

RATNABALI CAPITAL MARKETS LTD. A

v.

SECURITIES & EXCHANGE BOARD OF INDIA AND ORS.

OCTOBER 23, 2007

[S.H. KAPADIA AND B. SUDERSHAN REDDY, JJ.] B

*Securities and Exchange Board of India Act, 1992:*

s.11(2)—Circular dated 30.9.2002 stating that fresh registration fee not payable by transferee entity if merger takes place due to compulsion of law—Merger of two companies for increasing reserve component of net worth in order to enter derivative market—Entitlement of transferee entity, to claim benefit of Circular dated 30.9.2002—Held: Not entitled as merger had not taken place due to compulsion of law—Object of the Act—Discussed—Companies Act, 1956—ss. 391 to 394—SEBI (Stock-brokers and Sub-brokers) Regulations, 1992—Schedule III—Circular dated 30.9.2002—Para 7. C

*Securities and Exchange Board of India and Stock Exchange—Functions performed by the two entities—Distinction between—Explained.* E

*Companies Act, 1956:*

*Object of the Companies Act and Securities and Exchange Board of India Act, 1992—Discussed.* F

*Words and phrases:*

*'compulsion of law'—Meaning of—In the context of winding up proceedings under Companies Act, 1956.*

In 1995, RSL was registered as a broker with NSE. It had paid initial registration fees for the first year and thereafter paid fees on turnover basis for subsequent four years. SEBI had adopted recommendations of Gupta Committee which stated that the G

A company whose net worth was less than rupees three crores would not be allowed to trade as a broker in the derivative segment of the Stock Exchange. To meet this net worth criteria, RSL and RCML, the appellant company merged under the Scheme of Amalgamation sanctioned by the order of the High Court.

B On 30.9.2002, SEBI issued a circular stating that in the case of merger carried out as a result of compulsion of law, fresh fees would not be payable by the transferee entity. After the merger of RSL with RCML, a demand was made by SEBI for registration fees on turnover basis. RCML claimed that it is entitled to the benefit of registration fees which RSL had paid from time to time as a broker in the cash and spot market. This claim of RCML was rejected by the Securities Appellate Tribunal.

In appeals to this Court, the appellants contended that the two companies were required to merge because of acceptance of the recommendations of Gupta Committee by SEBI according to which, if a broker desires to enter derivative market then he is required to have a net worth of at least rupees three crores; that this precondition of possessing net worth of rupees three crores constituted compulsion of law, which made RSL merge into RCML and, in the circumstances, the appellants were entitled to the benefit of Circular dated 30.9.2002 issued by SEBI.

Thus, the two points which have arisen for determination are : whether the merged entity, on amalgamation, duly sanctioned by High Court, was entitled to claim the benefit of fee continuity and, whether the demand made by SEBI imposing fresh turnover/registration fees on the merged entity constituted an act in derogation of the provisions of any other law for the time being in force in terms of s.32 of the Securities and Exchange Board of India Act, 1992.

G Dismissing the appeals, the Court

HELD: I. The licence from NSE/BSE only provided a platform to RSL/RCML to carry on the business of buying and selling shares on the stock exchange. However, trade had to be regulated by SEBI.

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The Companies Act has been enacted with a view to consolidate and A  
amend the law relating to companies and certain other associations.  
The Securities and Exchange Board of India Act, 1992 has been B  
enacted to provide for the establishment of a Board to protect the  
investors' interests in securities and to regulate the securities market  
and for matters connected thereto. Under the said 1992 Act, SEBI C  
is required to provide for regulating the business in stock exchanges,  
registering and regulating the working of stock brokers and  
numerous other functions which are enlisted in s.11(2) of the 1992  
Act. Under s.11B of the 1992 Act, SEBI is also empowered to issue  
directions to any person associated with the securities market. As  
a regulator, therefore, SEBI is entitled to charge registration fees  
for enabling it to carry out the functions stipulated in s.11(2) of the  
1992 Act. There is a dichotomy between functions of stock exchange  
and the functions performed by SEBI. The licences given by the  
stock exchange enables the stock-broker to buy and sell securities  
on the exchange whereas the regulation of the trade *per se* is done  
by SEBI for which it is entitled to charge requisite registration fees. D

[Para 11] [635-F-H; 636-A-C]

2.1. RSL had merged into RCML after complying with the E  
provisions of ss.391 to 394 of the Companies Act. The Scheme of  
Amalgamation has been approved by the High Court. However, what  
is "compulsion of law" has not been defined by SEBI. The reason  
is obvious. Under s.391 of the Companies Act, a compromise or  
arrangement is proposed generally as an alternative to liquidation.  
Where a scheme appears to be feasible and workable, it is preferred  
to a winding up order. [Para 15] [637-F-G] F

*Himalaya Bank Ltd. v. L. Roshan Lal Mehra, AIR (48) (1961)*  
PUNJAB 550, referred to.

2.2. It would depend on the facts of each case whether a scheme G  
under ss.391 could be construed as an alternative to liquidation. It  
is not in every matter that the scheme under s.391 would constitute  
an alternative to liquidation. Under circular dated 30.9.2002 what  
SEBI intends to say is that fresh turnover/registration fees would  
not be payable by a company which goes for amalgamation/merger H

- A as an alternative to liquidation. In other words, if the company's net worth is negative and if that company is on the brink of liquidation, which compels it to go for a scheme under s.391, then in such cases SEBI exempts such companies from payment of fresh turnover/registration fees. Such is not the case herein. On the contrary, in
- B the present case, amalgamation has taken place in order to increase the "reserve" component of the net worth. The transferee companies were not on the brink of liquidation. The scheme under s.391 was not an alternative to liquidation. Hence, the transferee companies were not entitled to claim the benefit of Circular dated 30.9.2002.

C [Para 17] [640-C-F]

3. The demand raised by SEBI for fresh turnover/registration fees does not constitute an act derogatory of the provisions of the Companies Act. On the emergence of a new entity, which was entitled

- D to operate in derivative market, SEBI was certainly entitled to regulate its trade in the derivative segment for which it was entitled to charge requisite fees. Under the 1992 Act, a duty is cast on SEBI to protect the interest of investors in securities and to regulate the trade in securities on the Stock Exchange. Such Regulation is not a part of the Companies Act. Derivative market is highly speculative.
- E It carries lot of risks. In fact, history shows that many investors and traders lost money earlier when badla transactions were prevalent. Derivative market, to a certain extent, replaces badla. The Gupta Committee recommended the net worth of rupees three crores in order to secure the interests of investors and traders who regularly play in derivatives. In the circumstances, it cannot be said that raising of an amount of rupees three crores as net worth constituted legal compulsion for RSL to merge into RCML. The Government decided to vest SEBI with statutory powers in order to deal effectively with all matters relating to capital market. The main function of SEBI is to regulate the trade which takes place in the securities market and for that purpose it is entitled to charge registration fees. [Para 17] [640-G-H; 641-A-C]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4945 of H 2007.

From the Judgment and final Order dated 4.5.2007 by the Securities Appellate Tribunal Mumbai in Review Petition No. 8 of 2006 in Appeal No. 267 of 2006. A

WITH

C.A. No. 3674 of 2007. B

R.F. Nariman, Ranjeet Kumar, Ratnako Banerjee, Dheeraj Nair, Mayank Mishra, Bina Gupta, Karan Bharioke, Shweta Verma, Gaurav Singh, Suruchii Aggarwal and Viraj Kadam for the appearing parties.

The Judgment of the Court was delivered by C

**KAPADIA, J.** 1. Delay condoned.

2. Admit.

3. The above two civil appeals are directed against the decisions dated 18.5.2006 and 4.5.2007 delivered by the Securities Appellate Tribunal, Mumbai in appeal Nos. 267/04 and 245/04 respectively. D

4. The short question that arises for our consideration in these civil appeals filed under Section 15Z of the Securities and Exchange Board of India Act, 1992 (for short the "1992 Act") is whether the appellants were entitled to the benefit of fee continuity under para 7 of Circular dated 30.9.2002 issued by SEBI. E

5. For the sake of convenience, we may mention hereinafter the facts in the case of Ratnabali Capital Markets Ltd. ("RCML") which are as under. F

6. In 1995 Ratnabali Securities Ltd. ("RSL") was registered as a broker with National Stock Exchange ("NSE"). In terms of Schedule III of SEBI (Stock-brokers and Sub-brokers) Regulations, 1992 ("the Regulations"), RSL had paid initial registration fees for the first year and thereafter it had paid fees on turnover basis for subsequent four years. No further fees on turnover basis was paid by RSL under the said Regulations for continuation of registration except a fee of rupees five thousand for a block of next five years. RSL operated in cash and spot market. G H

A 7. SEBI adopted recommendations of Gupta Committee stating that no company whose net worth was less than rupees three crores would be allowed to trade as a broker in the derivative segment of the Stock Exchange. To meet this net worth criteria, RSL and RCML merged under the Scheme of Amalgamation sanctioned by the order of the Calcutta High Court. Under that order, all rights, licences, assets, properties and registrations of RSL stood transferred by operation of law to RCML.

B C 8. On 30.9.2002 SEBI issued a circular stating that in the case of merger carried out as a result of compulsion of law, fees would not have to be paid afresh by a transferee entity provided that majority shareholders of transferor entity (RSL) continues to hold majority shareholding in the transferee entity (RCML).

D E 9. After the merger of RSL with RCML, a demand was made by SEBI for registration fees on turnover basis. Under the said Regulations, no stock-broker can buy, sell or deal in securities unless he holds a certificate granted by SEBI under its Regulations. Under the said Regulations, the stock-broker is required to pay fees for registration in the manner provided in the Regulations. Under Regulation 10, every applicant eligible for grant of a certificate has to pay fees in the manner specified in Schedule III. Under that Schedule, every stock-broker whose annual turnover does not exceed rupees one crore during any financial year has to pay rupees five thousand as registration fees for each financial year and whereas the annual turnover exceeds rupees one crore during any financial year he has to pay rupees five thousand plus one hundredth of one per cent of the turnover in excess of rupees one crore for each financial year. We quote hereinbelow clause (c) of para 1 of Schedule III, which reads as under:

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“After the expiry of five financial years from the date of initial registration as a stock-broker, he shall pay a sum of rupees five thousand for every block of five financial years commencing from the sixth financial year after the date of grant of initial registration to keep his registration in force”

H A reading of clause (c) makes it clear that where the stock-broker has paid registration fees either under clause (a) or clause (b) he shall have

to pay rupees five thousand for every block of five financial years A  
commencing from the sixth financial year after the date of initial registration  
in order to keep his registration in force.

10. What RCML is now claiming is the benefit of initial registration B  
of RSL as a stock-broker. According to RCML, when the above two  
companies stood merged on 9.2.2000, which merger was approved by  
Calcutta High Court, all assets and liabilities, including benefits in the form  
of licences obtained by RSL, stood transferred by operation of law in  
the hands of RCML. According to RCML, the concept of merger  
constitutes transfer by operation of law. According to RCML, the concept  
of merger operates on account of legal compulsion or compulsion in law. C  
According to RCML, in the case of merger, which takes place after  
complying with the procedure prescribed by Sections 391 to 394 of the  
Companies Act, duly approved by the High Court, the assets and liabilities  
of the transferor company comes into the hands of RCML on account of  
legal compulsion. There is nothing voluntary in such cases of merger. D  
According to RCML, the registration fees once paid by RSL should be  
given the benefit of continuity vide para 7 of Circular dated 30.9.2002  
issued by SEBI. In other words, RCML now claims that it is entitled to  
the benefit of registration fees which RSL had paid from time to time as  
a broker in the cash and spot market. This claim of RCML has been E  
rejected by the impugned decision. Hence, this civil appeal.

11. In the present case, the two companies merged because after F  
2000, derivative markets opened out. RSL basically operated under the  
licences in cash and spot markets. They did not operate in the derivative  
markets. When the two companies merged, a new entity emerged. That  
entity was RCML. At this stage, it is important to bear in mind that licence G  
from NSE/BSE only provided a platform to RSL/RCML to carry on the  
business of buying and selling shares on the stock exchange. However,  
trade had to be regulated by SEBI. The Companies Act has been enacted  
with a view to consolidate and amend the law relating to companies and  
certain other associations. On the other hand, the 1992 Act has been  
enacted to provide for the establishment of a Board to protect the  
investors' interests in securities and to regulate the securities market and  
for matters connected thereto. Under the said 1992 Act, SEBI is required H

- A to provide for regulating the business in stock exchanges, registering and regulating the working of stock brokers and numerous other functions which are enlisted in section 11(2) of the said 1992 Act. Under section 11B of the 1992 Act, SEBI is also empowered to issue directions *inter alia* to any person associated with the securities market. As a regulator,
- B therefore, SEBI is entitled to charge registration fees for enabling it to carry out the functions stipulated in section 11(2) of the 1992 Act. We repeat that there is a dichotomy between functions of the stock exchange and the functions performed by SEBI. The licences given by the stock exchange enables the stock-broker to buy and sell securities on the
- C exchange whereas the regulation of the trade *per se* is done by SEBI for which it is entitled to charge requisite registration fees. In the present case, we have no doubt in our mind that, on merger of the above two companies, a new entity stood emerged/constituted, which was given a right to operate in the derivative segment and, therefore, it had to pay
- D fresh registration fees on the turnover basis. That new entity (RCML) was not entitled to the benefit of continuity of fees deposited earlier by RSL, which got merged into RCML. According to RCML, the two companies were required to merge because of acceptance of recommendations of Gupta Committee by SEBI. According to the report of the said
- E Committee, if a broker desires to enter derivative market then he is required to have a net worth of at least rupees three crores. According to RCML, the said requirement constituted a pre-condition for entering the derivative market. According to RCML, this pre-condition of possessing net worth of rupees three crores constituted compulsion of law, which made RSL merged into RCML and, in the circumstances, the appellants were entitled to the benefit of Circular dated 30.9.2002 issued by SEBI. Under the said circular, mergers/amalgamations carried out as a result of compulsion of law stood excluded from payment of fees afresh.

12. We quote hereinbelow the said provision, which reads as under:

- G "Merger/Amalgamations

Where mergers/amalgamations are carried out as a result of compulsion of law, fees would not have to be paid afresh to hold majority shareholding in transferee entity. The Exchange would have to enumerate what constitutes "compulsion of law" resulting

in such merger/amalgamations, for consideration of SEBI." A

13. Placing reliance on the aforesaid clause, RCML contended that, in the present case, RSL had merged into RCML on account of compulsion of law and, therefore, they were entitled to the benefit of continuity of fees earlier paid by RSL. According to RCML, but for the recommendations of Gupta Committee, RSL would not have merged into RCML. According to RCML, because of Gupta Committee prescribing the net worth of rupees three crores for entering into derivative market, RSL had to merge in RCML, which, according to the appellant, constituted legal compulsion. B

14. We do not find any merit in the above arguments. Two points arises for determination in the present case. They are interconnected. Firstly, whether RCML, on amalgamation, duly sanctioned by Calcutta High Court, was entitled to claim the benefit of Fee Continuity and, secondly, whether the demand made by SEBI imposing fresh turnover/registration fees on the merged entity (RCML) constituted an act in derogation of the provisions of any other law for the time being in force in terms of section 32 of the said 1992 Act. C

15. As stated above, on 30.9.2002 SEBI had issued a circular stating that in the case of amalgamation/merger carried out as a result of compulsion of law, fresh turnover/registration fees would not have to be paid afresh by a transferee entity. We are concerned with the expression "compulsion of law" in that circular. It is true that, in the present case, RSL had merged into RCML after complying with the provisions of sections 391 to 394 of the Companies Act. It is equally true that the Scheme of Amalgamation has been approved by the Calcutta High Court. However, what is "compulsion of law" has not been defined by SEBI. The reason is obvious. Under section 391 of the Companies Act, a compromise or arrangement is proposed generally as an alternative to liquidation. Where a scheme appears to be feasible and workable, it should be preferred to a winding up order. F

16. In the case of *Himalaya Bank Ltd. v. L. Roshan Lal Mehra* reported in AIR (48) (1961) PUNJAB 550 it has been held vide para 6 that the scheme of arrangement under section 391 is an alternative to G

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A liquidation. We quote hereinbelow para 6 of the said judgment:

“(6) Mr. D.N. Avasthy, learned counsel for the bank has next drawn my attention to Section 37 of the Banking Companies Act which provides that the High Court may on the application of a banking company which is temporarily unable to meet its obligations, make an order staying commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper.

C The High Court is empowered under Section 37(3) to appoint a special officer who is required to take into custody or control the assets, books etc., including actionable claims to which the banking company may be entitled. Section 38 empowers the High Court to order the winding up of banking company if it is unable to pay its debts. Mr. D.N. Avasthy also maintains that the scheme of arrangement is an alternative mode of winding up and, therefore, such powers as the High Court possesses under Section 45-D of the Banking Companies Act, 1949, will also entitle it to exercise the same powers for enforcement of the scheme of arrangement etc.

E He has rested his argument on three decisions reported in *Madan Gopal v. Peoples Bank of Northern India, Ltd.*, AIR (1935) Lah 779 (SB), *Motilal Kanji and Co. v. Natwarlal M. Jhaveri*, AIR (1932) Bom 78, *In re Travancore National and Quilon Bank Ltd.*, AIR (1939) Mad 318. In AIR 1935 Lah 779 (SB), Tek Chand J. said:

G ‘Section 153, Companies Act, makes provision not merely for schemes for the 'resuscitation' or 're-organisation' of companies, but it also provides for 'schemes of arrangement', which in the words of Vaughan Williams J. (used in reference to the corresponding section of the English Act) provide an alternative mode of liquidation, which the law allows the statutory majority of creditors to substitute for winding-up whether voluntary or under the Court. In *re London Chartered Bank of Australia*, (1893) 3 Ch. 540 at

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p. 546.'

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On the strength of these decisions, it was argued that the scheme of arrangement was an alternative mode of liquidation. This does not appear to be so either under the Companies Act, 1956, or under the Indian Companies Act, 1913, which preceded the present statute. Provisions of the Companies Act relating to "Arbitration, Compromises, Arrangements and Reconstruction" covered by Sections 389 to 396 are placed in Chapter V of Part VI which deals with Management and Administration. Part VII is devoted to Winding Up. A scheme, therefore, cannot be said to be an alternative mode of liquidation but only an alternative to liquidation. The incidents of scheme of arrangement and of winding up are distinct both in principle and in consequences.

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The dictum of Vaughan Williams, J., which was cited in the three decisions referred to above, was examined by a Full Bench of this Court in *Sm. Bhagwanti v. New Bank of India Ltd., Amritsar*, AIR (1950) EP 111. It was held by the Full Bench that in the corresponding English Act all the sections relating to the scheme were contained within the bar dealing with winding-up; and, therefore, a scheme of that particular kind was correctly described as an alternative mode of winding up. That particular provision which was being considered was applicable only to a company in liquidation.

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This is also clear from the observations of Vaughan Williams, J., only a portion of which was noticed in the three decisions referred to above. He said:

'The scheme of arrangement under the Act of 1879 is -- as I have had occasion to point out in several cases -- an alternative mode of liquidation which the law allows the statutory majority of Creditors to substitute for the pending winding-up, whether voluntary or under the Court, just as the Bankruptcy Act, 1869, allowed the creditors the substituted liquidation by arrangement under Section 125, or composition under Section 126, of that Act, for a pending bankruptcy .....

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A In view of this, I am not persuaded by this argument of the learned counsel for the bank, that the scheme of arrangement should be treated as a specie of liquidation. I am, therefore, satisfied that this Court has jurisdiction to entertain the petition and to pass appropriate order in view of the provisions of section 392 of the Companies Act read with Section 391."

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17. We make it clear that it would depend on the facts of each case whether a scheme under section 391 could be construed as an alternative to liquidation. It is not in every matter that the scheme under section 391 would constitute an alternative to liquidation. Therefore, it would depend

C on the facts of each case. Under circular dated 30.9.2002 what SEBI intends to say is that fresh turnover/registration fees would not be payable by a company which goes for amalgamation/merger as an alternative to liquidation. In other words, if the company's net worth is negative and if that company is on the brink of liquidation, which compels it to go for a

D scheme under section 391, then in such cases SEBI exempts such companies from payment of fresh turnover/ registration fees. Such is not the case herein. On the contrary, in the present case, amalgamation has taken place in order to increase the "reserves" component of the net worth. The difference between the amount recorded as fresh share capital

E issued by the transferee company on amalgamation and the amount of share capital of the transferor company to be reflected in the Revenue Reserve(s) of the transferee company was the sole object behind amalgamation. (see page 429 of vol. II in civil appeal No. 3674/07). Therefore, SEBI was right, in the present case, in refusing to give the

F benefit of exemption to the transferee companies. These transferee companies were not on the brink of liquidation. The scheme under section 391 was not an alternative to liquidation. Hence, the transferee companies were not entitled to claim the benefit of Circular dated 30.9.2002. Further, we do not find any merit in the argument that the demand raised by SEBI

G for fresh turnover/registration fees constituted an act derogatory of the provisions of the Companies Act. In our view, on the emergence of a new entity, which was entitled to operate in derivative market, SEBI was certainly entitled to regulate its trade in the derivative segment for which it was entitled to charge requisite fees. Under the 1992 Act, a duty is

H cast on SEBI to protect the interest of investors in securities and to

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regulate the trade in securities on the Stock Exchange. Such Regulation is A not a part of the Companies Act. Derivative market is highly speculative. It carries lot of risks. In fact, history shows that many investors and traders lost money earlier when badla transactions were prevalent. Derivative market, to a certain extent, replaces badla. The point to be noted is that Gupta Committee recommended the net worth of rupees three crores in B order to secure the interests of investors and traders who regularly play in derivatives. In the circumstances, it cannot be said that raising of an amount of rupees three crores as net worth constituted legal compulsion for RSL to merge into RCML. As stated above, the Government decided to vest SEBI with statutory powers in order to deal effectively with all matters relating to capital market. The main function of SEBI is to regulate the trade which takes place in the securities market and for that purpose it is entitled to charge registration fees. In the present case, we are concerned with merger of two distinct independent companies. In the present case, we are not concerned with merger of firms. In the present case, we are not concerned with joint ventures. After the merger of RSL into RCML a new entity has emerged. In the circumstances, SEBI was entitled to charge the stipulated fees. For the aforesated reasons, we find no merit in these two civil appeals. C D

18. Before concluding, we may note that, according to the appellants, E in the past SEBI has not charged registration charges at the rates prescribed in case of two other companies. According to the appellants, SKP Securities Ltd. and BNK Securities Pvt. Ltd. were given in the past the benefit of fee continuity under para 7 of Circular dated 30.9.2002 whereas the said benefit has been denied to RCML. We do not know all the facts of those transactions. Be that as it may, we are concerned with the position in law. We reiterate that there is no merit in these civil appeals. F

19. For the aforesated reasons, we see no reason to interfere with the impugned orders passed by the Securities Appellate Tribunal, Mumbai. Accordingly, both the civil appeals stand dismissed with no order as to costs. G

D.G.

Appeals dismissed.