Fault lines in India's regulatory state

Regulators must rebuild walls separating lawmaking, enforcement, and adjudication

ILLUSTRATION: BINAY SINHA

The discourse on the separation of powers in India has traditionally centred on the legislature, executive, and judiciary within the constitutional framework. The sharper challenge today, however, lies beyond this classical trinity, in the proliferating world of regulatory bodies. Regulators operate as mini-states within their domains, simultaneously exercising quasi-legislative, executive, and quasi-judicial powers.

In practice, this often means that the same individual or division within a regulatory agency may perform multiple roles — lawmaker, investigator, and adjudicator — with blurred procedural boundaries. The Supreme Court, in *Clariant International Ltd & Anr vs Sebi (2004)*, observed that the regulator not only frames regulations but also administers them and adjudicates their contraventions. It cautioned that the integration of these powers within the same body "may raise several public law concerns in future."

M S SAHOO & SUMIT AGRAWAL

There is a growing recognition of the need to separate executive and quasi-judicial functions, ensuring that the individuals tasked with establishing facts are different from those empowered to impose penalties. In *Vishal Tiwari vs Union of India (2024)*, the Supreme Court directed the Securities and Exchange Board of India (Sebi) to maintain a separation between its quasi-judicial and executive arms. A comparable institutional design exists in competition law, where the office of the Director General (Investigation) functions independently of the Competition Commission of India. Many regulators follow the convention that matters emanating from the domain of one whole-time member are adjudicated by another.

Yet, this separation often collapses in practice. Company law mandates the National Financial Reporting Authority (NFRA) to organise its functions into distinct divisions. However, non-segregation of audit quality review from disciplinary functions led the Delhi High Court, in *Deloitte Haskins vs Union of India (2025)*, to quash several of its show-cause notices and final orders. While admitting an appeal against this decision, the Supreme Court has restrained NFRA from issuing or enforcing any final orders, pending adjudication.

The United States offers a sharper contrast. Agencies such as the Securities and Exchange Commission (SEC) and the Federal Trade Commission maintain a much stricter divide between their investigative staff and adjudicatory commissioners. The US Supreme Court recently reinforced this principle in *SEC vs Jarkesy (2024)*, holding that the SEC could not employ its in-house administrative law judges to impose civil penalties for fraud, as doing so violated the constitutional right to a jury trial. Adjudication must rest with courts when penalties carry a punitive character.

The fusion of quasi-legislative and quasi-judicial functions is even more problematic, for it conflates the lawmaker and the adjudicator in the same person. It is akin to Parliament enacting a law and then sitting in judgement over its violations, something no constitutional democracy can countenance. NFRA's experience illustrates how regulators may fail to implement the safeguards envisaged by the legislature. It is unrealistic to expect every regulator to design such safeguards for itself. Even if it does, it could readily dilute or modify them to suit its administrative convenience.

The Insolvency and Bankruptcy Board of India (IBBI) initially framed regulations providing a vital safeguard: A whole-time member associated with an investigation shall not participate in its adjudication. It later amended this provision, narrowing the term to mean involvement. This seemingly technical change has profound implications. It allows members with supervisory or institutional links to an investigation to adjudicate the very matters they oversaw. In its legislative capacity, the regulator diluted a safeguard against bias; in its judicial capacity, it now applies that diluted rule, making the risk of conflict both real and immediate.

In the constitutional scheme, penalties are prescribed by the legislature and imposed by the judiciary. Until the early 1990s, it was inconceivable that an entity outside the government could levy monetary penalties. In the interest of regulatory governance, however, Sebi was empowered to impose such penalties, but under strict conditions. The statute specified the contraventions and corresponding penalties. Sebi could impose them only under rules made by the Central government, and the penalties were to be credited to the Consolidated Fund of India. This approach has been replicated across regulatory laws.

Over time, the catalogue of contraventions and sanctions has expanded steadily through subordinate legislation and subsidiary instructions. The Sebi Act, for instance, penalises the violation of any provision of the regulations, effectively empowering the regulator to create new contraventions by rule-making. In some cases, regulations themselves prescribe penalties for non-compliance. The Sebi (Stock Brokers) Regulations, 1992, for example, specify a range of penalties for diverse lapses by brokers. A similar pattern is discernible across other regulatory domains, including insurance, pensions, and telecommunications.

Even circulars have progressively stretched the catalogue. For instance, a 2020 Sebi circular enumerates 28 specific contraventions under the Sebi (Listing Obligations and Disclosure Requirements) Regulations, 2015, and prescribes corresponding monetary penalties to be imposed by stock exchanges and credited to their Investor Protection Funds. Issued with the approval of the regulator, a recent stock exchange circular, while rationalising the penalty framework for brokers, introduced 12 new penalty provisions. In effect, the regulator both defines the offence and authorises itself or its delegates to impose penalties, illustrating the danger of the fusion of legislative and judicial functions.

As India's regulatory landscape stretches into new frontiers — fintech, data protection, climate governance — the temptation to give regulators sweeping powers will only intensify. There is nothing inherently wrong with empowering regulators. Modern markets demand strong, responsive institutions. But power must walk hand in hand with restraint. Regulators must lean towards caution in conflict-of-interest matters, guarding not just their independence but even its appearance.

What India needs are institutional design laws that clearly mandate three separate wings within the regulator — for rule-making, execution, and adjudication. Regulators should not have the discretion to outsource adjudication to agencies of their choosing. Where internal separation is not feasible, independent tribunals should step in. And courts must stay alert, calling out any regulator that blurs the line between writing the law and judging its breach.

India's constitutional promise lies not merely in effective governance but in fair governance. When regulators both frame the rules and sit in judgement over their breach, that promise begins to fade. The strength of the Indian regulatory state will be measured not by how much power it wields, but by how fairly it exercises that power. The separation of quasi-legislative and quasi-judicial functions within regulators is not a procedural nicety — it is fundamental to the integrity of governance.

The authors are advocates who previously served in regulatory bodies