

# Dispute Resolution Hotline

August 07, 2013

## SEBI COMMANDS INCREASED AUTHORITY

On July 18, 2013 the President of India promulgated the Securities Laws (Amendment) Ordinance, 2013 ("Ordinance") amending the Securities Exchange Board of India Act, 1992 ("SEBI Act"), Depositories Act, 1996 and Securities Contracts (Regulation) Act, 1956 ("SCRA") (collectively, the "Acts"). The ordinance, in essence, is aimed at providing greater power and authority to the Securities Exchange Board of India ("SEBI") to deal with securities law violations and to protect investor interests. The capital markets watchdog now has wide ranging powers for conducting an inquiry or investigation, settling disputes, enforcing its directions etc. The Ordinance amends the Acts to grant wider powers to SEBI in terms of the investment schemes it can monitor and regulate as also the steps which SEBI may undertake in regard to such collective investment schemes. Following is a brief on few critical changes which have been brought about by the Ordinance.

## KEY AMENDMENTS IN THE ACTS AS UNDER THE ORDINANCE

### 1. Investigative Powers

#### Previous Provision

Section 11(2): Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for:

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(ia) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;

Section 11C(8): Where in the course of investigation, the Investigating Authority has reasonable ground to believe that the books, registers, other documents and record of, person or enterprise, as the case may be, to whom a or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such books, registers, other documents and record.

#### Amended Provision after the Ordinance

Section 11(2): Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for:

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(ia) calling for information and records from any person including any bank or any other authority or board or corporation established or constituted by or under any Central or State Act which, in the opinion of the Board, shall be relevant to any investigation or inquiry by the Board in respect of any transaction in securities;

Section 11C(8) Where in the course of an investigation, the Investigating Authority has reason to believe that any person or enterprise, as the case may be, to whom a notice under subsection (3) has been issued or might be issued, or relating to, any intermediary or any person associated with securities market in any manner, may be destroyed, mutilated, altered, falsified or secreted, the Investigating Authority may make an application to the Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such books, registers, other documents and record.

(a) has omitted or failed to provide the information or produce documents as required in the notice; or

(b) would not provide the information or produce documents which shall be useful for, or relevant to, the investigation; or

(c) would destroy, mutilate, alter, falsify or secrete the information or documents useful for, or relevant to, the investigation,

then, the Chairman may, after being satisfied that it is necessary to do so, authorise the Investigating Authority or any other officer of the Board (the officer so authorised in all cases being hereinafter referred to as the authorised officer), to-

(i) enter and search, with such assistance, as may be required, the building, place, vessel, vehicle or aircraft where such information or documents are expected or believed to be kept;

(ii) break open the lock of any door, box, locker, safe almirah or other receptacle for exercising the powers conferred by sub-clause (i), where the keys thereof are not available;

(iii) search any person who has got out of, or is about to get into, or is in, the building, place, vessel, vehicle or aircraft, if the authorised officer has reason to suspect that such person has secreted about his person any such books of account or other documents;

(iv) require any person who is found to be in possession or control of any books of account or other documents,

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maintained in the form of electronic record, to provide the authorised officer the necessary facility to inspect such books of account or other documents.

Explanation.- For the purposes of this sub-clause, the expression "electronic record" shall have the meaning assigned to it in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000.

(v) seize any such books of account or other documents found as a result of such search;

(vi) place marks of identification on any books of account or other documents or make or cause to be made extracts or copies therefrom;

(vii) record on oath the statement of any person who is found to be in possession or in control of the information or documents referred to in sub-clauses (i), (iii) and (iv)."

Analysis

Owing to the aforementioned changes in the SEBI Act, the investigative powers of SEBI have been broadened manifolds. SEBI's power to call for information is now not limited to banks / corporations / other authorities and to that extent SEBI can ask any person to provide information in regard to any transaction under inquiry.

Further, SEBI's power of investigation is now independent from any initial judicial check. Against the previous requirement of making prior application to the Judicial Magistrate in cases where investigation was deemed necessary, it is the Chairman of SEBI who now has the power to authorize the investigating authority to undertake the necessary action, thereby doing away with the initial judicial scrutiny.

Also, by means of a new provision, Section 11(2)(ib), being inserted in the SEBI Act, SEBI now enjoys the power to call for or provide information to any authority in India or outside, which has functions similar to SEBI. This specific amendment has been brought into effect retrospectively i.e. from March 6, 1998, which is the same date on which SEBI and Securities and Exchange Commission of United States signed the Memorandum of Understanding for cooperating and sharing information for enforcing U.S. and Indian securities laws.<sup>1</sup>

2. Collective Investment Schemes

Previous Provision	Amended Provision after the Ordinance
Section 11AA: (1) Any scheme or arrangement which satisfies the conditions referred to in subsection (2) shall be a collective investment scheme.	Section 11AA: (1) Any scheme or arrangement which satisfies the conditions referred to in subsection (2) or sub-section (2A) shall be a collective investment scheme.  Provided that any pooling of funds under any scheme or arrangement, which is not registered with the Board or is not covered under sub-section (3), involving a corpus amount of one hundred crore rupees or more shall be deemed to be a collective investment scheme.
Section 11AA (2) Any scheme or arrangement made or offered by any company under which,---	Section 11AA (2) Any scheme or arrangement made or offered by any person under which,---
***	***  (2A) Any scheme or arrangement made or offered by any person satisfying the conditions as may be specified in accordance with the regulations made under this Act.

Analysis

The Ordinance has enlarged the scope and kind of entities which would be covered under the definition of "Collective Investment Scheme" ("**CIS**") as defined under Section 11AA of the SEBI Act, 2002. The effect of the amendment inter alia is that any pooling of funds under any scheme or arrangement, even if such scheme is not registered with SEBI, in so far as it has a corpus amount of one hundred crore rupees or more shall be considered a CIS (unless the same has been specifically excluded from the regulatory purview under clause 3 of Section 11AA of the SEBI Act).

In recent past, SEBI had received complaints and grievances from investors in relation to certain entities who were pooling funds but had not registered themselves as a CIS with SEBI. In one such case<sup>2</sup> the steps undertaken and the oversight and control exercised by SEBI for the protection of the investors over the investment schemes were resisted by the opposite party on the ground that the scheme in question was not covered under the definition of '**CIS**' under Section 11AA of the SEBI Act. Thus, by virtue of the amendment the definition of CIS has now been expanded with the aim of curbing any such objections from parties that contend that a particular fund raising activity does not fall within the purview of CIS.<sup>3</sup> However, the amendment is not clarificatory in nature and to that extent keeping in view the intent behind such change in the definition of CIS, it may now well be argued that all such fund raising activities undertaken prior to the Ordinance were not covered by the definition of CIS as per previous provisions.

3. Special Courts

The Ordinance has brought about an important amendment in the dispute resolution mechanism under the Acts. The newly inserted Sections 26A, 26B, 26C, 26D and 26E of the SEBI Act, provide for establishment of special courts for speedy trial of offences under the Acts. Similar provisions have also been inserted in the SCRA Act and the Depositories Act. The provisions of the Code of Criminal Procedure, 1973 would be applicable to the proceedings of these special courts unless otherwise stated in the Acts.

#### 4. Disgorgement

##### Previous Provision

Section 11B. Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary,-

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it may issue such directions,-

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##### Amended Provision after the Ordinance

Section 11B. Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary,-

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it may issue such directions,-

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Explanation.-For the removal of doubts, it is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

#### Analysis

The addition of the explanation to Section 11B of the SEBI Act clarifying that SEBI has and should be deemed to always have had the power to pass disgorgement orders spells positive news for persons who have suffered financial losses owing to offences committed by persons in violation of securities laws. In commercial terms, disgorgement is the forced giving up of profits obtained by illegal or unethical acts. It is a repayment of ill-gotten gains that is imposed on wrongdoers by the courts.<sup>4</sup>

The power of SEBI to issue disgorgement orders has been questioned in the past on the ground that the SEBI Act does not expressly confer this power on SEBI.<sup>5</sup> This clarificatory amendment, which has been inserted in all the three Acts, thus clears the position and empowers SEBI to pass disgorgement orders.

#### 5. Settlement Proceedings

The Ordinance amends the SEBI Act (and the other two Acts) to insert the following new section:

"Section 15JB. (1) Notwithstanding anything contained in any other law for the time being in force, any person, against whom any proceedings have been initiated or may be initiated under section 11, section 11B, section 11D, sub-section (3) of section 12 or section 15-I, may file an application in writing to the Board proposing for settlement of the proceedings initiated or to be initiated for the alleged defaults.

(2) The Board may, after taking into consideration the nature, gravity and impact of defaults, agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by the Board in accordance with the regulations made under this Act.

(3) The settlement proceedings under this section shall be conducted in accordance with the procedure specified in the regulations made under this Act.

(4) No appeal shall lie under section 15T against any order passed by the Board or adjudicating officer, as the case may be, under this section."

#### Analysis

Thus, the amended Acts provide for settlement of the proceedings initiated or to be initiated for alleged defaults by a person upon application to SEBI by such person. However, the process and manner in which the settlement applications and proceedings are to be handled have largely been left to the discretion of SEBI. Highly subjective yardsticks, such as nature, gravity and impact of defaults, have been laid down for the same.

An interesting observation in this regard is that the new provision has been deemed to be effective from April 20, 2007, which happens to be the date on which SEBI had issued Guidelines for Consent Orders and for considering requests for composition of offences under the Acts ("**Guidelines**") These Guidelines had later been amended by SEBI's circular dated May 25, 2012<sup>7</sup> by means of which consent orders were to be issued based on objective criteria as regards the kinds of cases which could be considered for consent orders and the process for determining and imposing a penalty. Thus, the amended Guidelines were instrumental in improving transparency and reducing discretion of SEBI in passing consent order.<sup>8</sup> However, the application of the new provisions relating to settlement proceedings has the effect of undoing the checks placed by the aforementioned Guidelines.

Thus, it would now have to be seen whether the securities market regulator would frame similar regulations under sub-section (2) of Section 15JB to provide for guidelines in accordance with which the matters may be settled. This is essential from the perspective of persons availing the benefit of the provisions as they would require clarity to a certain extent to understand the quantum of amount they may be required to pay or the nature of terms they would be subject to as part of the settlement. Without such clarity the aim with which such provisions have been inserted may not be achieved.

It would also be apt to note over here that the new section specifically denies any right of appeal to the Securities Appellate Tribunal to the applicant against the order of SEBI in the settlement proceedings, which further mandates for stipulation of more objective criteria's and transparent procedure in regard passing of such settlement orders.

#### 6. Enforcement

The Ordinance puts in place new provisions in the Acts whereby if a person fails to pay the penalty imposed by the adjudicating officer or fails to comply with any direction of SEBI, including any direction of disgorgement, then the recovery officer will have the power to undertake the following steps:

- (a) attachment and sale of the person's movable property;
- (b) attachment of the person's bank accounts;
- (c) attachment and sale of the person's immovable property;
- (d) arrest of the person and his detention in prison;
- (e) appointing a receiver for the management of the person's movable and immovable properties

### Analysis

It is observed that the Ordinance has given SEBI not only sweeping powers to investigate but also teeth giving it powers of enforcement, a power which was not vested in SEBI earlier. The aforementioned powers of enforcement seem to be all encompassing and they are further streamlined by the detailed procedure and provisions for enforcement which are listed under the aforementioned sections of the Income Tax Act, 1961

### CONCLUSION / ANALYSIS

In conclusion it may be stated that the Securities Laws (Amendment) Ordinance, 2013 brings about important and also positive amendments to the Securities Exchange Board of India Act, 1992, the Depositories Act, 1996 and the Securities Contracts (Regulation) Act, 1956. The amendments confer upon SEBI wide powers to be able to monitor the implementation of the securities laws and to curb the offences thereunder. To ensure the success of these amendments it is necessary that SEBI use its newly conferred powers of investigation, issuing of disgorgement orders, acceptance of settlement applications and enforcement judiciously.

To view the Securities Laws (Amendment) Ordinance, 2013 please click [here](#).

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<sup>1</sup> <http://www.sec.gov/news/digest/1998/dig030698.pdf>

<sup>2</sup> *Alchemist Infra Realty Limited & Anr. v. The State of Jharkhand & Others*, W.P. (C) No. 1195 of 2013 and W.P. (C) No. 1198 of 2013

<sup>3</sup> Press release dated July 18, 2013, Press Information Bureau, Government of India (available at: [http://www.finmin.nic.in/press\\_room/2013/ordinance\\_securitiesLaw\\_SEBI.pdf](http://www.finmin.nic.in/press_room/2013/ordinance_securitiesLaw_SEBI.pdf))

<sup>4</sup> *Kavy Stock Broking Ltd. v. Securities and Exchange Board of India*, [2008] 84 SCL 208 (SAT)

<sup>5</sup> *Dushyant N. Dalal and Ms. Puloma D. Dalal v. Securities and Exchange Board of India*, MANU/SB/0112/2010"

<sup>6</sup> SEBI Circular No. EFD/ED/Cir-1/2007 (April 20, 2007) (available at: <http://www.sebi.gov.in/circulars/2007/CirEFD2007001.pdf>)

<sup>7</sup> SEBI Circular No. CIR/EFD/1/2012 (May 25, 2012) (available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1337946507938.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1337946507938.pdf))

<sup>8</sup> Nishith Desai Associates Hotline '*Indian Capital Market Regulator Amends Consent Order Circular: Scope Significantly Reduced*' dated May 31, 2012 maybe referred to for more details (available at: <https://nishithdesai.com/SectionCategory/33/Corpsec-Hotline/12/55/CorpsecHotline/5581/1.html>)

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