

# Regulatory Hotline

September 09, 2014

## CHANGING REGULATORY LANDSCAPE

- RIL appeal against SEBI's order dismissed on grounds that appeal from consent order cannot lie in view of retrospective application of the Securities and Exchange Board of India (Settlement of Administrative and Civil Proceedings) Regulations, 2014
- Rejection of consent application of Reliance by SEBI bad in law as arbitrary and unreasonable
- Due process of law must be followed and principle of natural justice must be adhered to.
- 15 consent applications rejected.

## INTRODUCTION

On June 30, 2014, the Securities Appellate Tribunal ("SAT") in the case of Reliance Industries Limited ("RIL/Appellant") vs. Securities and Exchange Board of India ("SEBI")<sup>1</sup> dismissed the appeal filed by RIL, challenging the rejection of the consent application in view of the change in legal scenario. SEBI through its latest amendment of Settlement of Administrative and Civil Proceedings) Regulations, 2014 ("Settlement Regulations") has made consent orders,- ex-parte or otherwise, non-appealable. Interestingly SAT dealing with issues of procedural law and requirement to follow due process in statutory proceedings held that SEBI Order rejecting the consent application as per the consent circular dated May 25, 2012 ("Consent Circular") without affording an opportunity of hearing was arbitrary and unreasonable.

## FACTS

On April 29, 2009, Securities and Exchange Board of India ("SEBI") issued a show cause notice to the Appellant alleging that the Appellant in connivance with other entities related/connected to it took short positions in the Future and Options ("F&O") Segment of the National Stock Exchange of India Ltd. ("NSE") in the scrip of RPL. SEBI had alleged that prior to RIL's merger with Reliance Petroleum Limited ("RPL"), RIL had short-sold its stake of approx.20 crore shares in RPL to prevent a slump in stock in the F & O segment and thus, had contravened the provisions of SEBI Act, 1992 ("Act"), the Securities Contracts Regulation Act, 1956 and the SEBI (contravention of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 ("FUTP Regulations"). RIL had filed an application for the dispute to be resolved by way of a consensual settlement and further sought an inspection of documents which were relied upon and referred to by SEBI. The Appellant is alleged to have made an illegal gain of INR 513.12 crores on the short positions.

## BRIEF TIMELINE OF PROCEEDINGS BEFORE SEBI

Date	Event
April 29, 2009	SEBI issued Show-Cause Notice to Appellant
October 12, 2009	Appellant sought inspection of documents referred to in the Show Cause Notice dated April 29, 2009
November 05, 2009	Consent application was filed by the Appellant
March 08, 2010	Consent application rejected by SEBI
December 16, 2010	Fresh Show Cause Notice issued
December 28, 2010	Appellant sought inspection of documents referred to in Show Cause Notice dated December 16, 2010 and raised preliminary objections against issuance of Show-Cause Notice
April 26, 2011	Consent application filed by the Appellant
December 07, 2011	SEBI informed the Appellant that request for inspection not tenable
November 02, 2012	SEBI furnished notings relating to reinvestigation and declined to give inspection of documents to the Appellant
November 2012	Appeal No. 224 of 2012 filed by the Appellant before SAT challenging SEBI's decision of refusing to give inspection of documents
November 21-23, 2012 & November 27, 2012	SEBI gave inspection of documents and supplied photocopies of documents running into 1300 pages

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December 2012	Adjournment sought by Appellant before SEBI Internal Committee (“IC”); matter transferred to High Powered Advisory Committee (“HPAC”)
December 21, 2012	HPAC in view of the seriousness of the matter recommended that case may not be settled in view of the Consent Circular
December 31, 2012	HPAC recommendations approved by Whole-Time Member of SEBI
January 02, 2013	Order by SEBI
January, 2013	Appeal against SEBI Order filed by the Appellant
December 20, 2013	Appeal No. 224 of 2012 disposed of wherein SEBI agreed to furnish copy of documents demanded by the Appellant
January 06, 2014	Final arguments for Appeal
June 20, 2014	Written Submissions filed by SEBI stating that appeal is not maintainable

## ISSUES

The issue arising for consideration in the present case does not pertain to substantive law related to FUTP Regulations, but mainly deals with two procedural aspects of law:-

- Whether SEBI was justified in rejecting the consent application filed by the Appellant as per the Consent Circular?
- Whether appeal against an order rejecting consent application for a dispute which is non-consentable under Consent Circular issued by SEBI, is maintainable in view of the recent amendment<sup>2</sup> to SEBI Act, 1992 made with retrospective effect?

## ARGUMENTS

The Appellant contended that the SEBI Order was passed arbitrarily, capriciously and in disregard of the due process of law and therefore, was a nullity. Typically, there is a specific procedure for adjudicating consent applications which must be followed which involves –

- processing the consent application by the IC, which is then presented to the HPAC for its consideration;
- if the HPAC agrees with the consent terms or agrees with the modification, then the same is put for consideration before the WTM Panel of SEBI; and
- the WTM Panel considers the facts and circumstances of the case and gravity of charges and then passes a suitable order either accepting or refusing to consider the case under consent process.

It was submitted that due to failure on part of SEBI to give full and complete inspection of all documents, the Appellant was deprived of an opportunity of being heard before the IC/HPAC/WTM. The Consent Circular stipulated three levels of proceedings which were carried out separately at different stages before different fora viz., IC, HPAC and lastly, WTM of SEBI. Thus, at no stage can this mechanism could be subverted. The Consent Circular does not permit settlement in cases of certain serious defaults such as insider trading etc., however SEBI has the inherent power, if the facts of the case permit, to proceed to settle even cases of serious defaults set out in the Consent Circular.

SEBI contended that rejection of consent application did not affect the substantive right of the Appellant. Further, no appeal would lie before SAT against any order passed by SEBI under consent proceedings, in light of introduction of Section 15 JB (4) read with Section 30 A of the SEBI Act, 1992 by way of the Settlement Regulations, therefore the appeal was not maintainable.

It was further submitted that various opportunities were given to the Appellant to appear before the IC. Not only was the demand for inspection misplaced in the consent proceedings, the documents requested for were not wholly relevant. The consent application was rejected since it did not satisfy the requirements of the Consent Circular. It was further submitted relying on the Supreme Court judgment of *Shilpa Stock Broker Pvt. Ltd. vs. SEBI*.<sup>3</sup> that the Appellant cannot compel SEBI to settle the dispute as the Appellant did not have a vested right to insist that the dispute should be resolved by way of consensual settlement since the right to file a consent application does not imply that the consent application has to be accepted Further, the Appellant was not justified in contending that the impugned order was in violation of the principles of natural justice as that the Appellant had suffered no real and significant loss or prejudice due to the SEBI Order. Further, the Appellant had specifically given an undertaking in the consent application to waive its right of appeal/review before SAT/Courts.

## DECISION AND ANALYSIS

Without expressing any opinion on the merits of the consent application filed by RIL, SAT held that keeping the consent application pending for years even after holding that request for inspection of documents is untenable was unjustified and led to stalling the entire proceedings. SEBI took nearly three years to investigate/re-investigate the matter and more than two years to give inspection of all documents to the Appellant. SEBI gave inspection of documents in instalments and disposed the consent application even before completing the inspection process thereby, not giving reasonable time to the Appellant to go through the voluminous documents furnished. Thus, it was held that an ex-parte order passed in breach of the principles of natural justice led to great prejudice to the Appellant and amounted to miscarriage of justice. The Respondent decided the consent application in haste and failed to exercise due caution necessary for adjudicating such matters.

However, on the question of maintainability of the appeal against the SEBI Order, it was observed that the erstwhile Section 15T (2) of the Act barred appeals against orders passed with the consent of parties i.e. the bar was restricted to an order passed on merits of the consent application. An ex-parte order could still be challenged as per the erstwhile Section 15T (2) of the Act. However, with the amendment of 2014 in Settlement Regulation, Section 15T (2) of the Act was omitted and Section 15 JB was inserted in its place with retrospective effect from April 20, 2007. Section 15 JB of the Act now expressly bars appeals against any order passed by SEBI in settlement proceedings. Thus, in light of the position of law as it stands today, the appeal was dismissed.

The consent mechanism was introduced by SEBI to ensure speedy disposal of cases; promote orderly and healthy growth of the securities market and to protect the rights of the investors. Consent mechanism refers to settlement of a case dealing with alleged contravention of securities laws by paying a mutually agreed penalty to SEBI without any admission or denial of guilt. In India, the consent mechanism is modelled along the lines of the U.S. Securities Exchange Commission's settlement mechanism. On January 9, 2014, with a view to tighten the settlement norms in India, SEBI revamped the entire framework of settlement through consent orders by introduction of the Settlement Regulations. It is due to the retrospective applicability of the Settlement Regulation; the appeal filed by RIL against SEBI was dismissed by SAT, even when in SAT's opinion the order passed by SEBI was bad in law. Due to the introduction of the new retrospective law, the number of settlements by way of consent orders has gone down significantly. About fourteen consent applications have been rejected so far in 2014 as they were not found to be in consonance with the Consent Circular and the Regulations. Nonetheless, SAT, in its Order, has reinstated that due process of law must be followed in case of regulatory action of any nature. It must be appreciated that Tribunals/Courts are slowly recognizing the fact that regulators cannot subvert due process of law and act capriciously.

Interestingly, the debate about the legal sanctity of such consent orders was renewed yet again since the Settlement Regulations absolutely bar any appeal against such consent orders, irrespective of whether such a consent application was considered on merits or not. The SAT Order only reflects that orders passed by SEBI in consent proceedings cannot be called into question.

– **Tanya Pahwa, Payel Chatterjee & Pratibha Jain**

You can direct your queries or comments to the authors

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<sup>1</sup> Appeal No. 1 of 2013

<sup>2</sup> Section 15 JB (4) was inserted to the SEBI Act, 1992 by Ordinance No. 2 of 2014

<sup>3</sup> 2012 (3) ALL MR 908

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