

ADR ON DISPUTE BETWEEN A CLIENT AND TRADING MEMBER AT THE LEADING STOCK EXCHANGE IN INDIA: A CASE STUDY¹

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ABSTRACT

This case is an appeal matter with the Leading Stock Exchange of India Ltd (LSE) about a dispute between a client and a trading member of the LSE. The Appellant contended that the award passed by the arbitrator had not taken into account the evidence, documents and rules of stock exchange properly while determining the case matter and passed the award. Appellant challenged the award because the award was beyond the scope of submissions to the arbitration, non-application of mind, and ignorance of established judicial principles. The Appellate Member has to determine whether there had been any lapses on the part of the arbitration in applying the trading rules and procedures of the exchange while analyzing the matter, determining the case and passing the award. Based on that, the Appellant Arbitral Tribunal had to decide whether to set aside the award passed by the sole arbitrator, modify it, or uphold it. The findings and conclusions provide inputs for developing an appropriate regulatory framework for the Futures Market. However, the results may be generalized only in the emerging markets environment. Hence, researchers are suggested to study margin guidelines of the futures market, appreciate the dynamics of the futures market and apply the same in their future research in India and abroad.

Keywords: Arbitration, Stock Exchange, Trading Member, Client.

JEL Classification Codes: J52, G14.

INTRODUCTION

Concern with a complaint against Andhra Broking Ltd by Mr. K Narayana Reddy with Grievances Redressal Committee (GRC). The complainant's claim was admitted and passed an order directing the trading member, Andhra Broking Ltd, to pay INR.1.5 million against INR.1.6 million. Appellant realized that he earned his profit of INR 1.0 million through other trades which were not related/connected to the "Intraday Auto Square off Facility" trades. Hence, he referred the matter to Arbitration of the Leading Stock Exchange (LSE) by filing the Arbitration Application. Appellant

¹ This paper is based on an arbitration matter adjudicated by the author at the leading stock Exchange of India. Names of the client (Appellant), trading member (Respondent Exchange and figures were disguised to preserve confidentiality. The facts and circumstances remained the same to maintain the case matter's originality.

claims that he had earned a profit of INR one million independent of "Intraday Auto Square off Facility trades carried by him. A personal hearing for the matter was held on June 04, 2021, through Video Conference at Hyderabad. Appellant, Mr. Narayana Reddy (hereafter referred to as the Appellant) appeared himself, and Andhra Broking Limited (Hereinafter referred to as the "Respondent") was represented by Ms. Prema Agarwal, Vice President, Compliance and Legal, Andhra Broking Ltd. Both the parties presented their respective cases, and they declared that they had nothing more to submit. The Appellant was directed to submit the full details of his claim (details of trades and profits) credit balance of INR one million. The respondent was also allowed to reply in response to the Appellant's details and submissions. Appellant submitted full details of trades and profit of INR 1.0 million, and respondent submitted the response to the Appellant's trade and profit details.

STATEMENT OF CASE BY APPELLANT

2.1 Appellant submits that he did trading on January 28, 2020, through respondent Andhra Broking Ltd., by depositing INR 4.0 million. Appellant earned a profit of INR 1.0 million on the same day. He executed the Bank Nifty options 30200, Put Option on January 28, 2021, expiry. He bought 12000 units of Put Options at INR 311. Appellant submits that the respondent had activated his account for "Intraday Auto Square off Faculty." Hence, the positions of the Appellant would be squared off automatically by the respondent's end. But the respondent didn't square off the open positions as per terms of Intraday Auto Square off Faculty. The Appellant tried to exit at INR 265. but the respondent's system didn't allow him to do so. The response he got from the respondent's end was, "Please note the order must have been rejected as 80% square-off order was going to be triggered and the system doesn't allow to place the order at the same time." Appellant submits that he tried placing the order at INR 34.80/- and it was executed at 3:03 PM. As per their response, he would not place the order, which was not true in this case. "They had routed the order to exchange, but the order remained pending as no counterparty. All the orders placed are sent to the exchange in a queue, based on price, quantity and time priority. Even as the market price keeps fluctuating, orders are executed when the rates and quantity match, and the orders that don't match stand unexecuted and pending. All the orders that are unmatched automatically expire. However, if there is no counterparty, the order gets canceled post trading session." Appellant submits that he was treated badly by their customer support division whenever he called them. He pleaded with them to arrange a call with one of the senior executives, but they didn't arrange, and they eventually ended up saying, "within 10 min, he would get a call." Finally, he executed the order after the mark to market (MTM) margin exceeded 80% of the loss. His client code was activated for Intraday, "Auto Square off facility." When he raised the complaint to Andhra Broking Ltd., Respondent responded that the position was auto squared from their end. Further, they said that the order must have been rejected as an 80% square-off order was going to be triggered, and the system didn't allow the order at the same time.

Appellant submits that the Grievances Redressal Committee (GRC) observed and noticed that INR 1.0 million were excluded from the calculations of losses for quantifying the claim. But the respondent didn't return his profit, and further, there was a debit of INR. 0.78 million due to this trade. Appellant submitted on June 07, 2021, the full details of trades and profits of INR 1.0 million. Appellant also provided the total loss incurred on Intraday Auto Square off was INR 5.5 million and not INR 4.76 million as reported by the respondent. He further claims that the respondent miscalculated and misrepresented the actual loss on account of failure or not functioning of Intraday Auto Square off facility for 12000 units of Bank Nifty PE 30,200 Put Option. The details of profit of INR 1.0 million. All the trades are as per the contract note issued by the respondent to the Appellant for trades of January 28, 2021. Only total net loss for the day INR INR.4.76 million was reflected in the ledger copy against a total loss of INR 5.5 million. Appellant further claims INR 5 million towards compensation for mental harassment.

STATEMENT OF DÉFENSE BY RESPONDENT

Andhra Broking Ltd. is a member of the Leading Stock Exchange (LSE) Capital Market Segment, Futures & Options segments, and a SEBI registered stockbroker. The respondent offers online and offline broking services to its clients. Andhra Broking Ltd. also offers its clients Demat accounts and other financial services. The client is an online client. Online clients execute trades using their securely encrypted Password and user ID by placing trade orders over the internet from their own devices; computer, mobile, or iPad. The clients place orders using user ID and Password. The trading member permits a secure login to the clients to access the trading system of the respondent to place their orders. Provided the clients placing orders have sufficient margin in their accounts to carry out the transaction, the orders are transmitted on the order routing system of the exchange for execution of trades. The entire process is automated and does not involve any human intervention. The dispute relates to intraday trades placed by the Appellant for OPTIDX BANKNIFTY January 28, 2021, 30200.00 PE (Put Option) bought by the client on January 28, 2021; the Appellant reports the same in his Statement of Claim.

The Appellant (client) did intraday trading in the derivatives segment on January 28, 2021; the Appellant alleges that the trading member did not square off the disputed position at 80% losses of the margin money, and the Appellant finally closed the trade at losses which were more than 80%. The Appellant had raised this complaint to LSE for arbitration. Further, the respondent submits that Appellant created the debit balance of INR 4.76 million for all his trades for January 28, 2021. The margin report indicates the total available margin of Appellant on January 28, 2021, was INR 4.0 million. The amount mentioned in the contract note and the available margin were the basis for consideration by the GRC member to pay compensation. The Appellant had raised the same dispute with GRC for a hearing wherein the trading member expressly stated that square off is the privilege and not an obligation. All clients have to safeguard their positions and accordingly take required steps rather than waiting for a trading member to mitigate each client's risk. However, the trading member was ready to close the issue by settling the matter at an 80% loss of the total margin available. Accordingly, the Appellant had a total margin of INR 4.00 million, squaring off at 80% losses would have been at 3.1 million for the disputed position. The Appellant had claimed an amount of INR 1.6 million, including the entire debit amount, including the disputed trades done by the Appellant on the said date. The GRC panel member passed an Order directing the trading member to cover all the losses incurred by the Appellant on the said trading day. The GRC member completely ignored the fact that the client made multiple trades executed by the client without any intervention of the trading member or any issues faced by the Appellant in all such trades.

The Appellant (client) was active throughout the day, and almost all his positions were closed by the Appellant at his discretion. However, the GRC member calculated that all losses for that particular day were above 80% margin. Hence all the losses, including the positions the Appellant himself closed and incurred losses at whatever juncture, were all covered in the said calculations. This was almost the same amount covering all losses the Appellant had himself claimed too. The trading member finds that the order was a little unfair, as nowhere in the replies or oral submission did the trading member mention any technical glitch at its end. However, as a goodwill gesture to retain the client, the trading member honored the GRC order dated April 09, 2021, and made the said payments on April 15, 2021. Despite making payments and closing the claim with full and final settlement as per the GRC order, the Appellant has opted to raise the claim with an inflated amount. In GRC, the claim amount was INR 1.6 million, and the GRC member duly passed an order of INR 1.57 million, which was honored and paid to the Appellant. In this present Arbitration claim, the Appellant went ahead to try his luck and claim mental agony and harassment of INR 5.0 million. As far as the claim of mental harassment is concerned, the respondent refutes and denies the same and would like to update the Appellant that there is no provision in SEBI/ LSE regulations to claim for mental harassment or legal notice charges. The respondent humbly prays and requests the arbitrator dismiss the claim raised since the same issue has been duly dealt with to the utmost satisfaction. The Appellant has come back with the same issue with an inflated claim compared to the GRC claim and order thereon to derive undue advantage of the regulatory recovery system's available legal process and framework.

In response to the trade and profit details of the Appellant, the respondent responded that all profits and losses during the day were adjusted and the net amount payable or receivable stated in the contract note issued to any clients. The amount of INR 4.76 million indicated in the contract note for January 28, 2021, covers and adjusts all profit and losses made by the Appellant during the day. This amount of INR 4.76 million payable by the Appellant for losses during the day was considered as a base in the GRC meeting to compensate the client, hence on what basis the client intends to claim yet again profits of INR 1.0 million that the arbitrator be pleased to pass an order to dismiss the entire claim including mental harassment claim of the Appellant that the arbitration is pleased to direct the Appellant to pay further for the cost of the arbitration.

OBSERVATIONS OF GRC AND ITS PROCEEDINGS

From the documents and the oral submissions made by both parties, the following observations were made by the GRC Member. The client had a credit balance of INR. 4.0 million /- excluding the profit of INR. 1.0 million earned by the client on 28-Jan-2021. The client bought a position of Bank Nifty Options 30200 PE of 12000 quantity. On that day, there was huge volatility in the trading price of the put options. As a result, 80 percent of the MTM loss was triggered, i.e., at INR 3.2 million against the credit balance of INR. 4.0 million. The Put Option was placed under auto square off mode, and the client was not allowed to square off the position though the prices moved up sharply. Once the scrip comes under auto square off mode, the client is barred from trading. The trading member automatically squares the positions, or the system drives the trading. Accordingly, 80% of the client's credit balance works out to INR. 3.2 million based on which the client's open positions should have been squared off the moment mark to market (MTM) loss touches INR.3.19 million. In the given case, if the positions were squared off at 80% MTM loss, the client would lose INR. 3.2 million against which the positions were allowed to square off at MTM loss of INR. 4.76 million. This resulted in a loss of INR. 4.76 million as against INR.

3.2 million. There was no mistake on the part of the client. However, the trading member should have squared off the client's positions immediately on reaching the 80 percent MTM loss, which the respondent failed to exercise. The trading member neither scrupulously applied and executed the client's positions under the head of the auto square off mode immediately after reaching 80 percent mark to market (MTM) loss nor allowed the client to do so at the appropriate time. Further, trading members cited technical snags and glitches due to which the Auto Square off mode did not get activated. Because of the above observations, an order was passed that the complainant's claim for INR.1.57 million was allowed against the actual claim of INR. 1.6 million.

ANALYSIS, OBSERVATIONS, FINDINGS AND CONCLUSIONS

As per Appellant, the loss on account of the failure of the "Intraday Auto Square off Facility" is as follows. He bought Bank Nifty 30200 Put option of January 28th expiry of 12000 units at an average price of INR.311 and sold at an average price of INR.34. The actual total loss is INR.5.52 million, not 4.76 million as reported by the respondent. It means the total loss incurred by the Appellant due to the disputed trade was INR 5.5 million, but the respondent calculated and reported it as INR.4.76 million. Despite the respondent's repeated submissions and arguments, it is neither appropriate nor relevant. The GRC member noted and observed that the Put Options were placed under "Intraday Auto Square off mode" by the respondent, and the Appellant was not allowed to square off the position. Once the scrip comes under Auto Square off mode, the trading member automatically squares off the positions or drives the trading. GRC member also observed that the client had a credit balance of INR 4.0 million, excluding the profit of INR. 1.0 million was earned by the client on January 28, 2021. GRC member calculated the loss on account of failure or non-functioning of auto square off facility as INR

4.76 million based on client's ledger copy instead of based on the difference between the purchase price and sale price and multiplied quantity. However, GRC Members recognized and identified the profit of INR 1.0 and excluded the same from the calculation of loss and admission of the claim. Therefore, the profit of INR 1.0 million earned by the Appellant is independent of the disputed trade losses. It is neither correct nor fair in clubbing this profit with the loss of disputed trade. The respondent could not justify denying the trades carried by the Appellant and profits earned by the Appellant as per contract note for January 28, 2021, in its additional submissions dated June 14, 2021.

AWARD

Because of the previous submissions, hearings, and documents of both parties, and based on Appellant arbitrator observations, findings and conclusions, the profit INR 1.0 million, which was earned by the Appellant independent of disputed trade, has to be paid by the Respondent, Andhra Broking Ltd to the Appellant. The Appellant also claimed INR 5 million/- damages towards compensation for mental harassment. This arbitration is not an appropriate forum to assess, evaluate and consider the compensation for physical and mental harassment and agony. The Appellant is free to approach the competent courts for said compensation and damages from the respondent. Accordingly, the arbitrator passed an award on June 15, 2021, directing the Respondent, Andhra Broking Ltd, to pay INR 1.0 million (Rupees one million only) to the Appellant, Mr. K Narayana Reddy and parties were asked to bear their costs.

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CONFLICT OF INTEREST STATEMENT

The author declares that he has no competing interests.

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