

(2011) 07 DEL CK 0382
In the Delhi High Court
Case No : LPA 507 of 2009

Chanchal Jain

APPELLANT

Vs

Securities Exchange Board of India and Others

RESPONDENT

Date of Decision : 22-07-2011

Acts Referred:

Securities and Exchange Board of India Act, 1992 — Section 11, 11(1), 11(2), 11(2A), 11(3)

Citation : (2012) 109 CLA 108 : (2012) 173 CompCas 414 : (2012) 2 CompLJ 256 : (2011) 125 DRJ 475 : (2011) 108 SCL 643

Hon'ble Judges : Sunil Gaur, J;Pradeep Nandrajog, J

Bench : Division Bench

Advocate : Vikramjit Banerjee and P.S. Sudheer, for the Appellant; Parag P. Tripathi, A.S.G., Neeraj Malhotra, S. Mukherjee and Shadan Farasat, for R-1, for the Respondent

Final Decision : Dismissed

Judgement

Pradeep Nandrajog, J.—The Petitioners, all of whom are distributors and sell mutual funds to investors have challenged the judgment and order dated 24.7.2009 passed by the learned Single Judge, dismissing WP(C) No. 10390/2009, in which petition the challenge was to a policy circular laying down guidelines; being the circular dated 30.6.2009.

2. Relevant portion of the circular which was challenged reads as under:

(a) There shall be No. entry load for all mutual fund schemes.

(b) The scheme application forms shall carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor.

(c) Of the exit load or CDSC charged to the investor, a maximum of 1% of the redemption proceeds shall be maintained in a separate account which can be

used by the AMC to pay commissions to the distributor and to take care of other marketing and selling expenses. Any balance shall be credited to the scheme immediately.

(d) The distributors should disclose all the commissions (in the form of trail commission or any other mode) payable to them for the different competing schemes of various mutual funds from amongst which the scheme is being recommended to the investor.

3. Challenge to the circular was on the ground that SEBI did not have any power to issue such kind of circulars i.e. that the subject matter of the circular was beyond the powers vested in SEBI.

4. The plea has been negated by the learned Trial Judge with reference to the powers conferred upon SEBI vide Section 11 of the Securities Exchange Board of India Act 1992, which section reads as under:

11 (1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

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

(a) regulating the business in stock exchanges and any other securities markets;

(b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(ba) registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification specify in this behalf;]

(c) registering and regulating the working of [venture capital funds, and collective investment schemes, including mutual funds;

(d) promoting and regulating self-regulatory organizations;

(e) prohibiting fraudulent and unfair trade practices relating to securities markets;

(f) promoting investors' education and training of intermediaries of securities markets;

(g) prohibiting insider trading in securities;

(h) regulating substantial acquisition of shares and take-over of companies;

(i) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the

securities market, intermediaries and self-regulatory organizations in the securities market;

(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 Provisional Act in respect of any transaction in securities which is under investigation or inquiry by the Board;

(j) performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956 (42 of 1956), as may be delegated to it by the Central Government;

(k) levying fees or other charges for carrying out the purposes of this section;

(l) conducting research for the above purposes; "(la) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;"

(m) performing such other functions as may be prescribed. "(2A) Without prejudice to the provisions contained in Sub-section (2), the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in Section 12) which intends to get its securities listed on any recognized stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

(3) Notwithstanding anything contained in any other law for the time being in force while exercising the powers under Clause (i) or Clause (ia) of Sub-section (2) or Sub-section (2A), the Board shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, (5 of 1908), while trying a suit, in respect of the following matters, namely:

(i) the discovery and production of books of account and other documents, at such place and such time as may be specified by the Board;

(ii) summoning and enforcing the attendance of persons and examining them on oath;

(iii) inspection of any books, registers and other documents of any person referred to in Section 12, at any place;

(iv) inspection of any book, or register, or other document or record of the company referred to in Sub-section (2A);

(v) issuing commissions for the examination of witnesses or documents.

(4) Without prejudice to the provisions contained in Sub-sections (1), (2), (2A) and (3) and Section 11B, the Board may, by an order, for reasons to be recorded in writing, in the interests of investors or securities market, take any of the following measures, either pending investigation or inquiry or on completion of

such investigation or inquiry, namely:

- (a) suspend the trading of any security in a recognised stock exchange;
- (b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities;
- (c) suspend any office-bearer of any stock exchange or self-regulatory organisation from holding such position;
- (d) impound and retain the proceeds or securities in respect of any transaction which is under investigation;
- (e) attach, after passing of an order on an application made for approval by the Judicial Magistrate of the first class having jurisdiction, for a period not exceeding one month, one or more bank account or accounts of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the Regulations made thereunder:

Provided that only the bank account or accounts or any transaction entered therein, so far as it relates to the proceeds actually involved in violation of any of the provisions of this Act, or the rules or the Regulations made thereunder shall be allowed to be attached;

- (f) direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation:

Provided that the Board may, without prejudice to the provisions contained in Sub-section (2) or Sub-section (2A), take any of the measures specified in Clause (d) or Clause (e) or Clause (f), in respect of any listed public company or a public company (not being intermediaries referred to in Section 12) which intends to get its securities listed on any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market:

Provided further that the Board shall, either before or after passing such orders, give an opportunity of hearing to such intermediaries or persons concerned.

5. In para 5 of the impugned decision, learned Single Judge has summarized SEBI's powers conferred by Section 11. We reproduce the said narrative. It reads as under:

5. Section 11(1) of the Act is very widely worded and casts a duty on the Board to protect the interest of the investors; promote, develop and regulate the securities market by such measures as it deems it. Sub-Section 2 does not restrict or narrows down the wide scope of Sub-Section 1. Sub-Section 2 is not exhaustive of the power and authority of SEBI. Under Sub-Section 1 itself, SEBI

has been authorized and empowered to regulate securities market, which will include power to regulate and control issue of new mutual funds by mutual fund managers and subscription to the said funds including application for Ms. Under Sub-Section 1, SEBI can regulate payment of commission or state that there shall not be any entry load. SEBI is controlling and regulating new issues by mutual fund managers. While doing so, they are entitled and empowered to issue circulars in respect of entry load in the new mutual fund. The contention of the learned Counsel for the Petitioner that u/s 11(2)(b) distributors of mutual funds cannot be regulated as they are not registered with SEBI, is misconceived. u/s 11(2)(b), SEBI has the power to regulate and control the working of the intermediaries like the distributors. It is difficult to accept that u/s 11(2)(b) SEBI can regulate the working of stock brokers, sub-brokers, intermediaries only if they are registered and not unregistered intermediaries like distributors. The power conferred u/s 11(2)(b) upon SEBI relates to both registration as well as the Regulation. It is not possible to accept the contention that without registration of distributors, SEBI cannot control or regulate their working.

6. We concur with the interpretation put upon Section 11 by the learned Single Judge and suffice would it be to state that under Sub-Section 1 of Section 11, to protect the interest of investors in securities, the Board is empowered to regulate the securities market and for which it is empowered to take such measures as it deems fit.

7. We would simply highlight that the circular does not prohibit commission to be charged by distributors, but prohibits an entry load in all mutual fund schemes.

8. We may highlight the evil of the past. For example, Rs. 100 was received from a customer, mutual fund units worth only Rs. 97.5 were allotted; informing the customer that Rs. 2.5 was the entry load. The Fund Managers would use the sum of Rs. 2.5 to pay commission to distributors. The circular has brought in transparency by prohibiting entry load for all mutual fund schemes. It means that the investor who subscribes Rs. 100 would be issued mutual fund units equivalent in value to Rs. 100, depending upon the prevailing unit rate of the unit of the fund. If the distributor so desires, he can negotiate with a customer and settle the commission which he would be receiving.

9. We note that the second contention urged before the learned Single Judge pertaining to discrimination vis-a-vis LIC agents who receive commission from the premium paid by policy holders and distributors of mutual fund was not urged before us.

10. An argument, not advanced before the learned Single Judge was sought to be urged. It was urged that by prohibiting entry load on mutual funds schemes and permitted negotiated commission to be received by distributors from the purchaser of the fund, small time distributors like Petitioners have been prejudiced for the reason institutional service providers are able to render the same service for a very small commission.

11. But, this is a matter of agreement between the service providers and the one who receives the benefit of the service. It would always happen that those who render service to a large number of people would be able to cut down on overhead expenses and those who operate individually would have to incur higher expense to maintain their establishment. Being inherent to every business, it would not render the policy circular violative of any law.

12. We dismiss the appeal but refrain from imposing any costs.