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Indian Court Sets Aside SEBI's First Use of New Power of Imprisonment

By Arjun Gupta, Sahil Kanuga and Vyapak Desai, of Nishith Desai Associates, Mumbai.

The Bombay High Court ("Court"), in the case of *Vinod Hingorani v The Securities and Exchange Board of India* (Writ Petition No. 639 of 2015), on March 10, 2015, in very clear terms expounded upon the new powers of arrest and detention of a recovery officer of the Securities and Exchange Board of India ("SEBI") under the provisions of the SEBI Act, 1992 ("SEBI Act") read with the Income Tax Act, 1961 ("Income Tax Act").

The Court set aside the December 18, 2014, order of a recovery officer of SEBI committing an individual defaulter, Mr. Vinod Hingorani ("Petitioner"), to civil imprisonment for a period of six months or until the dues are paid, for defaulting on payment of a monetary penalty imposed on him by SEBI in the past (*see report by Aditya Shukla, Sahil Kanuga and Vyapak Desai, of Nishith Desai Associates, Mumbai, at WSLR, February 2015, page 35*).

The Petitioner challenged SEBI's order before the Bombay High Court.

Contentions

The Petitioner contended that the order of the recovery officer was illegal for want of compliance with prerequisites stipulated under Rule 73 of Part V of Schedule II of the Income Tax Act. The Petitioner also argued that the recovery officer had not recorded in

writing the reasons for satisfaction pertaining to compliance with the prerequisites. The Petitioner submitted that the order of detention was arbitrary and illegal and was in violation of the principles of natural justice.

SEBI argued that the writ was not maintainable, as the Petitioner had an alternate remedy in approaching the Securities Appellate Tribunal.

Defending the order, SEBI argued that several opportunities had been granted to the defaulter to pay his dues, which remained outstanding, and the Petitioner had not challenged the order of the penalty, which had attained finality. SEBI was unable to trace any substantial sum of money belonging to the Petitioner, and so the situation necessitated the exercise of its recently introduced powers of arrest and detention.

Judgment

Alternate Efficacious Remedy

The Court, relying on *State of H.P. and Ors. v Gujarat Ambuja Cement Ltd. and Anr.* (AIR 2005 SC 39362), observed that it was a well settled principle of law that the existence of an alternate remedy would not serve as an absolute bar for not exercising writ jurisdiction.

Relying on a host of judgments passed by the Supreme Court, the Court observed that, even if an alternate

remedy exists, a writ petition can be entertained in the following circumstances:

- if there has been a violation of natural justice;
- if a procedure required for a decision has not been adopted;
- if there has been an infringement of fundamental rights;
- if the orders or proceedings are wholly without jurisdiction;
- if the *vires* of an act is challenged; or
- if it can be shown that forcing the petitioner to adopt other procedures would result in palpable injustice.

The Court went on to hold that the writ was maintainable, as the Petitioner had alleged that he had been detained in an arbitrary and illegal manner without due process having been followed, which was a violation of his fundamental rights.

Power of Arrest and Detention

The Court observed that the Petitioner had failed to challenge the order of the adjudicating authority of SEBI levying a penalty on the Petitioner for an amount of some INR 11 million (approximately U.S.\$175,000). This had prompted SEBI to initiate recovery proceedings under Section 28A of the SEBI Act, wherein the recovery officer of SEBI has the power to order the arrest of a person when he fails to pay a penalty imposed by an adjudicating officer.

The Court, agreeing with the contentions of the Petitioner, observed that a recovery officer has to resort to the mode of arrest and detention as prescribed in the Income Tax Act. The Court stated that Rule 73 confers the power of arrest and detention only in two situations: 1) when the defaulter transfers property with the object and intention of obstructing the execution of a certificate of demand issued on him; and 2) when, despite having the means, the defaulter refuses or neglects to pay the dues. Further, Rule 73 also makes it mandatory for the recovery officer to record in writing the reasons for his satisfaction with regard to compliance with the prerequisites.

In the instant case, the recovery officer had failed to record, in writing, the reasons for satisfaction with regard to the existence of the two aforementioned situations under Rule 73. The recovery officer had failed to provide the Petitioner a reasonable opportunity to defend himself as stipulated under Rule 74, which was in violation of the principles of natural justice. The Court observed that the recovery officer could not have ordered the arrest or detention of the Petitioner solely on the ground that he was unable to pay the amount or give a proposal for repayment. Relying on the judgment of the

Supreme Court in *Jolly George Vargese v Bank of Cochin* (AIR 1980 470), the Court held that mere non-payment of dues does not amount to neglect or refusal to pay. The operative condition would be the failure to take steps to pay an amount due in spite of having the capacity to do so.

The Court concluded by stating that the order of arrest without due process having been followed was sheer abuse of power and was arbitrary and illegal.

The Court ordered the release of the Petitioner and remitted the matter back to the recovery officer, with directions to decide it afresh in accordance with the provisions of law.

Analysis

The newfound power of SEBI to order the arrest and detention of a defaulter is a drastic step that should be invoked only when due process has been followed and the prerequisites of passing such an order have been strictly complied with. The recovery officer should record the reasons for satisfaction in writing while passing such an order; these are checks and balances which are required in order to provide a defaulter a fair opportunity of defense.

The power to order arrest and detention of a defaulter was introduced in order to provide SEBI with additional investigative and sanctioning powers and to enable SEBI to fulfill its role and purpose as an effective securities market regulator. In recent times, there have been several enactments which provide for the imposition of criminal liability. These enactments have conferred the power of adjudication and the imposition of liability on quasi-judicial bodies.

The decision of the Court is welcome and is a step in the right direction. It will work to keep a check on compliance with the due process of law before resorting to imprison/detain an alleged offender.

Interestingly, the Court has remitted the matter back to the tax recovery officer for a fresh hearing in a time-bound manner. The Court also considered the apprehension that the Petitioner was a flight risk by ordering that the Petitioner would not leave India during the pendency of proceedings before the tax recovery officer, and that the economic offenses wing would not return the Petitioner's passport during the pendency of proceedings before the tax recovery officer.

The text of the Bombay High Court's judgment is available at <http://op.bna.com/wslr:nsf/r?Open=besi-9v6ral>.

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