REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPEALATE JURISDICTION

I. A. NO. 53453 OF 2022
IN
CIVIL APPEAL NOS. 498-501 OF 2021

FRANKLIN TEMPLETON TRUSTEE SERVICES PRIVATE LIMITED AND ANOTHER ... APPELLANTS

VERSUS

AMRUTA GARG AND OTHERS ETC. ... RESPONDENTS

O R D E R

SANJIV KHANNA, J.

This Court, vide order dated 03rd August 2022, dismissed the aforesaid application filed on behalf of the Foundation of Independent Financial Advisors,[1] while stating that the reasons for such dismissal would follow. The order further directed that Rs. 684,00,00,000/- (Rupees Six Hundred and Eighty Four Crores) be distributed to the unitholders. As a corollary, the stay granted by us vide order dated 12th April 2022, while issuing notice in the application therein, also stood vacated. By the present order, we provide the reasons for dismissal of the captioned application.

[1] For short, 'FIFA'

2. FIFA claims that independent financial advisors/mutual fund distributors are entitled to payment of commission agreed between them and Franklin Templeton Asset Management (India) Private Limited, which are in the nature of recurring expenses as per Regulation 52 of the Security and Exchange Board of India (Mutual Funds) Regulations, 1996[2]. Our attention is drawn to sub-clause (i) of Regulation 52(4)(b), which states that 'recurring expenses' encompass marketing and selling expenses, including agents' commission, if any. The circular issued by Security and Exchange Board of India[3] dated 22nd October 2018, while referring to Regulation 52, states that the asset management companies/mutual funds shall adopt a full trail model of commission in all schemes, without payment of any upfront commission or upfronting of any trail commission, directly or indirectly. Upfronting of trail commission is allowed only in case of inflows through Systematic Investment Plans.

3. At the outset, we must state that FIFA is claiming commission for the period from 23rd April 2020 and up to 17th March 2021. The commission/service charges payable prior to 23rd April 2020 are not

[2] For short, "Regulations"
[3] For short, "SEBI"

subject matter of the present application. 23rd April 2020 is relevant as it is the date of publication of notices under Regulation 39(3)(b). Accordingly, on and from the said date, the trustees/asset management company ceased to carry on business in respect of the six schemes so wound up. In our opinion, Regulation 52, which relates to and permits deduction of expenses including commission payable to the distributor, is applicable when the scheme is in operation, and not post the decision of the trustees in terms of Regulation 39(2)(a) read with Regulation 39(3), when, upon publication of notices, the ceasure mandate of Regulation 40 is triggered. On and from the date of publication of notices under Regulation 39(3)(b), the trustees/asset management company cannot carry on business activities, create or cancel units and issue or redeem units of the scheme. It would be a different matter if the unitholders do not approve the winding up of the scheme, which is not a fact in the present case, as the unitholders have consented to the winding up of the six Schemes in accordance with Regulation 18(15)(c).

4. If we are to accept the contention of FIFA, the necessary sequitur is to also acknowledge and accept that the asset management company, even post the publication of notices under Regulation 39(3)(b), would be entitled to fees and expenses mentioned and

covered by Regulation 52, as per the terms and quantum specified in sub-regulation 6 to Regulation 52. Sub-clause (c) to Regulation 52(6) specifies the percentage of total expenses of the scheme which is allowable, varying from 2.5% to 1.75% of the daily net assets. This, in our opinion, would not be a correct interpretation and lead to anomalies and tribulation with adverse consequences for the suffering unitholders, and undo the embargo directing the ceasure of business. Regulations 40 and 52 need to be read harmoniously. When read together, Regulation 52, authorising and specifying the limit of the fees and expenses payable to the asset management company, would apply only when the scheme is in operation, and not after publication of the notice under Clause (b) to sub-regulation 3 to Regulation 39 resulting in ceasure of any business activities in respect of the scheme to be wound up.

5. Regulation 41, which deals with the procedure and manner of winding up, applies once the notice under Regulation 39(3)(b) is published and the unitholders' approval under Regulation 18(15)(c) of the Regulations is received. We are not required to interpret sub-regulation 1 to Regulation 41, as we have already interpreted it in our earlier order dated 14th July 2021 read with the order dated 12th February 2021. However, FIFA claims that they would be entitled

to payment of commission under clause (b) to sub-regulation 2 to Regulation 41 which, for the sake of convenience, is quoted below:

> "41. (1) ….
> (2)(a) ….
> (b) The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unitholders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken.
> (3) ….
> (4) …."

We would concede that, in the given case, some of the recurring expenses mentioned in clause (b) to Regulation 52(4) like audit fee, insurance premium, cost of statutory advertisements, etc., would be covered and would satisfy the requirement of clause (b) to Regulation 41(2). However, if and only when they fall under and meet the requirement of the expenses connected with the winding up can they be allowed under Regulation 41(2)(b). Such expenses are allowed not because of clause (b) to Regulation 52(4), but because the expenses incurred would satisfy the requirement of being connected with such winding up under Regulation 41(2)(b). Commission payable to the mutual fund distributers is certainly not an expense connected with the winding up of the scheme.

6. In the aforesaid background, FIFA has claimed that the commission payment due to the mutual fund distributors on and from 23rd April 2020 is an amount 'due and payable under the scheme', as it is an amount or payment that had accrued before the publication of notices under Regulation 39(2)(b), but was not paid as it was payable in future. Commission payable to mutual fund distributors is in the nature of trail, and therefore, is payment due for the services rendered to the unitholders prior to the winding up. This argument is farfetched and fallacious.

7. In our order dated 14th July 2021, we have explained that the expression 'due and payable' has to be interpreted with reference to the context in which the words appear. In the context of the Regulations in question, we have held that the expression refers to the present liabilities which may be payable in *praesenti* or *in futuro*. There must be an existing obligation to pay though the appointed date of payment may not have arrived. Any liability which is not due and payable, in facts and in law, would not be covered by the expression 'due and payable'.[4] Clause (b) to Regulation 52(4) refers to recurring expenses, that is, expenses which will recur from time to time. It does not refer to one-time payment which is deferred.

[4] See paragraph 78 in the judgment reported as (2021) 9 SCC 606

The recurring liability is not a present liability, but an obligation which, on satisfaction of certain conditions, may accrue in future. The right to claim commission may not accrue and become due and payable. Distributor commission, as a recurring liability, is not payable if the unitholder(s) redeem the unit. Winding up of the scheme entails similar effects and consequences.

8. As noticed above, it is the asset management company which is entitled to charge fees and expenses in terms of sub-regulations (1) and (2) of Regulation 52. The mutual fund distributors are not entitled to direct payment from the unitholders. Payment to the distributors is made by the asset management company, from the amount that they deduct as a recurring expense in terms of Regulation 52(4)(b). On and after publication of the winding up notice in terms of Regulation 39(3)(b), the trustees and the asset management company cannot claim any payment on account of recurring expenses under clause (b) to sub- regulation (4) to Regulation 52. That being the position, as held above, the claim of FIFA has to be rejected. If the amount cannot be due and payable to the principal, the claim of the agent or a third party, in view of the Regulations, must also fail.

9. The claim of FIFA, on the basis of the Circular dated 22nd October 2018, which has been referred to above, is equally misconceived and untenable. The Circular dated 22nd October 2018 bars the asset management company from making upfront payment or upfronting of any trail commission, except in case of inflows through Systematic Investment Plans. It is also stipulated that, when the Systematic Investment Plan is discontinued for a period for which commission is paid, the commission amount has to be recovered on *pro rata* basis from the distributor. As a deduction, it follows that on publication of notices in terms of Regulation 39(3)(b), the business of the mutual fund comes to a stop and therefore, on and from that date the trail commission is not payable, as the scheme is to be wound up and the money is to be collected and paid to the unitholders, in terms of and as per the mandate of Regulation 41. Even if a distributor renders some services to the unitholders after publication of the notice under Regulation 39(3)(b), it would not entitle him to claim an amount from the asset management company. The Circular dated 22nd October 2018 cannot override the Regulations. The Circular does not intend to do so. It has been issued to bring about transparency in expenses, reduce portfolio churning and mis-selling in mutual fund schemes. The intent behind specifying total expense ratio and the performance disclosure for

mutual funds is to bring greater transparency in expenses and to not confer any right on the mutual fund distributors to claim expenses under clause (b) to Regulation 41(2), which pertains to the procedure and manner of winding up.

10. Franklin Templeton Trustee Services Private Limited and Franklin Templeton Asset Management (India) Private Limited have filed an affidavit before us stating that they have borne liquidation expenses amounting to approximately Rs. 40,00,00,000/- (Rupees Forty Crores) towards various services such as liquidator's fee, disbursement expenses, fees for the e-voting platform and the scrutinizer for voting results, etc. It is stated by them that this amount is not intended to be charged to the six Schemes in the interest of the unitholders of the Schemes. We have taken the said statement on record.

11. For the aforesaid reasons, the application IA No. 53453/2022 filed by FIFA is dismissed, without any orders as to costs.

…….J.
(S. ABDUL NAZEER)

……J.
(SANJIV KHANNA)

NEW DELHI;
AUGUST 12, 2022.