PART FOUR: REGULATORY CHANGES

1. REGULATORY AMENDMENTS

I. SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) (Amendment) Regulations, 2005

The above Principal Regulations were examined by the Hon'ble Committee of Subordinate Legislation, Lok Sabha which raised certain queries and made certain suggestions for their improvement. Accordingly, under intimation to the Hon'ble Committee, SEBI amended the above Principal Regulations which were notified in the Official Gazette *vide* S.O. No. 779(E) on June 7, 2005. The main features of the amendments are the following:

a) Regulations 6(3)(i), 8 and 16(2), pertaining to the notice period to intermediary for submission of written statement, time period for such submission and time period for submission of written submissions in summary proceedings, respectively were amended requiring the Enquiry Officer conducting summary proceedings to record reasons if he decides to extend such time periods.

b) Regulation 13(2) was amended to specifically require that the enquiry report shall be enclosed with the post-enquiry show cause notice issued by the Chairman or Member.

c) A non-binding indicative time limit of 120 days from the receipt of reply of the intermediary is given for the Chairman or Member to pass the final order pursuant to an enquiry.

II. SEBI (Mutual Funds) (Amendment) Regulations, 2006

SEBI had constituted a Committee under the Chairmanship of Shri Madhukar, the then Whole Time Member, SEBI to look into necessary amendments for implementing the announcement made by the Hon'ble Finance Minister in his Union Budget 2005-06 speech for the introduction of Gold Exchange Traded Funds (GETFs). Pursuant to the recommendations of the Committee, SEBI (Mutual Funds) Regulations, 1996 were amended on January 12, 2006 *vide* S.O.No.38(E) to provide for launching and regulation of GETFs. The main features of the amendment are as follows:

a) A GETF scheme can invest primarily in gold or gold related instruments. For this purpose, 'gold related instruments' shall be such instruments having gold as underlying, as may be specified by SEBI from time to time.

b) The gold or gold related instruments of a GETF scheme may be kept in the custody of a bank, which is a SEBI registered custodian.

c) The following are the regulatory provisions made in respect of GETF schemes:

   (i) Their funds can be invested only in gold or gold related instruments, except to the extent necessary to meet liquidity requirements of the scheme;

   (ii) Pending deployment of funds, such schemes may invest their funds in short term deposits of scheduled commercial banks;

   (iii) The initial issue expenses of such scheme cannot exceed 6 per cent of the funds raised; and

   (iv) Recurring expenses incurred towards storage and handling of gold can be charged to the scheme, among other permissible expenses.

III. SEBI (Custodian of Securities) (Amendment) Regulations, 2006

To further facilitate introduction of GETF schemes, the SEBI (Custodian of Securities)

Regulations, 1996 were amended *vide* S.O. No. 39(E) on January 12, 2006. The main features are as under:

a) It created a new class of custodians which may provide custodial services in respect of gold or gold related instruments held by a mutual fund (GETF scheme);

b) Existing custodians can take up this new activity with the prior approval of SEBI; and

c) An applicant for this new activity has to possess requisite approval for providing such services under other applicable laws, apart from fulfilling other eligibility criteria which are applicable to all custodians generally.

IV. SEBI (Venture Capital Funds) (Amendment) Regulations, 2006

SEBI (Venture Capital Funds) Regulations, 1996 were amended on January 25, 2006 *vide* Gazette Notification S.O. No. 93 (E) to permit a venture capital fund to invest in securities of foreign companies subject to conditions or guidelines issued by the Reserve Bank of India and the Board from time to time. To give effect to the amendment, definition of foreign company was inserted in line with the meaning of foreign company under Section 591 of the Companies Act, 1956.

2. SIGNIFICANT COURT PRONOUNCEMENTS: 2005-06

I. Supreme Court Cases

i. TECHNIP SA vs. SMS Holdings Pvt. Ltd. - Civil Appeal Nos. 9258-9265 of 2003

In the above matter, eight appeals were heard together on the issue of application of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 to the control of South East Asia Marine Engineering and Constructions Ltd. (SEAMEC) acquired by Technip through Coflexip without making public announcement. SEBI had directed Technip to make a public announcement and also to pay interest @ 15 per cent per annum to the shareholders for the delayed public announcement. In appeal, SAT had held that the applicable law to the question as to when control of SEAMEC has been taken over by Technip was the Indian law. The view of SEBI was that the applicable law for determining the date on which Technip acquired control over Coflexip would be the French Law. In the appeal filed by Technip before the Supreme Court, it was urged that the applicable law was French law since Technip and Coflexip were both registered in France and the takeover of Coflexip by Technip also took place in France. Hon'ble Supreme Court was pleased to uphold SEBI's order and set aside the order passed by SAT. Hon'ble Supreme Court was pleased to observe that for the purpose of determining Technip obligation under the Takeover Code, SAT should have addressed itself as SEBI had done to the question whether ISIS and Technip were acting in concert to obtain control over the target company *i.e.*, SEAMEC.

ii. SEBI vs. Roopram Sharma – Civil Appeal No. 4242 of 2004

SEBI had filed this appeal to challenge the order of SAT whereby in spite of holding that the respondent was in fact an Executive Director and involved in the public issue which was manipulated to defraud investors, SAT had struck down the directions of SEBI Chairman under Section 11B of SEBI Act prohibiting the respondent from accessing the capital and securities market for a period of three years. SAT had allowed the appeal of the respondent on the ground that though the charges against the respondent stood proved,

the directions of the Chairman tantamount to imposition of penalty which could not be passed under Section 11B in terms of which only directions of remedial nature could be passed. Hon'ble Supreme Court, while admitting SEBI appeal, has stayed the operation of the SAT judgment.

II. High Court Cases

i. Special Leave Application No.13946 of 2004 and Allied Matters, Ramesh Chandra Bansal vs. SEBI & Ors. - In the High Court of Gujarat at Ahmedabad

The Hon'ble High Court held

(i) There is no obligation upon SEBI, neither under the SEBI Act nor under the Regulations, to float a Scheme for awarding concession for the payment of outstanding interest and correspondingly, there is no legal right vested in the petitioners to get concession in the payment of interest.

(ii) The Scheme floated by SEBI is a sort of Settlement Scheme, which does not purport to adjudicate any rights and liabilities of the stock brokers. As large number of disputes relating to fees were pending from 1992 and as no regular payment of registration fees was coming to the stock exchanges and with a view to regularise the dues, the Scheme was floated by SEBI. It provided for deposit of 20 per cent of outstanding amount of interest and waiving of the remaining 80 per cent of interest on condition that the stock brokers should supply the turnover data with break-up and with Auditor's certificate on or before the cut-off date *i.e.,* July 15, 2002. The cut-off date was extended up to April 10, 2003 and was further extended up to August 31, 2003. They are entitled to avail the benefit of Settlement Scheme or Regularisation Scheme. Thus, it is a composite Scheme and, therefore, concession given and conditions imposed cannot be segregated.

(iii) In the absence of bifurcated data of turnover of the petitioners, SEBI can calculate the registration fees as per Para I (1) (b) of Schedule III of the Regulations. If any stock broker wants to avail the benefit of concessional rate of registration fees for those exceptional transactions, the burden is upon such claimant, i.e., upon the petitioners. If they fail to prove the existence of such exceptional transactions and if they fail to separate those turnovers from gross turnover, SEBI can calculate registration fees at 0.01 per cent of the gross annual turnover, as per Clause (b) of Clause (1) of Para I of Schedule III to the Regulations.

(iv) SEBI has power to calculate the registration fees at 0.01 per cent of gross annual turnover of the stock brokers. Those who are claiming benefit of exception or proviso, have to prove exception facts, which are enumerated in exceptions or proviso *i.e.,* in Clause (bb). The petitioners have failed in discharging this burden. Therefore, assessment made by SEBI is as per SEBI Regulations, 1993.

(v) The choice of date cannot always be termed as arbitrary, even if no reason is provided. Therefore, unless it is shown to be capricious or whimsical, it cannot be quashed or accepted by the court.

(vi) The conditions attached with SEBI Scheme are reasonable and cannot be labelled as capricious or whimsical. Several extensions have been given by SEBI and a large number of members

of the Ahmedabad Stock Exchange had availed the benefit of concessional rate of registration fees.

(vii) The cut-off date prescribed by SEBI for supply of bifurcated data on the turnover is true and correct and there will be always cut-off date in such type of Scheme, which gives concessions, rebate or remission or which is in the nature of Settlement Scheme or Regularisation Scheme. The Scheme is waiving certain sum of money which is otherwise due and payable. Instead of allowing the amount to remain in dispute since 1992 onwards, it might have been thought fit by SEBI to give concession and to get money promptly and therefore, cut-off date shall always be prescribed. Open ended policy may not give them prompt recovery. It always depends upon the subjective satisfaction of the authority and therefore, the Court cannot quash and set aside such cut-off date, unless it is capricious or whimsical, nor can the court extend the benefit of the Scheme after expiry of such cut-off date.

(viii) The petitioners cannot claim, as a matter of right, the benefit of such Regularisation Scheme. The matter of rebate, concession or remission or concession at concessional rate is a matter of policy. Concession and conditions are interwoven with each other. Separation thereof will lead to absurdity. Court cannot be more charitable than the law or the Scheme floated from time to time under the law. Whenever the State is procuring public revenue to which it is entitled under the Act, such loss to the public revenue (waiver of interest etc.,) is supposed to be compensated in one form or other to get prompt money which is not paid since decade, can be one of the considerations. An open ended policy in such type of Regularisation Scheme may not have been thought fit by the legislature. The word 'Regularisation' itself suggests that instead of long drawn disputes and non-payment of registration fees from 1992 onwards, with a view to get speedy recovery, the concession of 80 per cent of interest on outstanding amount of interest had been given. Therefore, cut-off date, in such type of Schemes, is inevitable.

(ix) Grant of Regularisation Scheme along with conditions is a matter of policy. Several factors must have weighed with the authority before floating such type of Regularisation Scheme or the Scheme which gives concession, remission of the public revenue. Hon'ble Supreme Court has time and again held that on the matter of policy of Government, normally the court will not interfere unless the policy is shown to be contrary to law or arbitrary or unreasonable.

(x) The Scheme is absolutely true, correct and legal and in consonance with the SEBI Act. The calculation of registration fees adopted by SEBI in the absence of break-up turnover and in the absence of auditor's report before the cut-off date, is true, correct, legal and in consonance with the SEBI Act and the Regulations. The court cannot extend the benefit of the Scheme after the cut-off date, especially in the facts of the present case, when enough extensions have been given by SEBI and whereby a large number of stock brokers of Ahmedabad Stock Exchange have already availed the benefit of Scheme. The cut-off date is an integral part of the benefit under the Scheme. In fact, the cut-off date in this case is not arbitrary. The concession and

conditions of the Regularisation Scheme cannot be segregated. It is a matter of Government policy, that what to give as a concession, for, what is to be achieved promptly, without keeping the policy open ended. The Scheme is optional. It is in consonance with the SEBI Act and the Regulations.

III. Securities Appellate Tribunal Cases

i. Appeal No. 107 of 2004 – Bishwanath Murlidhar Jhunjhunwala vs. SEBI

SEBI noticed a spurt in the volume in the trading of the scrip of Snowcem India Ltd. (SIL), both at NSE and BSE. Though the scrip was not very liquid, it was observed that during June 1999 to August 1999, price of the scrip ranged between Rs.55 to Rs.127.

The Appellant, a stock broker of BSE himself was found to have registered himself as a client with a broker of NSE and placed orders in large quantities in the scrip of SIL to the tune of 2,87,400 shares which amounted to 5.59 per cent of the total volume traded at NSE between June 1999 and August 1999. Orders placed by the Appellant were matched with those orders placed by Kosha Investment Ltd. (KIL). Further, the Appellant had not traded in his own account at BSE. The conduct of the Appellant was in violation of Regulation 4 (a), (b) and (d) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 in view of which he was prohibited from accessing capital market for a period of 2 years.

Upholding the impugned order in its totality, the Hon'ble SAT noted that, "It is a fact that the persons who operate in the market are required to maintain high standards of integrity, promptitude and fairness in the conduct of business dealings. I do not find any reason to interfere with the order of the respondent."

ii. Appeal No. 46 of 2005 – Padmini Technologies vs. SEBI

During the investigation done by SEBI into the buying, selling and dealing of shares of Padmini Technologies Ltd., the Appellant was required to provide certain information to SEBI as sought in summons dated October 3, 2003. In view of the Appellant's failure to comply with the said summons, an adjudicating officer was appointed to inquire into and adjudge the non-compliance of the Appellant.

Adjudicating officer holding the Appellant responsible for not complying with the said summons issued by SEBI, *vide* order dated August 16, 2004 and imposed a penalty of Rs.5 lakh on the Appellant. Appellant challenged the said order passed by adjudicating officer before the Hon'ble SAT by way of the instant appeal.

Hon'ble SAT *vide* order dated June 28, 2005, *inter alia,* observed as follows:

"When a serious case of alleged fraud with respect to allotment of preferential shares has taken place, it is the duty of the respondent to get to the information that is necessary and the appellant did not co-operate with the respondent by not responding to the show cause notice primarily.

Legal semantics cannot be an answer for genuine investigation with respect to alleged fraud since the preamble of the SEBI Act clearly states that the primary duty of SEBI is to protect the interests of investors in securities and to regulate the securities market and for matters connected therewith or incidental thereto.

The adjudicating officer was fully justified in holding that the appellant did not co-

operate with the adjudicating officer in furnishing information. It appears to us that the appellant took an intransigent attitude in the matter of furnishing information and the non-compliance of the appellant to the summons issued to him is violation of Section 15A of the SEBI Act.

In these circumstances, we have no hesitation in confirming the order passed by the adjudicating officer."

iii. Appeal Nos. 134,137,138 139 158,159,160,161,162,163 and 164 of 2005 before the Hon'ble SAT (Sultania and Hindustan National Glass and Industries Ltd. (HNGIL) Matter)

The issue in all the appeals is one and the same. The main issue in these appeals is that on November 13, 2003, the acquirers made public announcement for acquiring of 19.19 per cent shares of HNGIL at a price of Rs.47.70 per share (Rs.43 plus Rs.4.70 as interest). The Appellants contended that the same was not in accordance with the Takeover Regulations and urged SEBI to intervene. It is stated that SEBI appointed M/s. Patni & Co., Chartered Accounts to conduct valuation of HNGIL.

M/s. Patni & Co. arrived at the value of Rs.63.50 by one method and a value of Rs.64.17 as per the method approved by the Supreme Court in HLL Employees Union Case. It is stated that the appointment of M/s. Patni & Co. was objected on the ground that they were not independent valuers in terms of Takeover Regulations as they were associated with Registrars to the offer. In April 2005, UTI Bank Ltd., at the instance of SEBI, appointed another valuer, M/s. T. R. Chadha & Co. and they arrived at the value of Rs.60.04 per share.

The Appellants have alleged that SEBI has given go ahead to the acquirers *i.e.*, ACE Glass Containers Ltd. and C. K. Sumani to proceed with open offer at a price of Rs.64.17 plus interest per share almost two years after the public announcement was made on November 13, 2003.

In the said appeals, the Appellants have challenged the letter dated August 19, 2005 issued by SEBI whereby, it had conveyed, in terms of proviso to Regulation 18(2), the comments on the revised draft letter of offer. The Appellant alleged that SEBI has accepted the offer price specified in public announcement and corrigendum thereto, has not taken into consideration any of the letters written by the Appellant, has not taken into consideration the valuation reports and opinions relied upon by the Appellant and is guilty of non-application of mind. It was further alleged that the offer price, as approved by SEBI, was against/ contrary to the provisions of Regulations 20(5) of the Takeover Regulations.

After the hearing, Hon'ble SAT *vide* order dated December 8, 2005 dismissed the appeals stating that the appeals are devoid of merit and also observed the following:

- "It is not prudent or in public interest to overlook the role of the regulator in fixing of a fair price with respect to illiquid shares since it acts in the interest of the shareholders. The fact that the regulator did not accept Rs. 40 which could have been done under Regulation 20(5) (a) & (b) is a clear indication that the regulator wanted a fair bonafide offer of market price per share to be offered in the open offer to the shareholders. The regulator has done this by scrupulously following the proviso to Regulation 20(5)".

In the aforesaid decision, Hon'ble SAT upheld the action taken by SEBI in the matter.