



INITIATION OF LEGAL PROCEEDINGS TO AFFECT THE WELFARE OF INVESTORS IN EQUITY TRADING IN STOCK EXCHANGE*

INTRODUCTION

The word 'share' ordinarily means a part or definite portion of a thing owned by a number of persons in common. It contemplates something owned in common by two or more persons and has reference to that part of the undivided interest which belongs to some of them. According to **Sec 2(46) of the Companies Act, 1956**, 'Share' means share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied. The capital of a company is divided into a number of small units. Each unit is called a share. A share secures to its owner certain rights and liabilities. It is a bundle of rights and obligations.

'Stock' is a representation of capital paid or invested into a business entity by stockholders. Stock means any fund, annuity or security transferable in books kept by any company or society established or to be established, or transferable by deed alone, or by deed accompanied by other formalities, and any share or interest therein. Stock is a term used to denote first, the capital stock; second, the shares of stock or of the stockholder; third, as being applied so as to include both. The desire of stockholders to trade their shares has led to the establishment of stock exchanges, organizations which provide marketplaces for trading shares and other derivatives and financial products.

Stock Exchanges are the most perfect type of market for securities whether of government and semi-government bodies or other public bodies as also for shares and debentures issued by the joint-stock companies. In the stock market, purchases and sales of shares are made in conditions of free-competition. "*Stock Exchange means anybody or individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.*" It is an association of member brokers for the purpose of self-regulation and protecting the interests of its members. It can operate only if it is recognized by the Government under the SCRA, 1956. The recognition is granted under **Sec. 3 of the Act by the Central Government, Ministry of Finance.**

The securities market has two interdependent and inseparable segments, the new issues (primary) market and the stock (secondary) market. The primary market provides the channel for creation and sale of new securities, while the secondary market deals in securities previously issued. The Equity market also known as the Stock market is where the listed securities are traded in the secondary market. Hence, in secondary market, an investor buys shares from another investor at the prevailing market price or as per their mutual agreement. Normally, investors conduct such transactions through an intermediary, agent or a broker.

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This is one of the most vital areas of a market economy, as investors have the opportunity to own a slice of ownership in a company with the potential to realize gains based on its future performance. The price of shares and other assets is an important part of the dynamics of economic activity, and can influence or be an indicator of social mood. The major instruments of trading on the stock market are equity shares of companies followed in that order by debentures, preference shares, public sector bonds and government securities. The system of auction trading with bid and offer rates to arrive at a competitive price is mainly with respect to the equity shares.

OBJECTIVE:

The main objective is to provide protection to the investors. An investor is a person who is an individual or a corporate legal entity investing his capital in another venture or business but does not do the business himself or itself. It is imperative for the healthy growth of the corporate sector that this confidence of investor is maintained. However, many investors may not possess adequate expertise/knowledge to take informed investment decisions. Some of them may not be aware of the complete risk-return profile of the different investment options. Some investors may not be fully aware of the precautions they should take while dealing with market intermediaries and dealing in different securities.

Protecting the interests of investors is one of the key mandates of SEBI and their empowerment in the form of educating them and increasing their awareness is one of the measures to work towards that objective. Similarly, the training of the intermediaries is an essential concomitant of orderly development of the securities market.

For the purpose of dealing with the investors, SEBI internally has set up a separate department called *Office of Investor Assistance and Education (OIAE)*. This office acts as the focal point of SEBI's investor education effort and also as a nodal department for handling investor complaints. OIAE publishes educational literature on securities market for all categories of public, conducts workshops/seminars and disseminates information through recognized investor associations.

For educating the investors, *Securities Markets Awareness Campaign (SMAC)* was launched by SEBI in 2003 at the national level. Under this programme, workshops are conducted all across the country with the participation of market participants, market intermediaries, investors associations etc. to spread awareness about the functioning of securities market, basic fundamentals of investment and risk management etc. SEBI also sponsors and produces short films and advertisements that seek to create awareness through visual media as well.

For the purpose of "investor education and awareness and for compensation to the small investors in respect of fraud or misrepresentations or misstatements by companies or intermediaries" *Kania Committee* recommended to establish a "separate Investor Protection Fund on the lines of Subscriber Education and Protection Fund under PFRDA Ordinance 2004". SEBI approved the establishment of an Investor Protection and Education Fund with contribution from SEBI's general fund to be used for taking measures for investor education and the Chairman. SEBI created 'IPEF' with an initial corpus of Rs. 10 crore from SEBI General Fund.

In consonance with **Regulation 5(2)(d)** read with **Regulation 6** of *SEBI (Investor Protection and Education Fund) Regulations, 2009* relating to utilization of the fund aiding recognized investors association in legal proceedings, *SEBI (Aid for Legal Proceedings) Guidelines, 2009* were framed and brought into force simultaneously with SEBI (IPEF) Regulations, 2009. The said guidelines provide the procedure for receiving aid from the corpus of the fund. The aid provided in terms of these guidelines for the purpose of meeting legal expenses is an important step taken by SEBI towards protecting the interests of investors and participating in espousal of their cause.

SCORES (SEBI Complaints Redress System) has been launched with a view to remove the difficulties in the existing grievance redressal mechanism such as loss of complaints, multiple communications from the investors regarding the same complaint, storage, follow-up etc. SEBI has also framed *SEBI (Ombudsman) Regulations, 2003* where under any person not restricted to an investor, can lodge his complaint against an intermediary or a listed company with ombudsman in respect of specified matters such as non-receipt of refund orders, allotment letters, share certificates, dividend, interest on debentures, redemption amount, annual reports etc. or grievances in respect of issue or dealing in securities. The Ombudsman is to facilitate a settlement of the matter and in failure thereof has to adjudicate such complaints.

INVESTOR PROTECTION:

The term "**investor protection**" defines the entity of efforts and activities to observe, safeguard and enforce the rights and claims of a person in his role as an investor. This includes advice and legal action. The assumption of a need of protection is based on the experience that financial investors are usually structurally inferior to providers of financial services and products due to lack of professional knowledge, information or experience. Countries with stronger investor protections tend to grow faster than those with poor investor protections. Investor protection includes accurate financial reporting by public companies so the investors can make an informed decision. Investor protection also includes fairness of the market which means all participants in the market have access to the same information.

Besides SEBI Act, 1992, the Investor is also given protection under various legislations as follows:-

➤ **INVESTOR PROTECTION AND CONSUMER PROTECTION ACT, 1986**

The Act provides for effective safeguards to consumers against various types of exploitations and unfair dealings, relying on mainly compensatory rather than a punitive or preventive approach. The Act applies to all goods and services unless specifically exempted, and covers the private, public, and cooperative sectors and provides for speedy and inexpensive adjudication.

- Right to safety – This right gives protection against marketing of goods which are hazardous to life and property;
- The right to be informed about the quality, quantity, potency, purity, standard and price of goods and services, as the case may be, to protect the consumer against unfair trade practices
- Right to Choose – The consumers should have access to an authority of goods at competitive prices.
- Right to be heard – The consumers interests should receive due consideration at appropriate forums,
- Right to seek redressal – There should be redressal system against unfair trade practices or unscrupulous exploitation of consumers.

Since shares and securities are also legally deemed to be “goods” under the Consumer Protection Act, 1986, investors should have the option to approach Consumer Courts under the Consumer Protection Act as a forum to redress their complaints. The extent to which the jurisdiction of the Consumer Courts may apply in such cases would have to be defined with regard to the nature of the investment and the entitlements arising from the related transaction. The capacity of the consumer courts to adjudicate on such matters will have to be upgraded through capacity building and training of judicial officers manning such courts. Training institutes may be set up by

Government/Capital market Regulator to provide such training. With the increase in the number of investors and greater awareness on their part, timely and simplified institutional structure for dispute resolution is desirable so that the investors are not compelled to resort to costly legal proceedings for protection of their rights. This would be particularly relevant for the small investors. In this context, the institution of Ombudsman for Capital Market set up by SEBI should also be strengthened.

➤ **INVESTOR PROTECTION AND COMPETITION ACT, 2002**

The preamble of Competition act itself states to protect the interests of Consumers. The objective of CCI is to play an overarching role as a market regulator across all sectors with the focus on anti-competitive behaviour of enterprises that may distort competition. The market regulator, CCI, performs mostly ex post functions only to curb concentration in the market (laying down criterion for fair play).

Section 18 lays down the duties of the Commission which inter-alia provides for protection of the interests of the consumer. Section 36 of the Act provides the powers of the Commission and sub-clause (1) states that discharge of its functions shall be guided by the principles of natural justice

Apart from promoting competition in the market it is also the duty of the Commission to protect the consumers from anti – competitive practices. An enquiry can be initiated by a consumer or a consumer association by giving information to the commission accompanied by the required fees. Inquiry can also be initiated by any enterprise in the same manner. Further CCI can initiate inquiry on its own motion or on reference made to it by the central or state government or a statutory authority.

➤ **INVESTOR PROTECTION AND INFORMATION TECHNOLOGY ACT, 2000**

The (Indian) Information Technology Act, 2000 deals with the issues relating to payment of compensation (Civil) and punishment (Criminal) in case of wrongful disclosure and misuse of personal data and violation of contractual terms in respect of personal data.

Under Section 43A of the (Indian) Information Technology Act, 2000, a body corporate who is possessing, dealing or handling any sensitive personal data or information, and is negligent in implementing and maintaining reasonable security practices resulting in wrongful loss or wrongful gain to any person, then such body corporate may be held liable to pay damages to the person so affected. It is important to note that there is no upper limit specified for the compensation that can be claimed by the affected party in such circumstances.

Under Section 72A of the (Indian) Information Technology Act, 2000, disclosure of information, knowingly and intentionally, without the consent of the person concerned and in breach of the lawful contract has been also made punishable with imprisonment for a term extending to three years and fine extending to INR 5,00,000.

➤ **THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999 (FEMA) AND INVESTOR PROTECTION**

The Foreign Exchange Management Act, 1999 (FEMA) is an Act of the Parliament of India "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India". It enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organisation (WTO). It also paved the way for the introduction of the Prevention of Money Laundering Act 2002 to protect investors from being duped of their hard earned money and to make sure that the economy is stable.

Unlike other laws where everything is permitted unless specifically prohibited, under this act everything was prohibited unless specifically permitted to curb economic crisis and financial panic. The buying and selling of foreign currency and other debt instruments by businesses, individuals and governments happens in the foreign exchange market. Apart from being very competitive, this market is also the largest and most liquid market in the world as well as in India and with scams taking place which affects the hard earned money of the general Investor. It constantly undergoes changes and innovations, which can either be beneficial to a country or expose them to greater risks. The management of foreign exchange market becomes necessary in order to mitigate and avoid the risks. Activities such as payments made to any person outside India or receipts from them, along with the deals in foreign exchange and foreign security is restricted. It is FEMA that gives the central government the power to impose the restrictions. Without general or specific permission of the FEMA, restricts the transactions involving foreign exchange or foreign security and payments from outside the country to India – the transactions should be made only through an authorized person. To ensure that the transactions are carried out properly, RBI seeks compliance to protect the Investor and economy.

CASE STUDY ON KETAN PAREKH SCAM:

INTRODUCTION-

Ketan Parekh is a former stockbroker based in Mumbai who was convicted in 2008 for being involved in engineering the technology stocks scam in India's stock market in 1999-2001. A chartered accountant by training, Parekh comes from a family of brokers and is currently serving a period of disqualification from trading in the Indian bourses till 2017.

Ketan Parekh has been accorded with sobriquets such as the Penta four Bull and the One Man Army by the country's national business newspapers, while the market simply refers to him as 'KP' or associates him with his firm NH Securities. Parekh is known to have no reluctance in meeting the press. He is also known to have razor sharp forecasts on market developments.

THE SCAM-

Parekh attracted the attention of market players and they kept track of every move of Parekh as everything he was laying his hands on was virtually turning into gold. But the Penta four Bull still kept a low profile, except when he hosted a millennium party that was attended by politicians, business magnates and film stars. And by 1999-2000, as the technology industry began embracing the entire world, India's stock markets started showing signs of hyperactivity as well and this was when KP struck.

Almost everyone, from investment firms which were mostly controlled by promoters of listed companies to foreign corporate bodies and cooperative banks were eager to entrust their money with Parekh, which, he in turn used to inflate stock prices by making his interest obvious.

Almost immediately, stocks of firms such as Visual soft witnessed meteoric rises, from Rs 625 to Rs 8,448 per unit, while those of Sonata Software were up from Rs 90 to Rs 2,150. However, this fraudulent scheme did not end with price rigging. The rigged up stocks needed dumping onto someone in the end and KP used financial institutions such as the UTI for this.

When companies seek to raise money from the stock market, they take the help of brokers to back them in raising share prices. KP formed a network of brokers from smaller bourses such as the Allahabad Stock Exchange and the Calcutta Stock Exchange. He also used 'BENAMI' or share purchase in the names of poor people living in Mumbai's shanties. KP also had large borrowings from Global Trust Bank and he rigged up its shares in order to profit significantly at the time of its merger with UTI Bank. While the actual amount that came into Parekh's kitty as loan from Global Trust Bank was reportedly Rs 250 crore, its chairman Ramesh Gelli is known to have repeatedly asserted that Parekh had received less than Rs 100 crore in keeping with RBI norms.

Parekh and his associates also secured Rs 1,000crore as loan from the Madhavpura Mercantile Cooperative Bank despite RBI regulations that the maximum amount a broker could get as a loan was Rs15 crore. Hence, it was clear that KP's mode of operation was to inflate shares of select companies in collusion with their promoters.

THE EXPOSURE OF THE DUPE-

As with the Harshad Mehta scam, Ketan Parekh's fraudulent practices were first exposed by veteran columnist Sucheta Dalal. Sucheta's column read, "It was yet another black Friday for the capital market. The BSE sensitive index crashed another 147 points and the Central Bureau of Investigation (CBI) finally ended Ketan Parekh's two year dominance of the market by arresting him in connection with the Bank of India (BOI) complaint. Many people in the market are not surprised with Parekh's downfall because his speculative operations were too large, he was keeping dubious company, and he was dealing in too many shady scrips."

When the prices of select shares started constantly rising, innocent investors who had bought such shares believing that the market was genuine were about to stare at huge losses. Soon after the scam was exposed, the prices of these stocks came down to the fraction of the values at which they had been bought. When the scam did actually burst, the rigged shares lost their values so heavily that quite a few people lost their savings. Some banks including Bank of India also lost significant amounts of money.

Dalal goes on to state that Parekh's scheme was not visible to a layman given the positive deflection that media had made him a hero while some of the biggest national dailies had even quoted him profusely on that year's Union Budget. Dalal added that KP's arrest and the uncanny similarity of his operations to the Harshad Mehta securities scam of 1992 vindicated the miserable inadequacy of the country's regulatory system. The Securities Exchange Board of India (SEBI) and the Reserve Bank of India (RBI) had remained complacent when the stock bubble was created during the latter half of 1999 and through 2000 while it had not bothered to take any action through 2001 when it was ready to burst. Heavy Penalty imposed and he was imprisoned.

RECOMMENDATION BY VARIOUS COMMITTEES:

A number of committees came to be set up to review the control and regulatory mechanisms that are in place already and suggest necessary measures to overhaul the functioning of the stock

exchanges, so as to usher in a strong capital market in India. The salient features of these committees are presented below:

The G.S.Patel Committee- This was the high-powered committee constituted in May 1984, under the chairmanship of G.S.Patel. The terms of reference of the G.S.Patel Committee (GSPC) were: a) Organizational structure and management of stock exchanges b) Threshold level of quality for membership of brokers c) Market mechanism of trading and settlement d) New issues and listing requirement e) Investor protection and services.

Important recommendations of the Committee were as follows:

- All stock exchanges to follow a standard model of management by registering under the Section 25 of Companies Act, company limited by guarantee.
- Establishing an independent supervisory body modelled on the SEC of USA to monitor the market. This was the genesis of the SEBI, which is the regulatory authority today.
- Members to take insurance cover for loss of documents and acts of fraud committed by their employees.
- Introducing odd-lot dealing, prohibiting non-bank finance for 'badla' dealers and banning all option contracts.

The M.J.Pherwani Committee- This committee was set up to initiate orderly growth of the stock market and promote investor's interests. The most important recommendation was establishing of a National Stock Exchange System, which was established in 1995, in great Bombay. The NSE was created to offer competition to BSE, which is too gigantic and monolithic, handling almost two thirds of the country's primary and secondary market business. Other key recommendations were:

- Establishing Central Depository Trust, and evolving electronic hook-up with regional depositories, upgrading the stock holding corporation of India.
- Establishing National Clearing and Settlement Corporation for settlement between regional stock exchanges and central depositories.
- Creating a three-tier stock market system with more floors added to existing exchanges.
- Active promotion on jobbing or market-making in debt instruments, or providing separate trading hours.

J.R. Varma Committee- It was set up by SEBI to review the RCFS submitted its report in August 1997. These recommendations were aimed at modifying the RCFS and bringing in a new system called the modified carry forward system (MCFS). The committee recommended that the weekly carry forward system under the rolling settlement system be introduced as carry forward product to make it easier for the market to understand and use the product. The major recommendations of the committees are as follows:

- To abolish the twin-track system of segregating carry forward trades and delivery trades.
- A uniform margin of 10 per cent on gross positions with daily marking to market should be applied to both types of transactions.
- Capital adequacy and other prudential safeguards to be strictly enforced.
- Stock exchanges to ensure that the scrips have sufficient floating stock and high liquidity while choosing scrips for carry forward.

CONCLUSION:

Stock Exchanges in India although are relatively young as compared to their western counterparts, they have made rapid strides both in terms of quality and quantity. Regulating the working of stock exchanges has been one of the important missions of the government over the years. The Stock Exchanges in India is well regulated by a host of agencies and institutions. The necessary legislative framework of SEBI Act came into existence to exercise control over the mutual funds, portfolio managers and curb the menace of insider trading, manipulative trading practice, abolition of CCI so as to ensure high order of investor protection.

Investors constitute an important segment of the Indian stock market and therefore require all the support and protection. SEBI finalized several rules, regulation and bye-laws which would be applicable to all stock exchanges. Securities Contracts (Regulation) Act was aimed at preventing undesirable transactions in securities by regulating the business of dealing therewith. Various other SEBI regulations like Ombudsman, IPEF and schemes like OIAE, SMAC, SCORES were set up to create Investor awareness and to eradicate the complaints and grievances of the investor. Also, protection has been provided to an investor under various legislations other than SEBI Act, 1992. Case study on Ketan Parekh Scam helped us in understanding massive stock manipulation scheme financed by worthless bank receipts, through which his firm brokered in "ready forward" transactions between banks.

To conclude, various recommendations were prepared by committees from time to time in order to review the control, functioning and regulatory mechanisms of the stock exchange in India.

SUGGESTIONS:

- ✓ Expanding the jurisdiction of SEBI to control unlisted companies and their activities, since they constitute a large chunk of business in India. Normally SEBI has the power to control the behaviour of listed companies in India. It thus, needs to have more powers to control the nature of the business and protect the interest of share-holders, as well.
- ✓ It is the responsibility of the government and its various nodal agencies to furnish every area of business with necessary provisions to ensure that it is working, according to the interest of the nation and different shareholders, at large.
- ✓ Make necessary clarity and transparency in provisions dealing with regulating business towards the general objectives of the nation.
- ✓ Establish necessary banking institutions in the rural parts of India and make awareness among the people about various banking products. In essence, a loin share of people in rural parts of India does not have bank accounts for want of sufficient number of bank institutions.
- ✓ All the informal collective investment schemes must be brought under the jurisdiction of a centralised enforcement authority with necessary stipulations and moreover, discourage the un- scrupulous investment schemes.