IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
IN ITS COMMERCIAL DIVISION
COMMERCIAL APPEAL (L) NO.284 OF 2019
IN
COMMERCIAL ARBITRATION PETITION NO.220 OF 2014

1. Percept Finserve Private Limited)
a company incorporated under Companies Act,)
1956 and having its registered office at Percept)
House, P 22, Raghuvanshi Estate, 11/12, Senapati)
Bapat Marg, Mumbai – 400 013)

2. Percept Limited)
a company incorporated under Companies Act,)
1956 and having its registered office at Percept)
House, P 22, Raghuvanshi Estate, 11/12, Senapati)
Bapat Marg, Mumbai – 400 013) ….Appellants

V/s.

Edelweiss Financial Services Limited,)
(Formerly known as Edelweiss Capital Limited), a)
Company incorporated under Companies Act,)
1956 and having its registered office at Edelweiss)
House, Off. CST Road, Kalina, Mumbai - 400 098)
) ….Respondent

Mr. Aditya Pimple a/w. Mr. Deepak Deshmukh and Ms. Nisha Kaba i/b. Naik Naik and Co. for appellants.
Mr. Karl Tamboly a/w. Ms. Priyanka Shetty, Mr. Harshit Jaiswal and Mr. Aditya Singh Chauhan i/b. AZB and Partners for respondent.

CORAM : K. R. SHRIRAM & RAJESH S. PATIL, JJ.
DATED : 2nd FEBRUARY 2023

ORAL JUDGMENT (PER K.R. SHRIRAM, J.) :

1 Appellants have preferred this appeal under Section 37 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as “the said Act”) aggrieved by an order and judgment dated 27th March 2019 passed by the learned Single Judge of this Court under Section 34 of the said Act by which the learned Single Judge was pleased to allow the petition filed

under Section 34 and set aside the impugned Award.

2 In the petition, respondent to this appeal, i.e., Edelweiss Financial Services Limited (hereinafter referred to as "Edelweiss"), had challenged an Award dated 6th June 2013 passed by the sole Arbitrator, whereby the sole Arbitrator concluded that two clauses, viz., clause 8.5 and clause 8.5.1 in the Share Purchase Agreement between Edelweiss and appellants herein Percept Finserve Private Limited and Percept Limited (hereinafter collectively referred to as "Percept") are illegal because they were forward contracts contrary to the provisions of the circular issued by SEBI under Section 16 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "SCRA") and also because they are options and hence, contracts in derivatives not being traded on stock exchange and hit by Section 18A of SCRA. The Arbitral Tribunal held that clauses 8.5 and 8.5.1 are not enforceable.

3 Before we proceed further, it will be useful to remind us about the scope of an appeal under Section 37 of the said Act, its jurisdiction as an Appellate Court in examining an order, setting aside or refusing to set aside an Award. The Apex Court in ***UHL Power Company Limited V/s. State of Himachal Pradesh***[1], in paragraph 16 held as under :

> *16. As it is, the jurisdiction conferred on Courts under Section 34 of the Arbitration Act is fairly narrow, when it comes to the scope of an appeal under Section 37 of the Arbitration Act, the jurisdiction of an Appellate Court in examining an order, setting aside or refusing to set aside an award, is all the more circumscribed. In MMTC Limited v. Vedanta Limited, the reasons*

1. (2022) 4 SCC 116

for vesting such a limited jurisdiction on the High Court in exercise of powers under Section 34 of the Arbitration Act has been explained in the following words :

> *"11. As far as Section 34 is concerned, the position is well-settled by now that the Court does not sit in appeal over the arbitral award and may interfere on merits on the limited ground provided under Section 34(2)(b) (ii), i.e., if the award is against the public policy of India. As per the legal position clarified through decisions of this Court prior to the amendments to the 1996 Act in 2015, a violation of Indian public policy, in turn, includes a violation of the fundamental policy of Indian law, a violation of the interest of India, conflict with justice or morality, and the existence of patent illegality in the arbitral award. Additionally, the concept of the "fundamental policy of Indian law" would cover compliance with statutes and judicial precedents, adopting a judicial approach, compliance with the principles of natural justice, and Wednesbury reasonableness. Furthermore, "patent illegality" itself has been held to mean contravention of the substantive law of India, contravention of the 1996 Act, and contravention of the terms of the contract."*

4 Facts in brief are :

Edelweiss and Percept had entered into a Share Purchase Agreement dated 8th December 2007 (hereinafter referred to as "SPA") as amended by a Deed of Rectification dated 21st April 2008 (hereinafter referred to as "Deed") and an Amendment Agreement dated 23rd April 2008 (hereinafter referred to as "Amendment Agreement"). Under the SPA, Edelweiss purchased 2,28,374 shares of appellant no.2 - Percept Limited held by appellant no.1 - Percept Finserve Private Limited for a total consideration of Rs.20 Crores. The SPA had certain conditions subsequent set out therein, first of which required appellant no.1 as of appellant no.2 to accomplish restructuring of the entire Percept group by not later than 31st December 2007 and to provide Edelweiss documents in proof of

completion of such restructuring. The Second condition subsequent required appellant no.1 not to dispose of any of its assets to any third party and to reflect all assets of appellant no.1 in the books of appellant no.2. Appellant no.1 was also required to ensure that the shareholding of all promoters of all its affiliates/group companies would be transferred to appellant no.2 and no assets of appellant no.1 would be dissipated by Percept till the completion.

5 Edelweiss raised a dispute alleging that Percept failed and/or neglected to complete the restructuring of the Percept group within the period stipulated in the SPA, i.e., 31st December 2007, and therefore, committed breach of the SPA. According to Edelweiss, because of the breach committed by Percept, Edelweiss was entitled to resell the shares for Rs.20 Crores to appellant no.1 for the amount that would yield an internal return rate of 10% of the consideration paid to appellant no.1 under the SPA. Edelweiss extended the time line for execution of the obligations of Percept to a date not later than 30th June 2008 and entered into the Amendment Agreement dated 23rd April 2008. The Amendment Agreement provided that if appellant no.1 breaches its obligations under the conditions subsequent as aforesaid, Edelweiss was entitled to the following remedies under Clause 8.5.1, which read as under :

> *"8.5. In the event of non-fulfillment of the first Condition Subsequent, the Investor shall have the right to:*
>
> *8.5.1. Re-sell the Shares held by it to the Seller or its Affiliates and the Seller is bound to purchase the same, at a price which would give the Investor an internal rate of return of 10% on the*

Purchase Consideration; or

8.5.2. Continue as a shareholder of the Company, subject to the following undertaking from the Seller: xxxxxxxxxxxxxxxxxxxx

6 As Percept did not fulfill any of the conditions subsequent even within the extended period of 30th June 2008, Edelweiss contended that under clause 8.5.1 of the SPA as amended by the Amendment Agreement, it had the right to resell the shares of appellant no.2 held by it to appellant no.1 or any of Percept's affiliates and exit the investment. If Edelweiss chose to follow the said path of exit, appellant no.1 was bound to purchase the shares at a price which would give Edelweiss an internal rate of return of 10% on the purchase consideration paid by it. Clause 8.5.2 gave Edelweiss the option to continue as a shareholder of appellant no.2 in which case it had the remedies available under the said clause.

7 Edelweiss, therefore, commenced arbitration proceedings and sought an Award for the following reliefs :

"(a) ordering and directing Respondent No.1 to re-purchase the shareholding of the Claimant in Respondent No.2 for a sum of Rs.22,00,00,000/- (Rupees twenty two crores), being an amount which would give the Claimant an internal return rate of 10% on the purchase consideration (i.e. Rs.20,00,00,000/-) paid by it under the SPA and further pay an amount of Rs.2,99,16,986.30 (Rupees two crores ninety nine lakhs sixteen thousand nine hundred eighty six and paise thirty) being interest on the said principal amount of Rs.22,00,00,000/- (Rupees twenty two crores) at the rate of 18% per annum from December 30, 2008 to September 30, 2009 together with further interest at the rate of 18% per annum from October 1, 2009 till payment and/or realization as per the particulars of claim being Exhibit "CC" hereto;

(b) In the alternatively to prayer (a) above the Respondents be ordered and directed to pay to the Claimant a sum of Rs.10,00,00,000/- (Rupees Ten Crores only) by way of damages or such other sum as may be determined as the damage/loss

caused to the Claimant by the Respondents by the Hon'ble Tribunal."

8 After hearing the parties, the Arbitral Tribunal raised 15 issues/points for determination, one of which only is relevant for the purpose of this appeal, i.e., *Whether the transactions under amended the SPA (as amended from time to time) are illegal or void or unenforceable as alleged in the Statement of Defence and Counter Claims*?

9 By Award dated 6th June 2013 the learned Sole Arbitrator, despite coming to the conclusion that Percept had breached their obligations under the SPA, rejected Edelweiss's claim on the ground that the transaction of share purchase option was illegal and/or unenforceable being in breach of SCRA.

10 On the issue of legality or enforceability of the transaction of repurchase contained in the SPA, the learned Arbitrator firstly held that clauses 8.5 and 8.5.1, which gave an option to Edelweiss to demand repurchase of its shareholding in appellant no.2 by appellant no.1, were illegal because they constituted a forward contract prohibited under Section 16 of SCRA read with the Circular dated 1st March 2000 of SEBI issued thereunder. The learned Arbitrator secondly held that these clauses were also illegal because they contained an option concerning a future purchase of shares and were, thus, a contract in derivatives and not being traded on a recognized stock exchange were illegal under Section 18A (incorrectly typed as Section 20) of SCRA. For these two reasons, the learned Arbitrator

had held clauses 8.5 and 8.5.1 of the SPA to be unenforceable.

11 The learned Single Judge by the order and judgment impugned in this appeal reversed the findings of the learned Arbitrator by holding that clauses 8.5 and 8.5.1 of the SPA were not illegal and were perfectly legal and there was no prohibition. The learned Single Judge also held that clauses 8.5 and 8.5.1 of the SPA cannot be said to be a contract in derivatives prohibited by Section 18A of SCRA.

12 The learned Single Judge held that the learned Arbitrator's views that the purchase option contained in clauses 8.5 and 8.5.1 was a forward contract and hence, illegal and unenforceable was an incorrect view. The learned Single Judge, relying on the judgment of the Apex Court in ***MCX Stock Exchange Ltd. V/s. SEBI***[2], held that there was no contract of sale or purchase of shares at a future date. The contract would come into being, if at all, at a future point of time, when two conditions are satisfied, viz., (a) failure of condition subsequent attributable to appellant no.1 and (b) exercise by Edelweiss of its option to require repurchase of shares by appellant no.1 upon such failure. It is only after Edelweiss exercises such option that the contract is complete. The learned Single Judge held, and in our view rightly so, that the learned Arbitrator misread the judgment of *MCX* (Supra) and the law as laid by *MCX* (Supra) makes it clear that the learned Arbitrator's view that the contract in the present case was a forward contract, is an incorrect view.

2. 2012 Scc Online Bom 397

13 On the attempt of Percept, relying upon Edelweiss's letter 30th December 2008, by which it exercised its option and required repurchase of shares by appellant no.1, to argue that even in such a situation, if we accept the view expressed by the learned Single Judge still that would mean that there was a postponement of purchase of shares even after exercise of the option by Edelweiss and coming into being of the contract of share purchase is not an acceptable view. The submission by Percept that Edelweiss invoking its right under clauses 8.5 and 8.5.1 by virtue of paragraph 6 of the said letter calling upon appellant no.1 to act on the clauses either with immediate effect or in any case before 12th January 2009 would mean that this exercise of option demands repurchase on or before a future date and hence, it is not a contract excepted by the circular of SEBI dated 1st March 2000 is also not correct. Mr. Pimple submitted that the Circular dated 1st March 2000 only permitted spot delivery of shares against payment of price and since there was a postponement of purchase of shares even after exercise of the option by Edelweiss and coming into being of the contract of share purchase, it falls foul with the circular and hence, it is illegal. We do not agree with Mr. Pimple. The learned Single Judge very correctly held that just because the original vendor of securities is given an option to complete repurchase of securities by a particular date, it cannot be said that the contract for repurchase is on any basis other than spot delivery. The relevant portion of letter dated 30th December 2008 read as under :

> *Subject : Invocation under Clause 8.5.1 of the Share Purchase Agreement dated December 8, 2007 entered into by and between Edelweiss Capital Limited (ECL), Percept Finserve Private Limited ("Promoter") and Percept Pictures Company Limited ("Company").*
>
> *xxxxxxxxxxxxxxx*
>
> *5. Since you have not fulfilled the condition subsequent stated above within the stipulated time period ECL is entitled to invoke its right under Clause 8.5 (more particularly under Clause 8.5.1) of the Percept SPA as amended by the Amendment Agreement which reads as follows:*
>
> > *"8.5. In the event of non-fulfillment of the first Condition Subsequent, the Investor shall have the right to:*
> >
> > *8.5.1. re-sell the Shares held by it to the Seller or its Affiliates and the Seller is bound to purchase the same, at a price which would give the Investor an internal rate of return of 10% on the Purchase Consideration."*
>
> *6. ECL hereby invokes its right as stated in the above mentioned Clause and calls upon you to give effect to the aforesaid with immediate effect and in any case before January 12, 2009.*
>
> (emphasis supplied)

14 Reading the above, there is nothing to indicate or suggest that there was any time lag between payment of price and delivery of shares or that the shares would be delivered first and the price demanded later or vice versa. Just because Percept was given an option to complete repurchase of securities with immediate effect and in any case before a future date, it cannot be said that the contract for repurchase is on any basis other than spot delivery.

15 Mr. Pimple submitted that clauses 8.5 and 8.5.1 were contracts in derivatives and hence, the clauses being in breach of Section 18A of SCRA was illegal and unenforceable. Mr. Pimple submitted that clauses 8.5 and 8.5.1 is a contract in derivatives and hence, the regulatory mechanism

as postulated under SCRA and the notifications issued thereunder would lead to a conclusion that these two clauses were invalid and illegal under SCRA. It was also submitted that it has been the fundamental policy of Indian law to prohibit all contracts in derivatives except those expressly permitted under the provisions of SCRA. An option agreement in derivatives as contained in clauses 8.5 and 8.5.1 violates the provisions of Section 18A and was prohibited. Mr. Pimple submitted that :

(a) when SCRA was enacted and brought into force with effect from 20th February 1957, Section 20 thereof contained an absolute prohibition on options in securities. The legislative intention was also clear from the preamble of SCRA which provided that this legislation was enacted to prevent undesirable transactions in securities by regulating the business of dealing therein, by prohibiting options and other matters connected therewith;

(b) thereafter, on 27th June 1969 the Government of India, through the Ministry of Finance, vide its Notification No.SO 2561, issued under Section 16 of SCRA, prohibited forward contracts and permitted contracts for the sale or purchase of securities, *inter alia* so long as such contracts qualified as spot delivery contracts;

(c) by virtue of the Securities Laws (Amendment) Act, 1995, with effect from 25th January 1995, Section 20 of SCRA containing the prohibition on options in securities, came to be deleted. Although Section 20 was deleted, the 1960 notification continued to be in force prohibiting

forward contracts and permitting only spot delivery contracts;

(d) by the Securities Laws (Amendment) Act 1999, with effect from 22nd February 2000, Section 18A was introduced in the SCRA to regulate derivative transactions in terms specifying that transactions in derivatives would be legal and valid, if the same were traded on a recognised stock exchange and settled on the clearing house of a recognised stock exchange. Also Section 2 (aa) as it then stood , came to be inserted in the SCRA incorporating a definition of the term derivative. A corresponding amendment was also made to Section 2 (h) which defined securities for the purposes of the SCRA to include derivative as constituting a security under the SCRA and;

(e) on 1st March 2000 SEBI, by its notification bearing reference No.SO 184 (E), issued under Section 16 of SCRA prohibited contracts for the sale or purchase of securities other than, spot delivery contracts or contracts for cash or hand delivery or contract in derivatives as is permissible under the SCRA. In terms of the said notification, for the purposes of the present case, it was relevant that only contracts for spot delivery and contracts in derivatives in accordance with Section 18 A of the SCRA were permitted;

(f) on 3rd October 2013 SEBI vide its notification bearing No.LAD -NRO/GN/2013-14/26/6667 ("2013 SEBI Notification) issued under Section 16 of SCRA *inter alia* rescinded the Notification dated 27th June 1969, and for the first time *inter alia* permitted contracts in

shareholders agreements or articles of association of companies, for purchase or sale of securities pursuant to the exercise of an option contained therein to buy or sell the securities, on the terms and conditions set out therein. The second proviso to the said notification provided that nothing contained in the said notification shall 'affect or validate' any contract which has been entered into prior to the date of the said notification. Also the explanation to the said notification clarified that the contracts in shareholders agreements or articles of association of a company shall be valid notwithstanding anything contained in Section 18A. This notification, therefore, leaves no room for doubt that option contracts as in the present case, entered prior to the date of the said notification attracted the rigors of Section 18A of SCRA and were prohibited under the provisions of SCRA. Also this notification repealed the SEBI notification dated 1st March 2000;

(g) clauses 8.5 and 8.5.1 being contract in derivatives attracted the rigors of Section 18A, viz., that such an option must be traded on a recognised stock exchange and settlement on the clearing house of the recognised stock exchange. The option derived its value from the underlying shares of appellant no.2 and, therefore, was a derivative. A derivative in the present case, being an option attached to the shares of an unlisted public company, was not permitted and would fall foul of the public policy under SCRA violative of Section 18A;

(h) *MCX* (Supra) is not applicable in the present case because in the said case the Court held that options come into existence upon the exercise thereof, however, the Court did not decide the question of legality of buyback arrangements pursuant to put option, *vis-a-vis*, the provisions of Section 18A and the same was kept open as it was not the ground taken by SEBI in the show cause notice; and

(i) clauses 8.5 and 8.5.1 are void part of the SPA and can be properly separated from the rest and the rest of the provisions of the SPA does not become invalid. Mr. Tamboly did not have any issue on this submission.

16 Mr. Tamboly submitted that :

(a) though the policy underlying Section 18A of SCRA was to stop speculation/speculative trading, clauses 8.5 and 8.5.1 can never result in speculation because it only gives a right to Edelweiss to exercise an option contained in a contract in shareholders agreements and the notification of 2013 also expressly clarifies that the same shall be valid notwithstanding anything contained in Section 18A;

(b) to say that clause 8.5 and 8.5.1 is a contract in derivatives, is *ex-facie* incorrect and can never be illegal under Section 18A of SCRA or the notification issued thereunder;

(c) options contract/contract in derivatives are totally different from the contract between two shareholders containing an option to buy or

sell the shares owned by them;

(d) Section 18A of SCRA deals only with contracts in derivatives, i.e., options contract, which can be traded, brought, sold and settled. Section 18A of SCRA would not have any applicability to a contract between two shareholders, which contains an option for sale or purchase of their own shares. This distinction between a contract in derivatives and a contract for sale or purchase of securities, pursuant to the exercise of an option contained in shareholders agreement, is also apparent from the Notification dated 3rd October 2013 issued under Section 16 and 28 of SCRA, which reads contracts in derivatives [covered by clause (b)] as distinct and different from a contract for sale or purchase of securities pursuant to the exercise of an option contained in a shareholders agreement, which is covered separately by clause (d) of the said notification; and

(e) As held in *MCX* (Supra) a contract giving an option to one of the parties to sell or purchase the securities was a mere privilege that may or may not be exercised and the same did not constitute a contract for sale of securities falling within SCRA. A contract for the sale of securities falling within SCRA would come into existence only pursuant to the exercise of the option. Accordingly, there was no question of the shareholders agreement containing the option to sell securities, falling within the purview of SCRA, or for such an option being illegal as constituting a forward contract. Clause 8.5 and 8.5.1 was not a contract for

the sale or purchase of securities falling within SCRA and thus there is no question of it being illegal under the notification issued under Section 16 of SCRA.

Mr. Tamboly also relied upon judgments of a learned Single Judge of this Court in ***Banyan Tree Growth Capital L.L.C. V/s. Axiom Cordages Limited and Ors.***[3] and a learned Single Judge of the Calcutta High Court in ***EIG (Mauritius) Limited V/s. McNally Bharat Engineering Company Limited***[4] to buttress his submissions.

17 Having heard the counsel and considering the Arbitrator's Award and the impugned judgment, we are of the view that appellants have not made out any case for interference. We totally agree with the view expressed by the learned Single Judge that the Arbitrator's conclusion that the purchase option contained in clauses 8.5 and 8.5.1 was illegal and unenforceable being a forward contract is an incorrect view. The judgment in *MCX* (Supra) squarely deals with a purchase option, such as the present, where the purchaser of securities requires the vendor to repurchase on the occurrence of a contingency. As held in *MCX* (Supra), a contract giving an option to a purchaser to require repurchase of securities by his vendor on some contingency occurring would only mean that there was no present obligation at all but the obligation arose by reason of some contingency occurring. On the date when the SPA was entered into, there was no contract for sale or purchase of shares under clauses 8.5 and 8.5.1. A

3. 2020 SCC Online Bom 781
4. 2021 SCC Online Cal 2915

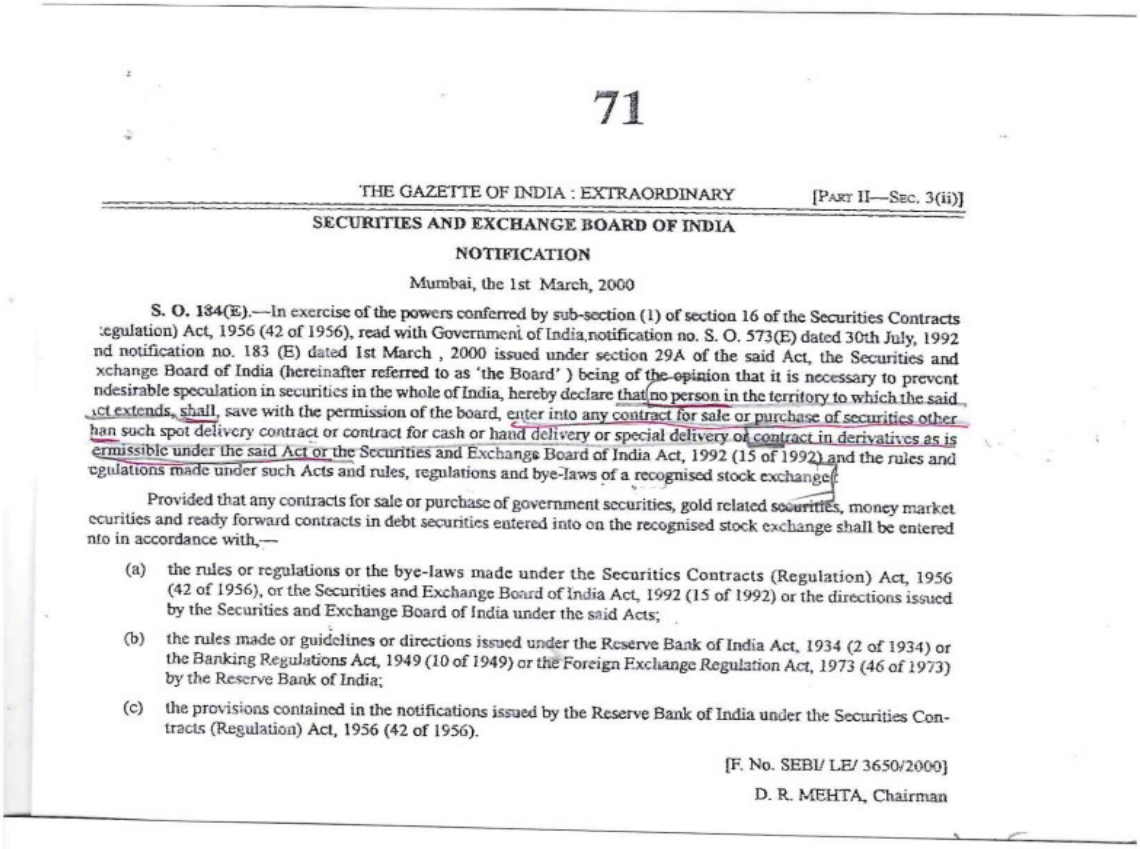
contract for sale or purchase of shares would come into being only at a future point of time in the eventuality of Edelweiss, which was granted such option, exercising it in future on the occurrence of a stipulated contingency. Clause 8.5 and 8.5.1 clearly indicates that there was no contract of sale or purchase of shares at a future date. The contract would come into being, if at all, at a future point of time, when two conditions are satisfied, viz., (i) failure of condition subsequent attributable to appellant no.1 and (ii) exercise by Edelweiss of its option to require repurchase of shares by appellant no.1 upon such failure. It is only after Edelweiss exercises such option that the contract is complete.

18 Section 18A of SCRA reads as under :

> *18A. Contracts in derivative - Notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are -*
>
> *(a) traded on a recognized stock exchange;*
>
> *(b) settled on the clearing house of the recognized stock exchange; or*
>
> *(c) between such parties and on such terms as the Central Government may, by notification in the Official Gazette, specify, in accordance with the rules and byelaws of such stock exchange.*

Section 18A of SCRA does not purport to invalidate any contract. It starts with a non-obstante clause, i.e., overriding effect over any other law for the time being in force. It provides that notwithstanding anything contained in any other law for the time being in force, the contracts in derivative shall be legal and valid, if such contracts satisfy the conditions mentioned therein. Section 18A of SCRA on its own does not

make any particular contract illegal or invalid. The circular of 1st March 2000 issued by SEBI has nothing to do with the contract such as the one we are concerned with. For ease of reference, the Circular dated 1st March 2000 is reproduced hereinbelow :



71

THE GAZETTE OF INDIA : EXTRAORDINARY [PART II—SEC. 3(ii)]

SECURITIES AND EXCHANGE BOARD OF INDIA

NOTIFICATION

Mumbai, the 1st March, 2000

S. O. 134(E).—In exercise of the powers conferred by sub-section (1) of section 16 of the Securities Contracts :egulation) Act, 1956 (42 of 1956), read with Government of India notification no. S. O. 573(E) dated 30th July, 1992 nd notification no. 183 (E) dated 1st March , 2000 issued under section 29A of the said Act, the Securities and xchange Board of India (hereinafter referred to as 'the Board') being of the opinion that it is necessary to prevent ndesirable speculation in securities in the whole of India, hereby declare that no person in the territory to which the said ict extends, shall, save with the permission of the board, enter into any contract for sale or purchase of securities other han such spot delivery contract or contract for cash or hand delivery or special delivery or contract in derivatives as is ermissible under the said Act or the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules and egulations made under such Acts and rules, regulations and bye-laws of a recognised stock exchange:

Provided that any contracts for sale or purchase of government securities, gold related securities, money market ecurities and ready forward contracts in debt securities entered into on the recognised stock exchange shall be entered nto in accordance with,—

(a) the rules or regulations or the bye-laws made under the Securities Contracts (Regulation) Act, 1956 (42 of 1956), or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or the directions issued by the Securities and Exchange Board of India under the said Acts;

(b) the rules made or guidelines or directions issued under the Reserve Bank of India Act, 1934 (2 of 1934) or the Banking Regulations Act, 1949 (10 of 1949) or the Foreign Exchange Regulation Act, 1973 (46 of 1973) by the Reserve Bank of India;

(c) the provisions contained in the notifications issued by the Reserve Bank of India under the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

[F. No. SEBI/ LE/ 3650/2000]

D. R. MEHTA, Chairman

19 The contract provided in clause 8.5 and 8.5.1 is no contract for sale or purchase of securities contemplated under the circular. The circular only prohibits forward contract for sale or purchase of securities because as noted earlier, the option contained in clauses 8.5 and 8.5.1 does not come within that prohibition, since it does not amount to a contract for sale or purchase of shares. At the cost of repetition, it would amount to contract of sale or purchase of shares only when Edelweiss would exercise such option upon happening of the two conditions subsequent. Moreover, the option contained in clauses 8.5 and 8.5.1 cannot be termed as a contract in derivative. Derivative is defined in clause (ac) of Section 2 of SCRA as under :

> *"2(ac) "derivative" includes -*
>
> *(A) a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security;*
>
> *(B) a contract which derives its value from the prices, or index of prices, of underlying securities;*
>
> *(C) commodity derivatives; and*
>
> *(D) such other instruments as may be declared by the Central Government to be derivatives."*

20 Mr. Pimple submitted, relying on ***Securities And Exchange Board of India V/s. Rakhi Trading Pvt. Ltd.***[5], that the contract in the present case contains a put option and is, thus, an option in securities contained in clause (d) of Section 2. It would not help Mr. Pimple's case because this put option in the present case may or may not be exercised by Edelweiss. As rightly held by the learned Single Judge, the real question is whether such

5. 2018 (13) SCC 753

option or its exercise is illegal. The Apex Court in *Rakhi Trading* (Supra) was explaining the meaning and content of the terms derivatives, futures, and options. Derivatives, as explained by the Apex Court, are a form of financial instruments which are traded in the securities market and whose values are derived from the value of the underlying variables like the share price of a particular scrip in the cash segment of the market or the stock index of a portfolio of stocks. Derivative trading is governed by Section 18A of SCRA. There are two types of derivative instruments, viz., futures and options. A future or future contract is an agreement between two parties to buy or sell an asset at a certain time in future at a price agreed upon on the date of the agreement. An option, on the other hand, is a contract between a buyer and his seller, which gives a right, but not an obligation, to buy or sell the underlying asset at a stated price on or before a specified date. What the buyer of an option buys is his right to exercise the option, often with a premium; his counter-party, who gives him such option, receives the option premium and in consideration thereof, is obliged to buy or sell the underlying asset against the option exercised by the buyer. Options are, as the Apex Court explained, either of call or put, call option giving the buyer a right to buy and put option giving him a right to sell, in both cases without an obligation, the underlying asset at a given price on or before a given date. Clauses 8.5 and 8.5.1 give Edelweiss the right, though not the obligation, to sell the shares purchased by it under the SPA to appellant no.1, its vendor, who is obliged to buy the same in case the right is

exercised by the former. What the law prohibits under Section 18A read with Section 16 read with the SEBI circular of 1st March 2000 is not entering into a call or a put option for sale but as rightly held by the learned Single Judge what it prohibits is trading or dealing in such option treating it as a security. This would mean that if clause 8.5 and 8.5.1 is considered to be a contract in derivatives as suggested by Mr. Pimple, the law prohibits trading or dealing in such contracts treating it as a security. Only when it is traded in or dealt with, it attracts the embargo of law as a derivative, i.e., a security derived from an underlying debt or equity instrument. As such derivative, no one can trade or deal in it or make a contract in respect thereof except on a recognized stock exchange or as settled on the clearing house of a recognized stock exchange or as between parties and on terms which the Central Government may specify, in accordance with the rules or bye-laws of such stock exchange, in keeping with the three categories referred to in clauses (a) to (c) of Section 18A. That is all that is meant by Section 18A read with clauses (ac) and (d) of Section 2 and Section 16 of SCRA read with the notification issued thereunder. Merely because the contract contains a put option in respect of securities, the contract cannot be termed as a trade or contract in derivatives. Simply making a put option concerning a security cannot be termed as illegal and that too under the provisions of Section 18A of SCRA. Clauses 8.5 and 8.5.1 are not contract for sale or purchase of securities, but merely an option which the promisee may or may not exercise and entering into such option does not amount to

making of a contract in a derivative. Such a contract was never prohibited.

21 In the circumstances, we do not see any reason to interfere. Appeal dismissed with costs, which we hereby fixed at Rs.5 lakhs. The cost to be paid by way of cheque drawn in favour of advocate on record for respondent within four weeks from today.

(RAJESH S. PATIL, J.) (K. R. SHRIRAM, J.)