Chapter 5
Abusive Corporate Activities
An Overview

The ever expanding investor’s population and market capitalization led to variety of malpractices on the part of the companies, brokers, merchant brokers and many other market participants involved in new shares and stock in India. Recently, various scams in the securities market have shaken the confidence of genuine investors, which is the main factor for a stable, active, and free securities market. Even the main regulatory body i.e. SEBI that is primarily constituted for investor’s protection is unable to curb these practices. No doubt, SEBI after its constitution has made various reforms in the securities market which we have already discussed in third chapter but these reforms are mainly on papers; the implementation of rules, regulations made by SEBI/govt. is not such as it ought to be. In case the securities markets are not active and free, adequate information was not available to the investors promptly and widely; the unscrupulous people would be able to manipulate particular prices for their own ends. In any of these contingencies, the relative value of the securities would no longer be ‘true’ value so that the relative yields obtainable from them would be mutually distorted. The signposts, which in well regulated market show the way along which saving ought to move, would point in the wrong direction. Consequently, the good business would get less, and indifferent and bad business, more finance than they deserved. The savings of the community would be misdirected and wasted. In addition, some investors would incur losses that they might otherwise have avoided and other might
reap profits, which not otherwise could have been made. Any such unfairness between one investor and another is obviously undesirable.

From what we have discussed in previous chapter it is clear that SEBI under different Acts has wide powers. In this chapter, we will discuss various abusive corporate activities, problems in securities market, recent scam related to stock market through which we will see how far SEBI is exercising its powers, and the legal provisions made for curbing these abusive activities. There are various malpractices and defects in the securities market, which are as follows:

A. Manipulation of Prices

The market witnesses regular attempts by participants of the securities market to manipulate the prices of the scrip to their own advantages. The word 'manipulative' connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the prices of securities.\(^1\) Therefore, it is different from negligence. This is the tendency in which the market intermediaries artificially push up the prices of the securities. In such circumstances the prices do not reflect the intrinsic or the true values of the securities. This is generally done by buying and selling securities by a few groups of persons among themselves and thereby pushing the prices up. In the words of the president of the DSE "at present what goes on in the stock exchanges can be described as sheer gambling where the prices of the scrip

\(^1\) Ernest & Ernest Vs Hochfelder, 425, US, 185 (1976)
have no relation to the actual performance of the company. A few interested parties can take a scrip to a dizzy height or make it plummet to rock bottom.\textsuperscript{2}

The net effect of such price manipulation is that the helpless investors are misguided. The price rigging will result in a situation where the market sentiments are not influenced by the intrinsic value of the scrip and by the interplay of the market forces.

To curb this practice SEBI has issued regulations in 1995.\textsuperscript{3} The regulations prohibit fraudulent and unfair trade practices relating to securities markets. It provide that no person will:

- effect, take part in or enter into either directly or indirectly, transactions in securities, with the intention of artificially raising or depressing the prices of securities and thereby inducing the sale or purchase of securities by any person,

- indulge in any act, which is calculated to create a false or misleading appearance of trading on the securities market,

- indulge in any act that results in reflection of prices of securities based on transaction that is not genuine trade transactions,

- enter into a purchase or sale of any securities, not intended to effect transfer of beneficial ownership but intended to operate only as a device

\textsuperscript{2} The Economic Times, Feb. 2 1984
\textsuperscript{3} SEBI (Prohibition of Fraudulent and Unfair trade Practices relating to Securities Market) regulations 1995 notified by Notification No SEBI/LE/856 (E) dated 25.10.1995 issued by SEBI
to inflate, depress or cause fluctuations in the market prices of securities,
and
- pay, offer or agree to pay or offer, directly or indirectly, to any person
  any money or money’s worth for inducing another person to purchase or
  sell any security with the sole object of inflating, depressing or causing
  fluctuations in the market price of securities.  

In the above circumstances SEBI is empowered to appoint investigating
officer to investigate the conduct and affairs of any person buying, selling or
otherwise dealing in the securities.  

However SEBI’s power of investigation is limited and can be exercised
only for the following purposes:

- to ascertain whether there are circumstances which would render any
  person guilty of having contravened any of these regulations or any directives
  issued thereunder, and
- to investigate into any complaint of any contravention of the regulations,
  received from any investor, intermediary or any person.  

On completion of the investigation, the investigating officer will submit
a report to SEBI. SEBI may after consideration of the report filled by the
investigating officer issue direction for ensuring due compliance with the

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4 Regulation 4 of SEBI (Prohibition of Fraudulent and Unfair trade Practices relating to Securities
Market) regulations 1995
5 Regulation 7 (1), Ibid
6 Regulation 7 (2), Ibid
provisions of the Act, rules and regulations. But, before issuing such directions the person concerned will be given an opportunity of hearing to present his case. The directions may be issued for the following purposes:

- preventing the person concerned from dealing in securities in any particular manner,

- requiring the person concerned to call upon any of its officer, other employees or representatives to refrain from dealing in securities in any particular manner,

- prohibiting the person concerned from disposing of any of the securities acquired in contravention of these regulations, and

- directing the person concerned to dispose of any such securities acquired in contravention of these regulation, in such a manner as SEBI may deem fit, for restoring the status quo.

SEBI may also suspend or cancel the registration of the intermediary holding a certificate of registration under the Act.

The parties in various matters have challenged these powers of SEBI. Some of them are as follows:

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7 Regulation 11, Ibid
8 Regulation 12, Ibid
9 Section 12 of SEBI Act 1992
**BPL and Others V. SEBI**¹⁰

In this case the order of SEBI was challenged by the applicants. The orders were passed by SEBI directing the appellant company i.e. BPL “not to access the capital market for a period of four years” thereby prohibiting the appellant company from dealing the securities for a period of four years. The order further stated that the prosecution proceedings under section 24 of the Act would be initiated against the appellant company for violation of clause (a) and (d) of the regulations.¹²

The above directions were issued by SEBI on the findings based on documentary evidences, strong circumstantial evidences corroborated by statements of various persons, that the appellant company was involved in creating a false market and manipulating the prices of its scrip, in connivance with Harshad Mehta by aiding, abetting and being instrumental in effecting transaction by taking part and entering directly and indirectly into transaction in the shares of BPL.

In this case SAT set aside the orders passed by SEBI on the basis of lack of direct evidences against the appellant company and held that indulging in fraudulent and unfair trade practices under the regulation is a serious charge visiting serious consequences as could be seen from the regulations itself, which enable the respondent (SEBI) even to put a brake on a person and right

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¹⁰ 2002 Comp. L. J, V-5, 185 (SAT)
¹¹ Supra note 9
¹² SEBI (POF and UTPS) Regulation 1995
to do business for his livelihood. The wrong doer is also liable to be prosecuted under SEBI Act 1992. Therefore, the charges against the appellant need to be well proved. The charges based on mere conjectures and surmises and on baseless assumptions and resumption against the appellant it is not possible to hold the appellant guilty of such serious charges attracting serious consequences.

(a) Can a company be debarred from accessing the securities market if the promoters of the company are guilty of price manipulation?

*In Tirupati Finlease Ltd Vs. SEBI* 13

SAT applied basic principle of company law that the company is a separate legal entity different from its promoters. SEBI in this case passed an order against the appellant company on the finding that the promoters of the company had indulged in unfair and fraudulent trade practices in dealing in the shares. SEBI by its order debarred the appellant from accessing capital market for a period of 5 years. The appellant company challenged this order.

SAT held that the focus of the regulations 14 is on dealing in securities and a company cannot ‘deal’ in its own securities in the market. Normally the persons holding shares in the company would be riggers, as manipulating the share prices and hike would be to their advantage. In this case the so called

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13 (2001) 6 Comp. L. J., 260 (SAT)
14 Supra note 12
situation i.e. an artificial scarcity was created in the market to manipulate the price movements, by the promoters of the appellate company and therefore, the company can not be substituted for promoters for the purpose of imposing penalties. Consequently the impugned order passed by SEBI is without any justification.

(b) Can SEBI impose penalty under regulations\textsuperscript{15} and under Section 11 and 11 B of the Act\textsuperscript{16} for manipulation of prices?

\emph{Sterlite Industries (India) Ltd. Vs. SEBI}\textsuperscript{17}

SEBI carried out an investigation into the alleged price manipulation in the scrip of certain companies including the appellant. On the basis of the findings that the rise in the price of the scrip of appellant was due to price manipulations, SEBI passed an order against the appellant company prohibiting it from accessing the securities market for a period of two years and further ordered to initiate the prosecution proceedings under Section 24 of the Act\textsuperscript{18} for violation of regulations\textsuperscript{19}4(a) and 4(d). The appellant challenged the order on the ground that the charges against it are baseless.

SAT set aside the impugned order passed by SEBI and held that according to the impugned order the conduct of the appellant comes under

\textsuperscript{15} Ibid
\textsuperscript{16} SEBI Act 1992
\textsuperscript{17} 2001, 6 Comp. L. J., 276 (SAT)
\textsuperscript{18} Supra note 16
\textsuperscript{19} Supra note 12
clause (a) and (d) of regulations. On a perusal of the regulations it is clear that reach of clause (a) is wider than clause (d) as regulation 4 (a) attracts not only the purchaser and seller, but even third parties if they are found in any way involved in effecting or taking part in the transactions directly or indirectly. But the requirement is that these transactions must be “with the intention of distorting the price of securities. The element of deceit is an underlying factor in the transaction. Therefore, a genuine transaction by itself cannot attract the regulation though such a transaction had resulted in market price variation. Under regulation 4(d) the intention of the parties is relevant. Therefore in both the clauses, an element of ‘mens rea’ is involved. Thus, the proof of manipulation is generally not based on single activity but rather on a course of conduct showing an intentional interference with the normal functioning of the market for security.

Now coming to the question whether penalty can be imposed by SEBI. SAT while analyzing the powers of SEBI under section 11 and 11B held that the powers given to SEBI under section 11B of the Act are restricted to issue appropriate directions for the purpose of protecting the interest of the investors etc as mentioned in the section. Section 11B does not even remotely empower the respondent i.e. SEBI to impose penalty. Since legislation has deliberately chosen to create specific offences and penalty thereto, it is not possible to view that under sections 11B and 11 the respondent is competent to issue a directions which tantamount to imposition of penalties. These provisions of the

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20 Ibid
Act are only preventive and remedial in their applications and not punitive. Thus, the order passed by SEBI is neither remedial nor preventive but punitive in effect as it takes away the appellant’s right to mobilize funds from the public to carry on its business consequently it is not sustainable.

(c) Does SEBI have power to pass an interim order during investigation for price manipulations?

There is a very good decision of the Bombay HC on the question. The Bombay HC in *Anand Rathi Vs. SEBI*\(^1\) held that SEBI’s primary duty is to protect the public and the integrity of the securities market and as a regulator it is certainly empowered to take interim measures pending investigation under section 11 & 11B of the Act.

It can again be said that SEBI has to regulate speculative market and in case of speculative market, varied situations may arise and looking into the exigencies and requirements, it has been entrusted with the duty and functions to take such measures as it thinks fit to protects the interest of the investors and the capital market. The decision taken by the regulatory agency in exercise of its powers is entitled to the greatest weight and the courts will be slow to interfere with such decisions or orders.

There are various other cases in which SEBI’s orders (or SEBI’s powers) directing prohibition, cancellation and suspension of the registration for price manipulation have been challenged by the concerned parties. Like, in

\(^{1}\) (2001) 5 Comp. L. J., 1 (Bom)
Alka Synthetics Ltd. Vs. SEBI\textsuperscript{22} single judge of Gujrat HC held that SEBI has no authority under any provisions of the Act, rules or regulations under which it function to impound whole or any part of consideration of a completed transaction to which the persons entitled to receive consideration have acquired right to claim. In this case SEBI ordered investigation into abnormally high prices and a large value of trading in respect of certain shares only. SEBI ordered the suspension of trading in these securities and issued directions that the auction money be withheld till the investigation was completed, which was challenged.

But later on the division bench reversed the ruling of single judge and held\textsuperscript{23} that SEBI had authority to pass such orders under the existing statutes as whenever new situations or new problems arise they call for new solutions and the whole context in which SEBI had to take the decision, on the basis of which impugned orders were passed can not be said to be without authority of law on the face of provisions contained under section 11 and section 11B of the Act. Under section 11B SEBI is empowered to take such measures as it thinks fit.

(d) Whether such additional measures should be published in advance?

The division bench of Gujrat HC held that the measures have to be taken to meet a particular eventuality which may or may not be conceived earlier,

\textsuperscript{22} (1998) Comp. L. J., 5, 109 (Guj)
\textsuperscript{23} SEBI Vs Alka Synthetics Ltd & Others, 1999, Comp. L. J., 396, V-1 (Guj)
there is no question of laying down such measures in advance and publishing the same.

From the above discussion it is clear to some extent that in most of the cases SEBI’s power to issue directions to the or against persons involved in the price manipulation have been challenged by the parties in the courts on the ground of lack of specific powers under the Act.\(^{24}\)

SEBI itself stated\(^{25}\) that under the present legal framework SEBI does not have the following powers:

- to impound or disgorge ill-gotten gains or profits arising out of market manipulations. In some cases this was done by it under general powers of section 11 and section 11B that were mostly challenged,
- to impose monetary penalties. The penalties provided are very meager and are not commensurate with the gains made or losses avoided,
- collection of penalty, and
- issuing interlocutory directions pending completion of proceedings etc.

In this regard the joint committee\(^{26}\) suggested that a monetary penalty should be provided for violation of provisions of SEBI regulation.\(^{27}\)

\(^{24}\)SEBI Act 1992
\(^{25}\)Report of Joint Committee (Parliament) of Stock Market Scam, 19 Dec, 2002
\(^{26}\)Ibid
\(^{27}\)SEBI (POF & UTPS) Regulation, 1995
(e) Reforms to curb the price manipulations

To some extent above problems have been removed as SEBI Act 1992 has been amended by SEBI (Amendment) Act\(^{28}\) inserting the new provisions in this regard. Section 11 (4)\(^{29}\) provides that SEBI, in the interest of the investors or securities market can take measures such as suspension of trading of securities, restrictions on persons from accessing the securities market, impound and retention of the proceeds of securities in respect of any transactions which is under investigation etc. either pending investigation or inquiry or on completion of such investigation or inquiry.

Under SEBI Act new chapter for prohibition of manipulation and deceptive derives, insider trading and substantial acquisition of securities or central has been inserted.\(^{30}\) Penalty for fraudulent and unfair trade practices as suggested by committee has also been provided under the Act.\(^{31}\)

SEBI (UTP) Regulations 1995 have also been replaced by SEBI (UTP) Regulations 2003 under which SEBI almost have those powers which were challenged in the above matters. Now, SEBI may take actions or issue following directions to the persons if it satisfied by the report of the Investigating Authority that there is a violation of the Act, rules and regulation:

- suspend the trading of the security found to be involved in fraudulent and unfair trade practice in a recognized stock exchange,

\(^{28}\) SEBI (Amendment) Act, 2002 w.e.f. 29.10.2002
\(^{29}\) Inserted, Ibid
\(^{30}\) Chapter VA inserted, Ibid
\(^{31}\) Section 15 HA inserted, Ibid
- restrain persons from accessing the securities market and prohibit any person associated with securities market to bye, sale or deal in securities

- suspend any office bearer of any stock exchange or self regulatory organization from holding such position,

- impound and retain the proceeds or securities in respect of any transaction which is in violation or prima facie in violation of these regulation,

- direct an intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of a fraudulent and unfair transaction,

- require the person concerned to call upon any of its officers, other employees or representatives to refrain from dealing in securities in any particular manner,

- prohibit the person concerned from disposing of any of the securities acquired in contravention of these regulations, and

- direct the person concerned to dispose of any such securities acquired in contravention of these regulations in such manner as SEBI may deem fit, restoring the status quo ante.\(^\text{32}\)

SEBI can issue above directions or take actions on two stages either pending investigation or inquiry or on completion of investigation or inquiry.

\(^{32}\)SEBI (POF & UTPS) Regulations 2003
The person concerned must be given a reasonable opportunity of hearing before issuing directions or taking actions. SEBI may issue above directions even without giving an opportunity of hearing to the person concerned if it is in the interest of investors. While doing so SEBI has to record reasons in writing of not giving such opportunity to person concerned before issuing directions or taking actions.

Apart of above directions / actions SEBI may also issue a warning or censure, suspend the registration of the intermediary or cancel the registration of the intermediary.

B. Insider Trading

Insider trading is an unfair practice resorted to by persons who have access to unpublished price sensitive information about the company. As in any stock exchange the information is a commodity and news today, good or bad, about something to be announced tomorrow is the most precious commodity of all. For those with the information, the possibilities for huge returns are almost endless. Any information, regarding the listed companies, may affect their prices in the share market. Therefore insider trading can occur when a person who possesses material, non-public information trades securities or communicates such information to others who trade. Trading is prohibited when a person who receives information through a confidential relationship use or misappropriates the information for his or her own trading or tips to others.

33 "Is it insight, or is it illegal?" Monday, October 18, 1999 (The Small Investors) from Internet
People who receive information in confidence can include a broad range of persons involved in the securities market.\footnote{From the Lectric Law Library’s stacks, Insider Trading, 2000, P. 1 from Internet}

There were no statutes dealing with this undesirable practice in our country till 1992. Though the Bhabha Committee on Company Law Reform, which reported in 1952, was aware of the problem of insider trading but the matter was considered in depth by the subsequent Sastri Committee.\footnote{Report of the Companies Act Amendment Committee (1957)} The solution of insider trading suggested by both the Committees was to impose a duty to disclose their transactions in securities of their companies. Consequently, sections 303 to 307 were incorporated in the Companies Act, 1956. Sachar Committee further recommended some amendments in these sections for enhancement of the disclosure requirements. In 1985 the GS Patel Committee\footnote{High Power Committee on Stock Exchange Reforms, para 7-106, 1985} has taken a serious view on the absence of specific legislation in India curbing misuse of inside information by a selected few to the detriment of the common investors and had recommended that, to deter the persons who indulge in undesirable activities such as false trading, market rigging, spreading false rumours, making misleading statements to induce purchase or sale of securities and insider trading etc. the stock exchange authorities should be empowered, by law, to take disciplinary action themselves and also to file civil and criminal proceedings against the offenders so that they do not go unpunished. For this purpose, it was recommended that the SC(R) Act, be amended to make such undesirable activities civil and criminal offences...
punishable with heavy fine and imprisonment up to five years. Further, it recommended that persons misusing such information also be compelled by law to surrender to the stock exchange, the profit they may have made or the amount equivalent to the losses they have averted.

For the first time to curb this unhealthy practice SEBI notified the regulations in 1992 under the powers vested in it under the Act 1992. The regulations make insider trading a criminal offence punishable in accordance with the provisions of the Act.

(a) Who is an insider?

Defining insider is an important task because it will serve two purposes, first, it will determine that who would be liable under the provisions prohibiting insider trading and second, who will be obliged to disclose their trading under any disclosure requirements. An insider is deemed to be any person who:

- on the basis of non-public and material information possesses regarding a company, trades in the shares/securities of that company or
- with or without trading himself passes on such information to another, ultimately there is trading in the scrip of that company.

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37 Ibid
38 Ibid
39 SEBI (Insider Trading) Regulations 1992
40 Ibid
41 SEBI Act 1992
SEBI Regulations\(^{42}\) define insider as "any person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access\(^{43}\) to unpublished price sensitive information in respect of securities of a company, or who has received or has had access to such unpublished price sensitive information."

Thus the definition of insider includes the following persons:

- person who is connected with the company,
- person who was connected with the company, and
- persons deemed to have been connected with the company.

SEBI Regulations further define connected person as "any person who:

- is a director\(^{44}\) of company or is deemed to be a director of that company by virtue of sub-clause (10) of section 307 of the Companies Act 1956 or
- occupies the position as an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company, whether temporary or permanent,\(^{45}\) and who may reasonably be expected to have an access to unpublished price sensitive information in relation to that company.

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\(^{42}\) SEBI (Prohibition of Insider Trading) Regulations 1992

\(^{43}\) Words 'by virtue of such connections' omitted by SEBI (Insider Trading) Regulation 2002 w.e.f. 20.2.2002

\(^{44}\) Rule 2 (c) of SEBI (Prohibition of Insider Trading) Regulations, 1992 [Prohibition of] Inserted by SEBI (Insider Trading) (Amendment) Regulations, 2002, w.e.f. 20.2.2002

\(^{45}\) Substituted for 'include' by SEBI (Prohibition of Insiders Trading) (2\(^{nd}\) Amendment) Regulations 2002 w.e.f. 29.11.02
Person is deemed to be connected person if such person:

- is a company under the same management or group, or any subsidiary company or

- is an intermediary as specified in section 12 of SEBI Act, Investment company, Trustee Company, Asset Management company or an employee or director thereof or an official of a stock exchange or of clearing house or corporation or

- is a merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, investment advisor, sub-broker, investment company or an employee thereof, or, is a member of the Board of Trustees of a mutual fund or a member of the Board of Directors of the Asset Management Company of a mutual fund or is an employee thereof who has a fiduciary relationship with the company or

- is a Member of the Board of Directors, or an employee, of a public financial institution as defined in section 4A of the Companies Act, 1956,


47 Subsidiary Company within the meaning of Sub-Section (1B) of Section 370, or Sub-Section (11) of section 372, of the Companies Act 1956 (1 of 1956), or Sub-Clause (g) of Section 2 of the MRTP Act, 1969 (54 of 1969)

48 Substituted by SEBI (Insider Trading) (Amendment) Regulations, 2002. Prior to its substitution it reads as under…

“(ii) is an official or a member of a stock exchange or of a clearing house of that stock exchange, or a dealer in securities within the meaning of clause (c) of Section 2, and Section 17 of the Securities Contracts (Regulation) Act 1956 (42 of 1956), respectively, or any employee of such member or dealer of stock exchange”
is an official or an employee of a Self-regulatory Organisations recognized or authorized by the Board of a regulatory body,

is a relative of any of the persons mentioned above,

is a banker of the company,

is relative of the connected person, or

is a concern, firm, trust, HUF, company or association of persons in which persons\(^{49}\) have more than 10% of the holding or interest.

Now it is interesting to see what is the reach of regulations and the gaping holes, which have bearing on curbing insider trading:

The definition of ‘insider’ includes the persons having past connections but surprisingly no time frame has been provided in the Regulations for such past connections. Regulations \(^{50}\) provide that the words ‘connected person’ mean any person who is a connected person six month prior to an act of insider trading. That means if a person became director of the company two months before the act of insider trading than he would not be a connected person however, if a person was director of a company two years back he can still be regarded as connected person under regulations.

Companies under the same management or group have also been included in deemed to be connected persons. What is the relevance of including

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\(^{49}\) Association of persons wherein any of the connected persons mentioned in regulation sub- clause (i) of clause (c) or any of the persons mentioned in regulation 2(h) (vi) (vii) and (viii) have more than 10% of the holding or interest.

\(^{50}\) Inserted \(\textit{ibid}\)
companies at all as insiders? Companies being artificial persons cannot themselves indulge in insider trading or deal in securities therefore it serve no practical purpose.

As seen above the list of deemed to be connected persons covers a long list of persons but does not cover public servants and servants of SEBI itself they can also trade on the basis of unpublished information or they can pass such information to other person then that person can use such information.

(b) Price sensitive, material and non-public information

Material information is any news that could be reasonably believed to move a company's stock if it were known publicly. The Cohen committee defined inside information as “information known to them and not at the time known to the general body of shareholders e.g. the impending conclusion of a favourable contract or the intention of the board to recommend and increase dividend. Similarly Jenkins committee in their specific recommendation concerning insider trading, they spoke of:

“A particular piece of confidential information which might be expected materially to effect the value of those securities, unless that information was known to that person.”

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51 The Committee on Company Law Amendment (1945) Cmnd. 6656, Para 86
52 Company Law Committee (1962) Cmnd. (1949), Para 99 (b) popularly known as Jenkins Committee
Regulations define ‘price sensitive information’ as any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company.

Under regulations the price sensitive information includes periodical financial result of the company, intended declaration of interim and final dividends, issue of securities or buy back of securities, any major expansion plans or execution of new projects, amalgamation, mergers and takeovers, disposal of the whole or substantial part of the undertaking and any significant changes in policies, plans or operations of the company. Thus, any information reading these particulars of the company would be price sensitive information and the insider who deals in securities on the basis of such information will be liable for punishment if that information was unpublished. Unpublished means information, which is not published by the company or its agents and is not specific in nature.\(^\text{53}\)

Therefore, this unfair practice involves the use of price-sensitive, unpublished information about the company by the insiders of the company to

\(^{53}\) Regulations 2 (ha) and 2 (k) of SEBI (Prohibition of Insider Trading) Regulations, 1992 inserted by SEBI (Insider Trading) (Amendment) Regulations 2002. Prior to its substitution Clause (k) reads as under:

'(k) “unpublished price sensitive information” means any information which relates to the following matters or is of concern, directly or indirectly, to a company, and is not generally known or published by such company for general information, but which if published or known, is likely to materially affect the prices of securities of that company in the market—

(i) financial results (both half-yearly and annual) of the company;
(ii) intended declaration of dividends (both interim/final);
(iii) issue of shares by way of public rights, bonus, etc;
(iv) any major expansion plans or execution of new projects;
(v) amalgamation, merger and takeovers;
(vi) disposal of the whole or substantially the whole of undertaking;
(vii) such other information as may affect the earnings of the company;
(viii) any changes in policies, plans or operations of the company.'
the exclusion of others and thereby to buy or sell the shares of the company in such a way as to make gain or to avert the possible loss. The victims of insider trading are always the small investors. Insiders may include directors, auditors, consultants, officers, secretaries, stock exchange employees etc.

Insider trading is the result of the basic structural weakness of the securities market system where some investors have special access to information and also a desire to make gains out of such information.\(^5^4\)

For instance in a case of Garware Nylon sometimes in early 70's, one rumour that this company would propose a bonus issue suddenly hit the market. The share prices began to shoot up. But the then chairman of the company denied the rumour. Consequently the share prices fell.

Even the stock exchanges are not free from the infection of insiders trading. In the corporate sector, due to lack of restraints, a fairly large member of insiders take unfair advantage of their position. Therefore this practice is detrimental to the common investors.\(^5^5\)

The Act\(^5^6\) provides penalty for insider trading. It provides that if any insider who:

\(^5^4\) Shah R Cnubhai, Insider Trading: The Indian Scene, CS, 1991 (March) 195
\(^5^5\) Kumar Naresh, Kerb Deal and Insider Trading: Urgent Need for Regulation, Economic Times, 29 Apr, 1987
\(^5^6\) Section 15 G of SEBI Act 1992
either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price sensitive information, or

- communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law, or

- counsels or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information, shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, which ever is higher. In addition to this the persons liable for insider trading may be punished with imprisonment for a term, which may extent to ten years, or with fine, which may extent to twenty-five crore rupees, or with both.

Now, it is interesting to see the implementation of the above provisions by SEBI. Till the year 2000-2001, i.e. almost in ten years, SEBI has initiated prosecution proceedings in respect of only one case for insider trading. This shows the poor performance of SEBI in this regard.

No doubt the insider trading is an extraordinary difficult offence to prove. As the underlying acts of buying or selling securities are of course perfectly a legal activity. It is only the intention of the trader that can make this

57 Substituted for "not exceeding five lakh rupees" by SEBI (Amendment) Act 2002
58 Report of Joint Committee (Parliament) on stock market scam, 19 December, 2002
legal activity a prohibited act of insider trading. However, “enforcement is the key to success of the regulations”.

Reforms discussed regarding price manipulations are also applicable to insider trading. But in spite of all these measures insider trading continues unchecked and the insiders continue to trade. Regarding stock market one reason of failure in preventing the insider trading was that the basic structure of the stock exchange itself was the problem. As held by SAT\(^{61}\) that in the present set up of stock exchanges, brokers are the umpires and also the players. In fact, even as of now the stock exchanges (barring NSE) are of the brokers, for the brokers and run by the brokers. This situation has been properly described by Mr. Palkhiwala, an eminent jurist, regarding formation of board of stock exchange as “the offender, the prosecutor, as well as the judge.”\(^{62}\) He suggested that the authorities might adopt appropriate measures to streamline the stock exchange management to impart more credibility to the institution, to enhance the common investors faith in the capital market.

Therefore, in the above circumstances practically it was not possible to curb the insider trading until and unless the basis structure of the stock exchanges is changed. In the above set up when the persons in management and the brokers are same it was very difficult to restrain them from using the

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59 Baijal Sonia, Regulatory Framework for Capital market- Emerging Issues and Challenges, Backgrounder
60 Ibid
61 Anand Rathi Vs SEBI, 2002 Comp. L. J. V-2 p.100 (SAT)
62 Sahni SK, Stock Market of India, 1st Edition 1985
inside information. The office bearers or the management will have access to inside information, which they can misuse.

For the purpose of removing this defect the Securities Laws (Amendment) Bill\(^3\) provides for corporatisation and demutualisation of stock exchanges as discussed earlier.\(^4\) But the reforms regarding insider trading are mainly on papers and it can be said that controlling insider trading is similar to controlling black money.

**C. Excessive speculation**

Certainly the speculation keeps market alive, active and vibrant. Speculation is important for ready and continuous market. There are two types of transaction in the stock exchanges.

- **Investment transactions and**

- **Speculative transactions**

Investment transactions refer to purchase or sale of securities undertaken with the long-term prospects relating to their yields and prices. Investment transactions generally involve the actual delivery of the security and the payment of its full price. On the other hand, speculative transactions refer to the purchase or sale of a security with a view to profit from short period variations in market prices. In such type of transactions only differences in prices are paid and the delivery of the securities and the payment of full prices

\(^3\) Securities Laws (Amendment) Bill 2003

\(^4\) See chapter III
are rare. The predominance of speculative transactions over investment transactions in a stock exchange is due to the fact that the investment transactions involve a large volume of money while speculative transactions are possible with smaller amounts of money as delivery of securities and payment of full prices are rare in such type of transactions.  

Thus, speculative activities are dominating the genuine trading activities. Very small transactions represent purchases or sales by genuine investors.

As stated earlier, speculation is important as it provides liquidity of securities. But a healthy market needs the right degree of speculation. Speculation may degenerate into gambling when operations are undertaken blindly and ignorantly by speculators and this unchecked speculation can kill the market. To control this excessive speculation SEBI recently banned carry forward transactions “badla” from July 2001. It will certainty help in curtailing the speculations in the stock market to some extent.

Now code of conduct prescribed by SEBI for market intermediaries also provides that they shall not involve themselves in excessive speculative business in the market beyond reasonable level.

\[65^{65} \text{Dr Veena—Stock Market in India} \]
\[66^{66} \text{w.e.f. 2.7.2001 carry forward transaction were banned and rolling system was introduced by SEBI} \]
(a) Factors responsible for excessive speculation

There are various factors that are responsible for speculation. Some of them are as follows:

(i) Forward Dealings

Forward delivery contracts are permitted only in respect of those securities, which are specified by the stock exchanges for this purpose. In such type of transactions the settlement of the transaction is postponed to the next settlement day. In economic terms, the carrying forward system is totally unjustifiable and unhealthy practice. It is exclusively aimed at helping the spurious speculators who have neither money to pay nor shares to deliver.\(^\text{67}\) Forward trading has been banned by SEBI since 2001.

(ii) Blank Transfers

Transfer of securities is completed only when the name of the transferee is registered with the company issuing the securities. But in case of blank transfer, securities are transferred without disclosing the name of the transferee in the transfer form; the date of transfer is also not mentioned. Such types of transactions increase speculation. Recently justice Dhanuka Committee\(^\text{68}\) recommended that the blank transfer deeds should not be permitted.

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\(^{67}\) Gupta LC- The Stock exchange Trading in India, 1st Edition 1992

\(^{68}\) Report of the Committee pertaining to review and reforms of securities laws under the chairmanship of Justice Dhanuka
The Atlay Committee, which reported in 1924, also recommended the total abolition of blank transfers. The Morison committee in 1937 went a step further and recommended that blank transfer should be made a “bad delivery.”

(iii) Margin Trading

The stock exchange broker demands a cash deposit or margin that is a certain percentage of the value of the securities bought or sold by his clients. The margin serves as a security in case of losses. By depositing Rs. 1,000 with a broker, a speculator can buy shares of worth Rs. 10,000 if the margin is 10%. This facility enables a speculator to buy or sell securities the value of which may be many times the funds at their disposal. The brokers may also borrow expensively from banks and financials for speculating transactions.

(iv) Option Dealings

The option dealings refer to the right to buy or sell certain securities at a certain price by a certain date discussed earlier. Such type of dealings also encourages speculations.

Besides above, in securities markets there are many other defects that are as follows:

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69 Simha SLN- The Capital market of India
70 Discussed under chapter III
D. Lack of Liquidity

Liquidity means the ability to convert his investment into cash whenever the person holding investment wants to do this. Liquidity of securities is very important part of the securities market or it can be said that an efficient market can be judged on the basis of liquidity it provides. The stock markets provide continuous market and thereby facilitate rising of funds through issue and sale of securities. Lack of liquidity is most important problem relating to the secondary market. Many securities listed on stock exchange are not traded and trading in many other securities is negligible. On the average about 25% companies at Bombay stock exchange were traded every month during 2001-2002. Only 23.15% of the companies traded on BSE were traded for more than 100 days during 2001-02. Trading took place for less than 100 days in case of 76.85% of companies traded at BSE during the year, and for less than 10 days in case of 24.76% of companies traded. On an average 93% of companies available for trading at NSE were traded every month during 2001-02. Nearly, 78% of companies traded of NSE were traded for more than 100 days during the same year. There are no trades in several companies listed on number of regional stock exchanges. This indicated that trading is concentrated among only a limited number of stocks and is very small in a large number of stocks.\(^{71}\)

\(^{71}\) Sahoo MS, A Overview of Securities Market in India, 30\(^{th}\) National Convention of Company Secretaries, Backgrounder
Moreover, the business is concentrating nowadays only on some big stock exchanges i.e. NSE, BSE, the regional stock exchanges or small stock exchanges are disappearing slowly.

E. Non-Compliance of Statutory Provisions by Stockbrokers

Before SEBI Act 1992 there was no control over the stock-brokers and sub-brokers as discussed. But nowadays strict control over them is excised through SEBI Act\textsuperscript{72} itself and the regulations\textsuperscript{73} issued by SEBI under the Act.\textsuperscript{74} The code of conduct\textsuperscript{75} for stock brokers and sub-brokers have also been prescribed by SEBI in order to increase the transparency and fairness to the operations of stock market by them. The code of conduct clearly explains the duties of the stock-brokers towards the investors. It provides that the stockbroker or sub-broker shall promptly inform his client about the execution or non-execution of an order, and make prompt payment in respect of securities sold, and arrange for prompt delivery of securities purchased by clients. It further provides that a stockbroker or sub-broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all their business and they should act with due skill, care and diligence in the conduct of their business.

\textsuperscript{72} SEBI Act 1992
\textsuperscript{73} SEBI (Stock Broker and Sub-Broker) Regulations 1992
\textsuperscript{74} Supra note 72
\textsuperscript{75} Supra note 73, Regulations 7, Schedule II
Now, some case law will be discussed which will show us the actual working of stockbrokers or sub-brokers and how far they are complying with the statutory provisions.

In Radar Securities Ltd. Vs. SEBI, SEBI carried out usual inspection of books of account and other records of a stockbroker who was registered with it and was a member of NSE. The inspection report of SEBI revealed the following non-compliance of the statutory provisions or the defects in the working of the stockbroker.

- Failure to maintain margin deposit book under regulation 17.
- Delay in making payments to the clients
- Failure to obtain acknowledgement from clients on the contract notes.
- Failure to affix stamps and disclose the order receipt timely on the contract notes.
- Incomplete client registration form
- Stockbroker dealt with sub-brokers not registered with SEBI.
- Made off the floor transaction without reporting the same to NSE.

SEBI considered the above omissions as serious and suspended the certificate of registration for six month. Aggrieved by this order of SEBI the concerned broker filed an appeal before Securities Appellate Tribunal. SAT

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76 2003, Comp. L. J., 3, 259 (SAT)
77 Supra note 73
allowed the appeal and reduced the period of six month’s suspension to two
months suspension of registration.

Further, in *Subhkam Securities (p) Ltd. Vs SEBI*\(^78\) penalty was not
imposed on the stock broker for obtaining an incomplete registration form from
his client as the broker or one of the director of the firm personally knew him
(Client.).

In the above case the stockbroker obtained a client registration form
with few blanks. Moreover it did not disclose the annual income of Shre Bajaj
(his client). The stockbroker had also not collected requisite margin from his
client before effecting transaction on his behalf. SEBI observed that the stock­
brokers have not exercised due skill and care in their dealings as required under
code of conduct\(^79\) and therefore suspended the certificate of registration for
seven days. This order of SEBI was challenged.

SAT held that the broker personally knew the client therefore obtaining
a client registration form with some blank space does not amount lack of due
care and skill on the part of the stockbrokers.

Again in *Ujala Finstock (P) Ltd. V. SEBI*\(^80\) the respondent (SEBI)
imposed a penalty of Rs.3 lakhs against the appellate in terms under section
15A(a) of Act\(^81\) for non-production of the requisite books, etc. and the details as

\(^78\) 2003, Comp. L. J. V-3, p.301 (SAT)

\(^79\) Clause A (2) of the code of conduct prescribed under SEBI (Stock Brokers and Sub-Brokers)
Regulations 1992

\(^80\) 2001, Comp. L. J. V-6, 595 (SAT)

\(^81\) SEBI Act 1992
called for by respondent thus the appellant did not cooperated with SEBI at the
time of inspection carried out for the purpose of ascertaining the level of
compliance of statutory provisions by them.

The order of SEBI was challenged by the parties and the amount of
penalty reduced to Rs one lakh by SAT.

From the above cases it is clear that there are many rules and regulation
meant to regulate the conduct of the stock brokers in business, but in practice
the stock broker do the things as they suits to them and violate many rules and
regulations.

(a) Can it be checked?

SEBI is empowered under regulations[^1] to inspect the books of accounts,
the documents of the stockbrokers or sub-brokers etc. for the following
purposes[^2]:

- to ensure that the books of accounts and other books are being
  maintained in the manner required,

- that the provisions of the Act, rules, regulation and the provisions of the
  SC(R) Act and the rules made there of are being complied with,

- to investigate into the complaints received from investors, other stock
  brokers, sub-brokers or any others person on any matter having a
  bearing on the activities of the stock brokers, and

[^1]: Regulation 19(1) of SEBI (Stock Broker and Sub-Broker) Regulation 1992
• to investigate suo-moto in the interest of securities business or investor’s interest, into the affairs of the stock brokers.

But the problem is that SEBI itself has no power to inspect the activities of the stock brokers or sub-brokers but for this purpose it has to appoint one or more persons as inspecting authority. It causes unnecessary delay in taking the action. The provisions should be like “SEBI itself or may appoint” thereby empowering SEBI itself to inspect the activities of the brokers whenever it deems fit.

Secondly, if SEBI finds non-compliance of the statutory provision on the part of brokers then it can either suspend or cancel the registration of the defaulting broker.

But some times the default is so minor that it can not suspend or cancel the registration of the brokers, in such circumstances there is no provision of monetary penalty under the regulations though it has been prescribed under Act for certain defaults.

Therefore, SEBI should be empowered to impose monetary penalty against the defaulting brokers under the regulations.
(b) Appointment of compliance officer: How effective?

Recently the regulations have been amended which provide that "every stock broker shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notification, guidelines, instructions etc."

Further it provides that the "compliance officer shall immediately and independently report to SEBI any non-compliance observed by him."

The appointment of compliance officer is a flawed process. How a person appointed as compliance officer by the broker can go against him or how can he report against that particular broker for non-compliance of statutory provisions to SEBI. This is practically not possible. Secondly, in case if he negligently or willfully fails to report SEBI what would be the consequences of that failure?

In such cases, to make the appointment of compliance officer effective he must share the liability if he negligently or intentionally fails to report non-compliance to SEBI.

Moreover, no guidelines have been prescribed regarding the qualifications of the person who may be appointed as compliance officer and moreover, there is no eligibility criteria for him. Hence, it should be prescribed by SEBI.

Regulation 18A inserted by SEBI (Investment Advice by Intermediaries) Amendment Regulations 2001 vide Notification no SO 476 (E) dated 29.5.2001
F. Misleading Prospectus and its Consequences

Prospectus is a document circulated by a company making public issue inviting applications for subscription from the public. Prospectus contains adequate disclosures about the issue, issuing company and the risk factors. It is on the basis of the information contained in the prospectus that the investors are expected to make an informed decision about their investment in the issue.\(^{85}\)

Supreme Court in a case\(^{86}\) held that "those who issue prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representation therein contained are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as fact that which is not so, but to omit so one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality, of the privileges and advantages which the prospectus holds out as inducements to take shares."

Companies Act\(^{87}\) and SEBI Guidelines\(^{88}\) lays down various requirements to be satisfied before a prospectus is to be issued to the public for subscription. The Companies Act casts upon the companies and their promoters a number of obligations to ensure that a prospectus contains true and correct information.

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\(^{86}\) Larsen & Toubro Ltd Vs Haresh Jagtiani, 1991, Comp. L. J. V-2 (SC) p.1
\(^{87}\) Section 56 of Companies Act 1956
\(^{88}\) SEBI (DIP) Guidelines 2000
Moreover, the Companies Act itself provides civil and criminal liabilities in case of any misstatement in the prospectus. It provides\textsuperscript{86} that where a prospectus invites persons to subscribe for shares or debentures of a company, the following persons shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of untrue statement included therein, that is to say:

- Every person who is a director of the company at the time of the issue of the prospectus.
- Every person who has authorized himself to be named and is named in the prospectus either as director, or as having agreed to become director, either immediately or after an interval of time.
- Every person who is a promoter of the company and
- Every person who has authorized the issue of prospectus.

Criminal liabilities for misstatement in prospectus is provided under section \textsuperscript{63} which provides that every person who authorized the issue of the prospectus will be punishable with imprisonment for a term which may extend to two years or with fine which may extend to fifty\textsuperscript{91} thousand rupees or with both unless he proves either that the statement was immaterial or that he has

\textsuperscript{86} Supra note 87, Section 62
\textsuperscript{90} The Companies Act 1956
\textsuperscript{91} Substituted for "five" by Companies (Amendment) Act 2000, w.e.f. 13.12.2000
reasonable ground to believe, and did up to the time of the issue of the prospectus believe, that the statement is true.

Recently, SEBI has been empowered\(^2\) to administer the provisions relating to issue of securities under the Companies Act if the following two conditions are satisfied.

- In case of listed public companies.
- In case of those public companies, which intend to get their securities listed on any recognised stock exchange in India.

Thus the investors now can write to SEBI in case of misstatement or suppression of important and material facts in the prospectus.

The investor apathy to stock exchanges is clearly visible due to their loss of confidence. There are many other reasons for this besides the problems and malpractices discussed above. There is considerable delay in refunding application money, issuing of allotment letters, posting of share certificates etc. It takes more than 6 months to effect transfer of shares. Bad deliveries, loss of certificates etc are also quite common despite the reforms made by SEBI to curb these malpractices. To make matter worse, the investor’s associations in India are still weak body.\(^3\)

\(^2\) Section 55 A inserted, \(\textit{ibid}\)
\(^3\) Gordon E, Natraj K- Capital Market in India, 1\(^{st}\) Edition 1999
G. Recent Stock Market Scam and Working of SEBI\(^4\): A Critical Analysis

As discussed earlier that there are many rules regulations, bye laws etc., which regulate the securities market and the activities of participants in the securities market. The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Department of Company Affairs (DCA) Reserve Bank of India (RBI) and Securities Exchange Board of India (SEBI).

Most of the powers under the Securities Contract (Regulation) Act are exercisable by DEA while a few others by SEBI. The powers of the DEA under SC (R) Act are also concurrently exercised by SEBI. Powers in respect of the gold related securities, money market securities, and securities connected thereto are exercised concurrently by RBI. SEBI Act and the Depositories Act are mostly administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities are also administered by SEBI in case of listed public companies and public companies proposing to get their securities listed.\(^5\) Therefore, SEBI is entrusted with very wide powers related to securities market transactions and authorised to exercise the strict control over the market intermediaries. For this purpose SEBI has issued various

\(^4\) Based on Joint Parliamentary Committee Report on Stock Market Scam and Matters Relating Their to, 13\(^{th}\) Lok Sabha V-1, 19 December, 2002
\(^5\) Supra note 71
guidelines and regulation under the Act as discussed. Moreover the stock exchanges itself are acting as supervisory bodies and have various byelaws to regulate the securities market transactions. SEBI has power to amend and to give instructions to stock exchanges in the interest of securities market and the investors at large. The role of stock exchanges is to ensure that the brokers are following the law, regulations, rules and the guidelines framed by SEBI/Govt. from time to time and in case of inconsistency and suspiciousness in the conduct of brokers it has to report SEBI in this regard. But SEBI is the primary regulator of securities market.

Now we will discuss the payment crisis in the Calcutta stock exchanges, its reasons and the role of SEBI and the CSE in this regard.

(a) Payment Crisis at CSE and its reasons

As discussed, earlier the stock exchanges are governed by their respective governing boards which was constituted on the 50:50 basis in 2001 meaning thereby 50% of the representatives of the brokers and 50% from outside the brokers community. Discussion on governing board is important, as one of the biggest defaulters in the payment crisis was the member of the governing Board.

The payment problem in CSE arose after the post-budget fall in the market prices in March 2001. There were various large brokers who were...
involved in this including Ketan Parekh (defaulter at BSE) and his associated entities had linkage with CSE brokers.

Ketan Parekh during his evidence before the committee stated that his entities were doing lot of arbitrage between CSE, BSE and NSE. They used to buy from CSE and sell later on BSE.

There were following reasons of the payment crisis in CSE:

- Building up of large outstanding position by a few brokers in the few scrips.
- Violation of SEBI directives regarding gross exposure limits and margins.
- Failure to take timely action for non-payment of margin on T-1 bases.
- Failure of surveillance department of CSE to detect concentration of position built by a few brokers in few scrips and to take preventive action etc.
- Violations of carry forward limits set by SEBI.
- Private deals between the individuals or illegal badla.

Above were the main reasons that were responsible for payment crisis in CSE. Therefore it all mainly relates to price manipulations.
(b) Role of SEBI and CSE

Now, we will discuss the role of SEBI during that period. During year 1998-99 and 2000 the regulator (SEBI) inspected exchanges that have active trading including CSE for the following purposes whether:

- The exchange provides a fair, equitable and growing market to investors,
- The exchange’s organization, systems and practices are in accordance with the SC (R) Acts and rules framed there under.
- The exchange has implemented the directives, guidelines and instructions issued by it from time to time.
- The exchange has complied with the conditions if any imposed under section 4 of the SC(R) Act while granting recognition to it.

SEBI’s inspection report during above period had brought out following violations or deficiencies in the working of CSE that were repeated in all the three years. It brought to notice that SEBI’s following directives were violated by CSE repeatedly:

- The exchange will reduce the post settlement period by one day and comply with SEBI circular dated 13-8-96 which require the exchange to complete the settlement within 7 days.
The exchange is advised to take strict, stern action such as suspension of membership, de-activation of trading terminals, imposition of fine or penalty against the defaulting members, depending upon the nature of violation, so that it acts as a deterrent for them to repeat such violations in future.

The exchange should empower its officials to take immediate action with the approval of the president or Executive Director regarding de-activation of the trading terminals of the members.

The exchange should not adjust the amount deposited by the members towards additional capital against the margin liability.

The exchange should ensure that the margins are collected before the commencement of trading on the following day by directly debiting the margin liability to the member’s bank account.

The exchange should immediately streamline the system of reporting and recording of all the off the floor transactions.

All above SEBI’s directives were violated in the CSE during the period of 1998, 99, 2000 and moreover SEBI’s inspection report of that period itself pointed it out. Surprisingly, most of the above deficiencies have contributed the payment rises in CSE in 2001. From this various questions arise like.

What were the actions taken by SEBI to remove the above deficiencies when its inspection report revealed the violations?
• Should SEBI act only on the basis of compliance report filed by stock exchange concerned?

• Who should ensure that the stock exchanges or members or the persons connected to it are complying with the statutory provisions?

• Who will be responsible for submitting a wrong compliance report to SEBI?

• What were the steps SEBI took after noticing the deficiencies or violations in CSE to remove them?

In a response, the representative of SEBI said during evidence:

“…We do the follow up by calling for some compliance reports from the exchange. The compliance reports which we have been receiving from the exchange showed that whatever irregularities have been pointed out have been complied with or rectified. We found in the subsequent inspections again there were certain irregularities of that nature these things were regularly being taken up.”

Further SEBI stated in a written reply that...

“CSE could have prevented the payment crisis by strictly following SEBI’s directives on margins and exposure limits.”

Regarding the query of the concentrated position of members in certain scripts the former executive director of CSE stated that SEBI had been informed in the past by exchange regarding those price manipulations.
SEBI defended its actions in this crisis by stating that:

- In regular meetings and interaction with exchanges no feedback was received which warranted initiation of investigation at that time.

- With reference to specific communications by SEBI as regard the behaviour of certain scrips, the exchange never indicated any need for investigation into the behaviour of these select scrips.

- On the basis of their monitoring also, exchanges never made any reference to SEBI as regards any abnormality in the behaviour of these scrips.

- In response to specific complaints received by SEBI and forwarded to exchanges, the exchanges did not indicate any abnormality in the behaviour of these scripts.

- Exchanges reported that there was no concentration in the trading, circular trading etc.

Above statements made by SEBI showed that SEBI was working or acting totally on the basis of advices and the suggestions given to it by exchanges and in accordance with the their wishes.

The committee in its report stated that it is evident that SEBI suspected something might be wrong but, for fear of being held responsible for pricking the balloon, decided to go along with stock exchanges report that all was well
instead of fulfilling its regulatory duties of cross checking complacent stock exchanges' replies.

Thus, it was the short survey on the price crises in CSE and the role of SEBI and the concerned stock exchange i.e. CSE. As stated earlier that SEBI is a primary and so called independent regulatory body, which has very wide powers under different Acts. But how far it is exercising those powers is clear from above discussion to some extent.

Although, SEBI noticed during its inspection some violations or irregularities in the working of CSE in the period of 1998, 1999 and 2000 repeatedly it has taken no action against the exchange in spite of the fact that it has power under the SC (R) Act. Under Section 11 of the Act it has the power to supersede the governing body of a stock exchange in case it is not working in accordance with the statutory provisions. It is the duty of SEBI to check that stock exchanges are working under statutory framework prescribed for them.

Moreover, when the exchange assured SEBI that all irregularities have been rectified it did not bother to make any effort to check it. This attitude of SEBI has given the impression to exchanges that they can do whatever they want and no action against them can be taken by regulatory body until they themselves report to SEBI.

**Recapitulation**

Thus, in spite of many reforms by SEBI in securities market there are many problems and malpractices, which still exist in the market. Though under
the Securities Laws (Amendment) Act 1995, SEBI has power to impose monetary penalties on the defaulters but it rarely exercises those powers. As seen in many cases SEBI has suspended registration certificate of the defaulters which have been challenged by the parties before SAT and in most of the cases SAT either set aside SEBI’s order or reduced the penalties. SEBI also hesitates in imposing monetary penalties on the defaulters. Therefore, SEBI is not leaving any deterrent effect on the market participants and regular violations of the rules and regulations are in practice. Even during the recent securities scam SEBI failed to initiate timely actions against the offenders.