
(2003) 11 AHC CK 0179
In the Allahabad High Court
Case No : Writ Petition No. 51911 of 1999

Paramount Bio-Tech Industries Ltd.

APPELLANT

Vs

Union of India (UOI)

RESPONDENT

Date of Decision : 25-11-2003

Acts Referred:

Companies (Amendment) Act, 2000 — Section 292A
Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 — Regulation 12, 5
Securities and Exchange Board of India Act, 1992 — Section 11(2), 11A, 11AA, 12, 12(1B)
Securities Contracts (Regulation) Act, 1956 — Section 2(h)

Citation : (2004) 120 CompCas 18 : (2004) 2 CompLJ 446 : (2004) 49 SCL 77

Hon'ble Judges : R.S. Tripathi, J;M. Katju, J

Bench : Division Bench

Advocate : S.M.A. Kazami and S.S. Ray, for the Appellant; S.P. Gupta, Sanjay Goswami and Subodh Kumar, for the Respondent

Final Decision : Dismissed

Judgement

M. Katju, J.—This writ petition has been filed with a prayer for a writ of ceriorari for quashing the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 notified on 15-10-1999 (hereinafter referred to as the 1999 Regulations), vide Annexure 9 to the writ petition. The petitioners have also prayed for a mandamus directing the respondents not to treat the petitioner No. 1 as a Collective Investment Management Company.

2. Heard learned Counsel for the parties, Shri S.S. Ray and Shri S.M.A. Kazmi for the petitioner and Shri S.P. Gupta for the respondent No. 4.

3. The petitioner No. 1 is a public Ltd. Company incorporated under the Indian Companies Act, 1956 carrying on inter alia the business of collective hi-tech and hi-brid agro-plantation sale and development of orchards on behalf of the owners, Cottages & Agricultural land. The petitioner No. 1 has also initiated its

food processing unit at NOIDA (U.P.) in the name of "Paramount foods" for which it has got sanction for allotment of an industrial plot from NOIDA. The petitioner No. 1 is also in the field of information technology and software consultancy. Thus petitioner No. 1 has been in three types of business since its incorporation in the year 1996 viz. (a) Collective hi-brid, hi-tech agro-farming plantation projects, (b) Sale and purchase of agriculture land and related services and (c) I.T. and Software Consultancy.

4. The petitioner No. 2 is a shareholder and Director of petitioner No. 1.

5. It is alleged in paragraph 2 of the petition that this petition is being filed in order to safeguard the interest of the shareholders and investors/joint venture associates, who have invested their hard earned money with petitioner No. 1, the interest of the individuals working for petitioner No. 1, and in order to prevent agro-plantation and other projects implemented by petitioner No. 1 from being destroyed/collapsed. It is alleged in paragraph 4 of the petition that for the past more than three years the petitioner No. 1 and hundreds of other Companies were implementing crucial projects and schemes of collective hi-brid, agro-plantation, horticulture and orchard development schemes by pooling the resources of its Promoters, Shareholders and Directors and also by enrolling Co-investors/joint Venture Associates amongst interested individuals by advertising and marketing network.

6. In paragraph 5 of the petition it is alleged that certain businesses/ schemes of the Companies like the petitioner No. 1 had been termed as "Collective Investment Schemes" on the lines of similar schemes carried on by companies in various other countries.

7. It is alleged in paragraph 7 of the petition that petitioner No. 1 since its incorporation in the year 1996 has been engaged in lawful business activities and had genuinely implemented hi-tech collective agro-plantation projects at its project sites in Bareilly and Garh Mukteshwar, Ghaziabad in U.P. The petitioner No. 1 had sufficient area of land under its possession to implement the projects so as to meet the liabilities of its investors/joint venture associates. There are approximately seventeen thousand poplar trees being planted in the land at Bareilly. The maturity value of these trees after 4 to 5 years is estimated to be about Rs. 3 crores 40 lakhs @ Rs. 2,000 per tree. The petitioner had its major marketing network in U.P. A large number of investors/joint venture associates are from U.P. Besides, petitioner No. 1 has also launched a scheme of selling the land to be developed into orchards but could not continue due to the negative atmosphere. However, the petitioner No. 1 intends to continue the scheme of selling land to be developed as orchards on behalf of the owners, but due to certain provisions in the impugned regulations this activity is being hampered as the sale and purchase of such land is being brought within the purview of Securities & Exchange Board of India (hereinafter referred to as SEBI).

8. The total liabilities of petitioner No. 1 towards its investors/joint venture

associates has to be paid off, as per the original schemes, in a period of 11 years from the date of investment. The total investment mobilised by the petitioner No. 1 under various schemes is Rs. 2.36 crores of which about 1.10 crores has already been paid off. The chart giving the details is contained in paragraph 8 of the petition.

9. In paragraph 9 of the petition it is alleged that from the above figures it is evident that petitioner No. 1 is one of those companies which has been carrying on its business with prudence. The petitioner No. 1 had been returning the investment of its joint venture associates and striving hard and returning the investment of its investors as well as trying to salvage various schemes and projects which are underway.

10. In the month of November, 1997 the Central Government issued a press release making known its decision that various schemes through which instruments like agro bonds, plantation bonds etc. are issued would be treated as "Collective Investment Schemes" under the purview of the SEBI Act. Copy of the public notice issued by SEBI dated 18-12-1997 is annexed as Annexure 3 to the petition.

The aforesaid notice states :--

"The Central Government has by a press release dated 19-11-1997 decided that an appropriate regulatory framework for regulating entities which issue instruments such as agro bonds, plantation bonds, etc. has to be put in place. The Government has decided that schemes through which such instruments are issued would be treated as collective investment schemes coming under the provisions of the SEBI Act. In terms of the press release, SEBI has initiated action for drafting regulations for such collective investment schemes. A committee under the Chairmanship of Dr. S.A. Dave has already been constituted.

The provisions of Section 12(1B) of the SEBI Act prohibits collective investment schemes including mutual funds from sponsoring any new scheme till the regulations are notified. While the regulations for mutual fund schemes have been notified by SEBI, regulations for collective investment schemes including plantations schemes require to be notified in view of the press release issued by the Central Government. These regulations are under preparation and will be issued in due course, first in draft form for public discussion and later in the final form. Till these regulations are notified, it is hereby brought to the notice of the public that as a result of the provisions of Section 12(1B) of the SEBI Act no person can sponsor or cause to be sponsored any new collective investment scheme and thereafter raise further funds.

Further, the proviso to Section 12(1B) provides that till regulations are notified all collective investment schemes which are operating can continue with their operations till the regulations are notified. It is hereby brought to the notice of the public that existing collective investment schemes which are desirous of taking benefit of the proviso to Section 12(1B) of the SEBI Act and continue their

operations are directed to send to SEBI by 15th January, 1998, information containing details such as : Terms and conditions of the schemes launched; Funds raised through all the schemes; Promises or assurances or assured returns made in the scheme; Copies of offer document of the scheme; and Names, details and background of promoters/sponsors."

11. It is alleged in paragraph 14 of the petition that thereafter on 28-2-1998 the petitioner No. 1 received a letter dated 27-2-1998 from SEBI contradicting its earlier directive through the aforesaid public notice published on 18-12-1997 and directing the petitioner No. 1 to stop its business activities with immediate effect unless it obtains credit rating from any one of the four SEBI approved credit rating agencies vide Annexure-4 to the writ petition.

12. It is alleged in paragraph 15 of the writ petition that when the petitioner No. 1 and other Companies contacted the SEBI approved credit rating agencies they were informed by the said Agencies that the agencies were not having any guidelines from SEBI so that these agencies could rate the schemes of the companies. This position lasted for one and a half to two months.

13. It is alleged in paragraph 16 of the writ petition that this action of SEBI was followed by a number of deliberate and motivated press releases, public notices/news-items presenting generalised negative opinion about all the agro-plantation companies vide Annexure-5 to the writ petition. This created a panic situation amongst the investors and they started approaching various companies including the petitioner for premature withdrawal of their investments. Thereafter the petitioner No. 1 circulated letters to all its investors/joint venture associates giving details about the prevailing condition. At the same time, to cut down the overheads the petitioner No. 1 closed down its branch offices. After consulting with the investors, the petitioner No. 1 informed all its investors/joint venture associates individually, about the entire grim scenario that had emerged consequent to SEBI's unmindful actions and resultant financial position of the company and also offered a rescheduled payment plan to them. Copies of the said letters and reschedule payment plan carrying the consent from the investors/joint venture associates are Annexure-6 to the writ petition.

14. It is alleged that since the time SEBI started its regulatory mechanism, there was a virtual collapse of this crucial industry. Most of the companies (almost 600 odd) started closing one after the other and neither the Government of India nor SEBI did do anything worthwhile to control the situation and help investors to get their money back. A number of investors approached various High Courts e.g. the Delhi High Court as stated in paragraph 19 of the petition.

15. It is alleged in paragraph 21 of the petition that a Committee under the Chairmanship of Dr. S.A. Dave was constituted by SEBI to draft regulations for the so-called "Collective Investment Scheme". The draft regulations were discussed in detail by the representatives of the Industry with SEBI and the Dave Committee. Certain shortcomings were pointed by the industry. In fact a detailed

study was made and observations were sent to all the relevant Ministries. The Dave Committee and SEBI, but it is alleged that nothing was seriously considered by these authorities.

16. It is alleged in paragraph 22 of the writ petition that the worst came for the petitioner on 15-10-1999 when SEBI notified the regulations for his collective investment schemes. A letter in this regard was received by the petitioner No. 1 from SEBI vide Annexure-7 to the writ petition. It is mentioned in this letter that a copy of the 1999 regulations has been posted on the SEBI Website. It is alleged by the petitioner that a number of provisions contained in the impugned regulations are impossible to be followed and complied with. It is alleged that there are many inconsistencies inter se in these regulations. It is also alleged that some of the regulations are violative of the parent Act viz. The Securities and Exchange Board of India Act, 1992 and also the Securities Contract (Regulations) Act, 1956, the Companies Act, 1956, the Income Tax Act, 1961, the Indian Trust Act, 1882 and the Constitution of India.

17. It is alleged in paragraph 24 that the power to frame regulations contained in Section 30 of the SEBI Act does not authorise SEBI to make regulations to regulate collective investment schemes, but confines the power to make regulations which may provide for the conditions subject to which certificate of registration is to be issued, the amount of fees to be paid for the certificate of registration, and the manner of suspension or cancellation of certificate of registration u/s 30 states :

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

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

(a) the time and places of meetings of the Board and the procedure to be followed at such meetings under Sub-section (1) of Section 7 including quorum necessary for the transaction of business;

(b) the terms and other conditions of service of officers and employees of the Board under Sub-section (2) of Section 9;

(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;

(d) the conditions subject to which certificate of registration is to be issued, the amount of fee to be paid for certificate of registration and the manner of suspension or cancellation of certificate of registration u/s 12."

Section 11A of the Act states :--

"Board to regulate or prohibit issue of prospectus, of a document or

advertisement soliciting money for issue of securities.--(1) Without prejudice to the provisions of the Companies Act, 1956 (1 of 1956), the Board may, for the protection of investors,--

(a) specify, by regulations--

(i) the matters relating to issue of capital, transfer of securities and other matters incidental thereto; and

(ii) the manner in which such matters, shall be disclosed by the companies;"

Section 2(i) of the SEBI Act defines "securities" as having the same meaning as in Section 2 of the Securities Contracts (Regulation) Act, 1956.

Section 2(h) of the Securities Contracts (Regulation) Act, 1956 defines securities to include :--

"(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ii) Government securities;

(ia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interest in securities;"

18. It is alleged in paragraph 29(b) of the petition that the instruments involved in the transfer of ownership of land to an investor like in the orchard scheme of the petitioner and in giving the right to develop the said land to the company are a sale deed and an agreement. It is alleged that these instruments cannot be characterised as securities within the meaning of the aforesaid definition of "securities". This is because they are not marketable in the way securities are i.e. sold or purchased in the stock exchange, and also because the title to the land having been transferred to the investors these instruments cannot be said to be marketable securities of a like nature in or of any incorporated Company.

19. It is alleged in paragraph 30 of the petition that the impugned regulations are in violation of the provisions of the SEBI Act and are hence ultra vires,

20. The specific objections of the petitioner to the impugned regulations as mentioned in paragraph 31 of the writ petition are :--

(1) The restriction imposed by Regulation 70(1)(c) that 50 per cent of the Director should be independent, is restricting the rights of the shareholders to appoint any individual to the office of Directors. The expression "Independent Director" has been explained to mean those Directors who are not associates of the persons operating the existing collective investment scheme.

(2) Regulation 11(c) which provides that appointment of directors shall be made

with the prior approval of the trustees is again a restrictive clause which limits the rights of the shareholders to appoint any one as Director and it is thus violative of Article 257 of the Companies Act.

It may be mentioned that u/s 32 of the SEBI Act the provisions of the Act shall not be in derogation of any other law for the time being in force. Hence, it is alleged, it cannot be in derogation of Companies Act.

Regulation 9(b) provides that the Company should in its memorandum of association specify managing of collective investment scheme as one of its main objects. However, Regulation 13 provides that collective investment management company shall not undertake any activity other than that of managing the scheme. It is alleged that this is in violation of Section 17 of the Companies Act which permits the company by special resolution to alter its memorandum of association regarding the objects of the Company. Section 149(2A)(b) read with Section 13(1)(d) of the Company Act authorises the Company to carry on any business as specified under "other objects". This can be done by passing a special resolution at a general meeting. It is alleged that the petitioner is also in the business of sale and purchase of agricultural land, food processing, IT and software consultancy. Hence it is alleged that Section 9(b) read with Regulation 13 arc derogatory restrictions on the rights of the shareholders.

(3) Regulation 14(f) provides that the collective investment management company shall be incompetent to enter into any transaction with or through its associates or their relatives relating to the scheme. However, the proviso to this regulation states that the Company can enter into any transaction relating to the scheme provided a report to that effect is immediately given to the trustee and the SEBI. It is alleged that these provisions are in violation of Section 11 of the Indian Contract Act which permits every person who is a major and is of a sound mind to enter into a contract. Various other objections are mentioned in paragraph 31 of the writ petition.

21. In paragraph 32 of the petition it is mentioned that the accounting norms as specified in Schedule IX of the impugned regulations suffers from certain discrepancies mentioned in that paragraph. It is alleged that all these minor and major flaws in the impugned regulations are because the impugned regulations were drafted in an irresponsible casual manner while apparently having a mala fide and biased approach against the genuine Companies.

22. It is alleged in paragraph 34 of the petition that Regulation 69 provides that the existing collective investment management company shall not launch any new scheme or raise money from the investors even under the existing schemes unless a certificate of registration is granted to it by the Board under Regulation 10. It is alleged that compliance of this formality may take minimum of two years and the business of the Company shall remain suspended till then. Hence it is alleged that this is violative of Article 19(1)(g) of the Constitution.

23. It is alleged in paragraph 35 of the writ petition that the provisions in the

impugned regulations for existing companies are impractical and impossible to be followed and the chances of safeguarding the interest of the existing investors have all faded, what to talk of future investors. If the existing companies are not rehabilitated, the chances of investors getting back their money will be totally lost.

24. Regulation 71(4) states that the Company shall after complying with the conditions of provisional registration under Regulation 70 shall also comply with the conditions for seeking registration specified under Regulation 9. Only then will the company become eligible for grant of certificate of registration under Regulation 10.

25. It is alleged in paragraph 36 of the petition that the above regulation means that the SEBI is directing the company to suspend business with immediate effect until the registration is granted, thereby suspending the business indefinitely and certainly for a minimum period of two years. It is alleged that this is against the going concern concept which is a fundamental principle of accounting. Corporate financial statements are generally prepared following "going concern" assumptions which implies that the reporting entity is expected to continue operations in the foreseeable future. Thus, because of the said Regulation the truth and fairness of the balance sheet and profit and loss account of the Companies vide 211(1) and (2) of the Companies Act is diluted.

26. It is alleged in paragraph 46 of the petition that Regulation 30 of the impugned Regulations which provides that the Schemes shall be opened for subscription for not more than 90 days is violative of Articles 14 and 19(1)(g) of the Constitution. It is alleged that plantation projects are of very long gestation period and as such require 7-8 years to 20-25 years or more to attain normal maturity. Similarly, orchards stock, bear fruit after gestation period of 4-5 years. The industry therefore, requires long-term funds ranging from 8-25 years. Where the funds are raised for a short term period, loans have to be recycled to ensure continuity of the project. This restriction of raising funds for only 90 days is not feasible as the industry cannot afford interruption since plants are living beings and should be treated as a process industry. Revenues in this industry can be generated in the long run only and hence loans have to be matched with the maturity of plants after keeping adequate margin for cutting and marketing.

Various other discrepancies and shortcomings alleged by the petitioners in the impugned Regulations are mentioned in tabular form in Annexure-9 to the writ petition.

27. A counter affidavit has been filed on behalf of the SEBI, respondent No. 4. In paragraph 5 of the same it is alleged that the SEBI was constituted as an administrative body to function under the overall administrative control of the Ministry of Finance, Central Government by a notification dated 12-4-1988. Later on SEBI was conferred statutory status by an Ordinance dated 30-1-1992 which became an Act on 4-4-1992 (the SEBI Act). As per preamble to this Act is was

enacted to protect the interest of investors in securities, to promote the development of, and to regulate, the securities market, and matters incidental thereto. Section 11(1) of the SEBI Act states:

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

Section 11(2) mentions certain specific powers of the SEBI, without prejudice to the generality of Section 11(1).

28. In paragraph 12 of the counter-affidavit it is stated that the securities market in India has grown tremendously over "a" period. A number of entities, incorporated or not, had come into existence which promised attractive returns to investments made with them and mobilised huge public funds on the pretext of high returns. Such entities utilized the funds collected by them for the purpose which had not been disclosed by them at the time of inviting their investments. This was causing not only loss to the public but also eroding the confidence of the investors.

29. In paragraph 13 of the counter-affidavit it is alleged that it came to the notice of the Government of India that there were entities which were issuing instruments against the investment such as agro bonds, plantation bonds etc. by offering very high rates of returns which were not consistent with the normal returns in such schemes. They were calling such companies plantation companies. The Central Government was concerned with the high element of risk of the investors in such schemes, and hence felt it necessary to set up appropriate regulatory framework for regulating entities which float such schemes. The Central Government decided to treat such schemes as collective investment schemes falling within the purview of Section 11(2)(c) of the SEBI Act.

Section 11(2)(c) states :

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

** **

(c) registering and regulating the working of venture capital funds and collective investment schemes including mutual funds."

30. In Section 11(2)(c) the words "venture capital funds and collective investment scheme" were inserted by the Securities Laws (Amendment) Act, 1995.

In this regard a Press Release dated 18-11-1997 is Annexure-1 to the counter-affidavit. Pursuant to this Press Release dated 18-11-1997 the SEBI by Press Release dated 26-11-1997 notified that the regulations for the collective investment schemes including the investment schemes advertised as plantation

schemes were under preparation and would be issued in due course. The Press Release further stated that under the proviso to Section 12(1B) till the regulations are notified all collective investment schemes which were in existence could continue their activities till the regulations are notified.

31. Section 12(1B) of the SEBI Act states :

"(1B) No person shall sponsor or cause to be sponsored or carry on or cause to be carried on any venture capital funds or collective investment scheme including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations :

Provided that any person sponsoring or causing to be sponsored, carrying or causing to be carried on any venture capital funds or collective investment scheme operating in the securities market immediately before the commencement of the Securities Laws (Amendment) Act, 1995 for which no certificate of registration was required prior to such commencement, may continue to operate till such time regulations are made under Clause (d) of Sub-section (2) of Section 30."

The Press Release further directed that the persons concerned with any collective investment schemes will send to SEBI the information within 21 days from 26-11-1997 containing the details of the terms and conditions of such schemes along with the funds raised through this scheme, promises or assurance or assured returns made in this scheme, and the names, details and background of promoters/sponsors. Copy of the Press Release dated 26-11-1997 is Annexure 2 to the counter-affidavit.

32. In paragraph 15 of the counter-affidavit it is alleged that it came to the notice of the Central Government that some unscrupulous companies were floating collective investment schemes and alluring the gullible investors with promise of high returns although such returns were not commercially viable and were apprehended to be unrealistic. The Central Government thought it essential to look into the claims made by these companies to prevent exploitation of investors and to provide adequate safeguard to the investment made so that it should be properly utilized. With this object the Ministry of Environment and Forest of Central Government constituted an inter-departmental committee vide letter dated 17-4-1996 to study the growth rate and economics of plantations undertaken by private promoters. The Chairman of the Committee was Sri P.B. Gangopadhyay, I.F.S. and there were altogether six members as stated in paragraph 15 of the counter-affidavit. These members were experts in various fields. The Committee submitted its report on 31-12-1997. The preface and the recommendations in this report are Annexures 3-A and 3-B to the counter-affidavit.

The Committee in its report stated :

"Investors are attracted by the lucrative returns promised by these companies

and have responded extensively to such offers... the confidence reposed by individual investors in these schemes is very high... there has also been a mushrooming of several plantation companies with high promises without authenticity... the plantation companies have set their targets very high . . . The Committee members strongly felt a need for defining regulatory mechanisms to be imposed on private companies to guarantee/safeguard interest of the investors. This will automatically eliminate fraudulent companies and attract investment for undertaking afforestation activities by genuine companies." Again the report observes "the plantation projects of most of the companies have serious inadequacies in terms of technical parameters which adversely affect the feasibility of the projects and the promised returns ... Most of the Companies do not have qualified personnel with forestry background for proper execution of a technical project dealing with forestry ... at present the stake of the promoter companies is very low vis-a-vis that of the public ... the yield promised by these companies are too ambitious ... Presently there does not appear to be any system to see that the funds of the depositors are invested properly ... the plantation companies should not be allowed to bear unlimited liabilities of any partnership firms which these companies may float after collection of funds from the investors ... The plantation companies must clearly indicate other sources of income generation if any for payment of such returns as promised by them." In the end the committee observed that "the committee strongly recommends that SEBI should look into the whole matter from the angle of safety of investors" money and issue suitable guidelines for the plantation companies to follow."

It was only thereafter that the Central Government issued the Press Release dated 18-11-1997 Annexure 1 to the counter-affidavit.

33. In paragraph 20 of the counter-affidavit it is alleged that as a consequence of the aforesaid Press Release by the Central Government the SEBI sought information regarding details of the schemes launched by the plantation companies, the amount collected from the public under the scheme and other relevant information to study whether the promises held out by these companies were realistic. SEBI also asked these companies to abide by the Code of advertisement framed by SEBI for investors" protection. From the information gathered from the aforesaid companies it was found that the offer documents of these companies promised very high returns which was wholly unrealistic. Photocopy of such offer document of the petitioner company is Annexure 4 to the counter-affidavit. In this offer the petitioner company offered to issue bonds against the investments. They published that these bonds and investments were 100 per cent secured through advance post-dated cheques, and the returns therefrom were also tax-free. It was also mentioned that the investment will grow 75 times in 20 years while the principal amount is returned in first five years. Other such attractive terms were made in these offer documents vide Annexure 4 and paragraph 21 to the counter-affidavit.

34. In paragraph 22 it is stated that some companies mentioned that the return

on the investment would be 22 per cent to 28 per cent per annum for 15 years. The return was said to be secured by post-dated cheques and the income was said to be tax free as agricultural income.

35. In paragraph 23 it is stated that SEBI started receiving many complaints across the country informing that the cheques issued by the plantation companies were bouncing because the companies had stopped payment. It was also mentioned in some complaints that the companies were not responding and some of the companies requested to surrender the cheques in return for which fresh cheques or promissory notes would be issued. Hundreds of post-dated cheques issued by the companies bounced and the bank accounts have been closed and the working in the branches had been paralysed. True copy of one of such complaints is Annexure 8 to the counter-affidavit. Copy of a complaint regarding bouncing of cheques filed before the District Consumer Forum, Allahabad is Annexure 9. Copy of the legal notice given enclosing the cheque is Annexure 10.

36. In paragraph 25 it is stated that having regard to the deluge of complaints regarding the bouncing of cheques and non-fulfilment of the promises made, the SEBI got a special audit done by reputed chartered accountant in the case of about 35 companies. One such report is of M/s. J.C. Bhalla & Co., Chartered Accountant, New Delhi regarding one of the plantation companies by the name of M/s. Okara Agro Industries Limited, Delhi. It is mentioned that the company did not give the accounts of the year ending 31-3-1998 and hence the report was based on the accounts upto 31-3-1997. In this audit report it is mentioned that the company diverted Rs. 35.47 crores to its group companies. Rs. 16.69 crores was given away as interest-free loan to the group companies. The company paid lease rent of Rs. 2 crores to Okara Leasing & Investment Limited for the land whose book value is Rs. 14.49 lakhs. Sale deeds were executed in the individual names of the directors and their relatives. The funds raised from the public were utilized for purchase of land in the State of Maharashtra in the individual names of directors and relatives. It was further observed by the auditors that the company was repaying the matured deposits out of the fresh deposits received. The Directors of the company were arrested by the Crime Branch, Delhi police and special auditors were also appointed by the Delhi police. The report of the auditors mentioned that the post-dated cheques had bounced and the company issued promissory notes in place of cheques. However, the company's account in Punjab National Bank from which the post-dated cheques were issued to the investors was closed. The deposits taken from the investors were diverted to sister companies free of interest. The management utilized the funds of the investors for purchase of land in Maharashtra State in the name of promoters and directors of the companies or their relatives. In paragraph 27 of the counter-affidavit it is stated that according to the aforesaid audit report of about 35 companies SEBI found that the situation in almost all the plantation companies which were soliciting investments on the promise of very high returns was the same. The investment of the innocent poor public was in a state of a very high

risk. SEBI considered it extremely urgent and necessary to save the innocent public from being exploited by the collective investment schemes of the aforesaid companies. The number of companies were fast increasing. As it would appear from the special audit report, these companies were not generating income at all. In fact they were diverting the funds of the investors. Whatever payments they were making to the investors were the funds of the fresh investors. SEBI hence filed a writ petition before the Bombay High Court details of which are mentioned in paragraphs 28 and 29 to the counter affidavit. Summary of the orders passed by the Bombay High Court are mentioned in paragraph 30 of the counter-affidavit. The Bombay High Court directed investigation by the various authorities on these petitions. At the same time SEBI started working for framing regulations to regulate the collective investment schemes by the entities referred to earlier. To examine and finalise the draft regulations for this purpose, SEBI appointed a committee that contained representatives of the Government Ministries Regulatory Bodies, Consumer Forum, Professional Bodies and Plantation Industries. This was known as the Dave Committee. The Dave Committee after protracted deliberations and after taking into account the views of various sections of the public including representatives of the industry made an interim recommendation to SEBI regarding the plantation companies. On the basis of such interim recommendation SEBI directed the plantation companies on 24-2-1998 not to mobilise any money from the public under the existing scheme unless the instruments of such schemes carried a rating from any one of the credit rating agencies set out in the said letter. About 70 companies obtained credit ratings from the specified credit rating agencies and all of them were found to be below investment grade. The rating agencies have informed that all the companies rated so far were found to be below investment grade and many were in the default/ imminent default category. An analysis of cash flow of these schemes had revealed that a sizable portion of the amount mobilised by the collective investment schemes was being paid as commissions/marketing expenses for raising funds and a large amount of money raised under the schemes was being used for non-agricultural purpose. These companies inducing the investors by promising investment in agricultural and plantation activities were deploying a large corpus of the funds so raised in activities akin to those of non-banking finance companies. Further, many companies were deploying funds in areas like real estate, resorts, golf courses, etc. The rating agencies also gave adverse comments on the accounting practices and methods which were followed by these entities. Many of the entities were found to be lacking in application of fundamental accounting principles while preparing their accounts. True copy of the Dave Committee Report submitted on 5-4-1999 is Annexure 12 to the counter-affidavit.

Many points noted by the Dave Committee are mentioned in paragraph 34 of the Counter-Affidavit. These points show how malpractices were being done by the Companies on a large scale.

37. In para 40 of the Counter-Affidavit it is stated that the SEBI published the

Regulations in the Draft Form on the basis of the recommendations of Dave Committee. The SEBI invited comments and objections of the general public, and the views of the general public were received which were considered by the SEBI and thereafter the impugned regulations were approved.

38. In para 43 of the Counter Affidavit it is denied that the impugned regulations are in violation of Articles 14, 19 and 246(3) of the Constitution. In para 45 it is slated that the special auditors appointed by SEBI to inspect some of the plantation companies have reported that majority of them were not following sound accounting principles, there was diversion of funds to the group companies, inter-corporate investments by way of share application money without shares being allotted, commissions were paid to associate sales agent and huge expenditure was incurred on the promotional activities. The petitioner was issued a show-cause notice dated 27-1-1998 for violating the advertisement code of SEBI. The petitioner was also not cooperating with SEBI in filing information with the SEBI in respect of his schemes. By its letter dated 30-4-1998, the petitioner submitted sketchy information and sought further time on the ground that they were facing financial and other related problems.

39. In para 46 it is denied that the petitioner is a genuine company. Many of the collective investment schemes have been floated by unscrupulous companies to lure the gullible investors with promise of high returns, although such returns were not commercially viable. Many of the innocent investors who invested in such plantation companies have lost their life long savings and made complaints to SEBI about the cheating and fraud perpetrated by these companies.

40. In para 47 of the Counter-Affidavit it is stated that under the Constitution of India stock exchange is a central subject vide entry 48 in List I (Union list) in the seventh schedule.

41. In para 48 it is stated that the impugned regulations in no way regulate the business of sale and purchase of the land perse. SEBI only governs the issuance of securities and when units are sought to be issued through collective investment in land or other projects with a view to common development of the property without day to day involvement of the investor in the affairs of the scheme, such activities assume the character of collective investment schemes u/s 11(2)(c) of the SEBI Act.

42. In para 49 it is stated that SEBI has received about 53 grievances from the investors of the petitioner company regarding non-redressal of their grievances. In para 50 it is denied that the petitioner No. 1 had been returning investments and has been carrying on the business with ordinary prudence.

43. It is alleged in para 52 of the Counter-Affidavit that the collective investment schemes are covered u/s 11(2)(c) of the SEBI Act and as such no separate notification was required for the said purpose. The Press release by the Government of India was only clarificatory in nature informing that units issued by plantation companies will be treated as collective investment schemes. It is

wrong to say that SEBI acted in a most irresponsible manner.

44. In para 54 of the Counter-Affidavit it is stated that the expression "collective investment schemes" is a concept which was known throughout the world in financial circles. The Dave Committee in its report observed that "collective investment scheme" is a generic term, and therefore, would encapsulate within its fold various activities which have been found to have certain specific characteristics. It is alleged that the definition of collective investment schemes as inserted by the Securities Laws (Amendment) Act, 1999 is substantially the same as mentioned in the Dave Committee report. The expression "collective investment scheme" though not initially defined under the Statute, was generally understood to include such schemes as are floated for mobilisation of money by way of contribution from the public at large and the corpus is invested in property with a view to share the benefits arising out of deployment of such common corpus. In the absence of the definition of collective investment scheme it cannot be said that SEBI has no power to regulate such scheme. In fact such power is conferred u/s 11(2)(c) of the SEBI Act. The Securities Laws (Amendment) Act, 1999 defines the collective investment scheme by inserting Section 11AA and Section 2(h)(i-b).

45. In paragraph 55 it is denied that the SEBI ever stopped the business activities of the petitioner. However, it is true that the SEBI asked for the credit rating of the petitioner and also all the other companies to safeguard the interests of other investors. After the directions received from the Government the SEBI officials visited some of the plantation companies running collective investment schemes and examined their projects and found that there was high risk in making investment in such schemes. In fact the companies were recycling the funds by returning money from new investors and not from that generated under any of schemes. The gravity of the situation may be gauged from the fact that although initially about 642 companies filed the information in response to SEBI's notice, ultimately only about 23 companies have come forward with an application for grant of provisional registration under the impugned regulations.

46. Due to the public notices issued by SEBI in the newspapers alerting the public regarding the plantation companies in general and the requirement of compulsory credit rating, the said companies could not continue fresh mobilisation of funds from the public. Many of such companies started defaulting on repayments to the investors and also misled the public that in view of the restrictions imposed by SEBI with regard to credit rating they are not able to service the investors. Under these circumstances, the SEBI issued a clarification that it had not stopped the companies from running collective investment schemes nor had stopped them from making payments to the investors but rather clarified that it required mobilisation of fresh deposit. The credit rating agencies are independent professional institutions most of which are promoted by development financial institutions like IDBI, ICICI etc. They employ professional chartered accountants and financial analysts with rich and varied

experience necessary to perform their duties.

47. In para 59 it is denied that all projects of plantation companies required long gestation periods. Some projects include raising of short term crops. In fact from the facts gathered by the SEBI the plantation companies were not generating any income, but were passing on the funds of the fresh investors to the old investors. In para 63 it is stated that while framing the regulations, SEBI had to take into account the interest of various groups including that of industry and the investors. The paramount consideration, however, was accorded to the protection of investors' interest.

48. In para 70 it is stated that the requirement of Regulation 70(1)(c) to have at least 50 per cent independent Directors on the Board is aimed at protecting the interest of investors and to ensure that the Boards of these companies which raise huge resources from the public are not packed with the friends and relatives of the promoters. This requirement of having at least 50 per cent of the directors to be independent of the promoters was formulated when it was pointed out to SEBI that many plantation companies wherein the Boards of the said companies which were packed with the associates of the promoters had often remained silent when the investor's money was diverted or frittered away. The provisions of the Companies Act do not place any restriction on the number independent Directors who can be appointed on the Board. Hence there is no violation of the Companies Act. Besides, the impugned regulations only regulate Collective Investment management company and not other companies.

49. As regards Regulation 9(b) which provides that the company should have the main object of managing the collective investment scheme, it is stated that this is in the interest of investors. It came to the knowledge of SEBI on the basis of various reports of the auditors appointed by it to look into the affairs of some of the plantation companies that they have diverted the funds raised from the public to projects other than collective investment schemes. Hence by way of abundant caution it was stipulated that the collective investment management company shall not undertake any other activity together with the collective investment schemes. This was with a view to segregate the business and identify properly the end use of funds raised from the public.

50. Regulation 14 restraining the Collective Investment Management Company to enter into transaction with or through its associates or their relatives in respect of the same is a provision aimed at securing the interest of the investors and to ensure that the public money is not siphoned off to the friends, relatives and associates of the promoters. It was reported to SEBI that many plantation companies have paid huge commissions, promotional expenses etc. to associates, friends and relatives. Hence reasonable restrictions had to be imposed to stop this malpractice.

51. SEBI being a regulatory authority made certain provisions which required prior permission from the Board before the Collective Investment Management

Company makes a policy change. These were all in the interest of the investors.

52. Section 32 of the SEBI Act states that the Act is in addition to the provisions of any other law or the time being in force. There are already regulations for the registration of the Debenture Trustees made under the SEBI Act, and the present regulations require the appointment of trustees to be the custodian of public funds. Although the Trustee is appointed by the Collective Investment Management Company, the trustees act in a fiduciary capacity in respect of the trust property which in this case is raised by sale of units to the public at large by the collective investment management company, and in case the persons in charge of the affairs of the Company act in a manner which is detrimental to the interest of the investors, the trustees are duty bound to bring the same to the notice of the Board as well as the investors.

53. In para 78 it is stated that SEBI regulates various intermediaries in the capital market which were involved in raising of huge resources from the investors in general. Having regard to the high volumes and turnover in the capital market, it is essential that the person who is permitted to operate in the capital market is a person of high standard of integrity. SEBI has framed internal guidelines to determine whether an intermediary is a fit and proper person, and thus it cannot be said that there is absolute or unfettered discretions in SEBI while declaring whether a person is fit and proper in the capital market.

We have also perused the rejoinder affidavit and other affidavits.

The first question which arises in this case is whether the activities of the petitioner are covered by the Securities and Exchange Board of India Act, 1992 (SEBI Act). It may be mentioned that the word "securities" in Section 2(i) has the same meaning as in Section 2 of the Security Contracts (Regulation) Act, 1956 which has already been quoted above in this judgment. u/s 12 of the SEBI Act the persons mentioned therein can only buy, sell or deal in securities in accordance with the conditions of the certificate of registration obtained from the Board in accordance with the rules made under the Act.

In our opinion agro bonds, plantation bonds, etc., (which the plantation companies, including the petitioner, issued) are certainly securities as defined in the Act. In fact Section 2(h) of the Securities Contract (Regulation) Act 1956, (quoted earlier) specifically includes bonds in the definition of securities. Hence, the activity of the petitioner in issuing such bonds is clearly covered by the SEBI Act.

54. Section 11(2)(c) of the SEBI Act uses the expression "collective investment schemes". Section 11(1) states--

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

Sub-section (2) of Section 11 mentions specific measures which can be taken by the Board in this connection and these include the registering and regulating the working of collecting investment schemes, including mutual funds.

55. The expression "collective investment scheme" was not defined initially in the SEBI Act. However, it was used in Section 11(2)(c) and its meaning explained in Chapter 2 of the Dave Committee Report (vide Annexure CA-12) which refers to the Howey's Test as laid down by the U.S. Supreme Court. We are of the opinion that in the absence of a statutory definition before 1999 the definition given by the Dave Committee Report should be accepted as it is the opinion of experts. Courts should ordinarily defer to the opinion of experts in the commercial world this expression had almost the same meaning which has now been specifically given in Section 11AA which has been introduced by the Security Laws (Amendment) Act, 1999 which is as follows:

"Collective investment scheme".--(1) Any scheme or arrangement which satisfies the conditions referred to in Sub-section (2) shall be a collective investment scheme.

(2) Any scheme or arrangement made or offered by any company under which,--

"(i) the contribution, or payments made by the investors, by whatever name called, are pooled and utilized for the purposes of the scheme or arrangement;

(ii) the contributions or payments are made to such scheme or arrangement by the investors with a view to receive profits, income, produce or property, whether movable or immovable, from such scheme or arrangement;

(iii) the property, contribution or investment forming part of scheme or arrangement, whether identifiable or not is managed on behalf of the investors;

(iv) the investors do not have day-to-day control over the management and operation of the scheme or arrangement."

56. Shri S.S. Ray, learned Senior Counsel for the petitioner submitted that the above definition requires pooling of resources, but the petitioner did not pool the resources of its investors, and hence the scheme was not a Collective Investment Scheme. However, there is no such averment in the writ petition that there was no pooling of resources, rather the averment in para 4 of the writ petition is to the contrary.

57. In the supplementary affidavit filed by the petitioner in September 2002 no doubt there is an averment in para 8 that there is no pooling in the transaction of sale and purchase of land. This averment, however, relates only to the second type of business, (i.e., Sale and purchase of land) which the petitioner claims to be doing and not to the first type of business which comprised admittedly of 98 per cent of the petitioner's business, i.e., business through offering plantation and agricultural bonds. So far as the first type of business which the petitioner was doing, the reply is given in para 9 of the supplementary Counter affidavit.

Shri S.P. Gupta, learned counsel for the SEBI in fact admitted that SEBI is not seeking to investigate pure transactions of sale and purchase of land simpliciter, but it is certainly entitled to enquire and find out the genuineness of these transactions and verify whether they really pertain to a collective investment scheme or are pure transactions of sale/purchase of land. We agree with this submission. The SEBI is not only entitled but it is also its duty to make investigations so that innocent investors are not duped by unscrupulous businessmen.

As already stated earlier in this judgment, it is the own case of the petitioner that 98 per cent of the total money received was in the first business of the petitioner viz. Collective High-Tech & High-brid Agro-Plantation scheme in this business, what the petitioner was doing was that it collected money from the investors with promise of high returns and it gave to the investors under called Plantation Bonds. These bonds were in our opinion clearly securities as defined in Section 2(k) of the Securities Contracts (Regulation) Act, 1956 (which has already been quoted earlier in this judgment) because Section 2(h) includes bonds within the definition of the word "security". Hence this business was clearly covered by the SEBI Act. The petitioner's case, however, is that so far as the second business of the petitioner, namely, sale and purchase of the agricultural land is concerned neither the provisions of SEBI Act nor the 1999 Regulations made thereunder would apply because this does not involve dealing with securities and it is not a collective investment scheme. So far as this argument is concerned, we have already observed above that there was no such averment initially in the writ petition and it was later introduced by a corrective supplementary affidavit. This supplementary affidavit was filed after the arguments at the stage of final hearing had begun before us. No such ground had been taken initially nor any amendment application was filed nor any relief sought in this connection. The respondent SEBI has seriously disputed this averment of fact disclosed in the corrected supplementary affidavit. The SEBI admits that if it is a genuine sale or purchase transaction of land and the SEBI will not interfere with the same. All that the SEBI desires is that the petitioner and other parties doing this business should report this matter to the SEBI so that it can be verified whether it is a genuine transaction of sale or purchase of land or not. Moreover, if the decision of the SEBI on this issue is incorrect there is a right of appeal u/s 20 of the SEBI Act. Hence we cannot see what grievance the petitioner can have in this connection.

58. As regards the business of Collective High-Tech & High-brid Agro-Plantation the petitioner has alleged that that has been closed down by the petitioner from 1998. In this connection the stand of the SEBI is that it will verify whether in fact the business has been closed or not. The procedure for closing the business is contained in Regulations 73 and 74 of the 1999 Regulations copy of which is Annexure 9 to the writ petition.

59. It has been alleged by the petitioner that since the expression "Collective

Investment Scheme" had not been defined in the Act prior to the amendment introduced by the Security Laws (Amendment) Act of 1999 w.e.f. 22-2-2000 hence the Regulations regarding "Collective Investment Scheme" made on 15-10-1999 were invalid. In our opinion since the expression "Collective Investment Scheme" had been utilized in Section 11(2)(c) of the SEBI Act right at the inception of the Act obviously that expression has to be given some meaning. In our opinion the meaning given to it by the Dave Committee Report (vide Annexure CA-12 Chapter 2 to the counter-affidavit) should be treated to be the correct meaning, as we have already observed above, as it is the opinion of experts. In our opinion the amendment introducing Section 11AA has only clarified the meaning, and it does not mean that prior to the amendment of 1999 Regulations could not be framed at all regarding "Collective Investment Scheme". To accept the argument of learned Counsel for the petitioner would make the expression "Collective Investment Scheme" in Section 11(2)(c) otiose and redundant. This would be against the settled principle of interpretation, according to which no word or expression in a statute should be treated as superfluous or redundant. Hence we cannot accept the submission of learned Counsel for the petitioner in this connection.

60. It has also been contended that the definition of "Collective Investment Scheme" in the Regulations is different from the definition in Section 11AA. A perusal of these two provisions shows that originally there was only a slight distinction between these two definitions. At any event, since now the expression has been defined in Section 11AA itself we have to go by that definition because if there is any conflict between the Act and the Regulations then the provisions of the Act will prevail. However, this does not help the petitioner in any way, and at any event SEBI has amended Regulation 2(2) on 14-2-2000 wherein it was stated that the term "Collective Investment Scheme" will have the same meaning as in Section 11AA.

61. As regards the submission of Shri Ray that the Regulations cannot be retrospective, we agree with learned Counsel for the petitioner that Regulations made under an Act cannot be retrospective unless the parent Act so permits vide *State of Bihar v. K.K. Kalra*. Vested rights of a company cannot be disturbed retrospectively by subordinate legislation vide *Bejgam Veeranna Venkata Narasimloo and Others Vs. State of A.P. and Others*, ; *State of M.P. v. G.S. Dhall Flour Mills* [1992] 1 SCC 150 ; *Eicher Motors Limited and Another Vs. Union of India and Others Etc.*, ; *M/s. Pawan Alloys and Casting Pvt. Ltd., Meerut etc, etc. Vs. U.P. State Electricity Board and others*, . Regulations are only delegated legislation, and unless permitted by the parent Act they cannot be retrospective.

62. However, learned Counsel for the respondents has submitted that neither the directive issued u/s 16 of the SEBI Act (vide Annexures 3 and 5 to the writ petition) nor the Regulations made u/s 30 are being enforced retrospectively. As regards the argument that these Regulations of 1999 are being applied to a business which has been closed in 1998, it is submitted by learned Counsel for

the respondents that this factual averment has to be examined by SEBI and cannot be accepted on its face value. Admittedly, the petitioner No. 1 has not returned the entire money to the investors and it continued to return the same even after the enforcement of the 1999 Regulations. This is evident when we compare para 8 of the writ petition with para 3 of the supplementary affidavit. The writ petition was filed in December 1999 while the supplementary affidavit was filed in September 2002. In para 8 of the writ petition it is alleged that the petitioner mobilised Rs. 2.36 crores in various investment schemes, out of which Rs. 1.10 crores has been paid off. In para 3 of the supplementary affidavit the petitioner has alleged that it raised Rs. 2.13 crores out of which only about Rs. 22 lakhs has to be paid off. Shri S.P. Gupta submitted that the respondents have to investigate these facts. Hence we are not inclined to interfere in the matter as the matter is still under investigation.

63. Learned Counsel for the petitioner Shri S.S. Ray submitted that the impugned Regulations and the directions of SEBI dated 21-10-1998 and 10-12-1999 cannot retrospectively apply to a business which has closed down. In our opinion the impugned Regulations and directions are not retrospective at all, nor are they being retrospectively applied.

Regulation 3 states : "No person other than a Collective Management Investment Company which has obtained a certificate under these regulations shall carry on or sponsor or launch a collective investment scheme."

Regulation 5(1) states: "Any person who immediately prior to the commencement of these regulations was operating a scheme shall, subject to the provisions of Chapter IX of these regulations make an application to the Board for the grant of a certificate within a period of two months from such date".

"Regulation 9 mentions the conditions which have to be satisfied for getting registration."

Regulation 10 states that on being satisfied that the applicant satisfies the requirements of Regulation 9, and on payment of the registration fee, the Board may grant the certificate in Form B on such terms and conditions as are in the interest of the investors.

Under Regulation 12 the Board can reject the application if it is not satisfied about the conditions mentioned in Regulation 9, and this decision has to be communicated within 30 days.

Regulation 13 places certain restrictions on the Collective Investment Management Company, and Regulation 14 mentions the obligations of such a Company.

Under Section 20 of the Act an appeal lies against the decision of the Board.

We fail to see how any of these Regulations can be called retrospective.

64. The petitioner-company was admittedly operating before the impugned

Regulations of 1999 were made. In view of Section 12(1B), which came into force in 1995 it could continue its business of collective investment scheme only after getting a certificate of registration from the Board in accordance with the regulations. Hence, regulations had to be framed and the petitioner could continue its operations only after applying under Regulation 5 and obtaining[^] certificate under Regulation 12. If its application was rejected it could appeal u/s 20.

65. As regards the public notice copy of which is Annexure 3 of the writ petition (and which has been quoted in entirety of this judgment) we are of the opinion that this has been issued by the Central Government under its power in Section 16(1) of the SEBI Act, and it is perfectly valid. It refers to Section 12(1B) which had come into force on 25th January, 1995. SEBI has only acted in accordance with this directive of the Central Government, which indeed it was bound to do in view of Section 16.

66. It is true that there were no Regulations upto 1999 and, hence, certificate could not be granted u/s 12(1B). However, the proviso to Section 12(1B) permitted only those persons who were carrying on the business of Collective Investment Scheme prior to the 1995 Amendment (which came into force w.e.f. 25-1-1995) to continue to operate till Regulations were framed. The petitioner No. 1 was incorporated in 1996 (vide para 7 to the writ petition) and hence it was obviously not carrying on the said business before 25-1-1995. Hence it could not get the benefit of the proviso to Section 12(1B). It follows that the business of Collective Investment Scheme which it was doing was wholly illegal. The letter of SEBI to the petitioner dated 27-2-1998 (vide Annexure-4 to the writ petition) was therefore unexpected. In fact by that letter SEBI took a lenient view by permitting the petitioner to operate after getting rating from a credit agency. In fact even this concession could not have been granted by SEBI, as the proviso to Section 12(1B) does not apply to the petitioner, for the reasons given above. SEBI should in fact have totally prohibited the petitioner from doing the business of Collective Investment Scheme, and should have directed prosecution of the petitioner and its officials u/s 24 read with Section 27 of the SEBI Act.

It is then submitted by the learned Counsel for the petitioner that the sale and purchase of agricultural land would fall in List II of the Seventh Schedule of the Constitution and Parliament cannot legislate on the same as agricultural land is excluded from the ambit of List I, and hence Parliament had no power to enact Section 11A of the SEBI Act and SEBI had no power to issue the impugned Regulations. In our opinion the facts of the case reveal that the respondent is only regulating the investments to protect the interest of the investors who invest in various securities/ bonds in the nature of "Collective Investment Schemes". In our opinion Parliament and SEBI have the legislative competence to frame the Act and Regulations as the subject-matter falls under Entries 43, 46 and 48 of List I of the Seventh Schedule to the Constitution.

Entry 43 of List I reads:

"Incorporation, regulation and winding up of trading corporations, including bankers, insurance and any financial corporations but not including co-operative societies".

Entry 48 reads:

"Stock exchanges and futures markets."

In our opinion these entries in List I give legislative competence to Parliament to enact the SEBI Act. The Statement of Objects and Reasons of the Act states that it is being enacted to protect the investors. The capital market has witnessed tremendous growth in recent times, characterised particularly by the increasing participation of the public, and hence, it was necessary to regulate the same so as to instill a sense of confidence in the public.

67. The impugned Regulations have been made u/s 30 of the Act, and we find no illegality in the same.. Their object is to protect the investors in Collective Investment Management Schemes, and this is a landable object.

68. However, even if the impugned regulations incidentally touch on some matter that will not invalidate them because we have to see the pith & substance of the Regulations, and not the incidental matters. Hence, the impugned Regulations are not invalid on this account. The object of making the Regulations was to bring transparency in the "Collective Investment Schemes" introduced to check and regulate various "Fly by Night" companies and make such companies accountable to the SEBI so that the public is not duped or swindled of their hard earned money.

69. We are of the opinion that Parliament has the competence to legislate on such matters as they come within the ambit of Entries 43 and 48 of List I of the Seventh Schedule. It is a cardinal principle of interpretation that the language of the entries should be given the widest scope of their meaning, and while interpreting an entry in the list, it would not be reasonable to import any limitation therein vide *Ram Ram Narain Medhi v. State of Bombay* MR 1959 SC 459 (vide para 12); *Seth Banarsi Das etc. Vs. Wealth Tax Officer, Special Circle Meerut, etc.,* . It has also been held by the Supreme Court that the general words in an entry would be held to extend to all ancillary or subsidiary matters which can fairly and reasonably be comprehended in it vide *R.S. Joshi, Sales Tax Officer, Gujarat and Others Vs. Ajit Mills Limited and Another, ; Hans Muller of Nuremburg Vs. Superintendent, Presidency Jail, Calcutta and Others, ; Navinchandra Mafatlal Vs. The Commissioner of Income Tax, Bombay City, ; Chaturbhai M. Patel Vs. Union of India (UOI) and Others, ; Rai Ramkrishna and Others Vs. The State of Bihar*, In case of an apparent conflict between different entries of List I & II, the same has to be decided by the principle of the principle of "pith and substance" vide *Southern Pharmaceuticals and Chemicals, Trichur and Others Vs. State of Kerala and Others, ; Synthetics and Chemicals Ltd. and Others Vs. State of U.P. and Others, , Federation of Hotel and Restaurant Association of India, etc., Vs. Union of India (UOI) and Others, , Union of India v.*

Harbhajan Singh Dhillon, (1972) 83 ITR 582 (SC) .

70. In our opinion on an examination, of the impugned Regulations there can be no doubt that Section 11A and the said Regulations deal with the matters pertaining to Entries 43, 46 and 48 of List I of the Seventh Schedule, and are not ultra vires the SEBI Act.

71. As regards the allegation that the impugned Regulations are contradictory to the Companies Act or other Acts, in our opinion the SEBI Act and the impugned Regulations are special laws and will prevail over the provisions of the Companies Act and other Acts which lay down the general law. It is well-settled that the special law prevails over the general law. Moreover, the Companies Act nowhere prohibits having 50 per cent independent directors. In the commercial scenario today where gullible investors are often duped this provision for having 50 per cent independent directors is a salutary provision. There is no doubt that the interest of investors needs to be safeguarded against unscrupulous persons because of whom a large number of people have lost their hard earned money all over the world. Even in the U.S.A. we have seen how persons in charge of certain companies e.g. Enron, Worldcom, etc. had by unscrupulous methods duped their shareholders and the general public and thus caused the loss of entire lives savings of a large number of people. It may be mentioned that one of the main reasons for the 1929 Wall Street slump in America and the Great Depression thereafter and in that country was that there was no effective Regulation of the securities market and no protection of the interest of the investors. That is why the Security and Exchange Commission was created subsequently in America also.

72. In our opinion, the impugned Regulations are reasonable restrictions and were in fact very much needed to protect the public against many finance companies which recently have duped the investors and then disappeared. Even the Government of India in the Companies (Amendment) Act, 2000 has introduced the concept of having 50 per cent independent directors in the "Audit Committee" by inserting section 292A in the Companies Act. At any event the impugned Regulations and the SEBI Act fall within the ambit of residuary Item 97 in List I if it does not fall within any other entry. We do not agree with the submission made by learned Counsel for the petitioner that the impugned Regulations and Section 11AA of the SEBI Act relate merely to agricultural land. In our opinion, in pith and substance they relate to the protection of the investors investing in various securities/bonds in the nature of collective investment schemes. In our opinion, it cannot be said that the transactions initiated by the petitioner are merely sale/purchase transactions of land simpliciter. The manner of procuring investment, the transactions, and the manner in which the transactions were entered into clearly show that the transactions are in the nature of Collective Investment Schemes.

73. As regards the averment of the petitioner that it had repaid all the amounts deposited by the investors, this is a factual matter which requires investigation

by SEBI. Hence we are not expressing any opinion on the same.

74. As regards the submission of the learned Counsel for the petitioner that the impugned Regulations impose unreasonable restrictions on the fundamental right of the petitioner to do business under Article 19(1), in our opinion the impugned Regulations impose reasonable restrictions as they are in the interest of the general public to protect them from being duped and swindled. In our opinion, the State is empowered to regulate trade or business with the view to protect the public and its welfare vide - M.J. Sivani and Others Vs. State of Karnataka and Others, , U.K. Trivedi v. State of Gujarat [1986] SCC 20 , Sat Pal and Co. and Others Vs. Lt. Governor of Delhi and Others, , The Quarry Owners Association Vs. The State of Bihar and Others, .

75. In fact the SEBI Act was enacted with the object to establish a Board to protect the interest of the investors in securities and to promote development of, and to regulate, the Securities Market and for matters connected therewith or incidental thereto.

76. In fact Section 11 of the SEBI Act casts a duty on the Board to protect the interest of the investors in securities and to promote the development of and to regulate the securities market, by such measures as it deems fit. Section 12(2) (c) specifically provide that the Board can register and regulate the working of Collective Investment Schemes. The Rules and Regulations made by SEBI have to be placed before Parliament as mentioned in Section 31 of the SEBI Act.

77. It may be mentioned that Section 12 of the SEBI Act was amended in 1995 and Section 12(1B) was incorporated which specifically stated that no person can sponsor or cause to be sponsored or carry on any venture capital funds or collective investment schemes unless he obtained a certificate of registration from the Board in accordance with the Regulations. Thus after 1995, nobody could have carried on a collective investment scheme unless he obtains a certificate of registration from the Board.

78. In our opinion the impugned public notice, copy of which is Annexure-3 to the writ petition and the letter to the petitioner from SEBI dated 27-2-1998 vide Annexure-4 to the writ petition were both issued u/s 12(1B) read with Section 16 of the SEBI Act and hence they cannot be said to be ultra vires.

79. It may be mentioned that before making the impugned Regulations SEBI undertook a survey of some of the entities issuing instruments, such as Agro-Bonds and Plantation Bonds. A report was prepared by the Primary Market Policy Department of the Central Government on the basis of these on-site visits. The information received by SEBI revealed that such schemes promised every high returns, material disclosures have not been made in several documents and the stakes of promoters in the scheme were almost negligible as the companies had disproportionately low equity basis. It was also informed by the rating-agencies to SEBI that the credit rating of all the companies, launching the schemes, was below investment grade and many were in the default category. It was informed

that the analysis of the offer clearly showed that a sizable portion of the amount mobilized by the scheme was being paid as commission/market expenses for raising funds and a large amount of the money raised under the schemes had been used for non-agricultural purposes. Further, many companies had diverted funds to areas like real estate, resort and golf courses and these entities followed defective accounting policies. An Inter-Departmental Committee on the growth and economics of private plantation of teak was set up by the Government of India, Ministry of Environment and Forest under the Chairmanship of Shri B.P. Gangopadhyaya. The said Committee strongly recommended the need for a regulatory mechanism to be imposed on private companies to safeguard the interest of the investors. It was observed by the Committee that plantation companies have serious technical inadequacies, which can effect the feasibility of the project and would not give the desired return. It was observed that precious money of the investors was being wasted on big scale advertisement and promotion activities which need to be controlled. Certain recommendations were made by this Committee which included the approval of project plan by the State Forest Departments; and the Committee strongly recommended that the SEBI should issue guidelines for the safety of such investors so that the precious money of the investors can be saved vide Paras 15, 16 and 18 and Annexures 3A & 3B to the counter-affidavit.

80. An Expert Committee having representation from the relevant fields e.g. Government of India, SEBI, Consumer Fora, Representatives of the Industries etc. was thereupon set up under the Chairmanship of Dr. Dave, former Chairman of UTI, to draft and finalise the Regulations. On 28th January 1998, the Dave Committee held a meeting and desired that the existing Collective Investment Scheme should be allowed to continue to raise or mobilize moneys from the public provided that the instruments of such Collective Investment Scheme are rated by the Credit Rating Agencies and the schemes are insured. On the basis of these recommendations of the Dave Committee, the SEBI on 24-2-1998 in exercise of its powers u/s 11B read with proviso to Section 12(1B) of the SEBI Act issued a direction to the effect that all existing Collective Investment Schemes can mobilize money only after obtaining a rating from one of the four Credit Rating Agencies indicated therein.

81. On 23-1-1998 SEBI decided to undertake a special audit of those Collective Investment Schemes which had mobilized an amount of more than Rs. 5 crores from the public, which included the petitioner. SEBI identified the Plantation Companies after seeking information from the Registrar of Companies and then initiated a process of classifying those companies which had mobilized money through Collective Investment Schemes. In pursuance of the notices issued by SEBI on 17-4-1998, 478 Companies field returns with SEBI. On 5-5-1998 SEBI held a meeting with the Credit Rating Agencies to estimate the ratings of the Collective Investment Scheme, and it was informed by the agencies that all the Companies rated were found to be below investment grade and many were in the defaulting category. It was further informed that a sizeable portion of the amount

mobilized has been paid for commission expenses and the agencies were of the opinion that these companies were deploying the funds received from the public for non-banking financial companies, real estate etc.

82. On 31-12-1998, the Dave Committee gave its report which highlighted the following inadequacies in such cases:

- (i) Entities have no sufficient experience in Agro-Based activities;
- (ii) The promoters of these companies themselves have invested a very petty amount and majority of funds in such ventures are from ordinary investors;
- (in) Large amount of money have been mobilized due to effective rural marketing and high returns promised;
- (iv) Marketing agents were offered huge commission as high as 10 per cent to 15 per cent of the amount mobilized;
- (v) Yields promised on these schemes are not at all achievable; (vi) Pieces of land allocated to investors were not distinctly identifiable;
- (vii) Many instances have been observed where funds have been diverted to unrelated activities by persons operating the CIS.
- (viii) There is intermingling of the Scheme accounts with those of the company's accounts and there is no distinction between management and trustee.

83. In our opinion the Regulations made in pursuance of the above steps are clearly reasonable and justified. The Regulations were not made whimsically or arbitrarily but after detailed study and examination of the mischief being perpetrated on innocent investors by unscrupulous businessmen.

84. It may be mentioned that to test the reasonability of a restriction we have to see the subject-matter, the extent of restriction, the mischief which it seeks to check, etc. The reasonableness of the restriction has to be determined in an objective manner and has to be seen from the point of view of the interest of the general public and not from the point of view of the persons upon whom the restrictions are imposed vide *Hanif Quareshi v. State of Bihar* AIR 1985 SC731 (sic). Moreover the impugned law cannot be said to be unreasonable merely because in a given case it operates harshly vide *State of Gujarat Vs. Shantilal Mangaldas and Others*, . As observed by the Supreme Court in *Laxmi Khandsari and Others Vs. State of U.P. and Others*, ; *D.K. Trivedi & Son's case* (supra); *State of Madras Vs. V.G. Row*, ; *Peerless General Finance and Investment Co. Limited and Another Vs. Reserve Bank of India*, ; *Harakchand Ratanchand Banthia and Others Vs. Union of India (UOI) and Others*, , the nature of the right alleged to have been infringed, the underlying purpose of the restriction imposed and the extent and urgency of the evil sought to be remedied thereby, disproportion of the imposition, prevailing conditions at the time etc. are the relevant considerations for determining whether the restrictions is reasonable.

Further, as held in *Jyoti Pershad Vs. The Administrator for The Union Territory of Delhi*, , the standard of reasonableness must also vary from age to age and be related to the adjustments necessary to solve the problems which communities face from time to time. In adjudging the validity of the restriction the Court has necessarily to approach the question from the point of view of the social interest which the legislation intends to promote vide *Pathumma and Others Vs. State of Kerala and Others*, ; *P.P. Enterprises and Others Vs. Union of India (UOI) and Others*, , *Jyoti Pershad's case (supra)* etc.

85. In our opinion judged by these standards the impugned Regulations and amendments to the SEBI Act cannot be faulted on the ground of lack of reasonableness. As stated in the counter-affidavit and as is also widely experienced by the public, there was a widely rampant racket operating in this country by so-called Finance Companies and other such bodies which were duping and swindling the investing public as a result of which thousands of people lost their entire life savings. This practice of late had become scandalous (e.g. the Harshad Mehta Scam). Hundreds of such so-called Companies in fact disappeared with the money taken from the investors.

When we judge the reasonableness of a restriction, we have to see the entire background and the context in which the Regulations were made. In our opinion taking into account this background and the context the impugned Regulations are salutary in nature what to say of being reasonable. They were in fact long overdue.

Some details have been given in the counter-affidavit in Paragraphs 12 to 17 of the writ petition of the scandalous malpractice going on in the country. As stated in Paragraph 13 of the counter-affidavit, it came to the notice of the Government of India that there were entities which were issuing instruments against the investments, such as agro bonds, plantation bonds etc. by offering very high rates of returns which were not consistent with the normal returns in such schemes. These were called plantation Companies. As stated in Paragraph 15 of the counter-affidavit, some of such unscrupulous companies were floating collective investment schemes and alluring the gullible investors with promise of high returns although such returns were not commercially viable, and appeared to be unrealistic. The Central Government decided to prevent the exploitation of investors and provide adequate safeguard to the investment so that the investors may not suffer. Hence, the Central Government set up the Gangopadhyaya Committee. As stated in Paras 15 and 16 of the counter-affidavit the investors were attracted by the lucrative returns promised by these companies and there was mushrooming of several plantation companies with high promises without authenticity, The plantation companies set their unrealistic targets very high, and, hence, the Committee strongly felt a need for defining regulatory mechanism to safeguard the interest of investors and eliminate the fraudulent companies. The Committee noted that most of the companies do not have qualified personnel with forestry background for proper execution of a technical

project dealing with forestry. There was no system to see that the funds of the depositors are invested properly.

As stated in Paragraph 21 of the counter-affidavit, these companies promised very high returns which were wholly unrealistic. Details are given in Paragraphs 21 and 22 of the counter-affidavit.

86. In para 23 of the counter-affidavit it is stated that the SEBI started receiving a deluge of complaints from across the country informing that the cheques issued by the plantation companies were bouncing, and the companies were not responding to the letters. Sometime they were requesting for surrender of the cheques in return for which fresh cheques or promissory notes would be issued. Often sale deeds were executed in the individual names of the directors and their relatives. A huge amount was given by these companies to the sister concerns as interest free loan.

87. In our opinion all these facts clearly show that the plantation companies were duping the investors and were diverting their funds which called for strong regulatory measures. Hence the action taken by the SEBI in our opinion, was fully justified and reasonable. In fact it was the duty of the SEBI to take such strong steps to protect the investors, and it would have failed in its duty had it not.

88. In *Srinivasa Enterprises v. Union of India* [1980] 4 SCC 507 the Supreme Court held that the ban on price chit enterprises, which were often fleecing the public, was reasonable and there was no violation of Article 19(1)(g) of the Constitution. In para 13 of this judgment the Supreme Court observed:

"...when a general evil is sought to be suppressed some martyrs may have to suffer, for the Legislature cannot easily make meticulous exceptions and has to proceed on broad categorizations, not singular individualisations (para 514). "

89. In *Peerless General Finance & Investment Co. Ltd.* 's case (supra) the Supreme Court upheld the directives issued by R.B.I., as they were for protecting the investors from unscrupulous financial investment companies.

90. In *Hatisingh Mfg. Co. Ltd. and Another Vs. Union of India (UOI) and Others*, the Supreme Court held that the freedom to carry on trade or business under Article 19(1)(g) is not an absolute one, and reasonable restrictions can be imposed on it in the interest of the general public vide Article 19(6) of the Constitution.

91. In *R.K. Garg v. Union of India* [1998] 4 SCC 675 (690) a Constitution Bench of the Supreme Court observed:

"8. Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion, etc. It has been said by no less a person than Holmes, J. that the Legislature should be allowed some play in the joints, because

it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with greater play in the joints has to be allowed to the Legislature. The Court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in *Morey v. Doud* 354 US 457 where Frankfurter, J. said in his inimitable style:

"In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The Legislature after all has the affirmative responsibility. The Courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the Judges have been overruled by events all these show that self-limitation can be seen to be the path to judicial wisdom and institutional prestige and stability." (p. 690)

92. In *Prag Ice & Oil Mills v. Union of India* AIR. 1978 SC 1296 the Supreme Court observed:

"We do not think that it is the function of the Court to sit in judgment over such matters of economic policy as must necessarily be left to the government of the day to decide. Many of them are matters of prediction of ultimate results on which even experts can seriously err and doubtlessly differ. Courts can certainly not be expected to decide them without even the aid of experts."

93. In *Shri Sitaram Sugar Co. Ltd. v. Union of India* [1990] 3 SCC 223 the Supreme Court observed;

"57. Judicial review is not concerned with matters of economic policy. The Court does not substitute its judgment for that of the Legislature or its agents as to matters within the province of either. The Court does not supplant the feel of experts by its own views..." (p. 255)

94. In *Delhi Cloth and General Mills Co. Ltd. and Others Vs. Union of India (UOI) and Others*, the Supreme Court observed:

"...Even at the cost of repetition, it can be stated with confidence that the rules which prescribed conditions subject to which deposits can be invited and accepted do operate to extend a measure of protection against the notorious abuses of economic power by the corporate sector, to the detriment of depositors/investors, a segment of society which can be appropriately described as weaker in relation to the mighty corporation...In a welfare State it is the constitutional obligation of the State to protect socially and economically weaker segments of society against the exploitation by Corporation..." (p. 188)

95. In *P.T.R. Exports (Madras) Pvt. Ltd. and others Vs. Union of India and others*,

the Supreme Court observed:

"In matters of economic policy it is settled law that the Court gives a large leeway to the executive and the legislature--Government would take diverse factors for formulating the policy in the overall larger interest of the economic of the country--The Court therefore would prefer to allow free play to the Government to evolve fiscal policy in the public interest and to act upon the same."

It must be remembered that certain matters are by their nature such as best be left to experts in the field. This Court does not have the technical and administrative expertise in this respect.

In the words of Chief Justice Neely:

"I have very few illusions about my own limitations as a Judge. I am not an accountant, electrical engineer, financier, banker, stock broker or system management analyst. It is the height of folly to expect Judges intelligently to review a 5000 page record addressing the intricacies of a public utility operation. It is not the function of a Judge to act as a super board, or with the zeal of a pedantic school master substituting its judgment for that of the administrator."

In our opinion there should be judicial restraint in fiscal and economic regulatory measures. The State should not be hampered by the Court in such measures unless they are clearly illegal or unconstitutional. All administrative decisions in the economic and social spheres are essentially ad hoc and experimental. Since economic matters are extremely complicated, this inevitably entails special treatment for distinct social phenomena. The State must therefore be left with wide latitude in devising ways and means of imposing fiscal regulatory measures, and the Court should not, unless compelled by the statute or by the Constitution, encroach into this field.

96. As Justice Frankfurter of the U.S. Supreme Court observed in *American Federation of Labour v. American Sash & Door Co* 335 US 538 (1949):

"Even where the social undesirability of a law may be convincingly urged, invalidation of the law by a Court debilitates popular democratic government. Most laws dealing with social and economic problems are matters of trial and error. That which before trial appears to be demonstrably bad may belie prophecy in actual operation. But even if a law is found wanting on trial, it is better that its defects should be demonstrated and removed by the legislature than that the law should be aborted by judicial fiat. Such an assertion of judicial power defeats responsibility from those on whom in a democratic society it ultimately rests. Hence rather than exercise judicial review Courts should ordinarily allow legislatures to correct their own mistakes wherever possible."

97. Similarly in his dissenting judgment in *New State Ice Co. v. Liebmann* 285 US 262 [1932] Mr. Justice Brandeis, the renowned Judge of the U.S. Supreme Court, observed that the government must be left free to engage in social experiments.

Progress in the social sciences, even as in the physical sciences, depends on "a process of trial and error" and Courts must not interfere with necessary experiments.

In the same decision Justice Brandeis also observed:

"To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation "(see also *The Legacy of Holmes and Brandeis*" by Samuel Konefsky)".

98. Thus, there is no force in this petition and it is dismissed.