

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved On: 10.09.2015

Date of Decision : 30.09.2015

Appeal No. 65 of 2014

Financial Planning Supervisory Foundation
702, 7th Floor, Leela Business Park,
Andheri-Kurla Road,
Andheri (E),
Mumbai- 400 059, India

...Appellant

Versus

1. Securities and Exchange Board of India,
SEBI Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai - 400 051

2. Institution for Mutual Fund Intermediaries
One Indiabulls Centre, Tower 2,
Wing B, 701, 7th Floor, 841,
S.B. Marg, Elphinstone Road,
Mumbai-400 013

...Respondents

Mr. Darius J. Khambata, Senior Advocate with Mr. Sandeep Parekh,
Mr. Anil Choudhary and Mr. Rajneesh Deka, Advocates i/b Finsec Law
Advisors for the Appellant.

Mr. Fredun Devitre, Senior Advocate with Mr. Shiraz Rustomjee, Senior
Advocate, Mr. Nishit Dhruva, Mr. Chirag Bhavsar and Ms. Khushbu
Chajjed, Advocates i/b MDP & Partners, for Respondent No. 1

Mr. Somasekhar Sundaresan, Advocate with Mr. Paras Parekh and
Mr. Dhaval Kothari, Advocates i/b J. Sagar Associates for Respondent
No. 2

CORAM: Justice J.P. Devadhar, Presiding Officer
Jog Singh, Member

Per: Justice J.P. Devadhar

1. This appeal is filed to challenge the communication of the Securities and Exchange Board of India ('SEBI' for short) dated February 06, 2014. By that communication the appellant is informed that after considering the application filed by the appellant as also the applications filed by respondent no. 2 and Organization of Financial Distributors ('OFD' for short), SEBI has selected and granted in-principle approval to the respondent no. 2 for setting up the Self Regulatory Organization ('SRO' for short) for distributors of mutual fund products.

2. Appellant challenges the aforesaid decision of SEBI basically on three grounds. Firstly, it is contended that under regulation 3 of the SRO Regulations, application for being considered as SRO for distributors of mutual fund products could only be made by a company registered under Section 25 of the Companies Act, 1956 ('1956 Act' for short). Since respondent no. 2 was not registered under Section 25 of the 1956 Act till 31.07.2013 which was the cut-off date for submitting the applications, respondent no. 2 was ineligible to apply till 31.07.2013 and therefore SEBI ought to have rejected the application filed by respondent no. 2 on 29.07.2013. Secondly, assuming that the respondent no. 2 was eligible to apply, decision of SEBI in selecting and granting in-principle approval to the respondent no. 2 amounts to rejecting the application filed by the appellant under regulation 3 in violation of regulation 10 because, under regulation 10, SEBI was mandatorily required to give opportunity of hearing before rejecting the application

submitted by the appellant under regulation 3. Admittedly, opportunity of hearing was not given before rejecting the application submitted by the appellant under regulation 3 and therefore, the impugned decision of SEBI is liable to be quashed and set aside. Thirdly, it is contended that SEBI was biased in favour of respondent no. 2 even before inviting applications for being recognized as SRO and hence the impugned decision of SEBI is liable to be quashed and set aside.

3. Facts relevant for deciding the aforesaid issues as set out in the Memorandum of Appeal are as follows:-

- a) Appellant is a 'not for profit company' duly registered under Section 25 of the 1956 Act. License under Section 25(1) of the 1956 Act was granted to the appellant by the Registrar of Companies, Mumbai on July 26, 2013 and certificate of incorporation under Section 25(2) of the 1956 Act was granted to the appellant on July 28, 2013.
- b) Appellant is promoted by Financial Planning Standards Board India ("FPSB" for short) an association of intermediaries, and a public-private enterprise, which is also a not for profit company registered under Section 25 of the 1956 Act. FPSB focuses on distribution, improvements, investment advisory and financial planning in securities and other

financial products with full disclosure and regulated practices. FPSB is established by forty seven (47) leading financial institutions in both public and private sector across all asset classes in personal finance including LIC, SBI, UTI AMC, ICICI Bank, Axis Bank, Deutsche Bank AG, Kotak Mahindra Bank, L&T Finance Holdings, Reliance AMC, Religare Enterprises etc. who support the financial planning movement. FPSB is registered under Section 12A, Section 10(23C)(vi) as also under Section 80G of the Income Tax Act, 1961 and is recognized as an educational institution.

- c) FPSB is a professional body of intermediaries (banks, mutual funds, insurance companies etc.) engaged in the pursuit of the well being of consumers of financial products that are manufactured, advised and sold by the industry. It is the licensing agency for the globally known Certified Financial Planner (CFP) mark that puts the interests of the customer above that of the industry. FPSB is the only professional body that is not an industry association or an NGO, but has a representation across the consumer facing financial sector. FPSB is essentially based on a voluntary self regulatory mechanism, which is reflected by virtue of

its Code of Ethics and Rules of professional conduct which is mandated for all its members.

- d) Respondent no. 2 (IMFI), a Section 25 Company was incorporated on August 2, 2013. Respondent no. 2 is promoted by Association of Mutual Funds in India (AMFI), an association to promote the interests of Mutual Fund in asset management companies.
- e) Under Section 11(1) and 11(2)(c) & (d) of the SEBI Act it is the duty of SEBI to regulate the Mutual Fund Industry and also to promote and regulate the Self Regulatory Organizations. Accordingly, SEBI (Self Regulatory Organizations) Regulations, 2004 (“SRO Regulations” for short) have been framed by SEBI in exercise of the powers conferred by Section 30 read with Section 11(2)(d) of SEBI Act. The SRO Regulations published in the Gazette of India on February 19, 2004 were to come into force on such date as may be specified by the Board.
- f) SEBI in its board meeting held on August 16, 2012 approved the proposal to set up an SRO for the distributors of securities such as Mutual Fund products, portfolio management products etc.

- g) By the SEBI (Self Regulatory Organizations) (Amendment) Regulations 2013, second proviso to regulation 1(2) of the SRO Regulations was inserted with effect from 7.01.2013. As per the said proviso, the SRO Regulations were to come into force in relation to different classes of intermediaries on such dates as the Board may by notification in the Official Gazette appoint. Accordingly, a notification was published in the Official Gazette on January 08, 2013, whereby SEBI appointed that day i.e. January 08, 2013 as the date on which the SRO Regulations shall come into force in relation to distributors engaged by asset management companies of mutual funds and distributors engaged by portfolio managers.
- h) On March 21, 2013 a public notice was uploaded on the SEBI website inviting applications from any group or association of intermediaries desirous of being recognised as an SRO for distributors of Mutual Fund products in terms of the SRO Regulations.
- i) By a public notice dated June 27, 2013, SEBI declared that July 31, 2013 shall be the last date for receiving applications from eligible applicants desirous of being recognized as an SRO for distributors of Mutual Fund products.

- j) On July 29, 2013 appellant submitted its application before SEBI for being recognized as an SRO for distributors of mutual fund products.
- k) On September 17, 2013 SEBI called upon the officers of the appellant and sought certain clarification in respect of its application for being recognized as an SRO. The appellant by its letters dated September 20, 2013, November 20, 2013 and November 21, 2013 provided all the necessary clarifications and information sought, to the satisfaction of SEBI.
- l) By the impugned letter dated February 6, 2014, appellant was informed that there were three applicants viz the appellant, respondent no. 2 (IMFI) and Organization of Financial Distributors (OFD) and after considering the details of all the applicants SEBI has selected and granted in-principle approval to the respondent no. 2 for setting up the SRO for distributors of Mutual Fund products.
- m) On February 10, 2014 appellant made a representation to the Chairman, SEBI stating therein that the respondent no. 2 was not a legal person when respondent no. 2 submitted its application on July 29, 2013 and therefore, in-principle approval could not be

granted to such an applicant who was a non-existent entity on the date of submitting the application. On the same day i.e. on February 10, 2014 appellant addressed a letter to the Secretary, Government of India, Department of Economic Affairs seeking intervention of the Ministry of Finance in the matter. A reminder letter was also sent to the Secretary, Government of India on March 14, 2014. As there was no response either from SEBI or from the Ministry of Finance, appellant has filed the present appeal.

4. Although in its affidavit in reply SEBI has raised a plea regarding the maintainability of the appeal against the impugned communication dated February 06, 2014, Mr. Devitre learned Senior Advocate appearing on behalf of SEBI fairly stated that the appeal may be heard on merits on the footing that the appeal is maintainable. Accordingly, the appeal is heard on merits on the footing that the appeal is maintainable against the impugned decision of SEBI.

5. First and the foremost argument put forth by Mr. Khambata, learned Senior Advocate appearing on behalf of the appellant is that the respondent no. 2 was a non-existent entity on the relevant date and therefore, SEBI could not and ought not to have entertained the application filed by such a non-existent entity. In support of the above argument Mr. Khambata submitted as follows:-

- a) Without the certificate of incorporation an entity does not become a company either under Section 34 or under Section 25 of the 1956 Act. Regulation 3 of the SRO Regulations specifically provide that a company registered under Section 25 of the 1956 Act alone is entitled to apply for grant of certificate of recognition as an SRO. Admittedly, respondent no. 2 was registered on 02.08.2013, whereas, last date for submitting applications under regulation 3 of SRO Regulations was 31.07.2013. Thus, on 29.07.2013 when respondent no. 2 submitted its application for being recognised as an SRO, it was a non-existent entity and therefore such an application submitted by a non-existent entity being invalid, SEBI ought to have rejected the application submitted by respondent no. 2 at the threshold itself.
- b) Section 25 of the 1956 Act makes a clear distinction between grant of a license under Section 25(1) and registration of a company under Section 25(2) of the 1956 Act. A license under Section 25(1) does not direct the Registrar of Companies ('ROC' for short) to register an association as an incorporated company. Rather, it directs the ROC that if it does decide to register the proposed company or

association, it would be bound to exclude the word ‘Limited’ or the words ‘Private Limited’ from the name of the proposed company. Since regulation 3 refers to submitting application by a company registered under Section 25 of the 1956 Act, SEBI could not have entertained the application filed by respondent no. 2 which was admittedly not registered under Section 25 of the 1956 Act on the date of submitting its application.

- c) In support of the contention that prior to incorporation/ registration a company does not exist and consequently no application could be submitted in the name of the non-existent company, reliance is placed on decisions of the Apex Court in case of CIT vs City Mills & Distributors (P) Ltd. (AIR 1996 SC 2888) and A.P. Tourism Development Corporation vs Pampa Hotels Ltd. (AIR 2010 SC 1806).
- d) The discretion vested in the ROC in directing registration under Section 25(2) after granting license under Section 25(1) of the 1956 Act is dispensed with in the new Companies Act, 2013 (‘2013 Act’ for short). Under Section 8 of 2013 Act the Central Government is empowered to issue a license to a person or association allowing such person or

association to be registered as a limited company without the word 'Limited' or the words 'Private Limited'. Dispute in the present case, relates to the period prior to the 2013 Act and therefore, application under regulation 3 could be made only by a company registered under Section 25(2) of the 1956 Act.

- e) Use of the words 'a company registered under Section 25 of the Companies Act, 1956.... may make an application' under regulation 3, clearly postulates that a company which is duly registered under Section 25(2) of the 1956 Act alone is eligible to submit an application under regulation 3. Second proviso to regulation 3(1) inserted with effect from 18.11.2013 merely provides that there shall be only one SRO from distributors of mutual fund products and that proviso cannot govern the interpretation of regulation 3(1) which has been in existence since inception.
- f) Very fact that regulation 3(3) provides that the application under regulation 3(1) shall be signed on behalf of the company under the authority of its Board of Directors by its Chairman, Managing Director, Chief Executive Officer or Whole Time

Director, clearly shows that only a company registered under Section 25(2) of the 1956 Act is entitled to submit application under regulation 3 of the SRO Regulations.

- g) It is only on incorporation, a company manifests into a completely unique legal personality distinct from its constituent individuals. It is only on incorporation a company becomes eligible to enter into contract with others and use a common seal. The eligibility criteria set out in regulation 4(a) of the SRO Regulations that SEBI shall not consider an application for grant of a certificate unless the applicant is a company to which license has been granted under Section 25 of the 1956 Act, does not in any way affect the mandatory requirement contained in regulation 3 that an applicant must be a company registered under Section 25 of the 1956 Act. Regulation 4(a) merely reiterates that SEBI shall consider the application made under regulation 3 only if the applicant holds a license under Section 25 of the 1956 Act. Therefore, submitting application under regulation 3 by an un-incorporated entity being a legal impossibility, SEBI is not justified in entertaining the application and granting in-principle

approval to the respondent no. 2 which was admittedly not an existing entity till the cut off date for submitting the applications.

- h) Argument of SEBI that the eligibility requirements are relevant only at the point of time when applications are actually taken up for consideration is incorrect and contrary to the specific provision contained in regulation 3(1) of the SRO Regulations. In the public notice issued on March 21, 2013 inviting applications, it was unambiguously stated that the applications should be submitted in compliance with the SRO Regulations. Since regulation 3 specifically provides that application may be submitted by a company registered under Section 25 of the 1956 Act, SEBI could not bypass the said mandatory requirement and entertain the application submitted by respondent no. 2 which was non-existent and was ineligible at the relevant time. Fact that the application of respondent no. 2 was incomplete is admitted by SEBI in its affidavit in reply. Contrary argument now put forth by SEBI is a means to accommodate the application of respondent no. 2 and cover up SEBI's contravention of SRO Regulations. As the eligibility criteria prescribed

under the SRO Regulations which are to be fulfilled at the time of making the application were not met by the respondent no. 2 till the cut off date i.e. till July 31, 2013, SEBI ought to have rejected the application of respondent no. 2 as ineligible.

- i) Argument of SEBI that the requirements of regulations 3&4 of the SRO Regulations are directory in nature and not mandatory is untenable, because, a qualification or eligibility criteria can never be directory in nature. The object of prescribing the eligibility criteria is to ensure that only qualifying persons are permitted to make an application. In fact, averments made in para 9 and para 16 (xv) of the affidavit in reply filed by SEBI clearly establish that the application filed by respondent no. 2 was incomplete and that the respondent no. 2 became eligible to apply on being registered under Section 25 of the Companies Act, 1956 on 02.08.2013 i.e. after the cut off date for submitting the application on 31.07.2013. Even the understanding of respondent no. 2 was that the application under regulation 3 could be made only by a company registered under Section 25 of the 1956 Act and therefore, in its letter addressed to the

Registrar of Companies on 25.07.2013, the Respondent No. 2 had sought registration before 31.07.2013 failing which it was submitted that there was danger that the respondent no. 2 may not be able to submit the application within the deadline prescribed by SEBI. Thus, requirements of regulation 3 of the SRO Regulations being mandatory, SEBI ought to have rejected the application of respondent no. 2 who was neither an eligible entity on the date of submitting the application nor an eligible entity on the cut off date.

- j) Fact that regulation 4A of the SRO Regulations empowers SEBI to grant in-principle approval to an applicant by granting extension of time to comply with the provisions of clauses (c) (d) or (h) of regulation 4 does not in any way affect or alter the eligibility criteria prescribed under regulation 3 which is required to be met at the time of submitting the application under regulation 3. Regulation 4A inserted with effect from 18.11.2013 does not seek to amend the eligibility criteria prescribed under regulation 3. Therefore, the application filed by respondent no. 2 which does not satisfy the eligibility

criteria prescribed under regulation 3 could not have been entertained by SEBI.

- k) Under regulation 6 of SRO Regulations, any application which is not complete in all respects or does not conform to the requirements of regulations 3, 4 & 5 are liable to be rejected. First proviso to regulation 6 provides for giving an opportunity to the applicant to remove such objections as may be indicated by the Board. However, that proviso would not apply to an applicant like respondent no. 2 who being non-existent was disqualified from even submitting an application before the cut off date. Thus, regulation 6, imposes a primary obligation on the regulator to 'reject' any application which does not conform to the requirements under the SRO Regulations. Granting additional time for compliance under regulation 6 is restricted to cases where there are genuine mitigating factors and is not intended to validate an otherwise invalid application of a favoured candidate of SEBI.
- l) SEBI is not justified in contending that power is conferred on SEBI to grant relaxation of the mandatory statutory provisions. Even the exceptions provided under regulation 4A do not lay down that

contrary to regulation 3, application could be made by an unincorporated entity and therefore, granting any such relaxation or opportunity to the ineligible to become eligible, would be ultra virus the powers of SEBI.

- m) SEBI is not justified in treating the objections raised by the appellant as mere technical objections, because, for any valid application to be made under the public notice dated March 21, 2013, the applicant was required to comply with the conditions and the procedure prescribed under the SRO Regulations. All regulations made by SEBI under the SEBI Act are tabled before both the Houses of Parliament and treating explicit requirements under such regulations as mere technical requirements is untenable and undermines the sanctity of SRO regulations. Committing violation of the dictates of SRO Regulations highlight a significant policy level lapse in the regulatory approach adopted by SEBI.
- n) Under Section 149(3) of the 1956 Act it was obligatory on part of respondent no. 2 as a public company to obtain a 'Certificate of Commencement of Business' prior to undertaking any transaction/business activity. Prior to obtaining such

certificate respondent no. 2 could not even submit application under regulation 3 of SRO Regulations. The Certificate of Commencement of Business was granted to the respondent no. 2 on March 15, 2014, whereas, the respondent no. 2 had commenced business activities 340 days prior to obtaining a Certificate of Commencement of Business in violation of Section 149 of the 1956 Act.

- o) Relying on certain file noting made by the officials of the Department of Economic Affairs, Ministry of Finance, Government of India it is submitted that the appellant company being the only eligible company having certificate of incorporation under Section 25 of the 1956 Act before 31st July 2013, SEBI ought to have entertained the application submitted by the appellant and SEBI is totally unjustified in entertaining the ineligible application submitted by respondent no. 2.

6. There is no merit in the above contentions.

7. As rightly contended by Mr. Devitre learned Senior Advocate appearing on behalf of SEBI and Mr. Sundaresan learned counsel appearing on behalf of respondent no. 2, the entity eligible to apply for

being recognized as an SRO for distributors of mutual fund products under regulation 3 of SRO Regulations would be an entity to which license under Section 25(1) of the 1956 Act has been granted for being registered as a company under Section 25(2) of the 1956 Act.

8. Above reasoning can be better understood by referring Section 25(1) and (2) of the 1956 Act as also regulation 2(1) (e), 3, 4(a) & 6 of the SRO Regulations, which read thus:-

Section 25(1) & (2) of 1956 Act

25. (1) Where it is proved to the satisfaction of the Central Government that an association—
- (a) is about to be formed as a limited company for promoting commerce, art, science, religion, charity or any other useful object, and
 - (b) intends to apply its profits, if any, or other income in promoting its objects, and to prohibit the payment of any dividend to its members,
- the Central Government may, by licence, direct that the association may be registered as a company with limited liability, without the addition to its name of the word "Limited" or the words "Private Limited".
- (2) The association may thereupon be registered accordingly; and on registration shall enjoy all the privileges, and (subject to the provisions of this section) be subject to all the obligations, of limited companies.

Regulation 2(1)(e), 3, 4 & 6 of the SRO Regulations

“Definitions

2.(1) In these regulations, unless the context otherwise requires, -

a)...

b)...

c)...

d)...

(e) "company" means a company which has been granted license under section 25 of the Companies Act, 1956 (1 of 1956);

Recognition of Self Regulatory Organization

3.(1) Any group or association of intermediaries, which is desirous of being recognized as a Self Regulatory Organization, may form a company registered under section 25 of the Companies Act, 1956 and such company may make an application to the Board for grant of certificate of recognition as a Self Regulatory Organization.

Provided that for the purpose of this sub-regulation a distributor shall be deemed to be in intermediary.

Provided further that the Board may, in case of distributors engaged by asset management companies of mutual funds, grant certificate of recognition to only one group or association making an application under this regulation.

[Second proviso to regulation 3(1) was inserted with effect from 18.11.2013]

(2) Every application made by such company under sub-regulation (1) shall contain such particulars as may be specified and shall be accompanied by a copy of the governing norms of Self Regulatory Organization and also a copy of the memorandum and articles of association relating in general to the constitution of the Self Regulatory Organization and in particular, to –

a. Board of Directors of Self Regulatory Organization, its constitution and powers of management and the manner in which its business would be transacted;

b. the powers and duties of the office bearers of Self Regulatory Organization;

c. the admission into the Self Regulatory Organization of members, agents, their qualifications for membership, and the exclusion, suspension, expulsion and readmission of members therefrom or therein to;

(3) Every application under sub-regulation (1) shall be signed on behalf of the applicant under authority of its Board of Directors by its Chairman, Managing Director, Chief Executive Officer or whole time director.

(4) Every application under sub-regulation (1) shall be made to the Board in Form A of the first schedule and shall be accompanied by a non-refundable application fee, as specified in Part A of the second schedule, to be paid in the manner specified in Part B thereof.

Eligibility criteria

4. The Board shall not consider an application for grant of a certificate under regulation 3 unless the applicant satisfies the following conditions, namely:-

(a) the applicant is a company which has been granted license under section 25 of Companies Act, 1956;

Application to conform to the requirements

6. Subject to the provisions of regulation 4A, any application for a certificate, which is not complete in all respects or does not conform to the requirements of these regulations and particularly regulations 3, 4 and 5 or instructions specified in Form A shall be rejected by the Board:

Provided that, before rejecting any such application, the Board shall give an opportunity to the applicant

to remove such objections as may be indicated by the Board, within 30 days of the date of receipt of relevant communication, from the Board:

***Provided further** that the Board may, on sufficient cause being shown, extend the time for removal of objections by such further time, not exceeding 30 days as the Board may consider fit, to enable the applicant to remove such objections.*

(Emphasis supplied)

9. No doubt that regulation 3 of the SRO Regulations when read in isolation, it appears that a company registered under Section 25(2) of the 1956 Act is eligible to apply for being recognized as an SRO for distributors of mutual fund products. However, regulation 3 when read with regulation 2(1)(e) of SRO Regulations and Section 25(1) of the 1956 Act it becomes evident that for the purposes of SRO Regulations a company comes into existence when license is granted under Section 25(1) with a direction for being registered under Section 25(2) of 1956 Act. Since regulation 2(1)(e) defines the expression ‘Company’ for the purposes of SRO Regulations to mean a company to which a license is granted under Section 25(1) of 1956 Act and license under Section 25(1) of 1956 Act is granted with a direction to register it under Section 25(2), it is apparent that a company to which license is granted under Section 25(1) of the 1956 Act for being registered under Section 25(2) of the 1956 Act would be eligible to

make an application under regulation 3 for being recognized as an SRO for distributors of mutual fund products.

10. Above reasoning is further fortified by the eligibility criteria prescribed under regulation 4 of the SRO Regulations. Regulation 4(a) of the SRO Regulations mandates that SEBI shall not consider an application made under regulation 3 for grant of a certificate, unless the applicant is a company to which license is granted under Section 25 of the 1956 Act. As noted above license under Section 25(1) of 1956 Act is granted to an applicant who fulfils the conditions set out in Section 25(1) with a direction that the said applicant be registered as a company under Section 25(2) of 1956 Act. Thus, registration under Section 25(2) is granted pursuant to the direction contained in the license issued under Section 25(1) of the 1956 Act. If it is held that while submitting the application under regulation 3 the applicant must be registered under Section 25(2) of the 1956 Act, then, it obviously means that at the time of submitting the application, the applicant holds license under Section 25(1) of the 1956 Act and in such a case, prescribing the eligibility criteria that at the time of considering the application, the applicant must be a company holding license under Section 25(1) would be meaningless. In other words, if it is held that the eligibility criteria for an applicant to submit application under regulation 3 is to hold registration under Section 25(2), then it would be meaningless to prescribe the eligibility criteria under regulation 4 that while considering the application submitted under regulation 3 the applicant must hold

license under Section 25(1), because registration under Section 25(2) is granted after grant of license under Section 25(1) of 1956 Act. Regulation 4A inserted to SRO Regulations with effect from 18.11.2013 further makes it clear that the eligibility criteria prescribed under regulation 4 are the eligibility criteria to be fulfilled at the time of submitting the application under regulation 3. Thus, reading regulation 3, 4 & 4A of the SRO Regulations together, it is apparent that an applicant to whom license is granted under Section 25(1) with a direction that the said applicant be registered as a company under Section 25(2) of the 1956 Act would be eligible to apply under regulation 3 for being recognized as an SRO for distributors of mutual fund products.

11. Accepting the argument of the appellant that an applicant seeking to submit application under regulation 3, must hold certificate of registration/incorporation under Section 25 (2) of the 1956 Act would mean rendering the eligibility criteria prescribed under regulation 4(a) redundant and otiose, because, the applicant holding registration under Section 25(2) obviously holds license under Section 25(1) of the 1956 Act and in such a case, prescribing the eligibility criteria that while considering the application submitted under regulation 3, must hold license under Section 25(1) would be totally redundant and otiose. In other words, if registration is held to be mandatory while submitting application under regulation 3, then it would be redundant to prescribe eligibility criteria under regulation 4(a) that while considering the

application submitted under regulation 3, the applicant must hold license under regulation 25(1), because registration under Section 25(2) is granted only after grant of license under Section 25(1). Therefore, the interpretation of regulation 3 put forth by the appellant which purports to render regulation 4(a) of SRO Regulations redundant and otiose cannot be accepted.

12. Apart from the above, regulation 6 of the SRO Regulations completely negates the argument advanced on behalf of the appellant. Regulation 6 of the SRO Regulations as originally brought into force with effect from 08.01.2013 limited only to distributors of mutual fund products specifically provides that any application which is not complete in all respects or does not conform to the requirements of regulation 3, 4 & 5 of the SRO Regulations shall be rejected only if the applicant fails to comply with the requirements set out in those provisions within the time extended by SEBI as specified under regulation 6 under the SRO Regulations. Question of SEBI extending time to comply with the requirements of regulation 3 would arise only after the application is submitted under regulation 3. Extension of time permissible under regulation 6 is not restricted to any particular requirement of regulation 3. Therefore, reading regulation 3 with regulation 6 it is imperative to hold that under regulation 3 a company to which license is granted under Section 25(1) of 1956 Act is eligible to apply for being recognized as an SRO for distributors of mutual fund products and it is obligatory on part of the applicant to obtain registration under Section

25(2) of 1956 Act within the extended time permitted under regulation 6 of the SRO Regulations, failing which the application is liable to be rejected.

13. It is relevant to note that a company incorporated under Section 34 of the 1956 Act is not entitled to the exemption available under Section 25 of the 1956 Act unless that company is registered under Section 25(2) of the 1956 Act. Registration under Section 25(2) is granted subsequent to grant of license under Section 25(1) of the 1956 Act. In fact Section 25(3) of the 1956 Act provides that a company duly incorporated under Section 34 of the 1956 Act may also make an application for grant of registration under Section 25 with a view to avail the exemption provided therein. In such a case, if the company incorporated under Section 34 of 1956 Act satisfies the conditions set out under Section 25, then, license is first granted under Section 25(1) with a direction for being registered under Section 25(2). Thus a company incorporated under Section 34 of the 1956 Act is entitled to the exemption under Section 25 only when that company holds license under Section 25(1) followed by registration granted under Section 25(2) of the 1956 Act. As per Section 25(7) of 1956 Act, if license granted to a company under Section 25(1) is revoked, then the company would continue to be incorporated under Section 34 of the 1956 Act but ceases to enjoy the exemption granted under Section 25 of the 1956 Act. Thus, under Section 25 of the 1956 Act holding license is of paramount consideration and registration under Section 25(2) of 1956 Act follows

grant of license under Section 25(1) of the 1956 Act. Therefore, reading various provisions of SRO Regulations together, it becomes abundantly clear that any group or association of intermediaries holding a license under Section 25 of the 1956 Act with a direction for being registered as a company under Section 25(2) of the 1956 Act is eligible to apply under regulation 3 of the SRO Regulations and it is obligatory for such company to obtain registration under Section 25(2) within the extended time that may be granted by SEBI under regulation 6 of SRO Regulations.

14. Various decisions of the Apex Court relied upon by the counsel for the appellant in support of the contention that a company does not exist prior to its incorporation have no bearing to the facts of present case, because of regulation 2(1)(e) of SRO Regulations which defines the expression 'Company' to mean a company to which a license is granted under Section 25(1) of the 1956 Act. Thus, for the purposes of SRO Regulations, a company is deemed to have come into existence when license is granted under Section 25(1) of the 1956 Act. Therefore, various decisions relied upon by the counsel for appellant have no bearing on facts of present case, in view of the expression 'Company' defined under regulation 2(1)(e) of SRO Regulations.

15. As per the SRO Regulations any group/ association of intermediaries could form a company registered under Section 25 of the 1956 Act and apply for being recognized as an SRO under regulation 3

of SRO Regulations. Dominant intention of SRO Regulations is to motivate group/ association of intermediaries to form a company under Section 25 of 1956 Act so that such company registered under Section 25 of the 1956 Act could be granted certificate of recognition to act as SRO for distributors of mutual fund products. With this background when regulation 3 is read with regulation 2(1)(e), 4, 4A & 6 of SRO Regulations it becomes clear that the applicant submitting application under regulation 3 need not be registered under Section 25 of the 1956 Act and if the applicant holds license under Section 25(1) of the 1956 Act, it would be a company eligible to apply regulation 3, subject to the condition that the said company obtains registration under Section 25(2) of 1956 Act within the time permitted by SEBI under regulation 6 of the SRO Regulations.

16. In the present case, license under Section 25(1) of the 1956 Act was granted to the respondent no. 2 on July 23, 2013 with a direction that the respondent no. 2 be registered as a company under Section 25(2) of the 1956 Act subject to fulfilling the conditions set out therein. Admittedly, on compliance of those conditions, the respondent no. 2 has been registered under Section 25(2) of the 1956 Act on 02.08.2013 that is within the time prescribed under regulation 6. Therefore, in the facts of present case, since respondent no. 2 was holding license under Section 25(1) of the 1956 Act on the date of submitting the application on 29.07.2013 and registration was obtained by the appellant within the time stipulated under regulation 6, no fault can be found with the

decision of SEBI in entertaining the application submitted by respondent no. 2.

17. Argument of the appellant that the application submitted by respondent no. 2 under regulation 3 of the SRO Regulations even before obtaining a 'Certificate of Commencement of Business', is in violation of Section 149 of the 1956 Act is without any merit, because, as per SRO Regulations an entity holding license under Section 25(1) of 1956 Act is a company eligible to submit application for being recognized as SRO for distributors of mutual fund products. Since regulation 3 of the SRO Regulations permit a company holding license under Section 25(1) to submit application for being recognized as an SRO, appellant is not justified in relying on general provisions contained in Section 149 of 1956 Act and contending that the application submitted by respondent no. 2 under regulation 3 of SRO Regulations is in contravention of Section 149 of 1956 Act. SEBI Act and the regulations framed thereunder are special provisions intended to cater to the needs of the securities market and therefore in the facts of present case, in the absence of any challenge to the SRO Regulations, appellant is not justified in contending that the application submitted under regulation 3 of SRO Regulations is in contravention of Section 149 of 1956 Act.

18. Once it is held that a company formed by any group or association of intermediaries holding license under Section 25(1) of the 1956 Act is eligible to submit an application for being recognized as an

SRO under the SRO Regulations, then, all other arguments to the contrary advanced on behalf of the appellant must fail. In particular, the appellant is not justified in contending that regulation 6 of SRO Regulations ought to be construed narrowly, when the language used in regulation 6 do not even remotely suggest that the said regulation ought to be construed narrowly. On the contrary the words ‘any application for a certificate, which is not complete in all respects or does not conform to the requirements of these regulations and particularly regulation 3’ used in regulation 6 unequivocally suggests that every requirement of regulation 3 could be removed within the extended time provided under regulation 6 of SRO Regulations. For all the above reasons, we reject the first contention raised by the appellant and hold that the respondent no. 2 having license under Section 25(1) of the 1956 Act was eligible to submit application under regulation 3 of SRO Regulations and therefore no fault can be found with the decision of SEBI in entertaining the application submitted by the respondent no. 2 on 29.07.2013.

19. Second argument advanced on behalf of the appellant is that the decision of SEBI in selecting and granting in-principle approval to the respondent no. 2 amounts to rejecting the application submitted by the appellant without following the procedure prescribed under regulation 10 of the SRO Regulations and hence bad in law. Submission is that, under regulation 10 it is mandatory for SEBI to grant personal hearing before rejecting the application submitted under regulation 3 and further mandatory to communicate the reasons for rejecting such application. In

the present case, it is submitted on behalf of the appellant that SEBI has neither heard the appellant before rejecting the application nor communicated reasons for rejecting the application submitted by the appellant under regulation 3 and therefore, the impugned decision of SEBI being in violation of regulation 10 of SRO Regulations is liable to be quashed and set aside.

20. On behalf of SEBI it is inter alia contended that regulation 10 has no application in the present case because, SRO Regulations were framed in the year 2004 wherein multiple SRO's were envisaged. However, by amending the SRO Regulations in the year 2013, it is provided that in case of distributors of mutual fund products there would be only one SRO. In such a case, where selection of one out of the several applicants is to be made, following the procedure prescribed under regulation 10 does not arise at all. Several alternate submissions in writing were also made on behalf of SEBI.

21. For sake of convenience, verbatim written submission of SEBI in relation to the applicability of regulation 10 to the facts of present case is set out herein below:-

- i) Regulation 10 was retained as part of the SRO Regulations even after the amendment of November 2013 whereby the process of 'recognition' of multiple SROs was now made into a 'selection' of a single SRO. No amendment to

regulation 10 was considered necessary since on its correct construction, it would not apply to the amended 'selection of one SRO' situation.

- ii) In selecting one of several applicants, there is no "rejection" of the other applicants within the meaning of that expression in regulations 10. The "rejection" contemplated in regulation 10 is a 'pejorative' rejection involving some kind of 'stigma' on the merits of the applicant. It does not contemplate the non-acceptance of the other applicants incidental to the selection of one applicant.
- iii) Alternately, in the amended situation of selection of one SRO (and not recognition of multiple SROs), the context and the connotation of the opportunity to be heard does not mean only a personal hearing. The opportunity to place all materials on record for consideration is sufficient compliance with the requirements of regulation 10. All applicants were given this opportunity and availed of it, between July and December 2013. Even the appellants make no grievance in the appeal regarding denial of personal hearing. Their allegation is that there was no formal interview.
- iv) Alternately, even in the amended situation of selection of one SRO, the opportunity of hearing contemplated by

regulation 10 relates to the stage of “rejection” of the applicant who has been granted the ‘in principle’ approval under regulation 4A. If such an applicant is rejected after the grant of the ‘in principle approval’, then an opportunity to be heard is required to be given under regulation 10 to a person to whom ‘in principle approval’ was granted.

- v) Alternately, regulation 10 contemplates a hearing to the ‘unsuccessful’ applicants only if it is sought after communication to them of the grant of in principle approval to one of the applicants, and before grant of the final certificate of recognition to the successful applicant under regulation 5, and not otherwise.
- vi) Alternately, regulation 10 contemplates an opportunity of hearing only at the stage of a final “rejection” of the “certificate” and not before or at the stage of the ‘in principle’ approval. That stage has not yet been reached. This is clear from the use of the words “certificate” and “rejection” in regulation 10. Thus, Respondent No. 1 will not issue a final certificate of recognition to Respondent No. 2 until it has first given an opportunity of hearing to the appellant.

22. Before considering the merits of the aforesaid submissions of SEBI it would be appropriate to quote regulation 10 of SRO Regulations which read thus:-

“Procedure where certificate is not granted

10. (1) If, after considering an application made under regulation 3 or regulation 9, as the case may be, the Board is of the opinion that a certificate should not be granted or renewed, it may, after giving the applicant a reasonable opportunity of being heard, reject the application within a period of thirty days of receipt of such application complete in all respects or within thirty days of receipt of further information or clarification sought under regulation 7.

(2) If any application is rejected under sub-regulation (1), the fact shall be communicated to the applicant forthwith, stating the grounds for such rejection.”

23. Under the SEBI Act which came into force in the year 1992, SEBI has been empowered to promote and regulate Self Regulatory Organizations. Accordingly, SRO Regulations were framed by SEBI in the year 2004 that is after lapse of about 12 years from the date of SEBI Act, 1992 coming into force. Even after framing the SRO Regulations in the year 2004, SEBI deemed it fit not to bring SRO Regulations into force for about nine years. It is only in the year 2013 SEBI decided to bring into force the SRO Regulations with effect from 08.01.2013 limited only to the distributors of mutual fund products wherein multiple SRO's could be appointed in respect of distributors of mutual fund

products. Thereafter, SEBI deemed it fit that there should be only one SRO for distributors of mutual fund products, and accordingly, effected amendments to the SRO Regulations with effect from 18.11.2013 so as to ensure that the SRO Regulations are in conformity with the single SRO regime for distributors of mutual fund products. Neither at the time of bringing into force the SRO Regulations limited only to the distributors of mutual fund products on 08.01.2013 nor while amending various provisions of SRO Regulations with effect from 18.11.2013 SEBI has deemed it fit to amend regulation 10 of SRO Regulations. Therefore, having brought into force the SRO Regulations 2004 for the first time with effect from 08.01.2013 limited only to the distributors of mutual fund products and having taken a decision not to amend regulation 10 even after amending various provisions of SRO Regulations in view of its decision that there would be only one SRO for distributors of mutual fund products, it is not open to SEBI to contend that regulation 10 of SRO Regulations would not apply while selecting a single SRO for distributors of mutual fund products.

24. No doubt that in a selection process, where one out of many is to be selected, ordinarily there would be no question of granting opportunity of hearing to the applicants whose applications are to be rejected. However, SRO Regulations framed in the year 2004 which includes regulation 10 having been brought into force in the year 2013 for the first time, limited only to the distributors of mutual fund products wherein single SRO is to be selected, it is not open for SEBI to contend

that regulation 10 of SRO Regulations would have no application while selecting single SRO for distributors of mutual fund products. In other words, having taken a decision that there should be a single SRO for distributors of mutual fund products under the SRO Regulations which are specifically brought into force limited only to the distributors of mutual fund products, SEBI cannot avoid its obligation to comply with the procedure prescribed under regulation 10 of the SRO Regulations in relation to applications received under regulation 3 of SRO Regulations. Regulation 10 does not specify the circumstances under which the opportunity of hearing should be given to the applicant whose application is being rejected. Regulation 10, simply provides that if SEBI after considering the application submitted under regulation 3 is of the opinion that a certificate should not be granted to the applicant, then SEBI may, after giving an opportunity of hearing reject the application. Obviously, opportunity of hearing under regulation 10 would have to be given when application made under regulation 3 is to be rejected on any ground whatsoever. Therefore, argument of SEBI that the 'rejection' contemplated in regulation 10 is restricted only to a 'pejorative' rejection involving some kind of 'stigma' on the merits of the applicant and that regulation 10 would not apply in case of selecting one out of several applicants being contrary to the plain language used in regulation 10, cannot be sustained. Similarly, argument of SEBI that opportunity of hearing under regulation 10 does not mean only personal hearing and hearing could also be by giving opportunity to place all material on record is also without any merit, because, it is only after all

material facts are placed on record if SEBI on consideration of those documents deems it fit not to grant certificate to any applicant, the question granting opportunity of hearing to that applicant arises. In the present case, it is not in dispute, that requisite documents called for were furnished by the appellant within the stipulated time. Thereafter, on consideration of the application/documents furnished by the appellant, if SEBI was of the opinion that a certificate should not be granted to the appellant, at that stage it was obligatory on part of SEBI to grant opportunity of hearing to the appellant under regulation 10 and in such a case, the opportunity of hearing would only be by granting personal hearing and not be any other mode. Admittedly, no opportunity of hearing was given to the appellant after deciding to reject the application of the appellant and after deciding to select and grant in-principle approval to the respondent no. 2 and thus SEBI has contravened regulation 10.

25. Having realized the inconsistency in its above argument, it is contended by SEBI, as an alternative argument, that opportunity of hearing under regulation 10 is relatable to the stage of rejecting the application of an applicant to whom in-principle approval is granted under regulation 4A. There is no merit in the above contention, because, the in-principle approval is granted to an applicant only when that applicant is selected and consequently all other applicants are rejected. Regulation 10 contemplates granting opportunity of hearing to an applicant whose application is being rejected and not to an applicant who is selected and to whom in-principle approval is granted. Therefore,

argument of SEBI that opportunity of hearing under regulation 10 is to be given while rejecting the application of an applicant to whom in-principle approval was granted cannot be accepted. Language used in regulation 10 does not even remotely suggest that opportunity of hearing is to be given only to the applicant to whom SEBI after granting in-principle approval deems it fit not to grant certificate to that applicant. On the contrary, language used in regulation contemplates granting opportunity of hearing to every applicant whose application SEBI deems it fit to reject.

26. Next alternate argument of SEBI is that regulation 10 contemplates grant of hearing to the unsuccessful applicants only if it is sought after communication of the grant of in-principle approval to one of the applicants is totally absurd to say the least. Under regulation 10 obligation is cast on SEBI to give opportunity of hearing to the applicant to whom SEBI is of the opinion that the certificate should not be granted and there is no obligation cast on the applicant to seek opportunity of hearing when that applicant is intimated that in-principle approval is granted to some other applicant. In any event, in the present case, after receiving the impugned communication appellant did make representation against rejection of its application. However, there was no response from SEBI and hence the present appeal is filed.

27. Last alternate submission of SEBI is that opportunity of hearing under regulation 10 is to be given to the applicants only at the stage of

final 'rejection' of the certificate and not before or at the stage of granting the in-principle approval. In this alternate submission, contrary to its earlier stand, SEBI has acknowledged its obligation to give opportunity of hearing under regulation 10 to the applicants whose applications SEBI wants to reject.

28. However, argument of SEBI that opportunity of hearing under regulation 10 to the applicants whose applications SEBI intends to reject, has to be given not at the time of selecting and granting in-principle approval to an applicant, but, at the time of granting final certificate to the applicant to whom in-principle approval has been granted, is totally without any merit. In-principle approval under regulation 4A is granted to an applicant with a view to enable that applicant to comply with the requirements of Clauses (c),(d) or (h) of regulation 4 within the time stipulated therein. Clauses (c),(d),(h) of regulation 4 require that the applicant (i) must have networth of one crore rupees (ii) must have adequate infrastructure for discharging functions as an SRO & (iii) must have in its employment persons having adequate professional and other relevant experience to the satisfaction of SEBI. Obviously, these requirements are to be fulfilled by an applicant who is selected by SEBI for discharging the functions of an SRO. Thus, in-principle approval is granted to an applicant when that applicant is selected for discharging the duties as an SRO. Since in-principle approval is granted by selecting one amongst many, it is just and proper to hold that opportunity of hearing to the non-selected applicants has to

be given at the time of granting in-principle approval to the selected applicant.

29. If the argument of SEBI is accepted it would mean that opportunity of hearing to the unsuccessful applicants would have to be given under regulation 10 at the time of granting final certificate of recognition to the selected applicant to whom in-principle approval was granted. Since opportunity of hearing under regulation 10 is not an empty formality, it is possible that in a given case, SEBI after hearing the unsuccessful applicant may change its opinion and decide to select that applicant. In that case, the applicant who was initially selected and to whom in-principle approval was granted would be left high and dry. Moreover, in such a case grave prejudice would be caused to the applicant to whom in-principle approval was initially granted, because, during the interregnum that applicant would have incurred huge expenditure on infrastructure and also would have employed adequate professional persons in compliance of regulation 4, on the footing that certificate of recognition would be granted in due course of time. SEBI cannot approbate and reprobate in its stand by contending on one hand that the applicant to whom in-principle approval is granted must set up SRO within the stipulated time and on the other hand contend that grant of in-principle approval does not necessarily mean that certificate would be granted to that applicant, because, after hearing the unsuccessful applicants under regulation 10, SEBI may select one of the unsuccessful applicants. Such an argument of SEBI which brings-in total uncertainty

would be detrimental to the interests of mutual fund market and hence, cannot be accepted.

30. Therefore, on a correct interpretation of regulation 10, it would be just and proper to hold that opportunity of hearing has to be given to the unsuccessful applicants at the time of selecting and granting in-principle approval to the successful applicant.

31. In these circumstances, without going into the merits of the third contention raised by the appellant that SEBI was biased in favour of respondent no. 2, we hold that SEBI is not justified in granting in-principle approval to the respondent no. 2 before granting opportunity of hearing to the appellant as contemplated under regulation 10 of SRO Regulations. Accordingly, we set aside the impugned decision of SEBI, and direct SEBI not to take any further steps in the matter till the mandate of regulation is complied with. SEBI is further directed to select an applicant for grant of certificate of recognition in accordance with law after taking into consideration all relevant facts of each applicant without being influenced by any particular factor related to any particular applicant.

32. To sum up, without going into the merits of the third issue, we dispose of the appeal, by answering the first two issues raised by the appellant as follows:-

- a) Regulation 3 of SRO Regulations, permits any group or association of intermediaries holding license under Section 25(1) of the 1956 Act to submit application for being recognized as an SRO for distributors of mutual fund products. Since respondent no. 2 held license under Section 25(1) of the 1956 Act on the date of submitting the application under regulation 3 of the SRO Regulations, respondent no. 2 was eligible to apply and therefore SEBI was justified in entertaining the application submitted by respondent no. 2.

- b) Argument of SEBI that regulation 10 contemplates granting opportunity of hearing to the unsuccessful applicants at the time of granting final certificate of recognition to the applicant to whom in-principle approval was granted is devoid of any merit. In our opinion, regulation 10 requires SEBI to give opportunity of hearing to the unsuccessful applicant at the time of selecting and granting in-principle approval to an applicant. Since SEBI has failed to comply with the requirements of regulation 10, we quash and set aside the impugned decision of SEBI dated 06.02.2014 and direct SEBI to select an

applicant afresh for grant of certificate of recognition
in respect of distributors of mutual fund products.

33. Appeal is disposed of in the above terms with no order as to costs.

Sd/-
Justice J.P. Devadhar
Presiding Officer

Sd/-
Jog Singh
Member

30.09.2015
Prepared & Compared By: PK