

POWER OF SEBI TO ADJUDICATE

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ABSTRACT

The role of a regulatory body for securities market in a country is determined by the stage of development of securities market in the country. In the Indian context, having regard to the emerging nature of the market, the regulatory body must necessarily have the twin role of development and regulations. Regulatory and development functions are strongly interlinked and have the same objectives in the long run, and very often, rapid and healthy development is an outcome of well-regulated structures.

In India, there have been several regulators that have been set up, the more prominent of which have been SEBI (securities markets), TRAI (telecom) and CERC (energy). Of these, SEBI was among the first, and has been seen to be one of the more effective in terms of delivering on a mandate that includes (a) protection of the investor, (b) prudential regulation of securities markets intermediaries and (c) development of the markets.

KEYWORDS: SEBI, TRAI, CERC, REGULATION, SECURITIES

INTRODUCTION

The role of a regulatory body for securities market in a country is determined by the stage of development of securities market in the country. In the Indian context, having regard to the emerging nature of the market, the regulatory body must necessarily have the twin role of development and regulations. Regulatory and development functions are strongly interlinked and have the same objectives in the long run, and very often, rapid and healthy development is an outcome of well-regulated structures.¹

¹ www.lawyerclubindia.com

In India, there have been several regulators that have been set up, the more prominent of which have been SEBI (securities markets), TRAI (telecom) and CERC (energy). Of these, SEBI was among the first, and has been seen to be one of the more effective in terms of delivering on a mandate that includes (a) protection of the investor, (b) prudential regulation of securities markets intermediaries and (c) development of the markets.²

In order to implement the mandate, the legal foundations to create regulators must have broad enabling legislation. The legislation gives the regulator powers to issue regulations for the sector, and to supervise based on the regulation. But most importantly, the regulator must be empowered to conduct investigation of misdemeanors, adjudicate and have the authority to impose fines and other penalties if wrong-doing is established. Lastly, the credibility of the regulatory process of the regulator is enforced when there are in place appeals processes by courts that have specialized domain knowledge to review regulatory action (which, in the case of the SEBI and securities markets, is the Securities Appellate Tribunals or SAT).³

The twin role of **Securities and Exchange Board of India (SEBI)** has accordingly been enshrined in the preamble⁴ of the very Act of 1992. The regulatory measures taken by SEBI therefore would always be subservient to the needs of regulatory measures taken by SEBI therefore would be subservient to the needs of market development and enough to enforce the required degree of discipline and foster high standards of fairness and integrity of the market and thereby protect the interest of investors. SEBI's efforts would always be to create an effective surveillance mechanism for the securities market, and encourage responsible and accountable autonomy on the part of all players in the market, who should discipline themselves and observe the rules of the game. In accomplishing its objectives, SEBI would be responsive to the needs of the three groups which

²available at: www.legalindia.in

³ibid

⁴ The preamble states: "An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto."

basically constitute the market: (i) the investors, (ii) the issuers of securities, and (iii) the market intermediaries.⁵

The SEBI has stood tall on the test of time while in the governance and regulation of the Securities market in India. Apart from the exclusive powers given to SEBI under the SEBI Act, 1992 and Depositories Act, 1996, SEBI also exercises most of the powers concurrently with the Central Government under the Securities Contracts (Regulations) Act, 1956.⁶

Chapter VI A and VI B were inserted in the SEBI Act, 1992 by the amendment Act 9 of 1995, thereby empowering SEBI with the adjudicatory powers. The SEBI under Section 15I can appoint any its officers as the adjudication officer, for the purpose of holding inquiry and imposing penalties of the erring persons. The adjudicating officer so appointed by SEBI shall not be below the rank of a division chief.⁷

Under the SEBI Act, all the rules are framed by the Central Government, as well as the rules are administered only by the Central Government along with Securities Appellate Tribunal (SAT). SEBI has a limited jurisdiction only upto the violation of SEBI Act and regulations, orders or directions issued under the Act. Under the current rule, the adjudicating officer is appointed by SEBI in order to adjudicate over the various cases of failure by persons to comply with the law. The adjudicating officer thereby has the power to impose penalties as per the Act.⁸

APPOINTMENT OF ADJUDICATING OFFICER

The first statutory regulatory body that the government of India set up post the reforms of 1991 was the Securities and Exchanges Board of India (SEBI).⁹ As a regulator for the securities markets, SEBI was given the powers to create subordinate legislation and to investigate wrong-doing and impose relevant penalties.¹⁰

⁵Sekhar K., SEBI Capital Issues, Debentures & Listing, (3rd Ed. 2003), Lexis Nexis, Wadhwa & Co. Nagpur, Page No. 214

⁶Supra Note 8

⁷Supra Note 5

⁸ibid

⁹ Section- 151, SEBI Act, 1992

¹⁰ www.caclub.in

SEBI does not have a cadre of adjudicating/enquiry officers. Instead, SEBI is known to appoint officers from the operational department to function as enquiry/adjudicating officers. The powers of the enquiry officer are wide ranging. For example, they can recommend cancellation of certification of registration of an intermediary and impose fines as mentioned in Section 3.4.2. It is therefore desirable that separate independent cadre of officers could be appointed for exercising such quasi-judicial powers. The officers should be well trained in the principles of law as well as being experts only in the securities market. The knowledge of administrative law, the constitution, specific relief acts are a few examples of the law which a enquiry or adjudicating officer has to possess. They should be readily able to access information of the decisions of the Supreme Court not only on securities market but also on the enquiry process. This coupled with structured annual refresher courses will enable SEBI to ensure a high level of delivery of justice.¹¹

Under Securities Contract (Regulation) Act, 1956: 23-I. (1) For the purpose of adjudging under sections 23A, 23B, 23C, 23D, 23E, 23F, 23G and 23H, the Securities and Exchange Board of India shall appoint any officer not below the rank of a Division Chief of the Securities and Exchange Board of India to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty.¹²

POWERS OF THE ADJUDICATING OFFICER

Section 15I(2) of the SEBI Act, 1992 says that while holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.¹³

¹¹ Supra Note 13

¹² ibid

¹³ www.encyclopedia.com

Section 23I(2) of Securities Contracts (Regulations) Act, 1956 says that while holding an inquiry, the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document, which in the opinion of the adjudicating officer, may be useful for or relevant to the subject-matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections specified in sub-section (1), he may impose such penalty as he thinks fit in accordance with the provisions of any of those sections.¹⁴

Therefore, we can sum-up the following as the powers that can be exercised by the adjudicating officer¹⁵:

1. Holding an inquiry.
2. Imposing penalty.
3. Power to summon.
4. Power to enforce the attendance of any person acquainted with the facts.¹⁶

JURISDICTION OF THE ADJUDICATING OFFICER

The procedure followed for issuing directions under Section 11 and 11(B) of the SEBI Act, 1992, passing punitive orders against an intermediary, and imposing monetary penalty are different under the Act. Three different procedures are prescribed under the Act, rules and regulations when taking disciplinary proceedings. This often becomes a cause for confusion to investors and notices as to what procedure which will be followed by SEBI to pass orders under the SEBI Act, 1992.¹⁷

For example, when enquiry proceedings are initiated and an enquiry officer is appointed, the notices are not aware that the enquiry officer is only a fact finding authority and will only recommend the penalty. Or that the final orders will be passed by the WTM only after issuing a second show-cause notice which offers an opportunity of hearing. While for the purpose of issuing directions under Sec 11 or Sec 11B, there is an only one stage proceeding wherein the WTM is a fact finding authority

¹⁴Supra Note 16

¹⁵KR Chandrate, Company Secretarial Practice Manual, Lexis Nexis Butterworths Wadhwa, Nagpur, (2nd ed, 2008)

¹⁶ibid

¹⁷ibid

and also the final authority issuing directions like directing the notice not to access the securities market, not to buy or sell any securities, etc.¹⁸

Under the provisions of *SEBI Act, 1992* and the *Securities Contract (Regulation) Act, 1956*, following matters can be summed up over which the adjudicating officer exercises his jurisdiction can take necessary actions including the imposition of fine¹⁹:

1. Failure to furnish information, documents, returns, etc. - *Section 15A of SEBI Act, 1992* and *Section 23A of SC(Regulation) Act, 1956*.
2. Failure of a recognized Stock Exchange to furnish periodical returns with the SEBI - *Section 23G of SC(Regulation) Act, 1956*
3. Failure of a registered intermediary or any person to enter into contracts with its clients – *Section 15B of SEBI Act, 1992* and *Section 23B of SC(Regulation) Act, 1956*.
4. Failure of a registered intermediary, broker to redress the grievances of the investors – *Section 15C of SEBI Act, 1992* and *Section 23C of SC(Regulation) Act, 1956*.
5. Defaults connected with the carrying on of any collective scheme or mutual fund – *Section 15D of SEBI Act, 1992* and *Section 23E of SC(Regulation) Act, 1956*.
6. Failure of an asset management company to comply with the rules and regulations – *Section 15E of SEBI Act, 1992*.
7. Failure of Stock Brokers to comply with the rules and regulations – *Section 15F of SEBI Act, 1992*.
8. Failure of brokers or sub-brokers to segregate securities or moneys of the clients - *Section 23D of SC(Regulation) Act, 1956*
9. Persons engaged in insider trading – *Section 15G of SEBI Act, 1992*.
10. Non-disclosure of acquisition of shares and take-over – *Section 15H of SEBI Act, 1992*.
11. Fraudulent and unfair trade practices – *Section 15HA of SEBI Act, 1992*.
12. Any contravention where no penalty has been specified – *Section 15HB of SEBI Act, 1992* and *Section 23H of SC(Regulation) Act, 1956*.

¹⁸available at: www.academia.edu

¹⁹Supra Note 21

13. Excess dematerialization of securities of an unlisted company by an issuer - and *Section 23F of SC(Regulation) Act, 1956*.²⁰

Procedures followed by the adjudicating officers

While conducting enquiries and adjudication, the enquiry officers and the adjudication officers do not follow uniform procedure. While the enquiry officers and adjudicating officers have a discretion regarding the conclusions to be arrived at, the procedure adopted should be uniform irrespective of the officer who is conducting the enquiry or adjudication. It is desirable that when discretion and powers are given to an inquiry/adjudicating officer, these are not exercised in a dis-similar fashion.²¹ There may be a lack of commonness in their approach or different standards adopted by different officers deciding on similar questions. This may lead to inconsistent decisions creating dissatisfactions in the mind of the public. It therefore becomes necessary to evolve a mechanism by which the vagaries of the decision making by the adjudicating/enquiry officer is reduced and that the element of certainty in the decisions is introduced so that their decisions become more objective fair and consistent.²²

ADJUDICATION IN CASE OF INSIDER TRADING

A person is prohibited by Section 12A of the SEBI Act, 1992 to deal in securities while in possession of material or 'non-public information'. While, if an insider deals in securities on the basis of any unpublished price sensitive information, he can be adjudicated by the adjudicating officer under Section 15G4 of the Act. So there is always a problem of interpretation in this case, because Section 12A is using the word 'non-public information', while Section 15G is using the word 'un-published information'. There will be a question as to what is the difference between the words 'non-public information' and 'un-published information'. It is, therefore, proposed to harmonize the language of both the sections by replacing the words *non-public information* with the words *unpublished price sensitive information* and replacing the words *on the basis of* with the words *while in possession of*.²³

²⁰Ibid

²¹Supra Note 21

²²www.iosco.org

²³www.sebi.gov.in/boardmeetings/124/SecuritiesLaw.pdf.

Some Important Cases:

In Re Sun Infoways Limited²⁴the said appeal was filed by Mrs. Sadhana Nabera against the order dated November 6, 2006 passed by the Adjudicating Officer, SEBI. The Adjudicating Officer in his order inter alia found Mrs. Sadhana Nabera guilty of insider trading and had levied Rs.5 lakhs penalty on her. While allowing the said appeal, the Hon'ble SAT observed, "We are of the considerate opinion that Nabera as an auditor could not be expected, much less reasonably, to have access to the information of merger of Zap with the company which was a policy decision In view of the above, we are of the view that Nabera had no concern with the information pertaining to the merger of Zap with the company nor was it a part of his duty to have access to such information while performing his duties. No company would allow such sensitive information to reach the auditor till it has been made public."²⁵

Kedar Nath Agarwal v Securities and Exchange Board of India²⁶the allegation that the stock broker had failed to prescribe the code of internal procedures and conduct for the prevention of insider trading; the Enquiry Officer observed that no specific instance has been pointed out where the stock broker or any of its associated entities had traded as an "insider" after having access to any price sensitive information. Though, the Enquiry Officer had not viewed this as a serious issue, the tribunal was of the view that the same is not in accordance with the provisions of Regulation 12 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992. The stock broker, being an intermediary recognized as such under Section 12 of the SEBI Act, and is very much active in the securities market, needs to comply with the aforesaid provision.²⁷

In Re : L & T Finance Holdings Limited²⁸, in the instant case, the contention of the noticee that the price sensitive information of impending OFS of LTFH was known to world at large on March 13, 2014 when the noticee had traded in the derivatives of LTFH, the tribunal noted that in terms of regulation 2(1)(k) of the SEBI (Prohibition of Insider Trading) Regulations, 1992 said price sensitive

²⁴ 2009 Indlaw SEBI 169

²⁵ www.legalserviceindia.com

²⁶ 2009 Indlaw SEBI 161

²⁷ Supra Note 30

²⁸ 2014 Indlaw SEBI 130

information remained unpublished till the same was disclosed on the stock exchange on March 13, 2014 after the close of the market hours. Admittedly, the noticee had traded in the derivatives of LTFH prior to such publication of the price sensitive information.²⁹

Furthermore, it was recorded that question that remains to be determined is as to whether, in the facts and circumstances of this case, the noticee can be said to be in possession of the said UPSI when it created such position.³⁰

The tribunal noted that the noticee was involved as a potential investor in the market gauging exercise undertaken by CS (prior to March 13, 2014). It is undisputed fact that, during the market gauging exercise by the CS with regard to the OFS of the LTFH, the noticee had been contacted by CS team as a prospective investor. This strengthens the prima facie finding that the noticee was in possession of unpublished price sensitive information about the discounted floor price of impending OFS of LTFH. Even if CS did not undertake any "wall-crossing" exercise, as contended by the noticee, it cannot be said that that the noticee was not in possession of this unpublished price sensitive information while it traded in the securities of LTFH.³¹

PENALTY ON THE ADJUDICATION

A penalty of a specific amount is provided under the SEBI Act on the adjudication for a particular violation of law. For example, under section 15A of the SEBI Act, 1992, if a person, who is required under the Act to furnish any document, fails to do so, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.³²

It shows that the adjudicating officer is under an obligation to impose the penalty. While Section 15J of the SEBI makes the provision for taking into account various factors by the adjudicating officer

²⁹Dr NV Paranjape, Company Law, Central Law Agency, Allahabad (5th ed)

³⁰ ibid

³¹Andrew Hicks & SH Goo, Cases & Materials on Company Law, 6th ed, Oxford University Press, 2008

³²www.sebi.gov.in/boardmeetings/124/SecuritiesLaw.pdf

while determining the quantum of penalty to be imposed over the defaulter, it makes both the provisions to be inconsistent with each other.³³

Therefore, it can be advocated here to make provisions so as to enable SEBI to expressly impose penalty up to the maximum permitted limit under the Act. The factors like the current value of money, value of transaction in the market, etc. can also be taken under account while imposing the penalty.³⁴

Section 15HB, which was inserted by SEBI (Amendment) Act, 2002, deals with the cases with regard to which no specific penalty has been provided in the Act. If any person is found to be in failure to comply with any provision of the Act, rules or regulations or directions of SEBI, for which no specific penalty has been mentioned in the Act, can be penalized under Section 15HB of the SEBI Act.³⁵

The quantum of penalty is to be fixed with due regard to (1) the amount of disproportionate gain or unfair advantage made as a result of the default, (2) the amount of loss caused to an investor/group of investors as a result of the default and (3) the repetitive nature of the default.³⁶

ADJUDICATION IN CASE OF PROVIDING FALSE INFORMATION

It is very well established within Section 15A, that where a person is required to furnish certain information or to submit certain documents to the SEBI, can be fined by the adjudicating officer if he fails to comply with the requirements within the certain time limit. But the question may arise that if

³³Supra Note 36

³⁴ibid

³⁵ 15HB. Penalty for contravention where no separate penalty has been provided.-

Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.

³⁶ www.citeman.com/3417-power-of-sebi-to-impose-penalties

a person submits the required documents and information with the SEBI and the information are found to be allegedly false or misleading, and then can that person be fined by the adjudicating.³⁷

In which provision of the SEBI does the power of the adjudicating officer to fine such person lies? Because Section 15A merely says that the person shall be bound to submit the required documents and information, but there is no specific provision saying that the information so provided shall not be false or misleading. As a result, the adjudicating officer seems to lack power to impose penalty on the basis of false or misleading information. Section 15A merely deals with certain failures related to providing the information and it difficult to interpret it in such a manner as to bring false and misleading information within its ambit.³⁸

The problem can be evidenced by an October, 2005 incident where some proceedings were initiated by SEBI against CMS Info tech and Silicon Infotech, the adjudicating officer of the SEBI himself admitted that he lacked power to penalize a person on the basis of providing false or misleading information, as there is no specific provision in the SEBI Act, 1992 to that effect.

This case again gave way to increase more powers to SEBI, particularly to meet the like situations. SEBI established a group of experts under the chairmanship of former Chief Justice MH Kania, which recommended furthering empowering SEBI for such situations. The group also held that the adjudicating officer under current provisions of the SEBI Act, 1992 lacked adequate powers for tackling with such a situation.

A. Chandra Sekhar Rao, Sebi-appointed Adjudicating Officer, in his order said, "I conclude that law does not permit me to adjudicate and impose penalty in cases where the information furnished by a person is allegedly false and misleading."³⁹

APPELLATE TRIBUNAL

³⁷ www.acga-asia.org/public/files/Kania_rep_032005

³⁸ ibid

³⁹ www.financialexpress.com

Chapter VI B of the SEBI Act, 1992 deals with the establishment, jurisdiction, authority and the procedure of appellate tribunal. Appellate tribunals, better known as the Securities Appellate Tribunals are appointed by the Central Government through a notification, under Section 15K of the SEBI Act, 1932. It is established particularly with a view to hear appeals on the orders passed under securities laws and various statutes in respect of participants and intermediaries by regulators like SEBI, PFRDA, IRDA and other regulatory authorities, dealing with the financial markets.

Any senior official of the SEBI holding a post equivalent to the post of Executive Director in the Board shall not be eligible to be appointed as a member of the Securities Appellate Tribunal, under Section 15M(2) of the SEBI Act, 1992.

Section 24A of the SEBI Act, 1992 was inserted by the SEBI (Amendment) Act, 2002. It provides that if the offence is punishable with imprisonment only or with both fine and imprisonment, it cannot be compounded in any condition by the Securities Appellate Tribunal. Otherwise all the other offences may be compounded by the Securities Appellate Tribunal or by a court before which such proceedings are pending.

SPEEDING UP THE PROCESS OF ENFORCEMENT

It should be remembered that under SEBI Act, Section 15I provides for the appointment of an adjudicating officer for the purpose of adjudicating functions. SEBI Act also says about appointing the inquiry officers in order to conduct various inquiries and recommend suspension or cancellation of registration of an intermediary to SEBI. SEBI passes its order on the basis of that inquiry report received from the inquiry officer. The orders of both the SEBI and the adjudicating officer can be challenged before the Securities Appellate Authority. But after judgment in the matter of Mathew Easo,⁴⁰ it was felt wise that both the adjudicating powers and the inquiry powers should be integrated in one and same should be conferred on a single authority.⁴¹

⁴⁰ www.sebi.gov.in/adjorder/mathewresearch.pdf

⁴¹ibid

The main problem felt in the current arrangement of having power to inquire and power to adjudicate in different persons is with the delay in execution and many a times it becomes even impossible to pass an order to the effect. For example, if in a particular case the inquiry officer finds that merely imposition of fine would suffice the cause, he cannot pass an order because he doesn't have the power to charge any fine or penalty under the current arrangement. Similarly, if in a particular case before the adjudicating officer, it is felt appropriate to warrant suspension or cancellation of registration, no order can be passed by him because under the current laws he doesn't have any power to this effect.

Even the market regulator SEBI has also come up with the same proposal of bringing changes in such a way as to have a single officer to carry on both the functions of holding inquiry and adjudication, along with the power to impose penalties, suspension and cancellation of licenses and registrations guilt of doing manipulation in the market. All this has been proposed with a view to make efficient and speedy enforcement of laws and regulations. The amendments are proposed to be made in the Securities Contracts Act, SEBI Act and the Depositories Act. It is expected that the new arrangement would speed up the tackling with the matter and there will always be remedy for taking recourse to the SEBI if the companies or complainants are not satisfied with the judgment.⁴²

CONCLUSION

The SEBI has been operating now as the securities markets regulator for a decade and a half, and has appeared to have done a commendable task in upholding the mandate it was charged with, in a period of high growth and reasonably heightened levels of economic volatility. The principles based on which the entity was created has stood it in good stead. Some of these principles include a clarity on the mandate it was to deliver on, non-interference from the government, statutory powers to issue subordinate legislation which can be notified expeditiously to accommodate the rapid changes that takes place in the equities markets in India and the powers to enforce the regulatory mandate.

⁴² www.financialexpress.com/news/sebi-for-more-power-to-fix-price-rigging/478925

The credibility of SEBI as a regulator also appears to have been facilitated hugely by the creation of specialized courts with specialized domain knowledge that can rapidly review regulatory actions. In the process of ensuring that the markets develop in such a way that the objective of securities markets continue to be met, the legal processes at SEBI have also continued to evolve along the lines of higher levels of transparency of processes, clarity of actions and credibility of legal action.

In order that the regulator continues to evolve and bridge any gaps between current process and what the principles driving a good regulatory functioning would suggest, we suggest that SEBI continues to fine-tune the legal processes, particularly in enforcement, to achieve better levels of clarity on regulation and the legal process.

