

Business Standard

Standardising regulatory prescriptions

Realisation of statutory objectives in the securities market requires absolute clarity of statutory provisions

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Market regulator Securities and Exchange Board of India (Sebi) passes a variety of preventive and remedial orders, ad interim or final, in the public interest—namely, the interest of investors in the securities market. Most such orders prohibit association with the securities market in general, in addition to specific prohibitions. A recent order in *Jalan Cement Works Ltd vs Sebi*, for example, prohibits the persons concerned from accessing the securities market from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of one year. Prohibiting a person from associating with the securities market seems to be an Indian innovation, with no parallel elsewhere. However, the law does not define “association”; hence it is not clear what is prohibited and what is not. The prohibited persons use their own definition to comply with the order, while stakeholders may ostracise them from the market altogether to avoid the wrath of the regulator. As stakeholders do not understand association uniformly, the extent

of prohibition suffered may be more or less than what is intended, and consequently markets may suffer from over or under prohibition, frustrating the regulatory objective.

The Sebi Act envisages three explicit forms of associations with the securities markets, namely, (a) acting as an intermediary; (b) accessing securities markets; and (c) buying, selling or dealing in securities. As these have potential to impact the public interest substantially, any direction “not to associate with the securities market” would obviously mean cessation of these associations. Difficulty, however, arises when the order prohibits association with the securities market in any manner whatsoever, extending the scope of association.

One may impact the public interest if one has the right to make decisions — via a controlling stake or a key managerial position — in relation to the securities markets, an intermediary, a listed company or a market transaction. Even without any formal right, one may decide matters relating to the securities market, say, through a front to trade on behalf of an individual or an entity. Prohibition obviously covers associations having a decision-making role, formal or informal. Can the scope be stretched to include a minority shareholder, retail investor, ordinary employee, subsidiary or a professional who may be in a position to influence decisions in relation to the securities markets?

Stretching the scope further, A could be considered associated with the securities market indirectly if it is associated with B, who is associated with C, who in turn is associated with an intermediary. A vendor — a technology provider to a market intermediary, lessor of premises to a listed company, or municipal body supplying electricity to a market infrastructure institution — could be considered associated. An expansive scope of association may lead to absurdity, having no nexus with the purpose.

In the absence of statutory guidance, stakeholders have been seeking guidance from courts. In *Pan Asia Advisors Ltd vs Sebi*, the apex court held that association in any manner encompasses anyone who, directly or indirectly or in a subterfuge manner, deals with securities to deceive the securities market and the investors. In *Karnavati Fincap Ltd & Anr*, the Gujarat High Court ruled that association includes all and sundry having something to do with the securities market. In specific cases, a director, key managerial personnel, auditor, investor, shareholder, insider and adviser have been held to be associated persons. Using rules and principles, the courts have taken a broad view of association in specific fact situations.

The association always includes specific associations such as dealing in securities or with a listed company. In its order in CG Power and Industrial Solutions Ltd, Sebi

has clarified that “dealing in securities in any manner whatsoever” applies to securities held in listed companies and their unlisted subsidiaries and private companies, where promoters are listed companies. This also includes voting as a shareholder in listed companies/promoter companies of listed companies and subsidiaries of listed companies. The same order clarified that being associated with any listed entity includes involvement in the capacity of an advisor/consultant.

The association also includes an “associated person” who, as defined in the certification regulations, is a principal or employee of an intermediary or an agent or distributor or other natural person engaged in the securities business.

Should the prohibition by way of interim orders be complied forthwith? Because, compliance with some directions could be irreversible. There are several instances where interim orders are reversed or revoked in the final order. It is unreasonable for a person to suffer irreversibly on account of an interim view, which Sebi may ultimately find to be incorrect. This does not mean business as usual, frustrating the order. Since prohibition is not punishment, as held by the Supreme Court in the *21st Century Entertainment Pvt Ltd* case, the ideal compliance could be suspension of association, till the confirmatory order, avoiding any possible impact on public interest.

Should the prohibition comply with applicable laws to come into effect? Sebi may, for instance, direct discontinuation as a director in a listed company. However, the company law provides a procedure for the removal of directors and entitles shareholders to do so. In the *Sahara India Real Estate Corporation Ltd* case, the Supreme Court held that the Sebi Act is a special law and a complete code in itself. Being a special Act dealing with a specific subject, it has to be read in harmony with the company law. Further, Sebi’s power to restrain an individual from acting as a director in a listed company has been upheld in several matters. Therefore, prohibition comes into effect immediately and it is not contingent on the process to be followed under the Companies Act.

It makes sense to provide statutory guidance of the term association, to ensure uniform compliance. Such guidance could be informed by what is required in the public interest, yet does not amount to unreasonable restriction on freedom of trade or business under the Constitution. Till that is done, the market should use a relatively more expansive definition of association to avoid being on the wrong side of the law.

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First Published: Jun 13 2022 | 11:29 PM IST

Page URL :https://www.business-standard.com/article/opinion/standardising-regulatory-prescriptions-122061301247_1.html