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Court : Delhi

Decided On : Jul-24-2009

Reported in : 165(2009)DLT95; [2009]95SCL31(Delhi)

Judge : Sanjiv Khanna, J.

Acts : [Securities and Exchange Board of India Act, 1992](#) - Sections 11, 11(1), 11(2), 11B(1), 11B(2), 11B(2A), 11B(3) and 12; Securities Contracts (Regulation) Act, 1956; [Constitution of India](#) - Articles 14, 19(1) and 21; [Code of Civil Procedure \(CPC\) , 1908](#)

Appeal No. : W.P. (C) 10390/2009

Appellant : Chanchal Jain and ors.

Respondent : Securities and Exchange Board of India and ors.

Advocate for Def. : Neeraj Malhotra, Adv. for respondent No. 1 and ; Praveen Trivedi, JCO, ;

Advocate for Pet/Ap. : Vikramjit Banerji and; P.S. Sudhir, Advs

Disposition : Petition dismissed

Judgement :

Sanjiv Khanna, J.

1. The petitioners herein are distributors, 'who sell mutual funds to investors'. Earlier mutual funds were loading entry charges of upto 2 1/2 % on any investment made in a new mutual fund. Part thereof was passed on to the distributor towards his commission.

2. Securities and Exchange Board of India (SEBI, for short), respondent No. 1 herein, has now issued a new circular/guidelines dated 30th June, 2009 under which the mutual funds are barred from charging entry load.

The relevant portion of the circular dated 30th June, 2009 reads as under:

a) There shall be no entry load for all mutual fund schemes.

b) The scheme application forms shall carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor.

c) Of the exit load or CDSC charged to the investor, a maximum of 1% of the redemption proceeds shall be maintained in a separate account which can be used by the AMC to pay commissions to the distributor and to take care of other marketing and selling expenses. Any balance shall be credited to the scheme immediately.

d) The distributors should disclose all the commissions (in the form of trail commission or any other mode) payable to them for the different competing schemes of various mutual funds from amongst which the scheme is being recommended to the investor.

3. As per this circular, there cannot be an entry load for all mutual fund schemes. The net effect thereof is that the mutual funds will not pay any commission to the distributors from the entry load. The circular provides that the mutual fund scheme application forms shall carry a suitable disclosure that upfront commission to the distributors will be paid by the investor directly to the distributor and will be subject matter of a mutual contract between them. Thus the distributors have not been barred or prohibited from charging service fee and the service charges are to be

mutually settled by the investor and the distributor. The distributors are required to disclose all commissions payable to them for different competing schemes of mutual funds including the scheme, which is being recommended by the distributor to the investor.

4. Learned Counsel for the petitioner submits that the circular is ultra vires and illegal as SEBI does not have any power to issue the said circular under Section 11(2)(b) of the [Securities and Exchange Board of India Act, 1992](#). Section 11 of the said Act reads as under:

POWERS AND FUNCTIONS OF THE BOARD Functions of Board.

11. (1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

(2) Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for-

(a) regulating the business in stock exchanges and any other securities markets;

(b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

1[13][(ba) registering and regulating the working of the depositories,

2[14] [participants,] custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf;]

(c) registering and regulating the working of 3[15][venture capital funds and collective investment schemes],including mutual funds;

(d) promoting and regulating self- regulatory organisations;

- (e) prohibiting fraudulent and unfair trade practices relating to securities markets;
- (f) promoting investors' education and training of intermediaries of securities markets;
- (g) prohibiting insider trading in securities;
- (h) regulating substantial acquisition of shares and take-over of companies;
- (i) calling for information from, undertaking inspection, conducting inquiries and audits of the 4[16][stock exchanges, mutual funds, other persons associated with the securities market] intermediaries and self- regulatory organizations in the securities market;

5[17]['(ia) calling for information and record from any bank or any other authority or board or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which is under investigation or inquiry by the Board;']

- (j) performing such functions and exercising such powers under the provisions of 6[18][...]the Securities Contracts (Regulation) Act, 1956(42 of 1956), as may be delegated to it by the Central Government;

- (k) levying fees or other charges for carrying out the purposes of this section;

- (l) conducting research for the above purposes;

['(la) calling from or furnishing to any such agencies, as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions;'](m) performing such other functions as may be prescribed.

['(2A) Without prejudice to the provisions contained in Sub-section (2), the Board may take measures to undertake inspection of any book, or register, or other document or record of any listed public company or a public company (not being intermediaries referred to in Section 12) which intends to get its securities listed on

any recognised stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.][(3) Notwithstanding anything contained in any other law for the time being in force while exercising the powers under 7[22][clause (i) or Clause (ia) of Sub-section (2) or Sub-section (2A)], the Board shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908), while trying a suit, in respect of the following matters, namely:

(i) the discovery and production of books of account and other documents, at such place and such time as may be specified by the Board;

(ii) summoning and enforcing the attendance of persons and examining them on oath;

(iii) inspection of any books, registers and other documents of any person referred to in Section 12, at any place;]

[(iv) inspection of any book, or register, or other document or record of the company referred to in Sub-section (2A);

(v) issuing commissions for the examination of witnesses or documents.]

[(4) Without prejudice to the provisions contained in Sub-sections (1), (2), (2A) and (3) and Section 11B, the Board may, by an order, for reasons to be recorded in writing, in the interests of investors or securities market, take any of the following measures, either pending investigation or inquiry or on completion of such investigation or inquiry, namely:

(a) suspend the trading of any security in a recognized stock exchange;

(b) restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities;

(c) suspend any office-bearer of any stock exchange or self-regulatory organization from holding such position;

(d) impound and retain the proceeds or securities in respect of any transaction which is under investigation;

(e) attach, after passing of an order on an application made for approval by the Judicial Magistrate of the first class having jurisdiction, for a period not exceeding one month, one or more bank account or accounts of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder:

Provided that only the bank account or accounts or any transaction entered therein, so far as it relates to the proceeds actually involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder shall be allowed to be attached;(f)direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation:

Provided that the Board may, without prejudice to the provisions contained in Sub-section (2) or Sub-section (2A), take any of the measures specified in Clause (d) or Clause (e) or Clause (f), in respect of any listed public company or a public company (not being intermediaries referred to in Section 12) which intends to get its securities listed on any recognized stock exchange where the Board has reasonable grounds to believe that such company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market:

Provided further that the Board shall, either before or after passing such orders, give an opportunity of hearing to such intermediaries or persons concerned.]

5. Section 11(1) of the Act is very widely worded and casts a duty on the Board to protect the interest of the investors; promote, develop and regulate the securities market by such measures as it deems fit. Sub-section 2 does not restrict or narrows down the wide scope of Sub-section 1. Sub-section 2 is not exhaustive of the power and authority SEBI. Under Sub-section 1 itself, SEBI has been authorized and empowered to regulate securities market, which will include power to regulate and control issue of new mutual funds by mutual fund managers and subscription to the said funds including application forms. Under Sub-section 1,

SEBI can regulate payment of commission or state that there shall not be any entry load. SEBI is controlling and regulating new issues by mutual fund managers. While doing so, they are entitled and empowered to issue circulars in respect of entry load in the new mutual fund. The contention of the learned Counsel for the petitioner that under Section 11(2)(b) distributors of mutual funds cannot be regulated as they are not registered with SEBI, is misconceived. Under Section 11(2)(b), SEBI has the power to regulate and control the working of the intermediaries like the distributors. It is difficult to accept that under Section 11(2)(b) SEBI can regulate the working of stock brokers, sub-brokers, intermediaries only if they are registered and not unregistered intermediaries like distributors. The power conferred under Section 11(2)(b) upon SEBI relates to both registration as well as the regulation. It is not possible to accept the contention that without registration of distributors, SEBI cannot control or regulate their working.

6. The second contention raised by the learned Counsel for the petitioners is that the circular infringes Articles 19(1)(g) and 21 of the [Constitution of India](#) as the petitioner's right to carry on trade and livelihood is violated. The contention has no merit. There is no prohibition in the circular which prevents the petitioners for carrying on trade and earn livelihood as a distributor. The petitioners are at a liberty to interact with the investors and fix the amount payable to them by the investor as per mutual contract. The petitioners have not been prohibited or barred from acting as distributors.

7. Learned Counsel for the petitioner submitted that Article 14 of the Constitution is violated as the petitioners have been discriminated. He submits that LIC agents are entitled to commission, which can go upto 40%. He further submits that the new circular will benefit larger and other national level distributors like banks. The said contention has no merit. Life Insurance policies serve a different purpose and object. Life Insurance policies form a separate class and cannot be clubbed with mutual funds. SEBI does not control and regulate life insurance policies. It is well known that rate of return in an LIC policy is substantially lower. The primary object of a life insurance policy is to secure and benefit beneficiaries on death of the insured. The rate of return in mutual funds is market driven. It is not possible to

accept the contention of the petitioner that insurance policies and their agents and mutual funds, agents and distributors form the same class and must have same rules of trade and charges. Article 14 does not prevent classification but ensures that there is no discrimination by treating two equals differently. Role of a distributor of a mutual fund is distinct and separate from the role of a life insurance agent. The plea that investors will invariably shift to bigger distributors or banks is merely an apprehension. Each investor is at a liberty to rely upon a distributor for making investment in mutual funds and settle terms of payment as per mutual contract. Investors will invariably examine pros and cons including the quantum of charges, quality of service, convenience, etc. before selecting a distributor.

8. The circular is for the benefit of the investors. It ensures transparency or openness as distributors have been asked to disclose the commissions they are entitled to, under different competing schemes of various mutual funds so that the investor can make a considered choice. Conflict of interest is avoided or at least informed to the investor. Distributor is required to disclose commission, if any, payable to him by the mutual fund on the investment made by the investor. Thus the circular does not bar payment of commission by a mutual fund but mutual funds cannot charge upfront load.

9. The distributor is entitled to charge for his services from the investor as per mutual contract. The scheme enforces and provides that there will be no entry load for all mutual funds. SEBI is an expert body, which is entitled to regulate the market and has now issued circular dated 30th June, 2009. In economic matters and matters relating to finance, courts are reluctant to interfere unless clear violation of Article 14 is made out. Sufficient latitude and play in the joints is required. In the case of *R.K. Garg v. Union of India and Ors.* : (1981) 4 SCC 675, it was observed as follows:

Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion etc. It has been said by no less a person than Holmes, J. that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or strait-

jacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in *Morey v. Doud* where Frankfurter, J. said in his inimitable style:

In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the judges have been overruled by events - self- limitation can be seen to be the path to judicial wisdom and institutional prestige and stability.

The court must always remember that 'legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry'; 'that exact wisdom and nice adaptation of remedy are not always possible' and that 'judgment is largely a prophecy based on meagre and uninterrupted experience'. Every legislation particularly in economic matters is essentially empiric and it is based on experimentation or what may one call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid. The courts cannot, as pointed out by the United States Supreme Court in *Secretary of Agriculture v. Central Reig Refining Company*, be converted into tribunals for relief from such crudities and inequities. There may even be possibilities of abuse, but that too cannot of itself be a ground for invalidating the legislation, because it is not possible for any legislature to anticipate as if by some divine prescience, distortions and abuses of its legislation which may be made by

those subject to its provisions and to provide against such distortions and abuses. Indeed, howsoever great may be the care bestowed on its framing, it is difficult to conceive of a legislation which is not capable of being abused by perverted human ingenuity. The court must therefore adjudge the constitutionality of such legislation by the generality of its provisions and not by its crudities or inequities or by the possibilities of abuse of any of its provisions. If any crudities, inequities or possibilities of abuse come to light, the legislature can always step in and enact suitable amendatory legislation. That is the essence of pragmatic approach which must guide and inspire the legislature in dealing with complex economic issues.

In view of the above, the writ petition is dismissed.

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