REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 4719 OF 2008

SECURITIES & EXCHANGE BOARD OF INDIA ... APPELLANT

VERSUS

MAGNUM EQUITY SERVICES LTD. & ORS. ... RESPONDENTS

WITH

CIVIL APPEAL NO. 5235 OF 2008

SECURITIES & EXCHANGE BOARD OF INDIA ... APELLANT

VERSUS

SODHANI SECURITIES LTD. & ANR. ... RESPONDENTS

J U D G M E N T

VIKRAMAJIT SEN, J.

1 These Appeals assail the decisions of the Securities Appellate Tribunal (for brevity 'Tribunal') dated 23.1.2008 and 29.1.2008, both of which reversed

the Order dated 12.6.2007 of Securities Exchange Board of India (SEBI) declining to grant fee continuity to the Respondents before us. In these Appeals SEBI seeks to reaffirm its stance that the Respondents lost all entitlement to the advantage of fee continuity, no sooner any of the erstwhile partners ceased to be Whole-time Directors of the corporate entity which was the metamorphosed partnership firm.

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2 Magnum Capital Services (hereinafter referred to as the Firm) was a registered partnership firm, comprising of seven partners, carrying on business as a stock broker; and was a member of the National Stock Exchange (NSE). All the seven partners moved a conjoint application for registration of a company under the Companies Act, 1956, during the pendency of which one of the partners exited from the Firm. The company was incorporated on 22.5.1995 consisting of the remaining six partners, in the name and style of Magnum Equity Services Limited (hereinafter referred to as Magnum). There has not even been a semblance of a debate that the six partners had less than 40 per cent shareholding in the firm and/or that they do not hold forty per cent of the equity of Magnum. All the remaining erstwhile partners became the Whole-time Directors of Magnum. In pursuance to an application filed by the Firm, NSE transferred the membership card of the Firm to Magnum on 25.4.1996. Thus

Magnum became a member of NSE with effect from 25.4.1996. Subsequently, the Company applied to the Securities and Exchange Board of India (SEBI) for registration as a stock broker, which request was granted on 29.5.1997. After being registered as a stock broker, Magnum commenced its broking business. In December 1997, three Directors resigned from Magnum and transferred their shares to the remaining Directors and their family members. We must again hasten to clarify, that it is not the Appellant's case that the equity holding of the three continuing Whole-time Directors had fallen below the 40 per cent criterion. Magnum also claimed the benefit of the fee which the Firm had paid earlier to SEBI. This claim was made on the ground that the earlier business carried on by the Firm had been transferred to Magnum and as a result there was continuity of that business. SEBI rejected this claim vide Order dated 12.6.2007 on the predication that only three out of the seven partners of the firm continued as its Whole-time Directors for the mandatory period of three years, which was in contravention of the conditions laid down in Paragraph I(4) of Schedule III of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 (Regulations for brevity). For the facility of reference, Paragraph I(4) is reproduced below:

> "4. Where a corporate entity has been formed by converting the individual or partnership membership card of the exchange, such corporate entity shall be exempted from payment of fee for the period for which the erstwhile individual or partnership member, as the case may be, has already paid the fees subject to the condition that the erstwhile individual or partner shall be the whole time

director of the corporate member so converted and such director will continue to hold a minimum of 40 per cent shares of the paid-up equity capital of the corporate entity for a period of at least three years from the date of such conversion.

Explanation – It is clarified that the conversion of individual or partnership membership card of the exchange into corporate entity shall be deemed to be in continuation of the old entity and no fee shall be collected again from the converted corporate entity for the period for which the erstwhile entity has paid the fee as per the regulations."

3 Aggrieved by the said Order, Magnum appealed before the Tribunal. The Tribunal observed that Paragraph I(4) in Schedule III of the Regulations was introduced on 21.1.1998. It provided for exemption from payment of fee where a corporate entity was formed by conversion of the individual or partnership card of the exchange. The Tribunal noted that the benefit of this provision was initially only given to those who corporatized on or after 21.1.1998. However, on representations made by those stock brokers who corporatized themselves prior to 21.1.1998, SEBI issued the Circular dated 28.3.2002 which extended the benefit to stock brokers who converted themselves into corporate entities between 1.4.1997 and 21.1.1998. The stock brokers who had corporatized prior to 1.4.1997 and who had been denied the fee continuity benefit challenged the said Circular in Alliance Finstock Ltd. v. Securities and Exchange Board of India in Appeal No. 123 of 2004 decided on 9.5.2006, wherein the Tribunal had held that the benefit of fee continuity be given even to those entities which corporatized themselves prior to 1.4.1997.

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It transpires that this view has attained finality, in terms of the decision of this Court in C.A. No.4493 of 2006, SEBI v. **Alliance Finstock Ltd.** (2015) 12 SCALE 271

4 The other issue which was a ground for refusal of the fee continuity benefit was that at the time of incorporation of Magnum, viz. 22.5.1995, it consisted of six members all of whom were erstwhile partners of the Firm and were also the Whole-time Directors of Magnum. However in December 1997, three out of the six erstwhile partners left. According to SEBI, the exit of these three partners disqualified Magnum from the benefit of fee continuity. The Tribunal referred to **Punit Capital & Debt Market Pvt. Ltd**. Vs. Securities and Exchange Board of India in Appeal No. 169 of 2004 decided on 4.5.2006, where the Tribunal had interpreted Paragraph I(4) and had held that the conditions enumerated in the said Paragraph would stand satisfied if one of the partners of the erstwhile partnership firm became a Whole-time Director in the corporate entity after its conversion. This decision was challenged before this Court, but was dismissed on the ground of delay, vide Order dated 25.11.2009. The Tribunal observed that in the case at hand, since three of the erstwhile partners of the firm remained Whole-time Directors in Magnum and continued to hold more than 40 per cent shares of the paid-up equity capital for a period of more than three years, the conditions set out in Paragraph I(4) stood satisfied. Before the Tribunal, SEBI placed reliance on its Circular dated 12.9.2002,

which stated that in order to get the benefit of Paragraph I(4), all the erstwhile partners should be Whole-time Directors in the corporate entity so formed. SEBI contended that the Circular issued a clarification, and hence was effective and efficacious retrospectively. The Tribunal rejected this contention, finding that the Circular was not clarificatory in nature, as it determined new parameters for the grant of the benefit of fee continuity and it was not effective retrospectively. The Tribunal, vide order dated 23.1.2008, allowed the Appeal and set aside the order of SEBI.

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5 M/s. Sodhani and Company was a registered partnership firm carrying on business of stock broking as a member of the NSE since November 1994. The firm consisted of four partners having equal share holding. In June 1997, the partnership firm corporatized itself as Sodhani Securities Ltd. and three out of the four erstwhile partners became its Whole-time Directors and continued to hold more than 40 per cent shares for three years subsequent to corporatization; the fourth partner continued only in his capacity of a shareholder. Sodhani Securities Ltd. was issued a certificate of registration as a broker by SEBI on 31.3.1998 and thereupon it claimed the benefit of fee continuity, which was rejected by SEBI vide order dated 12.6.2007. Reliance was placed on the aforementioned Circular dated 12.9.2002. Aggrieved by the said Order, Sodhani Securities Ltd. filed an Appeal before the Tribunal which, on

29.1.2008, held in favour of Sodhani Securities Ltd. stating that a plain reading of the Regulation indicates that "the erstwhile partner" had to become "the Whole-time Director" and that the reference was to any one of the partners. The Tribunal also referred to and applied **Punit Capital and Debt Market Pvt. Ltd**.; it reiterated that the Circular dated 12.9.2002 was not retrospective. Thus, as Sodhani Securities Ltd. got itself registered with SEBI as a corporate entity on 31.3.1998, which was well before the date of the Circular, viz. 12.9.2002, it had no applicability or relevance to Sodhani Securities Ltd. Further, the Tribunal observed that a similar view had been taken by the Tribunal in the case of Magnum Equity Services Ltd.

6 Learned Senior Counsel for the Appellant has relied on Section 13 of the General Clauses Act, 1897, sub-section (2) of which provides that singular includes plural and vice versa. In light of this provision, Counsel has submitted that the term "partner" as used in Paragraph I(4) of Schedule III implies 'partners', and that all the partners who comprised the partnership firm at the time of corporatization would have to remain part of the corporate entity for at least three years post conversion. Further, the exit of any partner other than due to death shall amount to altering the nature of the entity which is not in keeping with the spirit of continuity as envisaged by the provision. Counsel further contended that giving the provision a strict interpretation would lead to an absurdity, as that would imply that one person is to hold 40 per cent shares

because the term used in the provision is "Whole-time Director" indicating a singular person.

7 Counsel for the Respondents have contended that on a plain reading of Paragraph I(4) it is evident that the requirement was only that an erstwhile partner must be appointed as a Whole-time Director after the corporatisation of the firm for a minimum period of three years from the date of conversion, and that such Whole-time Director should hold at least 40 per cent shares of the paid-up equity capital. Counsel submitted that it was the prerogative of the corporate entity as to the number of erstwhile partners it appointed as its Whole-time Directors. Thus so long as the Respondents satisfied the criteria of an erstwhile partner being appointed as a Whole-time Director and that such person held 40 per cent shares of the paid-up equity capital of the company, the Respondents could not be found to be in violation of Paragraph I(4) of Schedule III.

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8 We have carefully cogitated upon the arguments articulated before us. As already mentioned, the issue regarding the benefit of fee continuity being granted to entities which corporatized prior to 1.4.1997 has been settled by this Court in SEBI v. **Alliance Finstock Ltd.** (2015) 12 SCALE 271 [Civil Appeal No. 4493 of 2006] wherein it has been held that even if a partnership or sole

proprietor corporatized prior to 1.4.1997, fee continuity benefit could be availed of.

9 The other issue that remains to be decided by us is with respect to the interpretation of Paragraph I(4) of Schedule III of SEBI (Stock Brokers and Sub-Brokers) Regulations 1992. The main contention raised by learned Senior Counsel for the Appellant is based on the application of The General Clauses Act, 1897 which under Section 13(2) states that plural includes singular. However, before we consider Section 13, we shall have to determine whether the General Clauses Act itself is applicable to the SEBI (Stock Brokers and Sub-Brokers) Regulations 1992. Section 3 of The General Clauses Act, 1897 states that the said Act is applicable to all Central Acts and Regulations made after the commencement of this Act. Further, the term Central Act has been defined under sub-section (7) as an Act of Parliament, which includes (a) an Act of the Dominion Legislature or of the Indian Legislature passed before the commencement of the Constitution, and (b) an Act made before such commencement by the Governor-General in Council or the Governor-General, acting in a legislative capacity. The SEBI (Stock Brokers and Sub-Brokers) Regulations 1992 are issued by SEBI in exercise of the powers conferred on it under Section 30 of the SEBI Act, 1992. Section 31 of the SEBI Act, reproduced below for the facility of reference, provides that Rules and Regulations are to be laid before Parliament.

> Every rule and every regulation made under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or regulation or both Houses agree that the rule or regulation should not be made, the rule or regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule or regulation.

10 Thus in light of the provisions of the SEBI Act, 1992 under which the said Regulations have been issued, the latter do not tantamount to a Central Act as defined under sub-section (7) of the definition clause of The General Clauses Act, 1897. As a result we cannot accept the submission made by the Senior Counsel for the Appellant that The General Clauses Act is applicable while interpreting the language of Paragraph I(4) of Schedule III of the Regulations. Ergo, what is postulated and prescribed is that even if an individual erstwhile partner holds 40 per cent of the equity and remains a Whole-time Director for the stipulated period of three years, fee continuity would become available. Moreover, the figure of 40 per cent cannot be rendered nugatory; it has a purpose viz. the umbilical cord between the firm and the company is present and palpable, and yet fluidity and growth, the *raison d'etre* for allowing corporatisation is also respected. The mutation is substantially of the same legal entity, in that process the erstwhile firm has no continuity of identity.

11 We are in agreement with the Tribunal on the interpretation it has given to Paragraph I(4) of Schedule III. We shall elucidate our understanding of Paragraph I(4) as it stood, up until the issuance of Circular dated 12.9.2002. Anecdotally, a partnership firm which consists of five partners and which holds a membership card of a stock exchange, may decide to convert itself into a corporate entity. After incorporation, of the five erstwhile partners, one of the partners holds 40 per cent shares of the paid-up equity capital of the newly formed corporate entity and is also its Whole-time Director. Subsequently, four of the partners decide to exit from the corporate entity, leaving behind only the Whole-time Director who was also an erstwhile partner. In our opinion the said corporate entity will still be eligible for the benefit of fee continuity under Paragraph I(4) of Schedule III of the Regulations.

12 In order to qualify for the benefit of the said provision, there is a two-fold requirement. First, the corporate entity must earlier have been either a sole proprietorship or a partnership. Second, an erstwhile partner should own at least 40 per cent of the paid-up equity share capital and should also be the Whole-time Director of the company, for a minimum period of three years. Alternatively, erstwhile partners who together hold at least 40 per cent equity must remain Whole-time Directors for a minimum of three years. Thus the subsequent entry or exit of partners to and from the original partnership firm would have no relevance on the entitlement of the newly formed corporate

entity to take advantage of the benefit not only of fee continuity under the said provision but also fillip to the growth of the corporate sector and the national economy.

13 The same benefit would also be extended to erstwhile partners who after corporatization jointly retain at least 40 per cent of the paid-up equity capital of the corporate entity and were its Whole-time Directors. In other words, if there are five partners, of which three partners subsequent to corporatization jointly hold 40 per cent of the shares of the paid-up equity capital and are also the Whole-time Directors of the company, then the departure of the other two erstwhile partners will not deny the corporate entity the benefits of fee continuity.

14 We also agree with the finding of the Tribunal that the Circular dated 12.9.2002 is not clarificatory. A clarificatory Circular is for the purpose of elaborating the existing provision and removing ambiguities, without altering the effect of the said provision. However, in the instant case, our interpretation of Paragraph I(4) prior to the issuance of Circular dated 12.9.2002, is contrary to that mentioned in the said circular. Hence this Circular cannot be held to be clarificatory in nature, and as a logical corollary is not capable of having any retroactive effect.

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15 We thus find no merit in these Appeals and accordingly dismiss the same. There will be no orders as to costs.

.....J.
[VIKRAMAJIT SEN]

.....J.
[SHIVA KIRTI SINGH]

NEW DELHI,
NOVEMBER 30, 2015.

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