



Critical Analysis of Securities Law (Amendment) Act

Kritika Bhargava

Student, LLM,

Gujarat National Law University,
Gandhinagar, Gujarat (India)

Abstract: *The need for a separate Securities Laws Act was felt by the government against the backdrop of lakhs of small investors being duped by numerous fraudulent investment schemes across the country, like in the alleged Saradha scam in West Bengal. For this, government promulgated first ordinance related to it in July 2013. The ordinance sought to grant these additional powers to SEBI. The ordinance was promulgated for second time in September 2013 and for third time in January 2014. But all the time bill failed to be passed in Parliament. The bill proposes to amend the SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956, and the Depositories Act, 1996. It empowers SEBI to regulate any pooling of funds of Rs 100 crore and above, that are not overseen by any regulator under law; conduct search-and-seizure operations on any suspected securities law violator's premises after obtaining permission from a magistrate or judge of a court in Mumbai (the initial ordinance had empowered the SEBI chairman to authorize such operations and had removed the need for seeking judicial permission), recover monetary penalties imposed by it through attachment and sale of assets, arrest and detain an individual for any failure to comply with its orders, call for information and records from any person, including banks or other authority, to aid its investigation, establish special courts for speedy trials of offences under the SEBI Act, re-examine an adjudicating officer's orders and raise the penalty amount if it is in the interest of the securities market and enter into agreements for exchange of information with foreign financial regulators. The author will use doctrinal method of research for this article. The author will highlight some of the main amendments in Securities law amendment bill 2014.*

Keywords: *Securities Law, SEBI, SAT.*

I. INTRODUCTION

The Securities Exchange Board of India is the securities market regulator in India. SEBI was established under Securities and Exchange Board of India Act, 1992 and it derives power, rights and authority from the Act. As the dynamics of capital market keep on changing from time to time, it is also important to give more power to SEBI with changing capital market. From quite a few times Legislature was constantly making efforts to enact new laws through amendments to the SEBI Act, 1992 however due to some or the other reasons such amendments were not able to get through the Parliament. The Central Government tried to get around with its inability to pass through the Parliament by promulgating the ordinance to amend the Act. The Central Government through President had issued ordinance to amend the SEBI Act in the year 2013 and 2014 and the new government was able to ensure that the Securities Law (Amendment) Bill, 2014 (herein after referred as Amendment Bill 2014), which includes the amendment to SEBI Act, Depositories Act, 1996 and Securities Contract (Regulation) Act, 1956, was passed on 6th August 2014 in Lok Sabha.¹ Within a span of one year two big scams in India have led to change almost all the legal framework of securities market in the country. The Sahara and Saradha scams have shown us the major lacunas and loopholes that existed in the regulatory framework controlling the affairs of securities market transactions in India. While some changes were brought by Supreme Court of India in companies' law in the form of chapter III, part II of the companies Act, 2013 so as to tackle the interpretation given to private placement by Sahara.² When the Saradha scam took place, the parliament was not in session; the President after getting fully satisfied about the magnitude of the scam issued or promulgated ordinances three times in a row by using his emergency powers. After the expiration of the ordinances, a bill was placed before the Lok Sabha to give it legal sanctity and also to amend some of the provisions present in the ordinances. The Bill reinstated certain provisions in the SEBI Act.³ The Parliament passed the bill which after sometime got the presidents assent and it was therefore officially published in official gazette by the name of Securities Law (Amendment) Act, 2014. This Bill is to empower the Securities and Exchange Board of India (SEBI) to check fraudulent investment schemes, to call for documents on entities under probe and provide for constitution of

¹ CS Vinita Nair, Aditya Shah, 'Securities Law (Amendment) Bill, 2014- comparison of Key changes made in SEBI Act, 1992' (tax guru 2014) https://www.google.co.in/url?sa=t&rct=j&q=&esrc=s&source=web&cd=7&cad=rja&uact=8&ved=0CEAQFjAG&url=http%3A%2F%2Ftaxguru.in%2Fsebi%2Fsecurities-law-amendment-bill-2014-comparison-key-sebi-act-1992.html&ei=4C8IVZSZKIntaKXSgvAN&usq=AFQjCNHj4gT7rzWaujGNAGu98gQgZacD2Q&sig2=raZV_INBwaJDsXvQho_n_9g accessed 17/3/2015

² Mubashshir Sarshar, 'The Securities Laws (Amendment) Act, 2014 – A Critical Analysis' (India corplaw 2014) <http://indiacorplaw.blogspot.in/2014/09/the-securities-laws-amendment-act-2014.html> accessed 17/3/2015

³ Mubashshir Sarshar, 'The Securities Laws (Amendment) Act, 2014 – A Critical Analysis' (India corplaw 2014) <http://indiacorplaw.blogspot.in/2014/09/the-securities-laws-amendment-act-2014.html> accessed 17/3/2015



special courts to expedite the cases was introduced in the Lok Sabha. It is essentially a Bill that was conceived by the UPA government.⁴

➤ **Rationale behind Amendment:**

The Securities Laws (Amendment) Bill, 2014, aims to give power to capital market watchdog Securities and Exchange Board of India (SEBI) by giving powers such as authority to seek call data records. It was introduced by Minister of State for Finance Nirmala Sitharaman. The objects and reasons listed by the government on the Bill said, "To protect the interests of investors and to ensure orderly development of securities markets, it has become necessary to enhance the powers of the Board".⁵ The bill proposes to amend the SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956, and the Depositories Act, 1996. It empowers SEBI to regulate any pooling of funds which is of the value of Rs 100 crore and above, that are not overseen by any regulator under law; to conduct search-and-seizure operations on any suspected securities law violator's premises after obtaining permission from a magistrate or judge of a court (the initial ordinance had empowered the SEBI chairman to authorize such operations and had removed the need for seeking judicial permission), recover monetary penalties obligatory by it through attachment and sale of assets, arrest and detain an individual for any failure to comply with its orders, call for information and records from any person, including banks or other authority, to aid its investigation, establish special courts for speedy trials of offences under the SEBI Act, re-examine an adjudicating officer's orders and raise the penalty amount if it is in the interest of the securities market and enter into agreements for exchange of information with foreign financial regulators.⁶ SEBI has been given the power to frame regulations on collective investment schemes. It will have to clearly define "pooling of funds" and also spell out the key attributes of what constitutes a collective investment scheme (CIS) to avoid any ambiguity. The regulator after this amendment will now be in a far better position to carry out its investigation in an expeditious manner as it can go to special courts to seek permission to carry out search and seizure operations, among others. SEBI can approach a court headed by a session's judge or additional session's judge. It has fifty seven clauses in order to amend various sections of the SEBI Act and two other legislations.⁷

➤ **Constitutionality of Multiple Ordinances:**

It is reported that two public interest litigations (PILs) have already challenged the constitutionality of the Ordinances that were issued by the president when the parliament was not in session in two High Courts. According to media reports, one of these PILs has also challenged the exercise of power by the President to re-promulgate the ordinance. On the first blush, these three repeated ordinances may seem to be in the teeth of Supreme Court judgment of D.C. Wadhwa vs. State of Bihar (1986) that held that a court will invalidate the ordinance that is re-promulgated time and again, and court may look into propriety, expediency and necessity for judicial review of the President's satisfaction. However, it is my view that, various scams in the securities market could be used to justify the necessity of repeated Ordinance to bestow certain powers on SEBI to effectively deal with these scams. But such repeated ordinances should be considered to be an exception rather than a norm. At the same time, it is arguable whether all the powers - such as retrospective power to settle securities laws violations, retrospective power to enter into MoUs with foreign regulators was 'emergent'.⁸

As the narration of the Act provides, it is a legislation to amend and fix the existing loopholes in three important legislations that control the securities market transactions in India, namely the Securities and Exchange Board of India (SEBI) Act, 1992, the Securities Contracts (Regulation) Act, 1956 and the Depositories Act, 1996.

II. POWERS GIVEN TO SEBI

a. *Collective Investment Schemes:*

One feature that requires a much closer look is the deeming provision in the Bill that provides that any pooling of funds that involving a corpus of more than Rs. 100 crore would be deemed to be a collective investment scheme (CIS). This provision could bring a wide range of business activity that do not contain any of the four elements of CIS specified in section 11AA(2) within the ambit of CIS, requiring registration from SEBI. This provision should be considered in light of the fact that only one CIS has been registered with SEBI since the CIS Regulations were brought into force in 1999, and that CIS is also yet to launch a scheme. One

⁴ B. Muralidhar, 'New Bill in Lok Sabha to give SEBI more teeth' *The Hindu*(4/8/2014), <http://www.thehindu.com/business/markets/securities-bill-to-empower-capital-market-watchdog-securities-and-exchange-board-of-india-sebi-introduced-in-lok-sabha/article6280639.ece>, last accessed 17/3/2015

⁵ *ibid*

⁶ Reena Zachariah 'The Securities Law Bill: Amendments and their legal implications' *The Economic Times*(11/8/2014), http://articles.economictimes.indiatimes.com/2014-08-11/news/52687407_1_sebi-act-the-securities-law-laws-bill last accessed 17/3/2015

⁷ Maxwell, 'Union Government notified Securities Laws Amendment Act, 2014' (Jagran Josh 2014) <<http://www.jagranjosh.com/current-affairs/union-government-notified-securities-laws-amendment-act-2014-1409303544-1>> accessed 17/3/2015

⁸ vaneesa abhishek, 'Critical Analysis of Securities Laws (Amendments) Bill, 2014' (India corp law 2014) <e.g. <http://www.legallaw.com> accessed 19/3/2015



needs to debate that the Ordinances have provided power to “regulate” or “prohibit” such schemes.⁹ The second one being a new sub-section (2A) which permits SEBI to make regulations for any scheme to be considered as a collective investment scheme, without prescribing any guidelines on the criteria that SEBI may use to formulate such regulations.¹⁰ Both these provisions, invite huge ramifications for SEBI so far so it is not able to clearly call out what ‘pooling of funds’ would be deemed to mean and what would constitute a collective investment scheme apart from the four attributes specified under the present Section 11AA(2) of the SEBI Act. On the second hand, if the delegated authority provided to SEBI to frame regulations for collective investment scheme is tested on the anvil of constitutionality and in the backdrop of the Supreme Court judgment in the case of *In Re Delhi Laws Act*, it might be considered as a case of excessive delegation of power.¹¹

b. Review of Adjudicating Officer’s order:

This latest Ordinance and 2014 Bill has introduced new section 15-I(3) which provides that if an order passed by an adjudicating officer of SEBI is considered that the order is erroneous to the extent that it is not in the interest of the securities market than SEBI can call for and examine. In these kinds of cases, SEBI can make a fresh inquiry and increase the quantum of penalty that was earlier imposed by the adjudicating officer. This is effectively nothing but a review of the Adjudicating Officer’s order. It has been proposed that such a review should take place within three months of the Adjudicating Officer’s decision or disposal of an appeal against his decision by the Securities Appellate Tribunal. The review of penalty orders of Adjudicating Officers by SEBI may undermine the scheme of the securities laws, which currently envisages that an adjudicating officer would be independent of SEBI and its orders will be reviewed not within the organization, but by the Securities Appellate Tribunal. Rather than this structure, SAT’s suggestion in *Mathew Easow and Opee Stock* cases may be the way forward. To quote from *Opee Stock* matter, SAT held that:-

“It is not in dispute that directions under section 11B of the Act are issued by the Board whereas proceedings under Chapter VI-A is conducted by an adjudicating officer who is a subordinate officer of the Board and it is he who passes the final order. As both sets of proceedings are independent of each other, as is often argued on behalf of the Board, the possibility of conflicting views on the same set of facts cannot be ruled out. In a given case, the whole-time member may hold the delinquent guilty of the charge levelled and the adjudicating officer may completely absolve him of the same or vice versa. Such anomalous situations could arise and these would not be in public interest. We feel that if only one enquiry is held against the delinquent and on the basis of the findings recorded therein, the same body is given the power to issue directions and impose monetary penalties as well, it would not only expedite matters but also avoid conflicting opinions. This would obviously require an amendment in the Act which is in the exclusive domain of Parliament.¹²

Therefore, what SAT had suggested was that if only one enquiry is held against the delinquent and on the basis of the findings recorded therein, the same body is given the power to issue directions and impose monetary penalties as well, it would not only expedite matters but also avoid conflicting opinions. In my opinion, such a restriction under the new provision would also come under severe judicial scrutiny because once a party receives an adverse order from SEBI under the settlement proceedings and the SAT refuses to entertain the matter for want of jurisdiction, the natural course of action followed would be to file a writ petition before a High Court under Article 226 of the Constitution or challenge the said provision to be unconstitutional before the Supreme Court under Article 32 of the Constitution.

c. Search and seizure Powers:

The SEBI Act before the promulgation of ordinances had permitted SEBI to carry out search and seizure operations on a suspected violator’s premises after obtaining permission from a First Class Judicial Magistrate. The successive ordinances removed the need for a Magistrate’s permission, and instead empowered the SEBI Chairman to authorize such operations. The 2014 Bill reinstates the judicial oversight of the process by requiring SEBI to obtain permission from the Magistrate or Judge of a court in Mumbai as designated by the government. The erstwhile Section 11C (8) of the SEBI Act provided that in case the investigative authority had any reasonable ground to believe that any documents associated with securities market may be destroyed, it may make an application to a Judicial Magistrate of the first class having jurisdiction for an order for the seizure of such documents. Further, there were certain other pre-qualifications prescribed under the said section before a magistrate could authorize such search and seizures.¹³ On the other hand the Ordinance removed all such impediments and gave the Chairman of SEBI unfettered powers to authorize the search and seizures without any prior judicial approval. However this time, the Act now reinstates the erstwhile position with a minor change, requiring SEBI to approach a Magistrate or Judge of a designated court in Mumbai as may be notified by the Central Government before undertaking the operations.¹⁴ Thus the ordinance gave unfettered power to the chairman of the SEBI Board to authorize such act which are normally empowered to be authorized by an Judicial

⁹ vaneesa abhishek, 'Critical Analysis of Securities Laws (Amendments) Bill, 2014' (India corp law 2014) <e.g. <http://www.legallaw.com>> accessed 19/3/2015

¹⁰ Mubashshir Sarshar, 'The Securities Laws (Amendment) Act, 2014 – A Critical Analysis' (India corplaw 2014) <http://indiacorplaw.blogspot.in/2014/09/the-securities-laws-amendment-act-2014.html> accessed 17/3/2015

¹¹ *ibid*

¹² vaneesa abhishek, 'Critical Analysis of Securities Laws (Amendments) Bill, 2014' (India corp law 2014) <e.g. <http://www.legallaw.com> accessed 19/3/2015

¹³ Mubashshir Sarshar, 'The Securities Laws (Amendment) Act, 2014 – A Critical Analysis' (India corplaw 2014) <http://indiacorplaw.blogspot.in/2014/09/the-securities-laws-amendment-act-2014.html> accessed 17/3/2015

¹⁴ Securities Amendment Act 2014 s 5



Body and thus the Amendment to the Act, restores such power to the judicial body and discard ordinance in that respect. Now pursuant to the amendment the power of seizure, as the earlier provision of the SEBI Act, was shall be with the Magistrate or Judge of such designated court in Mumbai, as may be notified by the Central Government. This is positive step from the erstwhile position as pointed out by the Finance Minister in his introduction to the Bill in the Lok Sabha, stating that while approaching a magistrate of an area where the search was to be conducted, the whole issue would become public and the purpose of a search was defeated as secrecy was an essential element of any search operation. On the other hand, power in the hands of executives without any safeguards is bound to be abused. Hence, the check and balance approach promulgated under the Act is a welcome step. However, the latest position of the government to designate special magistrates/judges from where a sectoral regulator could obtain permission before conducting a search and seizure operation could have repercussions and judicial scrutiny of other sectoral regulators especially that of the Income Tax authorities under Section 132 of the Income Tax Act, 1961 and more recently that of the Competition Commission under the proposed Section 41(3) of the Competition (Amendment) Bill, 2012.

d. Establishment of Special Courts:

A set of new provisions in the form of Section 26A to 26E has been inserted by the Act, which provides for the establishment of Special Courts for speedy trial of all offences committed under the SEBI Act. The Special Court would consist of a single judge appointed by the Central Government with the concurrence of the Chief Justice of High Court within whose jurisdiction the judge to be appointed is working. The Special Court would however, only serve as a Court of Sessions under the jurisdiction of the designated High Court.

This amendment is in consonance with Section 435 of the Companies Act, 2013 which also provides for the establishment of special courts to deal with all offences under the Companies Act. One could assume that the idea behind this move by the government to designate special courts to deal with offences under a particular statute is to provide a more efficient and specialized system of judicial functioning. However, the legislature has left a lot of scope for assumption, as to the rationale for creating a fast track feeder within the criminal justice system, which is not created by the judiciary but at the discretion of the executive. Although, in the backdrop of the vast number of securities frauds' surfacing of late, such a step is seen in a positive light by the various stakeholders.¹⁵ Further, in view of large pendency of cases, it is necessary to constitute Special Courts for prosecution of offences under the securities law to provide speedy trial. It envisages that any unregistered scheme having a corpus of Rs.100 crore or more would be deemed as a collective investment scheme.

e. Power of Disgorgement:

The Ordinance also retrospectively validates SEBI's powers of disgorgement. However, the Ordinance provides that the amount disgorged would be credited to the Investor Protection and Education Fund, but it doesn't provide guidance regarding the utilization of the amounts that have been disgorged. Under Section 11 of the SEBI Act, a new sub-section in the form of sub-section (5) has been inserted by the Act to provide that any amount that will be collected through disgorgement (repayment) i.e. amount of profit made or the loss averted in the said fraudulent transaction, after an issuance of a direction under Section 11B of the SEBI Act or Section 12A of the Securities Contracts (Regulation) Act, 1956 or Section 19 of the Depositories Act, 1996 would be credited to the Investor Protection and Education Fund ("IPF"). On the other hand, again the formulation of a framework to utilize such disgorged funds has been bestowed on SEBI. One can say that, the amount credited in the IPF should primarily be used to recoup the innocent investors who would have a rightful claim to such amounts. From the standpoint of SEBI, this addition has lent a fresh lease of life to disgorgement orders because of the clarity in the law that it has offered and the days to come should see SEBI come at par with the US Securities Exchange Commission (SEC) in terms of utilizing disgorgement orders to effectively curb securities market malpractices. Using this power, SEBI has amended the IPEF Regulations to provide that the disgorged amount would primarily be utilized for restitution to eligible and identifiable investors. Any amounts that are left would then be used for investor protection and education. However, as the Sahara case has demonstrated, it is difficult to identify eligible investors in many cases.¹⁶

III. CONCLUSION

In January last year, the regulator, based on its experience of dealing with the Sahara case, sought more power to plug regulatory gaps. SEBI had to battle the Subrata Roy-led group in the Supreme Court for the right to oversee the Lucknow-based group's fund-raising through optionally convertible debentures. Within a few months (in April), the Saradha Group financial scam broke out in West Bengal, leading to the collapse of the company's ponzi scheme and lakhs of investors losing their money. To respond to market needs, it became necessary to enhance SEBI's powers. As Parliament was not in session and the President was satisfied that immediate action was required against illegal deposit-taking schemes, the new securities law ordinance was promulgated to confer the regulator with certain powers to protect investors' interest and to enforce securities laws. The Securities Laws (Amendment) Bill 2014 proposes various amendments which inter-alia includes empowering Securities Exchange Board of India (SEBI) to call for relevant information and records from any person. There is a provision for disgorgement. The Bill provides that any pooling of funds in any unregistered scheme or arrangement, having corpus of Rs.100 crore or more, shall be

¹⁵ Mubashshir Sarshar, 'The Securities Laws (Amendment) Act, 2014 – A Critical Analysis' (India corplaw 2014) <http://indiacorplaw.blogspot.in/2014/09/the-securities-laws-amendment-act-2014.html> accessed 17/3/2015

¹⁶ Mubashshir Sarshar, 'The Securities Laws (Amendment) Act, 2014 – A Critical Analysis' (India corplaw 2014) <http://indiacorplaw.blogspot.in/2014/09/the-securities-laws-amendment-act-2014.html> accessed 17/3/2015



deemed to be a collective investment scheme. The Bill provides for express powers for the settlement (compounding); to establish Special Courts; powers of recovery of amounts; and empowering Board to enhance the penalty imposed by an adjudicating officer. Section 15A–HB of the SEBI Act prescribes penalties to be imposed for various offences. However, these sections only provide one level of penalty with no minimum level or range and without giving any discretion to the Adjudicating Officers. Amendment to these Sections are included in the Securities Laws (Amendment) Bill 2014 by prescribing minimum penalty to be imposed for each violation in the Securities Laws (Amendment) Bill 2014, in addition to the amendments included in the earlier Ordinance.

The Securities Laws (Amendment) Bill, 2014, aims to empower capital market watchdog Securities and Exchange Board of India (SEBI) by giving powers such as authority to seek call data records.

