

(1996) 05 GUJ CK 0016
In the Gujarat High Court

Case No : Special Civil Application No's. 2692 and 2694 of 1996

Karnavati Fincap Ltd. and Alka Spinners Ltd.

APPELLANT

Vs

Securities and Exchange Board of India

RESPONDENT

Date of Decision : 06-05-1996

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Section 30
Securities and Exchange Board of India Act, 1992 — Section 11, 11(3), 11B, 12
Securities Contracts (Regulation) Act, 1956 — Section 2

Citation : (1996) 87 CompCas 186

Hon'ble Judges : Rajesh Balia, J

Bench : Single Bench

Advocate : S.N. Soparkar and B.N. Kakadiya, for the Appellant; K.N. Raval and B.H. Chhatrapati, for the Respondent

Judgement

R. Balia, J.—These two petitions raise identical issues and are, therefore, decided by this common order.

2. The petitioners have challenged the issuance of summons to them by the Securities and Exchange Board of India (for short "SEBI"), respondent, to appear before the Investigating Authority u/s 11(3) of the SEBI Act. The contention of the petitioners is that under the provisions of the SEBI Act and under the provisions that have been referred to in the summons, the petitioners can (not ?) be called upon to furnish information nor can an enquiry be made against them. Their case is that the petitioners in both the cases are purchasers of securities, namely, shares of Mr. Madanlal B. Purohit listed on the Stock Exchange, Bombay. Merely because as investors they have dealt with those shares through stock brokers on the Stock Exchange, Bombay, they do not fall in the category of persons against whom inquiry can be instituted or from whom information can be called for or discovery of documents made. Learned counsel for the petitioners in support of his arguments relies on the statutory provisions contained in section 11, sub-section (2), clause (i), read with sections 11B and 12 of the SEBI Act. He contends that the combined reading of these provisions leads to only one

conclusion that the only persons who are covered by these provisions are stock exchanges, mutual funds, other persons associated with the securities market and intermediaries and self-regulatory organisations in the securities market. The persons referred to as "associated with the securities market" according to learned counsel, refers only to persons enumerated in clause (ba) of sub-section (2) which has been inserted by the Securities Laws (Amendment) Act, 1995, [See [1995] 83 Comp Cas 25.] with effect from January 25, 1995. His further contention is that section 11B confers on the SEBI power to issue directions in pursuance of any inquiry. For the present purpose, his argument is that such directions can be issued to any person or class of persons referred to in section 12 and persons referred to in section 12 do not include investors like the petitioners. To buttress this argument, a reference was also made to the object of the Bill for amending the securities laws in India.

3. Learned counsel for the respondent urged that a reading of the provisions of section 11 without reading sub-section (1) and without referring to the provisions of the [See [1996] 85 Comp Cas (St.) 33.] SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995, which have been framed under the powers conferred u/s 30 of the SEBI Act which have come into force after the same were placed before Parliament for its approval, have a statutory force. It was also urged that the object of the SEBI Act is to secure a check on the malpractice prevalent in dealing in the securities to protect the interests of investors. The provisions which have been made to achieve this object should not be read in a narrow and pedantic manner but full effect should be given to the provisions to make it effective to fulfil the object. It was also urged that if the language of the statute is clear, reference to the object clause of the Bill is not permissible. It was further urged that the power has been conferred in the widest possible amplitude in the matter of calling for information in the form of statements or documents by extending provisions of the Civil Procedure Code, while trying a suit regarding discovery and production of the books of account and other documents and summoning and enforcing the attendance of persons and examining them on oath, apart from inspection of any books, registers and other documents of any person referred to in section 12 of the Act.

4. For examining the rival contentions, it would be appropriate to refer to the relevant provisions of sections 11, 11B and section 12. Section 11(1) imposes a paramount duty on the Board to protect the interest of investors in securities and to promote the development of, and to regulate the securities market, and for achieving this object, it gives plenary powers to resort to such measures as it thinks fit. Section 11(1) not only prescribes duties but confers powers as well, to effectively discharge those duties. Viewed in this way, sub-section (2) which commences with the words "without prejudice to the generality of the foregoing provisions" and proceeds to enumerate matters for which the Board may provide such provision, is to be read as illustrative and not exhaustive of the matters in respect of the measures which can be provided for by the Board in furtherance of

the discharge of its duties referred to in sub-section (1).

5. The words "other persons associated with the securities market" have not been defined in the Act. The question then arises whether "persons associated with the securities market" takes its colour from persons enumerated in clause (ba)? If one has to go by the literal meaning, the interpretation which restricts the meaning of "persons associated with the securities market" to the persons enumerated in clause (ba) is not acceptable. In ordinary meaning, the persons associated with the securities market would include all and sundry who have something to do with the securities market. It is to be noted that the securities market in the sense is not confined to stock exchanges only. The words "persons associated with the securities market" are of much wider import than intermediaries. "Persons associated with" denotes a person having connection or having intercourse with the other; in the present case that "other" with whom a person is to have connection or intercourse is the securities market". The term "securities market" has not been defined under the statute. But taking the meaning of "securities" as defined in the Securities (Contracts) Regulation Act, 1956, because that is the definition of "securities" adopted under the SEBI Act, and the ordinary meaning of the word "market", it will mean a place or institution where the business of selling or buying of securities is carried on. Selling, buying or dealing with securities is the essential ingredient of a market. Though "securities market" has not been defined, the definition of "stock exchange" u/s 2(i) of the Securities Contracts (Regulation) Act means any body of individuals whether corporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. "Securities" has been defined u/s 2(h) to include shares, scrips, stocks, debentures, debenture stock or other marketable securities of like nature in or of any incorporated company or other body corporate, etc., etc. What is noticeable is it refers to "marketability" of it. A stock exchange is more than a mere selling, buying or dealing place for securities, but adorns the role of an assisting agency in smooth conduct of securities business by suitable regulating or controlling authority. None the less a market cannot be conceived of without a seller or buyer who are the primary persons for whose purpose the market exists. All activities of business of selling and buying are related to the seller or the buyer. It is inconceivable to think that a buyer or seller of a scrip is not a person associated with the securities market, where or through which he transacts his business, whether as trader or as investor, of selling or buying the required scrip.

6. Even taking the narrower view as suggested by learned counsel for the petitioners, by restricting the meaning of persons "associated with the securities market" only to that class of persons referred to in clause (ba) does not keep out the primary persons in the dealing of the securities out of inquiries as contemplated in clause (i) of section 11(2). What is contemplated is calling for information from the persons enumerated in clause (i) and, also conducting inquiries into the affairs of stock exchanges, mutual funds and other persons associated with the securities market and intermediaries and self-regulatory

organisations in the securities market. The provision is two fold. Firstly, calling for information primarily before holding any inquiry, and, secondly the holding of an inquiry into the affairs of the persons named therein and transactions in securities which takes place under its precincts or through its agencies. While calling for information, a power may be restricted to the persons enumerated therein. But where calling for the information is incidental to the conducting of inquiries into the affairs of a stock exchange or persons associated with stock exchange then the persons whom such an inquiry would reach cannot be restricted. It would be self defeating to hold that the investigation into any malpractice attached with any transaction or practice carried on in a stock exchange can be made only up to the intermediary but cannot reach the primary source of the transaction. It will be like searching for light in a tunnel without reaching its mouth. All the persons connected with the subject of enquiry are amenable to its reach.

7. Therefore, once an inquiry is to be conducted with respect to any securities dealt with on the stock exchanges or of any persons connected with such securities, whether primary dealers or intermediary dealers and whether there was a broker or a share transfer agent or in any capacity associated with the conduct of such transactions fall within the scope and ambit of inquiry u/s 11(2) (i) and, if anybody is found involved in any malpractice, it would be within the reach of the Board to issue directions u/s 11A.

8. Section 11B also enumerates the persons "associated with the securities market" to whom directions can be issued. What is stated in respect of interpreting of the meaning of "persons associated with the securities market" u/s 11(2)(i) equally applies to it.

9. The Regulations of 1995 shed doubts, if any, about the ambit of the authority of the SEBI regarding calling for information and holding of inquiry. The framing of regulations is empowered by section 30 which reads as under :

"Power to make regulations. - (1) The Board may, with the previous approval of the Central Government, by notification, make regulations consistent with this Act and the rules made thereunder to carry out the purpose of this Act.

(2) In particular, and without prejudice to the generally of the foregoing power, such regulations may provide for all or any of the following matters, namely :- ...

(c) the matters relating to issue of capital, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies u/s 11A."

10. Section 31 provides that every rule or regulation made under the Act shall be laid before each House of Parliament while in session, as soon as for a period of 30 days after such rule or regulation is made. If both the Houses agree to any modification, then such rule or regulation will operate only in its modified form. If both the Houses agree that such rule or regulation is not to be made, it ceases to

be in operation. These provisions clearly show that regulations are legislative in nature and statutory in character, and bear the seal of approval by Parliament, after they are made for their continued existence.

11. The purpose of the Act as indicated in the preamble is to provide for the establishment of the Board to protect the interest of investors in securities and to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto. Section 11 casts a duty on the Board to protect the interests of investors in securities and to promote the development of and to regulate the securities market. For achieving such object, it has been authorised to take such measures as it thinks fit. Thus, power to take all measures necessary to discharge its duty under the statute which is a reflection of the objective disclosed in the preamble has been conferred in widest amplitude. Protecting the interests of investors in securities and the healthy development of the securities market takes within its sweep all measures to effectively tackle the malpractices connected with securities trading meant for manipulating market prices for ulterior motives of inducing the investors in selling or purchasing securities at such manipulated and artificial market conditions. In furtherance of this object to keep a check on such manipulative or fraudulent transactions which are not bona fide and genuine transactions of sale and purchase but a part of manipulative mechanism, the Board had framed the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995, by publishing the same in the Gazette of India, Extraordinary, dated October 25, 1995, which were laid before Parliament and are in existence in the present form.

12. Regulation 3 prohibits the buying or selling of or dealing with securities in a fraudulent manner. Regulation 4 prohibits manipulative trade practices which include entering into any transactions with the intention of artificially raising or depressing the prices of securities thereby inducing other persons to sell or buy securities; which is calculated to create a false or misleading appearance of trading on the securities market; which results in reflection of prices of securities based on transactions that are not genuine trade transactions; which are not intended to effect transfer to beneficial interest of ownership but intended to operate only as a device to inflate, depress or cause fluctuations in the market price of securities; pay off for inducing another person to purchase or sell the security with the sole object of inflating, depressing or causing fluctuations in the market price of securities.

13. Regulation 5 prohibits the making of misleading statements in material particulars whether deliberately or without due care and caution, which is likely to induce other persons to purchase or sell their securities or affect market prices of securities. Regulation 6 prohibits fraudulent and unfair trade practices.

14. Laying down these norms to achieve their compliance and to achieve its paramount object, regulation 7 empowered the Board to investigate into the buying and selling of securities, and regulation 8 provided procedure for such

investigation. Regulations 7 and 8 read as under :

"7. (1) The Board may, suo motu or upon information received by it, cause and investigation to be made in respect of the conduct and affairs of any person buying, selling or otherwise dealing in securities, by an investigating officer whom the Board considers fit :

Provided that no such investigation shall be made except for the purposes specified in sub-regulation (2).

(2) The purposes referred to in sub-regulation (1) are the following, namely :-

(a) to ascertain whether there are any circumstance which would render any person guilty of having contravened any of these regulations or any directions issued thereunder;

(b) to investigate into any complaint of any contravention of the regulation, received from any investor, intermediary or any other person.

8. (1) Before causing an investigation to be made under regulation 7, the Board shall give notice.

(2) Notwithstanding anything contained in sub-regulation (1), where the Board is satisfied that in the interest of the investors or in the public interest, no such notice should be given, it may, by an order in writing and recording the reasons as far as practicable, direct that the investigation be undertaken without such notice.

(3) Subject to the provisions of this regulation, an order passed under regulation 7 shall be a sufficient authority for the investigating officer to undertake the investigation and, on production of an authenticated copy of the order, the person concerned shall be bound to carry out the duty imposed in regulation 9."

15. Regulation 9 casts a duty on the person concerned to co-operate and furnish requisite information and documents. Regulations 11 and 12 provide for issuing directions to buyers and sellers in respect of any transaction which has taken place in contravention of the regulations after the report of the enquiry has been submitted to the Board.

16. These provisions cannot be said to be inconsistent with any provision of the Act or Rules framed thereunder. In fact, no such contention was raised, except that summons u/s 11(3) could not have been issued to the buyer while holding inquiry u/s 11(2)(i).

17. Firstly, as I have discussed hereinbefore, the enquiry cannot be said to be beyond the scope of section 11(2)(i). Even assuming for the present purpose, that section 11(2)(i) does not contemplate any enquiry against a buyer or purchaser, the list of measures enumerated in sub-section (2) of section 11 is merely illustrative of the nature of measures that may be taken by the Board in furtherance of its duties to attain the object of the statute, without affecting the

generality of provisions of sub-section (1). It cannot be said that sub-section (2) provides an exhaustive list of measures which the Board can take and it cannot take other measures which are in consonance with the main purpose of the statute and consistent with the duty cast on it. It cannot be said that for protecting the interests of investors, the Board has no power to take appropriate measures to prevent and deal with fraudulent and manipulative transactions. The Board has such powers, nay duty, to take measures to prohibit unearthen and deal with fraudulent and manipulative transactions to effectively protect the interests of investors. This is also necessary in order to promote healthy, fraud free and manipulation free development of securities market in the country that effective measures are taken to check and prevent transactions which tend to artificially affect and manipulate market conditions to the advantage of a few and to the detriment of general genuine investors. Therefore, no prohibition can be read in the provisions of section 11(2) for giving effect to the Regulation of 1995.

18. The Regulations of 1995 in no uncertain terms provide for an investigation in respect of the conduct and affairs of any person buying, selling or otherwise dealing in securities.

19. Thus, necessary power to hold enquiry against the buyer or seller and power to call for information from him exists. The fact that in the summons reference has not been made to these regulations is immaterial. Such omission by itself does not invalidate the exercise of authority. Law in this regard is well settled that if the source of power exists, non-mentioning of it or wrong labelling of it would not invalidate exercise of such power.

20. I am unable to sustain the contention of the petitioners that the Board has no power to conduct an inquiry into the transaction of transfer of shares by the petitioners and the inquiry of the Board must stop at the stock brokers or intermediaries who have been instructed to carry out the transactions of the petitioners.

21. The contention that information cannot be called for from the petitioners because clause 11(2) restricts calling for information from undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market and self-regulatory organisations in the securities market only and the petitioners do not fall in any of them must also fail.

22. The contention that no enquiry can be held against the petitioner buyer has been rejected on two grounds, namely, (i) the buyer does fall within the purview of the class enumerated in clause (i) as a person associated with securities market; and (ii) that the Regulations of 1995 specifically provide for holding investigation into the conduct and affairs of any buyer or seller in respect of transactions referred to in regulations 3 to 6, even if it is assumed that he does fall outside the purview of persons associated in transaction which have been the subject-matter of inquiry. In either case, once an inquiry is to be conducted as to

who are the persons responsible for the malpractice falling within the purview of inquiry and if they otherwise fall within the subject-matter of inquiry then in that event, they are subject to the powers as are conferred on a civil court in the matter of discovery and production of documents and summoning and enforcing the attendance of persons and examining them on oath. In this connection, section 30 of the CPC read as under :

"30. Power to order discovery and the like. - Subject to such conditions and limitations as may be prescribed the court may, at any time, either of its own motion or on the application of any party, -

(a) make such orders as may be necessary or reasonable in all matters relating to the delivery and answering of interrogatories, the admission of documents and facts, and the discovery, inspection, production, impounding and return of documents or other material objects producible as evidence;

(b) issue summonses to persons whose attendance is required either to give evidence or to produce documents or such other objects as aforesaid;

(c) order any fact to be proved by affidavit."

23. Section 30 empowers the court on its own motion to issue summonses to person whose attendance is required either to give evidence or to produce documents or such other objects as aforesaid, that is to say, that persons whose attendance is necessary and relevant for the purposes of inquiry at any time, or in whose possession the relevant documents are there, the civil court has necessary jurisdiction and power to summon such a person and enforce his statement as well as production of documents relevant for the inquiry. Such person may or may not be a person against whom suit has been filed or relief has been claimed or is otherwise party to the suit. Therefore, power to call for information and documents relevant for the inquiry even from the persons against whom inquiry has not been instituted and/or cannot be instituted vests in the SEBI or in the person authorised to hold enquiry in terms of section 11(3). Exercise of such powers cannot be confined to the persons enumerated in clause (i) of section 11(2). To hold otherwise will be to infructuate the purpose of holding the inquiry by keeping out of the reach of the inquiry authority, relevant documents and evidence which can be said to be of primary importance for the enquiry and required by the authority for the purpose of such enquiry.

24. For the reasons as aforesaid, both these petitions fail and are hereby dismissed. Notice discharged in each case. No costs.