

# The legal price of State failure

## Failure must carry consequences, whether by a market participant or the State

ILLUSTRATION: AJAY MOHANTY



Reportedly, the National Stock Exchange of India Ltd, the country's leading stock exchange, is set to settle with the Securities and Exchange Board of India (Sebi) long-pending allegations that it failed to conduct its business in accordance with applicable laws by paying ₹1,800 crore.

At one level, this is a settlement between a regulated entity and its statutory regulator. Significantly, however, it involves two agencies performing statutory regulatory functions. This assumes added significance in light of the proposed Securities Markets Code, which recasts stock exchanges as market infrastructure institutions (MIIs) and entrusts them with functions akin to those of the regulator.

It is now routine for MIIs to face monetary consequences for regulatory failures, through settlement or adjudication, occasionally accompanied by non-monetary sanctions. This reflects a policy preference: Serious structural measures, such as cancellation of authorisation, are often impractical, given regulatory entry barriers and the systemic implications. While such penalties may influence internal governance and compliance incentives, their deterrent effect is not unambiguous, particularly where the financial burden is ultimately borne by shareholders of the MII and investors in the wider market, the very constituencies the regulatory framework seeks to protect.

This raises a deeper structural concern: An asymmetry in accountability. Economic laws typically distribute responsibilities across State actors (ministries, regulators, adjudicatory bodies) and private participants, including firms and individuals. Accountability mechanisms, however, are uneven. Private actors operate within a dense framework of clearly defined contraventions and calibrated penalties. By contrast, accountability for State actors is more diffuse, and not always designed to address regulatory failure directly or proportionately.

Securities law illustrates this contrast. The statute and its regulations meticulously enumerate contraventions by private entities and prescribe penalties, including a residual provision for unspecified violations. Yet, they do not establish a comparable framework for addressing failures by the regulator itself in discharging

statutory functions, such as delays in decision-making or failure to act within prescribed timelines. Nor do they provide an equivalent regime of legal norms and consequences for lapses by public sector entities. Similar patterns are observable across sectoral regimes, where detailed compliance architectures for private actors coexist with relatively underdeveloped mechanisms for addressing lapses by public authorities.

In practice, this produces an imbalance. Contraventions are assessed not by their nature or impact, but by the identity of the actor. MIIs and Sebi both perform delegated regulatory functions that are often indistinguishable in substance, yet their accountability is fundamentally asymmetrical. When a private entity, such as an MII, defaults, consequences are structured and predictable. When a regulator or public authority falters in a similar role, consequences, if any, tend to arise through indirect and discretionary channels, such as judicial intervention or audit findings. Courts have, on occasion, imposed costs or directed compensation against State agencies, but such outcomes are case-specific rather than anchored in a statutory framework, and are often diluted or set aside on appeal.

Traditional objections to imposing monetary or personal liability on State actors are not without force. Financial penalties on government departments may reallocate public funds without generating meaningful deterrence, while personal liability for institutional failures may discourage decision-making in already constrained environments. Many failures, moreover, stem from systemic or policy-level limitations rather than individual misconduct.

Yet, these concerns justify calibration, not inertia. In sectors such as finance, telecommunications, and infrastructure, regulatory delays or lapses by public authorities can impose high costs on markets and citizens. For example, under the Insolvency and Bankruptcy Code, delays in approvals by adjudicatory bodies can materially affect resolution outcomes, even where market participants have fulfilled their roles. A framework that does not adequately account for such failures risks weakening overall regulatory discipline.

Enforcement frameworks do evolve with institu-

tional roles. Stock exchanges operated for decades without a formal penalty regime; only through legislative changes in 2019 were they explicitly brought within the ambit of monetary penalties. This shift recognised that as exchanges assumed greater regulatory responsibilities, the accountability frameworks had to deepen. A similar evolution is now warranted for State actors performing comparable functions in a market economy.

What is required, therefore, is not an identical treatment of public and private actors, but a coherent and proportionate accountability framework that evolves with function. Such a framework could: (i) identify categories of regulatory or administrative failure by State actors; (ii) distinguish between systemic deficiencies and individual misconduct; and (iii) prescribe calibrated consequences, ranging from institutional corrective measures and compensatory remedies to, in cases of deliberate or grossly negligent conduct, disciplinary or pecuniary sanctions. Where individual culpability is clear and intentional, responsible officials should be held accountable, subject to appropriate safeguards.

The safeguards are critical. Good-faith actions taken within statutory bounds should be protected through clear safe-harbour provisions. Liability should attach primarily to clear, attributable failures that meet defined thresholds, such as bad faith, gross negligence, or wilful disregard of statutory duties, rather than to outcomes shaped by broader policy or resource constraints. This would help avoid excessive risk aversion while ensuring that accountability is meaningful.

Transparency can play a complementary role. The law could require periodic public reporting of penalties and adverse findings against government departments and agencies, alongside those levied on private participants. Such disclosure, in a clear and accessible manner, would enable citizens to assess patterns of compliance and institutional performance. This can shape electoral choices, with voters potentially favouring governments that incur fewer penalties, an indicator of more effective and lawful administration. Over time, it can also drive systemic improvements and reinforce a culture of responsibility without relying solely on punitive mechanisms. Equally important is ensuring that affected parties, market participants, professionals, or citizens have access to effective remedies where State action or inaction causes harm. This includes timely redress, appropriate compensation, and enforceable directions to perform statutory duties.

A framework of this nature would align responsibility with accountability across both public and private domains. It would preserve institutional autonomy while ensuring that the exercise of public power, whether by the State or by bodies performing regulatory functions, is matched by credible consequences for failure. Without such symmetry, the promise of equality before the law remains incomplete. Embedding it in practice would strengthen regulatory discipline, enhance institutional legitimacy, and affirm a simple principle: Accountability must keep pace with authority, and the rule of law must bind all who exercise it.

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