NSE declared the respondent as a defaulter on 19th June 2001. On 21st June 2001, the respondent referred his claim against the appellant to Arbitration under the Bye-laws of the NSE. The appellant contested the claim and contended that the Arbitration reference under the Bye-laws was not maintainable on the ground that the same was filed after the respondent had been declared a defaulter. The appellant also filed a counter claim against the respondent before the Arbitral Tribunal.

On 31st July 2002, the Arbitral Tribunal passed an award in favour of the respondent for an amount of Rs. 3,46,89,636 after rejecting the preliminary objection raised by the appellant as to the maintainability of the arbitration proceedings. The Arbitral Tribunal held that the transactions in question had been completed prior to the respondent being declared a defaulter and that the respondent was not in any way debarred or prevented from pursuing his claim to recover amounts due from the appellant in respect of such transactions.

Challenging the award the appellant filed an application under Section 34 of the Arbitration and Conciliation Act, 1996 in the High Court. The learned Single Judge noted that the appellant had made only two submissions in so far as the validity of the award was concerned. Firstly, it was submitted that after the respondent had been declared a defaulter, the respondent did not have the *locus standi* to refer the disputes to Arbitration or to carry on the arbitration proceedings. The second submission was that the Arbitrators had erred in holding that the appellant was liable to pay the purchase price of the shares although the appellant had specifically submitted before the Arbitrators that the respondent was not in a position to effect delivery of the shares which were alleged to have been purchased.

The learned Single Judge negatived the first submission but upheld the second submission. Hearing of the petition under Section 34 of the 1996 Act was adjourned and the Arbitral Tribunal was directed to give a finding specifically on the aspect as to whether the respondent was in a position to deliver the shares which were the subject matter of the reference. Because of the failure of the appellant to make payment for the shares which had

A according to the learned Single Judge resulted in “disastrous consequences” for the respondent, the order was made conditional upon the appellant’s depositing the awarded amount in the Court within a period of four weeks failing which the petition under Section 34 would stand dismissed.

B The appellant preferred an appeal challenging the order passed by the Single Judge. The Division Bench dismissed the appeal but set aside the direction of the learned Judge directing the deposit of the awarded amount. The Division Bench also directed that any amount which may be recovered by the respondent in respect of the arbitration proceedings be made over to the Defaulters’ Committee to be dealt with in accordance with the provisions of the Rules and Byelaws. The respondent has not challenged this direction and has given an undertaking that all amounts realised by him would be made over to the Defaulters’ Committee for clearing his default.

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D The decision of the Division Bench has been challenged only by the appellant. The basic issue to be resolved, therefore, is whether a trading member of the NSE who has been declared a defaulter has the right to initiate arbitration proceedings under the NSE Rules and Byelaws.

E The appellant submitted that Rule 33 of the NSE Rules which were framed under Section 8 read with Section 3(2) of the Securities Contract (Regulation) Act, 1956, provides for the cessation of a trading member’s right of membership immediately he is declared a defaulter. It is submitted that Rule 33 read with Chapter XI of the Bye-laws would show that a defaulter member had no right to refer a dispute to arbitration. Our particular attention was drawn to Byelaws 1 and 1-C in which the right of trading members to refer a dispute to arbitration not only in respect of on going transactions but also in respect of transactions prior to a member being declared a defaulter had been provided for. The appellant’s contention is that although the dispute relating to a defaulter member survived, the defaulter member loses his right to refer the dispute to arbitration by reason of Rule 33. According to the appellant the dispute in respect of such period could only be raised by the Defaulters’ Committee in terms of Byelaw 11 of Chapter XI.

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H Other bye-laws in Chapter XII were also referred to show that it is the Defaulters Committee which was required to collect and distribute the moneys payable to the defaulter. Byelaw 28 specifically empowers the

Defaulting Committee to initiate any proceeding in a Court of Law either in the name of the Exchange or in the name of the defaulter for the purpose of recovering any amount due to the defaulter. It is contended that once a Trading Member was declared a defaulter he was 'dead' as far as the NSE was concerned and the defaulter's estate could be represented by the Defaulters' Committee under Bye-law 26 of Chapter XII. It is contended that similar provisions of the Bombay Stock Exchange Act had been construed by this Court in *Vinay Bubna v. Stock Exchange, Mumbai*, [1999] 6 SCC 215 and it was held that once a member was declared a defaulter, his right of membership was forfeited and vested in the Exchange. The defaulting member retained no interest in his membership card which could be sold and the proceeds distributed amongst his creditors. The decision in *BSE Exchange v. Jaya I. Shah*, [2004] 1 SCC 160 was relied upon for contending that the Bye-laws of Exchanges being badly drafted should not be strictly construed but be read harmoniously along with the Rules in order to give effect to the object of the Rules. The appellant also relied upon the decision of the Bombay High Court in *Chandulal Laxminarayan Agarwal v. Ramdayal Onkarlal Agarwal*, ILR (1996) Nagpur 392 which held that under Section 28(2) of the Provincial Insolvency Act, 1920 once the property of an insolvent vests in the Insolvency Court or the receiver the insolvent is completely divested of the property, and he can have no right to sue for any declaration in respect of that property as the right to sue would also vest in the Insolvency Court or the receiver. The decision of *Chiranjilal Ramchandra Loyalka v. Jatashankar N. Joshi*, (1942) 44 Bom LR 692 was also relied on to urge that the right to refer a dispute to arbitration was granted to a member qua member of an Exchange.

The respondent has submitted that Rule 33 could not be construed to cover the right to go to arbitration. It is said that the right was not part of the privileges of membership but arose out of the contract between the respondent and the appellant and that there was no question, therefore, of the respondent being deprived of this right under Rule 33. It is also submitted that the requirement of referring the dispute in the Bye-laws between the trading members and their constituents to arbitration could not be said to be a right simpliciter. Parties to the arbitration agreement were obliged to refer disputes to arbitration. Rule 1C, according to the respondent clearly indicated that the disputes arising out of a transaction prior to a trading member being declared a defaulter survived and could be referred to arbitration only by the parties to the arbitration agreement. The Defaulters'

A Committee was not a party to the arbitration agreement. The decisions cited by the appellant have been distinguished. It has been emphasized that the provisions of the Provincial Insolvency Act, 1920 relied upon by the appellant were vastly dissimilar with the provisions of the Rules and the Byelaws of NSE. It is submitted that Byelaw 11 did not envisage a complete vesting of all assets of the defaulting member in the Defaulters' Committee. There was a limited vesting of certain assets which did not cover contractual rights of a defaulting member against a non-member. It was finally submitted that neither the Defaulters' Committee nor NSE had ever asserted the right to refer the disputes of a defaulting member to arbitration nor had they questioned the *locus standi* of the respondent to do so.

C The fulcrum of the appellants' argument is Rule 33. The Rule reads:

D "A trading member's right of membership shall lapse and vest with the Exchange immediately he is declared a defaulter. The member who is declared a defaulter shall forfeit all his rights and privileges as a member of the Exchange, including any right to use of or any claim upon or any interest in any property or funds of the Exchange, if any."

E The Rule speaks of the lapsing of a Trading Members right of membership and forfeiture of his rights and privileges as a member of the exchange on a member being declared as defaulter. The Rule further provides for the vesting of the right of membership of the defaulting members with the NSE. The question is whether these rights and privileges include the right to refer a dispute to arbitration between the defaulting member and another party.

F Reliance on *Jaya Shah's* case by the appellant was unnecessary. There is no dispute that the NSE Rules and Bye laws have to be read harmoniously particularly when: Rule (1) of the Rules provides:

G "(1) The rights and privileges of a trading member shall be subject to the Bye Laws, Rules and Regulations of the Exchange."

H The NSE Bye laws which have been framed by the Exchange under Section 9 of the Securities Contracts (Regulation) Act, 1956 contain a separate chapter, (Chapter XI), which deals exclusively with arbitrations.

Rule 2 of Chapter XI makes the provisions of the Byelaws and Regulations part of all dealings, contracts and transactions. It says:

“In all dealings, contracts and transactions, which are made or deemed to be made subject to the Byelaws, Rules and Regulations of the Exchange, the provisions relating to arbitration as provided in these Byelaws and Regulations shall form and shall be deemed to form part of the dealings, contracts and transactions and the parties shall be deemed to have entered into an arbitration agreement in writing by which all claims, differences or disputes of the nature referred to in Bye laws (1), (1A), (1B) and (1D) above shall be submitted to arbitration as per the provisions of these Byelaws and Regulations”.

The arbitration proceedings as provided in the Byelaws and Regulations are subject to the provisions of the Arbitration and Conciliation Act, 1996 to the extent not provided for in the Byelaws and Regulations (Byelaw 14). Byelaw 1 prescribes requirements for reference to arbitration with regard to claims, differences and disputes *inter alia* between Trading Members and Constituents in the following manner:

(1) “All claims, differences or disputes between the Trading Members *inter se* and between Trading Members and Constituents arising out of or in relation to dealings, contracts and transactions made subject to the Bye-Laws, Rules and Regulations of the Exchange or with reference to anything incidental thereto or in pursuance thereof or relating to their validity, construction, interpretation, fulfillment or the rights, obligations and liabilities of the parties thereto and including any question of whether such dealings, transactions and contracts have been entered into or not shall be submitted to arbitration in accordance with the provisions of these Byelaws and Regulations”.

Rule 1(C) deals with disputes of defaulting members. It says:

(1C) The provisions of Byelaws (1), (1A) and (1B) shall become applicable to all claims, differences, disputes between the parties mentioned therein for all dealings, contracts and transactions made subject to the Bye laws. Rules and

A Regulations of the Exchange provided such dealings, contracts and transactions had been entered into between the parties mentioned therein prior or to the date on which the Trading Member was either declared a defaulter or expelled or has surrendered his trading membership.”

B Under these Byelaws the parties to the reference are the parties to the agreement. This is also what is provided under Section 2(h) of the Arbitration and Conciliation Act, 1996 and a ‘party’ is defined as “a party to an arbitration agreement”.

C Byelaw (1C) envisages claims, differences, disputes between the parties mentioned in Bye-laws (1), (1A), (1B) in respect of dealings, contracts and transactions entered into prior to the date on which a Trading Member was either declared defaulter or expelled or has surrendered his trading membership. The parties remain parties to the arbitration agreement despite the fact that as far as the Trading Member is concerned, he may have ceased to be a Member when the reference is made. Byelaw 1C does not in any way indicate that an arbitration agreement between an ex-Trading Member and its constituent cannot be enforced at the instance of the ex-Trading Members, or that a defaulter member ceases to be a party to the arbitration agreement.

E The argument that all the rights of a Trading Member who has been declared to be a defaulter vests in the Defaulters’ Committee including the right to go to arbitration appears to be incorrect. For one this would amount to a rewriting of Byelaw 1C. For another it would necessitate a rewriting of the arbitration agreement by substituting the Defaulters’ Committee in place of the Trading Member as a party to the agreement.

F Furthermore even if one were to assume that the reference to arbitration is part of the membership rights of a Trading Member which are forfeited under Rule 33, in terms of that Rule the right lapses and vests in the Exchange and if at all it would be the Exchange which could enforce the arbitration agreement. However, Byelaw 18 of Chapter XI clearly states:

G “For removal of doubts, it is hereby clarified that the Exchange shall not be construed to be a party to the dealings, contracts and transactions referred to under these Byelaws; and the

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provisions of this Chapter shall not apply in case of claims, differences or disputes between the Exchange and a Trading Member and no arbitration shall lie between the Exchange and a Trading Member".

Rule 33 does not provide for the vesting of any rights in the Defaulters' Committee. The Exchange and the Defaulters' Committee are not the same. The Defaulters' Committee is set up under Chapter XII Byelaw 30 and may be constituted by the Board of Directors from time to time at any point of time. Not less than 60% of the members of the Defaulters' Committee shall be from among non-trading members who shall be nominated by the Exchange with the prior approval of Securities and Exchange Board of India.

Byelaw 11 on which particular emphasis has been placed by the appellant to support his argument that the Defaulters' Committee could refer the disputes of a defaulting member to arbitration reads thus:

"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 and on account 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."

This Rule gives the Defaulters' Committee limited powers to call in and realize (i) security deposits (ii) margin money (iii) other amounts lying to the credit of the defaulting member and (vi) securities deposited by the Defaulting Member. The Defaulting Committee has also the right to recover all moneys, securities and other assets, due, payable or deliverable to the defaulters by any other Trading Member. By expressly providing for these powers in the Committee, it would follow that other powers are excluded

A on the principle "*expressio unius est exclusio alterius*". Thus the assets which may be called in or realized or recovered by the Defaulting Committee do not include monies payable under a contract with a third party nor monies the recovery of which are yet to be made. Chapter XI Rule 11 is markedly different from the provisions of Section 28(2) and Section 29 of the Provincial

B Insolvency Act, 1920 which expressly provide for the complete vesting of all assets of an insolvent with the Insolvency Court or receiver. Had the intention been to bring about the same consequence as far as the Defaulting Members are concerned, the Rules or Bye-laws would have said so. Instead particular assets have been picked out for the purpose of realization by the Defaulters' Committee.

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D Doubtless, the Defaulting Committee has been given the power to distribute the moneys collected according to the priorities mentioned in Bye law 23 after defraying its expenses. But it is a very different proposition to infer from this that it is the Defaulting Committee which is responsible for or entitled to recover all such amounts that too by a reference to arbitration under Byelaw (1C) of Chapter XI.

E On the other hand the Defaulters' Committee is expressly empowered under Byelaw 28 of Chapter-XII to initiate proceedings in a Court of law in the name of the Exchange or in the name of the defaulter for the recovery of the dues of the defaulter. The words do not convey any intention to permit the Defaulters' Committee to also refer disputes in the name of the defaulter to the arbitrator under Rule 1C. The effect of the express empowerment of the Committee "to initiate action in Courts of law" cannot be read as implying initiating a reference to arbitration. Had the intention behind the

F Bye laws been to similarly authorize the Committee for the purposes of Byelaw 1C, it would have been expressly so provided. The plain language of the Byelaw precludes the Defaulters' Committee from referring defaulters' claims to arbitration. This may be contrasted with Section 59(h) of the Provincial Insolvency Act, 1920 which in terms authorizes the Receiver of an insolvent's property to refer any dispute to arbitration in order to realize

G the property of the insolvent.

H The submission of the appellant then was that if the defaulter were left free to pursue the arbitration to recover monies due to him, it would be possible that he may misappropriate any amounts realized thereby. The argument is an argument of desperation and is not based on any known

principle of interpretation. A

The provisions of Chapter XII would show that the amount which may be realised by the defaulter in respect of the transactions covered by Rules (1C) cannot be retained by him but must be made over by him to the Defaulters' Committee. Bye-law 19 accordingly provides:- B

“(19) The Defaulters' Committee shall keep a separate account in respect of all monies, securities and other assets payable to a defaulter *which are received by him* and shall defray therefrom all costs, charges and expenses incurred in or about the collection of such assets or in or about any proceedings it takes in connection with the default.” C

Additionally, the Defaulters' Committee may take action independently against the defaulter or his debtor or both under Bye law 28 in the name of the Exchange. If any further protection is required by the Exchange it is a need that must be met by the Exchange by framing an appropriate Bye law under Section 9 of the Securities Contracts (Regulation) Act, 1956 and not an exercise for the Courts to undertake by convoluted construction. D

The decisions cited by the appellant are inapposite and do not either factually or in law touch on the issues which call for resolution in this case. *Vinay Bubna's* case deals with Byelaws of the Bombay Stock Exchange which differ in form and substance with the Bye laws of NSE which we are called upon to interpret. Furthermore the question in that case was whether the defaulting member or the Assignee had any claim over the sale proceeds of the membership card, an item which clearly pertains to the rights of membership which are forfeited on default. The other decisions of the High Court of Bombay are equally inapposite and turn on the interpretation of the provisions of the Provincial Insolvency Act, 1920 which are wholly disparate from the provisions which are the subject matter of controversy in this appeal. E

For the reasons aforesaid we affirm the decision of the High Court and dismiss this appeal with costs. F

S.K.S.

Appeal dismissed. G