

CLUSTER 12

The Securities Contracts (Regulation) Act, 1956

1. The Rural Electrification Corporation, New Delhi issued 6 years bonds to public directly and not through any Stock Exchange. Whether the Rural Electrification Corporation can do so? Is it not a violation of Securities Contracts (Regulation) Act, 1956? [CA Final Nov 2004]

OR

The Mewar Rural Financial Corporation, Udaipur, established under a special statute issued 5 years bond to public directly and not through any Stock Exchange. Decide whether the said act of the Mewar Rural Financial Corporation is in violation of the provisions of the Securities Contracts (Regulation) Act, 1956. [CA Final June 2009]

OR

Industrial Finance Corporation of India, established under the Industrial Finance Corporation Act, 1948 having its Registered Office at Mumbai, issued 8% Redeemable Bonds redeemable after 7 years. These bonds were issued directly to the members of the public and not through the mechanism of Stock Exchanges. You are required to state with reference to the provisions of Securities Contract (Regulation) Act 1956, whether such direct issue of bonds by the Industrial Finance Corporation of India is not violating the provisions of the said Act. [CA Final June 2009]

Ans. As per Section 28, the provisions of the Act shall not apply to any corporation set up under a special law.

Since, Rural Electrification Corporation has been set up under a special law (viz. Rural Electrification Corporation Act), the provisions of Securities Contracts (Regulation) Act, 1956 shall not apply to it. Therefore, Rural Electrification Corporation can issue 6 years bonds to the public directly without requiring any permission of any stock exchange. Accordingly, issue of bonds directly to the public and not through any stock exchange, does not result in any contravention of the provisions of the Act.

2. Explain the meaning of the following terms used in the Securities Contracts (Regulation) Act, 1956;

(i) Option in Securities

(ii) Spot delivery contract. [CA Final May 2017]

OR

Define the term 'derivative' as appearing in the Securities Contract (Regulation) Act, 1956. [CA Final May 2019]

Ans. Option in securities [Section 2(d)]

'Option in securities' means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a tejimandi, a galli, a put, a call or a put and call in securities.

Derivative [Section 24(ac)]

Derivative' includes-

(A) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

(B) a contract which derives its value from the prices, or index of prices, of underlying securities,

(C) commodity derivatives; and

(D) such other instruments as may be declared by the Central Government to be derivatives.

3. A stock exchange desirous of taking over another stock exchange, seeks your advice on corporatisation. Examining the provisions of the Securities Contracts (Regulation) Act, 1956 and the meaning of the terms 'corporatisation' and 'demutualisation', advise the

stock exchange about the steps to be taken to give effect to the scheme of corporatisation. [CA Final Nov 2009]

OR

Explain the meaning of the term 'demutualisation' used under the Securities Contracts (Regulation) Act, 1956. [CA Final May 2018]

Ans. In simple words, demutualisation is a process of transition of mutual or co-operative associations into companies by converting the interests of the members (viz. stock brokers) into shareholdings which can be traded like the shares of a company. The purpose of demutualisation is to convert the stock exchanges that were originally formed as societies or body of individuals operating on not-for-profit basis into commercial business enterprises operating with profit making objective. Demutualisation ensures that the stock exchanges are professionally run and interests of investors are protected. Demutualisation requires separating the ownership of a stock exchange from the right to trade as a stock broker as well as separating the right to participate in management of stock exchange from the right to trade as a stock broker.

Demutualisation means the segregation of ownership and management from the trading rights of the members of a recognized stock exchange in accordance with scheme approved by SEBI.

Procedure for corporatisation and demutualisation

1. All recognised stock exchanges shall, within such time as may be specified by the SEBI, submit a scheme for corporatisation and demutualisation for its approval
2. The SEBI may in the interest of the trade and also in the public interest, approve the scheme with or without modification.
3. The approved scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognised stock exchange.
4. SEBI, in the interest of the trade and also in the public interest may reject the scheme after giving a reasonable opportunity of being heard to all the persons concerned.
5. The SEBI may, while approving the scheme, restrict the voting rights of the shareholders who are also stock brokers of the recognised stock exchange and the right of shareholders or a stock broker of the recognised stock exchange to appoint the representatives on the governing board of the stock exchange. The maximum number of representatives of the stock brokers, to be appointed on the governing board, shall not exceed one-fourth of the total strength of the governing board.
6. On receipt of approval of the scheme, the stock exchange shall issue equity shares to the public within 12 months ensuring that at least 51% of its equity share capital is held by the public other than shareholders having trading rights.

4. Rampur Stock Exchange wants to get itself recognized. Explain –

(i) Who enjoys the power to recognize stock exchange?

(ii) What information will have to be provided with the application for recognition? [CA Final May 2003]

OR

The Central Government has granted recognition to a stock exchange. To what conditions may such a recognition be subject to? Your answer should refer to the provisions of the Securities Contracts (Regulation) Act, 1956. [CA Final May 2010]

Ans. Recognition of stock exchanges

1. Any stock exchange, which is desirous of being recognized, shall make an **application to the Central Government.**
2. Every application shall be accompanied by 4 copies of the **byelaws and rules** of the stock exchange. The byelaws shall contain matters relating to the regulation and control of

contracts. The rules shall contain the matters relating to the constitution and management of the stock exchange.

In particular, the rules shall specify the following matters: (i) Constitution, powers of management and manner of transacting business by the Governing body; (ii) Powers and duties of Office bearers; (iii) Various classes of members and their qualifications, suspension, expulsion and readmission (iv) Admission of 'firm' as a member.

3. Grant of recognition to stock exchanges

(a) The central government shall ensure

- (i) that the rules and bye-laws of the stock exchange ensure fair dealing and protection to investors.
- (ii) that the stock exchange is willing to comply with any other conditions imposed.
- (iii) that it would be in the interest of the trade and also in the public interest to grant recognition to the stock exchange.

(b) Recognition subject to conditions: (i) the qualifications for membership of stock exchanges; (ii) the manner in which contracts shall be entered into and enforced as between members; (iii) the appointment of representatives of the Central Government (not exceeding three) on the stock exchanges; (iv) the maintenance of accounts of members and their audit by a chartered accountant.

(c) Amendment of the rules of the recognized stock exchange require prior approval of the Central Government.

4. Every grant of recognition to a stock exchange shall be published in the Gazette of India.

5. The power to recognize the stock exchanges vests with the Central Government. However, Central Government has **delegated these powers to SEBI**

5. The Central Govt. has formed its opinion on certain grounds that the recognition granted to a Stock-Exchange be withdrawn. Examining the provisions of the Securities (Contracts) Regulation Act, 1956, explain the procedure that must be followed by the Central Govt. to give effect to the above. Also state whether any such withdrawal of recognition shall affect the validity of the contracts already entered into by Stock-Exchange, before withdrawal of recognition. [CA Final Nov 2010]

OR

The Delhi Stock Exchange Ltd. was granted recognition by Securities Exchange Board of India. SEBI received complaint alleging that the said Stock Exchange is indulging in fraudulent activities. SEBI is of the opinion that the recognition granted should be withdrawn in the interest of trade and public. State the provisions to withdraw the recognition under the Securities Contracts (Regulation) Act, 1956.

OR

Examine the validity of the contracts entered by the Stock Exchange prior to such withdrawal order. [CA Final May 2018]

Ans.

Withdrawal of recognition

1. The Central Government may withdraw the recognition granted to a stock exchange in the interest of the trade or the public interest after giving an opportunity of being heard to the governing body.
2. Where the recognized stock exchange has not been corporatized or demutualised or it fails to submit the scheme within the specified time or the scheme has been rejected by SEBI, the recognition stands withdrawn.
3. Such withdrawal of recognition shall be published in the Official Gazette and shall not affect the validity of any contract entered before the date of the notification, and provisions shall be made for the due performance of any contracts outstanding on that date.

6. Securities and Exchange Board of India received serious complaints against the affairs of a member of a stock exchange. Explain the powers of SEBI under Securities Contracts (Regulation) Act, 1956 to make enquiries and to take action, if necessary, against the member of a stock exchange. [CA Final May 2004]

OR

The Securities and Exchange Board of India received serious complaints against Mr. Satyanarayan, a member of Mavli Stock Exchange. State as to what powers can be exercised by the securities and Exchange Board of India to make enquiries and to take action in this matter, under the provisions of the Securities Contracts (Regulation) Act, 1956? [CA Final May 2013]

OR

In public interest, HEM Stock Exchange Limited was issued an order by the Securities and Exchange Board of India to produce certain information and explanation relating to its operations in writing. The management of the stock exchange was reluctant to part with such information with SEBI and approached you to seek your advice in the following matters:

(i) Duty of HEM Stock Exchange limited to furnish periodic returns to SEBI;

(ii) Power of SEBI to ask for the information asked as stated above, over and above the periodic returns;

(iii) Period for which the stock exchange is required to maintain the books of accounts which may be inspected by SEBI;

(iv) Duty of the stock exchange and the persons dealing with the stock exchange with regard to the information sought for by SEBI.

Ans. The given problem relates to Section 6 of the Securities Contracts (Regulation) Act, 1956, as discussed below:

(i) Duty of HEM Stock Exchange Limited to furnish periodic returns to SEBI

As per Section 6, every recognized stock exchange shall furnish to SEBI such periodical returns relating to its affairs as maybe prescribed.

As per Rule 17A, every recognized stock exchange shall furnish to SEBI periodical returns relating to-

(i) the official rates for the securities enlisted thereon;

(ii) the number of shares delivered through the clearing house;

(iii) the making-up prices;

(iv) the clearing house programmes;

(v) the number of securities listed and de-listed during the previous 3 months;

(vi) the number of securities brought on or removed from the forward list during the previous months; and

(vii) any other matter as may be specified by SEBI.

Thus, HEM Stock Exchange Limited is required to furnish the periodical returns to SEBI containing the above-mentioned particulars.

(ii) Power of SEBI to ask for the information, over and above the periodic returns

AS per Section 6, SEBI has the power to call upon a recognized stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the member in relation to the Stock exchange as SEBI may require. SEBI can call the information or explanation provided it is satisfied that it is in the interest of trade or public interest to do so.

Thus, SEBI is empowered to call upon HEM Stock Exchange to furnish information and explanations in accordance with above provisions.

(iii) Period for which the Stock Exchange is required to maintain the books of accounts which

may be inspected by SEBI

As per Section 6, every recognized stock exchange shall maintain such books of account and other documents as the Central Government may prescribe. For this purpose, the Central Government shall consult the stock exchange concerned and give due consideration to the interest of the trade and public interest. Such books of account and other documents shall be preserved for such periods, not exceeding 5 years, as the Central Government may prescribe. Such books of account and other documents may be inspected by SEBI at all reasonable times. No notice of inspection is required to be given to the stock exchange. Also, SEBI is not required to disclose the reason's or purpose or such inspection.

(iv) Duty of the Stock Exchange and the persons dealing with the stock exchange with regard to the information sought for by SEBI

As per Section 6, where an inquiry has been undertaken in relation to the affairs of a recognized stock exchange or the affairs of any of its members, the following persons shall be bound to produce all such books of account, and other documents in his custody or power relating to or having a bearing on the subject-matter of such inquiry and also to furnish any such statement or information relating thereto as may be required of him;

- (a) every director, manager, secretary or other officer of such stock exchange.
- (b) every member of such stock exchange.
- (c) if the member of the stock exchange is a firm, every partner, manager, secretary or other officer or the firm.
- (d) every other person or body of persons who has had dealings in the course of business with any of the persons mentioned in clauses (a), (b) and (c), whether directly or indirectly.

7. RSE Stock Exchange Limited, a recognized stock exchange is involved in trading of shares of Son Limited. The SEBI on receiving a complaint from a group of investors enquired and found that trading of shares of Son Limited is being conducted in a manner detrimental to the interest of the general investors. In order to curb the same, the SEBI wants to issue some directions to RSE Stock Exchange Limited. Referring to the provisions of the Securities Contract (Regulations) Act, 1956, discuss whether the SEBI has power to issue such directions. Can such directions be given to an individual who made some profit in any transaction in contravention of any provision of the Securities Contracts (Regulation) Act, 1956, or regulations made there under? [CA Final Nov 2016]

Ans.

1. Conditions for issue of directions by SEBI

SEBI may issue the directions if, after making an inquiry, it is satisfied that issue of directions is necessary –

- (a) in the interest of investors, or orderly development of securities market; or
- (b) to prevent the affairs of any recognized stock exchange, or, clearing corporation, being conducted in a manner detrimental to the interests of investors or securities market: or
- (c) to secure the proper management of any such stock exchange or clearing corporation.

2. Directions to whom?

The directions can be given to-

- (i) any stock exchange or clearing corporation or any person or class of persons associated with the securities market: or
- (ii) any company whose securities are listed or proposed to be listed in a recognized stock exchange, as may be appropriate in the interests of investors in securities and the securities market.

Explanation to Section 12A

For the removal of doubts, it is hereby declared that power to issue directions under this Section shall include and always be deemed to have been included the power to direct any

person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made there under, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

8. Describe the provisions of the Securities Contracts (Regulation) Act, 1956 regarding the powers of the Central Government to supersede the governing body of a recognized stock exchange and the consequences of such super session. [CA Final May 2007, Nov 2005]

OR

Complaints of unethical practices have been received against members of the governing body of a recognized stock exchange.

Examine whether the Government has any power to take action against the governing body of the said exchange. [CA Final Nov 2002]

Ans. On receipt of a complaint of unethical practices against the members of the governing body of a recognized stock exchange, the Central Government is empowered to take the following actions.

1. Withdrawal of recognition (Section 5)

As per Section 5, the Central Government may withdraw the recognition granted to a stock exchange if, considering the interest of the trade or the public interest, the Central Government is of the opinion that the recognition granted to a stock exchange should be withdrawn. The Central Government shall give an opportunity of being heard to the governing body.

The withdrawal of recognition shall be published in the Official Gazette.

2. Super session of the governing body (Section 11)

Section 11 empowers the Central Government to supersede the governing body of a recognized stock exchange. It may also appoint any person or persons to exercise all the powers and perform all the duties of the governing body. Where the Central Government appoints more than one person, it may appoint one of such persons to be the chairman and another to be the vice-chairman of the governing body. The Central Government shall have these powers notwithstanding anything contained in any other law for the time being in force. An order of supersession shall require the fulfilment of all the following conditions:

(a) The Central Government shall serve on the governing body a written notice that it is considering the supersession of the governing body.

(b) The Central Government shall specify the reasons in the notice given to the governing body.

(c) The Central Government shall give an opportunity of being heard to the governing body.

(d) The Central Government must form an opinion that the governing body of the stock exchange should be superseded.

(e) The Central Government shall issue a notification in the Official Gazette that the governing body of the stock exchange has been superseded.

Section 12 empowers the Central Government to make an order directing a recognized stock exchange to suspend its business. The powers of the Central Government in this regard are explained as under:

3. Conditions for making the order of suspension

An order of suspension shall require the fulfilment of all the following conditions:

(a) The Central Government must form an opinion that some emergency has arisen and for the purpose of meeting the emergency, it is expedient to suspend the business of the stock exchange.

(b) The Central Government shall issue a notification in the Official Gazette that the business of the stock exchange has been suspended.

(c) The Central Government shall specify the reasons in the notification published in the

Official Gazette.

(d) The suspension of such business shall be subject to such conditions as may be specified in the notification.

(e) The suspension of business shall be for such period, not exceeding 7 days, as may be specified in the notification.

(f) The Central Government may extend the period of suspension by issuing a fresh notification in the Official Gazette. The extension may be ordered if –

(i) the Central Government forms an opinion that such extension is required in the interest of trade or public interest; and

(j) the Central Government has given an opportunity of being heard to the governing body of the stock exchange.

Delegation of powers to SEBI

The powers of Central Government under Section 12 have been concurrently delegated to SEBI [Notification No. 573, dated 30.7. 1992]

9. Complaints of unethical practices have been received against members of a recognized stock exchange by the Government. Examine whether the Government has any power to suspend the business of such a recognized stock exchange. [CA Final Nov. 2005]

OR

Central Government has received complaints regarding improper functioning of a stock exchange. Explain the powers of the Central Government under the Securities Contracts (Regulation) Act, 1956 to suspend the business of the stock exchange. [CA Final Nov 2014]

Ans. Section 16 empowers the Central Government to declare that any contract for the sale or purchase of a security shall not be entered into except with the permission of the Central Government. These provisions are explained as follows:

Conditions for making the prohibition order

(a) The Central Government must form an opinion that undesirable speculation in securities is being carried out in relation to certain securities in a certain State or area.

(b) The Central Government is satisfied that it is necessary to prevent such undesirable speculation in securities.

(c) The Central Government issues a notification in the Official Gazette specifying such State/area and the securities. It shall also declare that no person in such State/area shall enter into any contract for the sale or purchase of such securities.

(d) All contracts entered into after the date of the notification, for sale or purchase of the specified securities in these specified States/areas shall be illegal, except in the following cases:

(i) A contract entered into with the permission of the Central Government.

(ii) A contract entered into in the manner specified in the notification.

10. The governing body of City Stock Exchange Association Ltd. is desirous of putting various restrictions on voting rights of its members to be exercised in a meeting and on their right to appoint a proxy. You are required to state whether the same is permissible Also state the role of Central Government in this respect. [CA Final May 2008, May 2004]

OR

Examine with reference to the provisions of the Securities Contracts (Regulation) Act, 1956 whether it is possible for City Stock Exchange Limited, a company incorporated under the Companies Act and a recognized Stock Exchange, to insist that its members should appoint only other members as their proxies to attend and vote at the meeting of the Stock Exchange. [ICAI, RTP, Nov. 2017]

OR

Impressions Ltd. is holding 33% of the paid-up equity capital of Thyag Stock Exchange. The company appoints Tilt Ltd. as its proxy who is not a member of the Thyag Stock Exchange, to attend and vote at the meeting of the Thyag Stock Exchange. Examine whether Thyag Stock Exchange can restrict the appointment of Tilt Ltd. as proxy for Impression Ltd. and further restrict the voting rights of Impression Ltd. in Thyag Stock Exchange. [ICAI, RTP, May 2014, Oct. 2018]

Ans.

1. Conditions for making or amending rules

(a) Approval of CG required. The rules made or amended by a recognized stock exchange shall require the approval of the Central Government. While granting the approval, the Central Government may make such modifications therein as it things fit.

(b) Publication in Gazette. No rules of a recognized stock exchange made or amended shall have effect until they have been published by the Central Government in the Official Gazette.

2. Scope of the rules

The rules may provide for any of the following matters:

(a) Voting rights to members only- The restriction of voting rights to members only in respect of any matter placed before the stock exchange at any meeting.

(b) One member - one vote- The regulation of voting rights in respect of any matter placed before the stock exchange at any meeting so that each member may be entitled to have one vote only, irrespective of his share of the paid-up equity capital of the stock exchange.

(c) Proxies prohibited- The restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange.

(d) Other related matters- Such incidental, consequential and supplementary matters as may be necessary to give effect to any of the above matters.

11. A recognized stock exchange proposes to make bye-laws for the regulation and control of contracts relating to the purchase and sale of securities. State the legal requirements under the Securities Contracts (Regulation) Act, 1956 to give effect to the proposal. [CA Final Nov 2013]

Ans. Power of recognised stock exchange to make bye laws - Section 9

1. Stock Exchange shall make bye-laws only after obtaining the previous approval of SEBI. Approved bye-laws should be published in the Gazette of India and in the Official Gazette of the State in which the principal office of the RSE is situated. SEBI may dispense with requirement of publication of bye Laws in Official Gazette.

2. The bye laws may provide for the regulation and control of the contracts. It may provide for:

- a) the opening and closing of markets.
- b) clearing house for the periodical settlement.
- c) the regulation for blank transfers.
- d) the number and classes of contracts in respect of which settlements shall be made or differences paid through the clearing house.
- e) the regulation or prohibition of badlas or carry-over facilities.
- f) the fixing, altering or postponing of days for settlements.
- g) the determination and declaration of market rates for securities.
- h) the terms and conditions relating to contracts and margin requirement.
- i) the regulation for entering into contract, performance, cancellation & termination of contract between members, intermediaries and non-members.
- j) the listing, suspension & delisting of securities on the stock exchange.
- k) the method and procedure for the settlement.
- l) the recovery of fees, fines and penalties.

- m) the fixing of brokerage and other charges.
 - n) the emergencies in trade which may arise, whether as a result of pool or syndicated operations or cornering or otherwise, and the exercise of powers in such emergencies including the power to fix maximum and minimum prices for securities.
 - o) the regulation of dealings by members for their own account.
 - p) the separation of the functions of jobbers and brokers.
 - q) the limit volume of trade done by any individual member.
3. Any contract entered in contravention of its bye-laws is void. Bye-laws may provide that member is liable to expel, fine or suspension for contravention of bye-laws.

12. Explain the powers of the Securities and Exchange Board of India to amend the bye-laws of a recognized stock exchange. [CA Final Nov 2013]

Ans.

1. A recognized stock exchange may make a request in writing to the SEBI to make the bye-laws of the exchange or make an amendment in its existing bye-laws. Also, SEBI may suo motu consider the making or amendment of the bye-laws.
2. Before making the bye-laws or any amendment thereof, SEBI shall consult the governing body of the stock exchange.
3. If SEBI is satisfied that it is necessary or expedient so to do, it may make the bye-laws for all or any of the matters specified in Section 9 or amend any existing bye-laws of the stock exchange. SEBI shall record its reasons for making or amending the bye-laws.
4. The bye-laws so made or amended shall be published in the Gazette of India and also in the Official Gazette of the State in which the principal office of the recognized stock exchange is situated. The bye-laws shall have effect only from the date of its publication in the Gazette of India.
5. However, if in any case, the SEBI is satisfied that in the interest of the trade or in the public interest any bye-laws should be made immediately, it may, by order in writing specifying the reasons therefore, dispense with the condition of previous publication.
6. Where SEBI makes or amends the bye-laws of a stock exchange on its own motion, the governing body may object to it within 2 months of its publication in the Gazette of India. It may apply to SEBI for revision thereof. SEBI may, after giving an opportunity of being heard to the governing body, revise the bye-laws so made or amended. The revision shall have effect only from the date of its publication in the Gazette of India.
7. On the publication of bye-laws in the Gazette of India, the bye-laws so made or amended shall have effect as if they had been made or amended by the recognized stock exchange concerned.

13. SEBI is of the opinion that in the interest of investors it is desirable to amend the rules of XYZ Stock Exchange prohibiting the appointment of the broker-member as President of the stock exchange. Explain with reference to provisions of the Securities Contracts Regulation) Act, 1956 whether it is possible for SEBI to amend the rules of the Stock Exchange, if the rules are not amended by the stock exchange? [CA Final May 2007, Nov 2003]

Ans:

1. Order of Central Government to make or amend rules

(a) Nature of order - The Central Government has the power to direct the recognized stock exchanges generally or any particular recognized stock exchange to make any rules or to amend any rules already made.

(b) Requisites for making order -The Central Government may make such an order only if it complies with the following requirements:

- (i) The Central Government shall consult the governing bodies of the stock exchanges

generally or with the governing body of the stock exchange in particular, as the case may be.

(ii) The Central Government must form an opinion that it is necessary or expedient to make such an order.

(iii) The Central Government shall specify the reasons for making such an order.

(iv) The order to make any rules or to amend any rules already made shall be given only in respect of the matters specified in Section 3(2), i.e. the provisions relating to governing body, office bearers and members of the stock exchange, and admission of firm as a member of the stock exchange.

2. Compliance of order by the stock exchange

It shall be the duty of such recognized stock exchange(s) to make or amend the rules within 2 months from the date of the order of the Central Government.

3. Making or amendment of rules by the Central Government

If any recognized stock exchange fails or neglects to comply with the order of the Central Government within a period of 2 months, the Central Government may make or amend the rules. The Central Government may-

(a) make or amend the rules in the same form as proposed in the order; or

(b) make or amend the rules, after making certain modifications in the order previously issued to the stock exchange, provided that no such modification shall be made unless the stock exchange agrees to making of such modifications.

4. Publication of rules

Where in pursuance of this Section any rules have been made or amended, the rules so made or amended shall be published in the Gazette of India and also in the Official Gazette or Gazettes of the State or States in which the principal office or offices of the recognized stock exchange or exchanges is or are situated.

5. Effect of the rules

On the publication of rules in the Gazette of India, the rules so made or amended shall have effect -

(a) as if they had been made or amended by the recognized stock exchange or stock exchanges, as the case may be;

(b) notwithstanding anything to the contrary contained in the Companies Act, 2013 or in any other law for the time being in force.

14. M/s AB & Company, a member of a recognized stock exchange proposes to buy and sell shares of a particular company on behalf of investors as well as on their own account. They seek your advice as to restrictions, if any, under Securities Contracts (Regulation) Act, 1956 for dealing in securities on their own account. Advise. [CA Final May 2003]

OR

M/s. Goyanka & Company, which is a member of a recognised stock exchange desire to buy and sell shares of Crosslands Company Limited on their own count as well as on behalf of investors. Advise Mr. Goyanka & Company whether there are any restrictions for dealing in securities on their own count under the provisions of the Securities Contracts (Regulation) Act, 1956. [CA Final June 2009]

OR

M/s. Ganesham & Company is a member of recognized stock exchange. Nova Crafts Export Limited desires that shares of the company may be bought and sold by M/s. Ganesham & Company on their own as well as on behalf of the investors.

Advise M/s. Ganesham & Company whether they can do so under the provisions of the Securities Contracts (Regulation) Act, 1956. [CA Final May 2011]

Ans.

An investor cannot directly, by himself, trade (purchase or sell securities) on a stock exchange.

He can trade only through a member of a stock exchange. Therefore, a member of a stock exchange acts as an intermediary between the two investors, i.e. he acts as an agent, since he carries out the transactions on behalf of the investors.

As per Section 15, no member of a recognized stock exchange shall enter into any contract as a principal with any person other than a member of a recognized stock exchange, except in the following cases:

- (a) Where the member of the recognized stock exchange -
- (i) secures the consent of such other person in writing; and
 - (ii) makes a disclosure in the note, memorandum or agreement of sale or purchase that he is acting as a principal.
- (b) Where the member secures the consent of such other person otherwise than in writing, he shall secure written confirmation by such person of such consent within 3 days from the date of the contract.
- (c) A member may, without obtaining any written consent of such person, close out any outstanding contract entered into by such person in accordance with the bye-laws of the stock exchange. However, the member shall disclose in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as a principal.
- (d) Where the contract is a spot delivery contract.

15. A company Cookies Private Limited has two shareholders, Mr. Rock and Mr. Salt. Mr. Rock decides to sell his part of shares in Cookies Private Limited to another company, Crispy Private Limited for a specified monetary consideration. How should Mr. Rock proceed to document the transaction so as to make it legally binding on both the parties? [RTP May 18]

Ans. Requirement as to Share Purchase Agreement:

A Share Purchase Agreement (commonly known as SPA) is an agreement that sets out the terms and conditions relating to the sale and purchase of shares in a company. Such an agreement principally outlines the following:

As per the stated facts, Mr. Rock decides to sell his part of the share in other company. So, such an understanding of transfer of the shares of Cookies Private Limited held by Mr. Rock to Crispy Private Limited shall be recorded in Share Purchase Agreement (SPA), which is a legally binding contract, and lists down all the terms and conditions which are relevant to the sale of shares, such as –

1. the exact description of shares, i.e. the number of shares, price per share, premium amount, if any;
2. the conditions that must be satisfied before the sale takes place;
3. the date on which the sale will be completed;
4. the manner in which the transfer will be made;
5. any indemnities or protections available to the parties;
6. the representations and warranties made by either party; and
7. the conditions upon which the agreement will terminate

16. Mr. Vivaan is having 400 shares of M/s Travel Everywhere Limited and the current price of these shares in the market is INR 100. Vivaan's goal is to sell these shares in 6 months' time. However, he is worried that the price of these shares could fall considerably, by then. At the same time, Vivaan doesn't want to sell off these shares today, as he conjectured that the share price might appreciate in the near future. How should Mr. Vivaan protect his security and reduce the risk of loss on the share price? [RTP May 18]

Ans. Suggested way to protect the security and reduce the risk of loss on share price is to opt for a 'Option' derivative contract. Options are contracts, through which a seller give the buyer, a right, but not the obligation, to buy or sell a specified number of shares at a pre-determined price, within a set time period. These contracts are essentially derivatives, since

they derive their value from an underlying security on which the option is based. With options, one can tailor his position according to his own situation and stock market outlook.

In this case, Vivaan may opt for 'Option' derivative contract. However, it is not obligatory for him to hold the terms of the agreement, since he has an 'option' to exercise the contract. For example, if the current market price of the share is INR 100 and he buy an option to sell the shares to Mr. X at INR 200 after 3 months, so Vivaan bought a put option.

Now, if after 3 months, the current price of the shares is INR 215, Mr. Vivaan may opt not to sell the shares to Mr. X and instead sell them in the market, thus making a profit of INR 115. Had the market price of the shares after 3 months would have been INR 80, Mr. Vivaan would have obliged the option contract and sold those shares to Mr. X, thus making a profit, even though the current market price was below the contracted price.

17. Ms. Ashmita D'Souza recently graduated from National Law School, Bangalore and made her parents proud. While working on one of her assignments, she got really interested in knowing about the securities and gained expertise in the day-to-day working of financial markets. Meanwhile, her father got a wonderful opportunity at work to move to Germany and the whole family is very excited to make the move and settle there. Ashmita, along with her family applied for residence there and also gained the citizenship of Germany. She got married to a German, named Vincent, and they both came to India to start a career. After working with Ashmita on a couple of assignments, Vincent got interested to become a member of the Chennai Stock Exchange, Chennai. Discuss, whether Vincent or Ashmita can become a member of the stock exchange, stating the provisions of Securities Contract Regulations in India. [ICAI Mock Exam March 2018]

Ans.

Rule 8 of the Securities Contract (Regulations) Rules, 1957

Membership of recognized stock exchange:

- 1) Rule 8 of the Securities Contract (Regulations) Rules, 1957 details the qualifications for becoming the member of a recognized stock exchange. No person shall be eligible to be elected as a member if he/she is not a citizen of India.
- 2) Rule 8(3) prescribes that the persons that can be admitted as the members of the recognized stock exchange and mentions that no person who is a member at the time of application for recognition or subsequently admitted as a member if he ceases to be a citizen of India.

Analysis and Conclusion:

- a) Ashmita cannot become the member of the Chennai Stock Exchange since she ceased to be a citizen of India, as she has gained the citizenship of Germany.
- b) Mr. Vincent cannot be elected as the member of the recognized stock exchange since he is not a citizen of India.
- c) However, the governing body of the Chennai Stock Exchange may take the prior approval of SEBI, in case they are interested in electing Vincent as a member of the stock exchange.

18. Mr. G applied to be appointed as a member in the place of his brother Mr. Kumar, who was financial analyst (who met with an accident) in Bombay stock exchange. Governing body of the Stock exchange finds him to be eligible as member, considering him a close relative of Mr. Kumar. Rather experience and knowledge of Mr. G was not in alliance with the required skill for the conduct of business in securities. Determine the validity as to the appointment of the Mr. G in the Stock exchange with the reference to the provisions of the SCRA, 1956. [ICAI Mock Exam Aug 2018]

Ans. Rule 8 of the Securities Contract (Regulations) Rules, 1957

Membership of recognised stock exchange:

Rule 8 of the Securities Contracts (Regulation) Rules, 1957 details the qualifications for

becoming the member of a recognised stock exchange.

- a) As per Rule 8, no person eligible for admission as a member under Rule 8(1) shall be admitted as a member unless he succeeds to the established business of a deceased or retiring member who is his father, uncle, brother or any other person who is, in the opinion of the governing body, a close relative.
- b) It is also provided that the rules of the stock exchange may authorise the governing body to waive compliance with any of the foregoing conditions if the person seeking admission is in respect of means, position, integrity, knowledge and experience of business in securities, considered by the governing body to be otherwise qualified for membership.

Conclusion:

Though Mr. G was brother of Mr. Kumar, but was not eligible due to lack of his experience and knowledge in the business of securities.

19. Primex Securities (P) Ltd. is a Company involved in stock broking and is registered with SEBI. The said broking company failed to:

- a) Redress the grievances of the investors within the stipulated time.
- b) Segregate securities or money of clients and used the same for self-use for or for any other clients.

The Securities and Exchange Board of India issued an Order against the said Company for committing the above offences. The Managing Director of the Company seeks your advice on the following under the provisions of the Securities Contracts (Regulation) Act, 1956.

- a) What is the penalty for the above offences?
- b) Whether the offence committed by the stock broking company is compoundable? If so, by whom?
- c) Whether this offence can be compounded after institution of proceedings against the stock broking Company? [CA Final Nov 2018]

Ans. Section 23C of SCRA, 1956 is as follows

Penalty for failure to redress investors' grievances: As per Section 23C of Securities Contracts (Regulation) Act, 1956, if any stock broker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange, after having been called upon by the SEBI or a recognised stock exchange in writing, to redress the grievances of the investors, fails to redress such grievances within the time stipulated by the SEBI or a recognised stock exchange, he or it shall be liable to a penalty which shall not be less than 1 lakh but which may extend to Rs.1 lakh for each day during which such failure continues subject to a maximum of Rs.1 crore.

Penalty for failure to segregate securities or moneys of client or clients: As per Section 23D of Securities Contracts (Regulation) Act, 1956, if any person, who is registered u/s 12 of the SEBI Act, 1992 as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be liable to a penalty which shall not be less than Rs.1 lakh but which may extend to Rs.1 crore.

Compounding of Offences:

As per Sec. 23N of the Securities Contracts (Regulation) Act, 1956, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by a Securities Appellate Tribunal or a court before which such proceedings are pending.

Compounding of Offence after institution of proceedings:

Offence can be compounded after institution of proceedings against the stock broker as it is clearly stated u/s 23N

20. DVI Ltd, a company incorporated under the Companies Act, 1956 applies to Bombay Stock Exchange for listing of its shares. The Stock Exchange refuses to grant listing without assigning any reasons for refusal. Company seeks your advice on the options available to it against the Stock Exchange and wants to move the Court. Examining the provisions of the Securities Contracts (Regulation) Act, 1956, advise the company. Aggrieved by the order of Securities Appellate Tribunal (SAT), MNO Ltd. decided to prefer an appeal with the Supreme Court. Identify the provisions governing further appeal on the order by the company under the provision of Securities Contracts (Regulation) Act, 1956.

Also state whether any question of fact arising out of the order of SAT can be challenged in the appeal? [CA Final Nov 2018]

Ans. The given problem relates to Section 22F of the Securities Contracts (Regulation) Act, 1956.

Provisions

The provisions contained in Section 22F are as under

- (a) Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal with the Supreme Court.
- (b) The appeal shall be filed within 60 days of communication of order of the Securities Appellate Tribunal.
- (c) On sufficient cause being shown, the Supreme Court may extend the period for filing appeal. However, the extension shall not exceed 60 days.
- (d) The appeal can be filed only on a question of law.

Analysis and conclusion

- 1. The Securities Appellate Tribunal (SAT) has made an order by which MNO Ltd. is aggrieved. MNO Ltd. intends to prefer an appeal against the order of SAT.
- 2. MNO Ltd. is entitled to prefer an appeal to the Supreme Court against the order passed by SAT. Such appeal may be filed by MNO Ltd. within 60 days of order of SAT. However, delay up to 60 days may be condoned by the Supreme Court, in case sufficient cause is shown for such delay.

The appeal to the Supreme Court may be filed only on a question of law. Thus, no appeal shall be filed on a question of fact arising out of order of SAT.

21. The shares of MLM Limited were listed in Cochin Stock Exchange. The stock exchange delists the shares of the company. The aggrieved company approaches you to know the remedy available to the company. Give your suggestion to the company keeping in view the provisions of the Securities Contracts (Regulation) Act, 1956 [CA Final Nov 2006]

OR

MNC Limited whose shares are listed on recognized Stock Exchange, are de listed by the Stock Exchange. The company seeks your advice on the remedies available to the company against the order of the Stock Exchange. Referring to the provisions of the Securities Contracts (Regulation) Act, 1956, advise the company. [CA Final May 2010]

OR

Securities of Herbal Products Limited were listed in Madras Stock Exchange, which is a recognized stock exchange. The company has incurred losses during the preceding three consecutive years and it has also negative net worth. On having such information, Madras Stock Exchange decided to de list the securities of the company.

Decide the validity of the decision and explain the provisions of Securities Contract (Regulation) Act, 1956 along with the grounds made under the Securities Contract (Regulation) Rules regarding delisting of securities. [CA Final May 2018]

Ans. The given problem relates to Section 21A of the Securities Contracts (Regulation) Act, 1956 and Rule 21 of the Securities Contracts (Regulation) Rules, 1957.

Section 21A empowers a recognized stock exchange to delist the securities of a company on any of the grounds prescribed under the Act.

Rule 21 prescribes 6 grounds on the basis of which the securities of a company may be delisted. One of these grounds is as follows:

"The company has incurred losses during the preceding 3 consecutive years and it has negative net worth."

In the given case, Herbal Products Limited has incurred losses during preceding 3 consecutive years. Also, the net worth of Herbal Products Limited is negative. So, the ground on the basis of which a recognized stock exchange is empowered to delist the securities of a company, has been satisfied in the case of Herbal Products Limited.

Therefore, the decision of the Madras Stock Exchange to delist the securities of Herbal Products Limited is valid, provided –

(a) Madras stock exchange shall record the reasons for delisting the securities of Herbal Products Limited: and.

(b) Herbal Products Limited shall be given a reasonable opportunity of being heard before its securities are delisted.

The listed company (viz. Herbal Products Limited) or any aggrieved investor may, within 15 days, file an appeal with the Securities Appellate Tribunal against the order of delisting passed by the Madras Stock Exchange.

The grounds on the basis of which the securities of a company may be delisted, as contained in Rule 21 of the Securities Contracts (Regulation) Rules, 1957, are as follows

(a) The company has incurred losses during the preceding 3 consecutive years and it has negative net worth.

(b) Trading in the securities of the company has remained suspended for a period of more than 6 months.

(c) The securities of the company have remained infrequently traded during the preceding 3 years.

(d) The company or any of its promoters or any of its director has been convicted for failure to comply with any of the provisions of the Act or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 or rules, regulations, agreements made there under, as the case may be and awarded a penalty of not less than Rs. 1 crore imprisonment of not less than 3 years.

(e) The addresses of the company or any of its promoter or any of its directors, are not known or false addresses have been furnished or the company has changed its registered office in contravention of the provisions of the Companies Act, 1956.

(f) Shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange.

22. Mr. Patel has transferred his shares of a listed company registered in his name to Mr. Mehta. Mr. Mehta has failed to get the shares registered in his name before the company declared and paid the dividend on the shares. Examine with reference to the provisions of Securities Contracts (Regulation) Act, 1956 whether Mr. Patel is entitled to retain the dividend even though he has transferred the shares before declaration of dividend. [CA Final Nov 2003, Nov 2004, May 2015]

Ans. It shall be lawful for the holder of any security to receive and retain any income in respect of the units or other instruments issued by the collective investment scheme. The holder shall have such a right notwithstanding that the said security has already been transferred by him for consideration.

However, if the transferee has lodged the security and all other documents required for

making the transfer of security within 15 days of the date on which the income became due, the holder shall have no right to receive such income. The period of 15 days shall be extended:

- (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;
- (ii) in case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof, and
- (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

Nothing contained in the aforesaid provisions shall affect-

- (a) the right of a collective investment scheme to pay any income to the holder of the security; or
- (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

23. RST Ltd. is a Securitization and Reconstruction Company under SARFAESI Act, 2002. The Certificate of Registration granted to it was cancelled. State the Authority which can cancel the registration and right of RST Ltd. against such cancellation? [CA Final May 2011]

OR

Referring to the provisions of the SARFAESI Act, 2002 state the circumstances under which the RBI may cancel the certificate of registration granted to Securitization Company. [CA Final Nov 2014]

OR

GST Limited is a Securitization and Reconstruction Company under SARFAESI Act, 2002. The Certificate of Registration granted to it was cancelled. State the circumstances when the Certificate can be cancelled. Further, state the Authority which can cancel the Certificate of Registration. [CA Final Nov 2016]

Ans. Cancellation of registration-Section 4:

RBI may cancel a certificate of registration if company-

- a) **ceases to carry on the business** of securitisation or asset reconstruction.
- b) ceases to receive or hold any investment from a qualified institutional buyer.
- c) has failed **to comply with any conditions** imposed or conditions of Sec 3.
- d) fails to comply with **any direction issued by RBI** or maintain accounts.
- e) fails to submit for **inspection of its books of account** or other documents when demanded by the RBI.
- f) fails to obtain **prior approval of the Reserve Bank** as and when required.
- g) Before cancelling of registration of ARC, RBI should give an **opportunity of being heard** and for taking necessary steps to comply with such provisions.
- h) On cancellation of certificate of registration, ARC may **appeal to Central Government** within 30 days.

24. Explain briefly the procedure relating to enforcement of security interest under SARFAESI Act, 2002. [CA Final Nov 2011]

OR

Popular Limited defaulted in the repayment of term loan taken from a Bank against security created as a first charge on some of its assets. The bank issued notice pursuant to Section 13 of the SARFAESI Act, 2002 to the Company to discharge its liabilities within a

period of 60 days from the date of the notice. The company failed to discharge its liabilities within the time limit specified. Explain the measures to be taken by the Bank to enforce its security interest under the said Act. [CA Final May 2017]

Ans. Enforcement of Security Interest - Section 13

1. Secured creditor may enforce secured interest without interference of court or tribunal notwithstanding the provisions of The Transfer of Property Act.
 2. On classification of any debt as NPA, secured creditor may require by notice the borrower to discharge full liability in 60 days. This notice shall give details of the amount payable and the secured assets intended to be enforced by the secured creditor. If, the borrower makes any representation or raises any objection, the secured creditor shall consider it and if it is not acceptable or tenable, he shall communicate within 15 days the reasons for non-acceptance of the representation.
However, the borrower has no right to prefer an application to the Debts recovery Tribunal or to the Court.
 3. If borrower fails to discharge full debt, secured creditor may take any of the following measures to recover his secured debt:-
 - take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale to realise the secured asset.
 - take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale and realise the secured asset.
 - appoint any person to manage the secured assets after taking possession of assets.
 - require any person who has acquired any of the secured assets from the borrower and from whom any money is due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.
 4. Where the sale of the immovable property has been postponed, since the bid amount is less than the reserve price, the secured creditor himself can bid at any subsequent sale and the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor.
 5. In the case of financing of financial assets is by more than one secured creditor, above rights cannot be exercised unless secured creditors representing not less than 60% in value of the amount outstanding as on a record date agree to exercise for same. If it is agreed so, action agreed to be taken shall be binding on all the secured creditors.
 6. All cost, expenses and charges incurred by secured creditor can be recovered from the borrower
 7. In case of company in liquidation, amount realized from sale of secured assets should be distributed as per Section 326 of the Companies Act, 2013.
 8. If the sale proceeds of the secured assets are not fully satisfying the debt due, the lender may file a claim before the DRT or before a competent Court for the recovery of the shortfall.
 9. The lender also has an option to proceed against any of the guarantors or sell the pledged assets without taking any measures against the borrower.
 10. The lender can take the assistance of the Chief Metropolitan Magistrate or District Magistrate, as the case may be, in taking possession of the secured assets from the borrower.
- 25. Apex Limited failed to repay the amount borrowed from the Bankers, ACE Bank Limited, which is holding a charge on all the assets of the Company. The Bank took over the Management of the Company in accordance with the provisions of SARFAESI Act, 2002 by appointing four persons as Directors. The Company is managed by a Managing Director, Mr. X. Referring to the provisions of the said Act, examine whether Mr. X is entitled**

to compensation for loss of office and also explain the effect of such takeover on certain rights of the Shareholders of the Company. [CA Final May 2016]

Ans. No compensation to directors for loss of office (Section 16)

1. Irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act.
2. However, any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

26. Sharp Health Clinic Limited had availed the credit facilities from the United Bank Limited. The company made repayment of loan to some extent but not entirely and accordingly the Bank took recourse under the provisions of Section 13(2) the SARFAESI Act, 2002. Consequently, possession of the mortgaged property was taken up and it was duly advertised. The company also filed an application under Section 17(1) the SARFAESI Act, 2002 before the Debts Recovery Tribunal, which was dismissed by the impugned order. Being aggrieved, the company approached court. Will the company succeed in its petition referring to SARFAESI Act, 2002? [CA Final Nov 2017]

Ans. Appeal to DRT/Appellate Tribunal

- a) Borrower may appeal to **Debt Recovery Tribunal (DRT) within 45 days** if aggrieved by the measure of security creditor.
- b) If the creditor cannot fully satisfy the amount of debt on sale of secured assets, it may file an **appeal to DRT to recover the balance amount**.
- c) DRT should dispose the appeal **within 60 days**. However, this period may be **extended up to 4 months**. If the appeal is not disposed of by DRT, application can be made to **Appellate Tribunal**.
- d) **Borrower may appeal to Appellate Tribunal within 30 days** against order of DRT.
- e) Appeal to Appellate Tribunal will not be accepted unless borrower deposit **50% debt** with tribunal. However, tribunal may reduce **amount up to 25%** for special reason recorded in writing.

27. AA, a farmer mortgaged his agriculture land and obtained a term loan for cultivation purpose from a Nationalized Bank. Due to continuous drought, Mr. AA could not honour the repayment schedule. Identify whether the Bank can initiate action invoking the provisions of the SARFAESI Act, 2002. [CA Final May 2018]

Ans. The given problem relates to Section 31 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Section 31 contains all such cases where the provisions of the Act do not apply. In other words, if a case falls under Section 31, then, the benefit of provisions of the Act is not available.

One of the cases that is covered under Section 31 is 'any security interest created in agricultural land'. Thus, where the borrower mortgages his agricultural land and obtains a secured loan, the secured creditor cannot enforce the security interest under the Act.

In the given case, Mr. AA is a farmer, who obtained a term loan by mortgaging his agricultural land. After wards, he made a default in repayment of such loan. The Bank intends to enforce the security interest by invoking the provisions of SARFAESI Act, 2002.

In this case the secured asset is 'agricultural land, and any security interest created in agricultural land is covered under Section 31 of SARFAESI Act, 2002. Since as per Section 31, the provisions of the Act are not applicable to any security interest created in agricultural land, the Bank cannot invoke the provisions of SARFAESI Act, 2002.

1. Nature of exemption

The Central Government may, by notification in the public interest, direct that any of the provisions of this Act. -

- (a) shall not apply to such class or classes of banks or financial institutions; or
- (b) shall apply to the class or classes of banks or financial institutions with such exceptions, modifications and adaptations, as may be specified in the notification.

2. Laying of a copy of proposed notification

A copy of every such notification proposed to be issued, shall be laid in draft before each House of Parliament, while it is in session, for a total period of 30 days. If both the Houses agree in disapproving the issue of notification or both Houses agree in making any modification in the notification, the notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses.

In reckoning any such period of 30 days, no account shall be taken of any period during which the House is prorogued or adjourned for more than 4 consecutive days.

3. Laying of copy of notification issued

A copy of every notification issued under this Section shall, as soon as may be after it has been issued, be laid before each House of Parliament.

28. A Nationalized Bank had provided a term loan of Rs. 20 crores to Allwell Pharma Limited at an interest rate of 12% p.a. and principal amount is payable in equal half yearly instalments of Rs. 2 crores in 5 years from the date of disbursement of loan. The loan is fully secured against the plant and machinery of the company. The company was regular in paying 3 half yearly instalments along with the interest during the first two years. Due to recession in the market and increased competition from multinational companies, the price of the goods manufactured by the company had fallen down and consequently the company had to close down the plant. Hence, the company failed to pay the 4th instalment, but it paid the interest amount as and when due.

After a period of 2 months (60 days) from the due date of the 4th instalment, the Bank decided to sell the loan to an Asset Reconstruction Company. It has also decided to sell a loan of Rs. 50 lakhs given to a farmer which is secured against the agricultural land. The Manager seeks your advice on the above proposals in the light of the Provisions of the SARFASEI, Act, 2002. [CA Final May 2019]

Ans. Provisions

1. As per Section 13(1), a secured creditor may enforce any security interest created in his favour, without the intervention of any Court or Tribunal.
2. The secured creditor may take recourse to one or more measures for recovery of his secure debt as per Section 13(4), only if certain conditions are fulfilled. One of such conditions is that the borrower has made a default in repayment of the secured debt or any installment thereof because of which the account of such borrower is classified by the secured creditor as non-performing asset.
3. As per Section 31, the provisions of the Act shall not apply to such cases as are covered under Section 31. Two such cases which are relevant to the given problem are as under:
 - (a) Where the amount due is less than 20% of the principal amount and interest thereon.
 - (b) Any security interest created in agricultural land.

Analysis and conclusion

1. Allwell Pharma Limited failed to pay the principal amount due with respect to 4th installment of the loan taken by it.
2. The amount due from Allwell Pharma Limited to the Bank is Rs. 14 crores plus interest. Since the amount due from Allwell Pharma Limited to the Bank is not less than 20% of the principal amount and interest thereon, the provisions of Section 31 are not attracted in this case.
3. The Bank proposes to sell the loan of Allwell Pharma Limited to an Asset Reconstruction

Company. As on the date of such proposed sale, the default by Allwell Pharma Limited has continued for 60 days only. Since the period of default is less than 90 days, the account of Allwell Pharma Limited shall not be classified as non-performing asset in the books of the secured creditor (i.e the Bank).

Since the account of Allwell Pharma Limited is not classified as non-performing asset in the books of the Bank, the Bank is not entitled to issue notice under Section 13(2) to Allwell Pharma Limited requiring it to pay the loan within 60 days, and also, the Bank cannot take recourse to any of the measures specified under Section 13(4).

The proposal of the Bank to sell the loan of Allwell Pharma Limited to an Asset Reconstruction Company is not valid, since the account of the borrower has not yet become a non-performing asset.

Whether Bank is entitled to sell a loan of Rs. 50 lakhs given to a farmer?

Since the provisions of the Act do not apply to any security interest created in agricultural land (as per Section 31), the Bank cannot invoke the provisions of SARFAESI Act, 2002 with respect to loan of Rs. 50 lakh given to a farmer. Therefore, the Bank is not entitled to sell the agricultural land.