

# Dispute Resolution Hotline

December 29, 2014

## IN A FIRST, SEBI IMPOSES CRIMINAL SANCTION EXERCISING NEW-FOUND STATUTORY POWERS

- SEBI exercises new powers to arrest and commit an individual defaulter to imprisonment;
- The recourse to imprisonment exercised over other measures;
- Exposes the critical need to have guidelines on use of such power by the Recovery Officer.

The Securities and Exchange Board of India (“SEBI”), in a recent order<sup>1</sup> committed an individual defaulter, Mr. Vinod Hingorani, to civil imprisonment for a period of six months or until the dues are paid, for defaulting on payment of monetary penalty imposed on him by SEBI in the past. The said individual was a non-executive chairman of Adam Comsof Limited and Kolar Biotech Limited. SEBI exercised this authority under Rule 77 of Part V of Schedule II of the Income Tax Act, 1961 read with the newly added Section 28A of the SEBI Act, 1992. This is one of the first cases wherein SEBI has exercised its new found statutory powers to arrest a person and impose civil imprisonment.

### BACKGROUND

Section 28A of the SEBI Act was introduced by way of the Securities Laws (Amendment) Act, 2014 (“SLAA”) retrospectively with effect from July 18, 2013<sup>2</sup>. The SLAA was introduced in the backdrop of the shortcomings in the law identified during the recent investigations involving collective investment schemes. The SLAA was aimed at providing SEBI with additional investigative and sanctioning powers to enable SEBI to fulfill its role and purpose as an effective securities market regulator. Under Section 28A, where a person has failed to, *inter alia*, pay the penalty and/or comply with any directions of the board, the board may recover the proceeds from that person by one or more of the following modes: (a) attachment and sale of 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; and/or (e) appointing a receiver for the management of the person’s movable and immovable properties.

### FACTS OF THE INSTANT CASE

The instant case involved an individual on whom SEBI had imposed multiple penalties in April and June, 2010 for an aggregate amount of about INR 11 million (approximately USD 175,000), for carrying on fraudulent activities in the securities market. These orders became final. SEBI also raised several Notices of Demand in July 2014 for an aggregate amount of about INR 16 million (approximately USD 260,000) alongwith interest and expenses, to be paid within 15 days from the date of receipt of such notice. The defaulter failed to pay the penalty or respond to the notices of demand, pursuant to which the defaulter was directed to appear in person before the Recovery Officer. Since the defaulter did not respond to the notice, a notice under Rule 73 of Part I of Schedule II read with Section 222(1)(c) of the Income Tax Act, 1961 and Section 28A of the SEBI Act, 1992, was issued, calling on the defaulter to appear before the Recovery Officer, to show cause as to why he should not be committed to civil prison.

At the hearing, the defaulter failed to furnish any substantial proposal for payment of the dues except stating that he was not responsible for any activity for which the penalty was levied. Accordingly, the Recovery Officer initially detained the defaulter and directed him to provide a proposal for repayment of dues. Since the defaulter did not come up with a proposal for repayment of dues, the Recovery Officer directed the arrest and committal of the defaulter to civil imprisonment for a period of six months under Rule 77 of Part V of Schedule II of the Income Tax Act, 1961 read with Section 28A of the SEBI Act, 1992.

### ANALYSIS

It is interesting to note that amongst other Indian regulators, similar powers are exercised only by the Tax Recovery Officer under the Income Tax Act, 1961, and adjudicating authority under the Foreign Exchange Management Act, 1999. The Competition Commission of India (CCI) also initially had similar powers to order detention of a defaulter in civil prison; however, pursuant to an amendment made in the year 2007, the said power was vested with a judicial authority.

The objective of introducing Section 28A by way of SLAA was to enable and empower SEBI to recover its dues in an efficient and expedient manner. The objective of introducing the provision was to empower SEBI *inter alia*, to attach and sell movable and immovable property of the defaulters without recourse to any court of law and attach bank accounts of defaulters. While the intention of the legislature when giving an executive body like SEBI such powers is understandable, it is upto the executive body to exercise such powers with great responsibility and judiciously. This also becomes critical when similar power may not be enjoyed by regulators in other jurisdictions such as for e.g. the United States Securities and Exchange Commission (SEC).

In the instant case, from the order it appears that such power was exercised in preference to other measures like

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attachment of movable / immovable property which was the primary motivation to introduce the provision. It certainly gives a glimpse on the manner in which SEBI may elect to exercise its new-found powers going forward. The SLAA has enabled SEBI to order arrests even in cases where an arrest could have been avoided and other recourses such as attachment of movable / immovable property could have been explored.

The instant case may act as an inappropriate precedent for future action by SEBI. The power to arrest and restrict personal liberty is a significant power and should be exercised with great caution and restraint, by a primarily executive body such as SEBI, only after exhausting all other available options. SEBI should establish clear guidelines as to how and when such measures should be exercised. Additionally, the process of appointment of the Recovery Officer, who exercises such powers, should be done in such a manner in order to ensure that only senior officers with exposure and training in the judicial process are appointed as Recovery Officers. This will ensure maintenance of the procedural integrity of the proceedings and the confidence of the market participants in the regulator will be further strengthened.

– Aditya Shukla, Sahil Kanuga & Vyapak Desai

You can direct your queries or comments to the authors

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<sup>1</sup> In the matter of Adam Comsof and Kolar Biotech Limited, SEBI Order No. RO/012/2014 (December 18, 2014), *available at*: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1418898173309.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1418898173309.pdf)

<sup>2</sup> *Available at*: <http://www.finmin.nic.in/law/The%20Securities%20Laws%20Amendment%20Act%202014.pdf>

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