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Anurag K. Agarwal

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Anurag K. Agarwal
Professor, Indian Institute of Management Ahmedabad
Email: akagarwal@iimahd.ernet.in

Abstract

Real corporate governance requires tough financial regulators which effectively work to safeguard investors' interests in securities and endeavour to create a proper environment for the securities market to develop. The financial regulators – Securities and Exchange Board of India, SEBI in India, and Securities and Exchange Commission, SEC in the US – have been created by the legislature. They are independent expert bodies and are vested with remarkable powers, but they have to work within the framework of law, which is interpreted by the courts. This paper examines the role of courts vis-à-vis expert bodies in general and financial regulators in particular, and highlights the importance of the two being on the same page for effective corporate governance.

Keywords

Corporate Governance
Courts
Discretion
Financial Regulator
SEBI
SEC

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1. INTRODUCTION

Modern living, with the goal of the welfare of the people, has enhanced the role of the State and exercise of discretion is essentially needed for proper functioning of the society. It is not always possible for the regular courts to resolve all the disputes primarily due to paucity of time and, unsurprisingly, at times, due to lack of expertise in technical matters. While seeking a solution to these problems, it was made possible for the administrative tribunals and other expert bodies to be accepted, much to the chagrin of the strong proponents of the rule of law, who conservatively never agreed upon anything but the normal, regular courts. The regulatory bodies, including the financial regulators, are surely not a part of the regular courts, but do get legitimacy and all the powers from the parent statute, which creates them. These are now widely accepted and are ubiquitous in any evolved jurisdiction. The fact of the matter is that the existence of regulatory bodies is considered to be one of the criteria for a developed market system, endeavouring to provide a level playing field and aspiring to meet the highest norms of corporate governance.

2. REGULATORS AND COURTS

A regulator, typically, has the powers of legislature, executive and judiciary. All these powers are quasi in nature and emanate from the parent act creating that regulator. For instance, the Telecom Regulatory Authority of India –TRAI – is the creation of the Telecom Regulatory Authority of India Act, 1997, which itself has been enacted by the central legislature, which comprises the Lok Sabha, the Rajya Sabha and the President of India. Similarly, the Securities and Exchange Board of India – SEBI – is the financial regulator in India and had been established under the provisions of the Securities and Exchange Board of India Act, 1992. Its American counterpart, the US Securities and Exchange Commission – SEC – was created by the Securities and Exchange Act of 1934. Thus, the parent act created by the Legislature is the Fountainhead for a regulatory body. Under no circumstances, this regulatory body is permitted to transgress the limit defined by the act itself.

India follows the doctrine of separation of powers – legislative, executive and judicial – but not in totality. In no way an expert body or an administrative Tribunal can be said to replace the ordinary courts of law as they do not fulfil all the criteria for being a regular court, however, these are nonetheless quasi-judicial bodies which are bound to work within the four corners of the statute, which creates them. Under no circumstances, they can transgress the limits created by the statute, and also the outer limit as defined by the Constitution of India, or for that matter any other country. The decisions of these expert bodies are subject to appeal, a mechanism which is inbuilt in the parent statute. For instance, the SEBI Act provides that the decisions of the Board can be challenged in the Securities Appellate Tribunal (SAT), and the decisions of the Tribunal can be challenged in the Supreme Court of India.[1] The procedure for appointment of members and their qualifications are detailed in the act itself. Thus, it has been ensured by the Legislature that persons with requisite expertise are appointed as members of the Board and Tribunal.[2]

While deciding a matter related to telecom, the Supreme Court made certain observations regarding the working of Telecom Regulatory Authority of India (TRAI) and Telecom Dispute Settlement Appellate Tribunal (TDSAT). These observations, *mutatis mutandis*, apply to other regulatory bodies and appellate tribunals also, and are as follows:

[1] Section 15Z, SEBI Act, 1992
[2] Sections 4, 5, 15L, 15M, SEBI Act, 1992

> *"The regulatory bodies exercise wide jurisdiction. They lay down the law. They may prosecute. They may punish. Intrinsically, they act like an internal audit. They may fix the price, they may fix the area of operation and so on and so forth. While doing so, they may, as in the present case, interfere with the existing rights of the licensees. Statutory recommendations made by it are normally accepted by the Central Government, as a result of which the rights and obligations of the parties may seriously be affected.…It was in the aforementioned premise the Parliament thought of creating an independent expert tribunal which, if an occasion arises therefor, may interfere with the finding of fact, finding of law or a mixed question of law and fact of the Authority. Succinctly stated the jurisdiction of the tribunal is not circumscribed in any manner whatsoever."*[3]

Conflict of Jurisdiction

A question may arise regarding the conflict of jurisdiction between the ordinary courts of law and expert bodies. At times it becomes important to address this question as the credibility of any expert body is at great risk when judges of the regular courts – generalist in nature – have the power, by law, to negate the decisions of the expert body, comprising specialists. Thus, it truly becomes a debate between the generalist versus the specialist.

Interestingly, there are fewer occasions when expert bodies have overstepped their authority given to them by the statute, but, unfortunately, there are many occasions on which the so-called expert body has refrained from stretching it to the limit and had been found complacent, while preferring to work at a much lower level of power and authority granted to it. There may be number of reasons for such a tendency, however, it is often observed that the regulatory bodies may be much more risk-averse than they are expected to be, both by the law and the public.

It would be enlightening to have a look at some of the provisions of the SEBI Act, 1992.

3. SECURITIES AND EXCHANGE BOARD OF INDIA

The Preamble of the SEBI Act[4], 1992 states:

> *"An Act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto."*

The SEBI Act defines 'securities' in section 2 (1) (i) and is as follows:

> *"2 (1) (i) "securities" has the meaning assigned to it in section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956)."*

The Securities Contracts (Regulation) Act, 1956[5] defines 'securities' in section 2 (h) and is as follows:

> *"2 (h) "Securities" include—*
> *(i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;*
> *(ia) Derivative;*
> *(ib) Units or any other instrument issued by any collective investment scheme to the investors in such schemes;*
> *(ic) Security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.*
> *(id) units or any other such instrument issued to the investors under any mutual fund scheme;*
> *Explanation.—For the removal of doubts, it is hereby declared that "securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever named called, which provides a combined benefit risk on the life of the persons and*

[3] Cellular Operators Association of India and Others v. Union of India and Others, Supreme Court of India, December 17, 2002; Bench: G. B. Pattanaik, H. K. Sema, S. B. Sinha, JJ.; 2002 Indlaw SC 1576; (2003) 3 SCC 186; AIR 2003 SC 899; 2002(9) SCALE 399; 2003 (1) SLT 322; 2003 (1) Supreme 736
[4] Act no. 15 of 1992
[5] Act no. 42 of 1956

> *investment by such persons and issued by an insurer referred to in clause (9) of Section 2 of the Insurance Act, 1938 (4 of 1938).*
> *(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be*
> *(ii) Government securities,*
> *(iia) Such other instruments as may be declared by the Central Government to be securities; and*
> *(iii) Rights or interests in securities;"*

Section 11 of the SEBI Act, 1992 enumerates the functions of the Board, and sub-section (1) grants it extensive powers, within the four corners of the Act itself, to achieve the goal as stated in the Preamble.

Section 11 (1) reads as follows:

> *"11. Functions of Board.*
> *(1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit."*

The use of words, *"…such measures as it thinks fit"* gives SEBI almost absolute power in exercising discretion. The only restriction is that it must work within the boundary created by the Act itself, and, of course, the understanding of public policy, along with the sense of propriety, which are capable of being interpreted in a different manner at different points of time by different courts. However, dynamism in interpretation should not necessarily create uncertainty, as the powers of SEBI are almost unbridled and it has been given an extremely long rope by the legislature.

Dog on a Long Leash

To use the words of noted jurist Nani A. Palkhivala, which he used while discussing fate of an individual or a nation, SEBI, as far as my understanding goes, is like "*a dog on a long leash – the dog has the freedom to move about as far as the leash permits, but not beyond.*"[6]

Even while working with the best of intentions, SEBI is not permitted by law, to go beyond the long leash granted by the Legislature; and where the leash does end has to be decided by the judiciary, keeping in mind the intention of the legislature while interpreting the black letter law. Unlike the physical leash, which is tangible and of finite length, the powers granted to SEBI may not be so easily comprehensible, even if written down in great detail in the Act itself. The same shall be true for the SEC in the US.

But, what if the dog is so lazy that it never uses the entire length of the leash to its advantage? What if the dog prefers torpor, and the mice run away with pieces of cheese – the same cheese, which the dog is supposed to protect – right under its nose? Anyone who has watched a couple of Tom and Jerry cartoon films can easily visualise this. What if the dog prefers the comforts of its kennel to sweating it out in protection of cheese? What if the dog can be tempted with a bone to the extent that it forgets, at least for the time being, its primary duty? What if the dog chases the mice with a lot of energy, making all sorts of noises, clenching its teeth as if it were going to tear apart the mice, but with no intention of even touching them? No use giving a long leash to such a dog, because, until and unless the master gives a thorough beating to the dog, it will never ever show the alacrity and vigilance expected of it.

Another interesting thought, while pondering over the powers given to SEBI, is regarding not taking the measures which must have been taken as the facts and circumstances of any case would demand. There is no denying the fact that the Act gives ample powers to SEBI to function in almost any manner to achieve the desired goals, however, whether not taking any such action would amount to dereliction of duty? It is akin to a motorist denying moving his vehicle when the traffic light turns green, despite being authorised not to stop even when the light is red, as is the case with fire engines, ambulances, and police vehicles.

[6] Palkhivala, Nani A., *We, the Nation: The Lost Decades*, UBS Publishers' Distributors Ltd., Delhi, 1994, Introduction, p.xvi.

Are inaction, half-hearted action, and unduly late action permissible? The answer is clearly 'no', as the market regulator must be extremely vigilant. Alas! That is not so. The Sahara case illustrates it so well.

The Sahara Case[7]

On August 31, 2012, the Supreme Court held that SEBI had jurisdiction over the Optionally Fully Convertible Debentures (OFCDs) issued by two companies of the Sahara group and directed Sahara to repay the investors, through SEBI, as the money had been collected without following the regulatory and legal norms. SEBI was ordered to verify the veracity of investors and make the payment. The court gave ten days to Sahara to submit the details of investors to SEBI and three months to make the payment. The order has not been complied fully till date – March 2013.

To say that SEBI had been dragging its feet in *Sahara* case would be an understatement. Had it not been for the dogged pursuit by the Supreme Court of India (SC), the matter regarding defrauding investors to the tune of about Rs. 24,000 crores – a little less than $ 5 billion, with roughly fifty rupees to a dollar – would have been buried under regulatory files and bureaucratic red tape. It would be like stating the obvious, that the financial regulator, SEBI, and the courts, with the SC at the top of the judicial hierarchy in India, must work in tandem for effective corporate governance, however, the nation witnessed in the last almost one year the undercurrents of a tenuous relationship between the two.

At times, unfortunately, it became quite obvious when the SC had to rebuke SEBI – which ironically was complaining about non-compliance of SC's orders by Sahara – for not following its orders, which amounted to contempt of court by SEBI. It was reported in the media:

> *"At a hearing yesterday, the same two-judge bench that gave the August verdict asked SEBI, which is seeking a contempt order against the Saharas, to stop pussyfooting around the judgment and implement it in toto. "We wonder whether Sahara is committing contempt (of court) or you are committing contempt," the bench observed. "You have done nothing, except issue notices after notices (to Sahara). Who is committing contempt?""*[8]

Such has been the blatant disregard of the SC's orders by SEBI, that the SC had been compelled to closely monitor the actions taken by SEBI in the case on a regular basis. This speaks volumes about the potency of the financial regulator and the lack of will to exercise discretion, even in cases where plain and simple facts warrant unambiguous and obvious actions. Some of the decisions made simply portray a lack of imagination and sheer obstinacy in continuing to make mechanical decisions without application of common sense. While evaluating most of these decisions from the legal perspective, it would not be difficult to reach at the conclusion that SEBI tried its best to circumvent the SC's decisions, and whenever it was following them, it became quite evident that it was interested only in doing the minimal to avoid being branded as someone who didn't care about the SC's orders, and at the same time without hurting in the real sense business interests of Sahara, which got ample time to play the victim.

Playing the victim

In a telling article, Sucheta Dalal wrote in November 2012, with reference to the Rajat Gupta trial, as to how a person would play the victim after getting caught.[9] In a similar manner, the Sahara group, after the Supreme Court's judgement of August 31, 2012, started its media campaign with full-page advertisements in almost all national dailies, highlighting the yeoman service – as per its own statement – it has so far done to the people of India. In late February and early March this year, the Sahara group blamed SEBI and the entire system for acting with vengeance. The Times of India reported:

> *"… the group said that it has knowledge that an IT raid "has been designed and decided", "Sebi, while acting under the system, has already orchestrated investigation/action through different ministries and*

[7] *Sahara India Real Estate Corporation Limited and others v. Securities and Exchange Board of India and Another*, Supreme Court of India, August 31, 2012; Bench: K. S. Radhakrishnan, Jagdish Singh Khehar, JJ.; 2012 Indlaw SC 272; 2012 (3) CLT(SC) 216; [2012] 174 Comp Cas 154; JT 2012 (8) SC 385; 2012(8) SCALE 101

[8] Jagannathan, R., *SEBI, SC have tied themselves in knots over Sahara*, Firstpost, Feb 7, 2013, http://www.firstpost.com/business/sebi-sc-have-tied-themselves-in-knots-over-sahara-616889.html, last accessed March 18, 2013

[9] Dalal, Sucheta, *Playing the victim after getting caught*, Moneylife, November 12, 2012, http://moneylife.in/article/playing-the-victim-after-getting-caught/29612.html, last accessed March 18, 2013

> *government departments against Sahara. What can be said about such negative attitude adopted towards an organisation which has done immense good for society as well as for the country," the statement said. "The big question that still remains to be answered is why such a vengeance?" it said."*[10]

The latest tirade by Sahara included another full-page advertisement in all national-dailies on Sunday, March 17, 2013. Live Mint wrote:

> "Sahara Group chief Subrata Roy Sahara has challenged executives from the Securities and Exchange Board of India for a live debate on a television channel to present his version of an on-going dispute with the regulator. "Enough is enough. I hereby challenge and invite the chairman or/and members or/ and executive directors of Sebi for a live debate with me on a TV channel and let people know their wrong intent and deed, as a corporate regulator and clearly understand what extreme degree of injustice is being done by them to malign the image of Sahara India Pariwar," said a full page advertisement released by the group on Sunday in newspapers. It was signed by Subrata Roy Sahara, managing worker and chairman. U.K. Sinha is the chairman of the markets regulator. The salvo from the Sahara group comes after the regulator filed a petition in the Supreme Court on Friday seeking civil detention of top Sahara group officials including Subrata Roy."[11]

Interestingly, SEBI is not the only market regulator to show tardiness; the SEC in the US has of late – in February 2013 – been chided by the US Supreme Court in the *Gabelli* case.

4. SECURITIES AND EXCHANGE COMMISSION, U.S.

The SEC is the market regulator in the US and has on some occasions faced the wrath of American courts. The latest has been the criticism by the US Supreme Court in *Gabelli* case.

Gabelli v. SEC, U.S. Supreme Court, February 27, 2013[12]

Between 1999 and 2002, SEC found that Gabelli Funds LLC had secretly allowed 'market timing' – short-term traders exploit inefficiencies in the pricing of shares of mutual fund – but did not file a complaint till 2008. According to the law of limitation in the United States, a time period of five years is provided to the SEC to file a complaint and initiate action. The only question is, from what date will the clock start ticking? SEC stated that it discovered the conduct in 2003 and hence the clock would have started ticking from that time according to the 'discovery rule', however, Gabelli argued that the time period would have started running from the date when the cause of action accrued. Thus, according to SEC, the initiation of proceedings was well within the time, however, according to Gabelli, the proceedings were time-barred. Interestingly, in 2008, Gabelli had agreed to pay $ 50 million to settle with the SEC, but without admitting or denying the guilt. The lower court had given additional time to the SEC, however, the Supreme Court in a unanimous decision reversed the lower court's ruling and held that the time period would start running from the time of the alleged offence, and not from the time it was discovered by SEC as the 'discovery rule' could not be extended to SEC, unlike private parties. It has been a big blow for the financial regulator.

With respect to the private parties, the US Supreme Court, *inter alia*, observed:

> *"There are good reasons why the fraud discovery rule has not been extended to Government enforcement actions for civil penalties. The discovery rule exists in part to preserve the claims of victims who do not know they are injured and who reasonably do not inquire as to any injury. Usually when a private party is injured, he is immediately aware of that injury and put on notice that his time to sue is running. But when the injury is self-concealing, private parties may be unaware that they have been harmed. Most of us do not live in a state of constant investigation; absent any reason to think we have been injured, we do not typically spend our days looking for evidence that we were lied to or*

[10] *Sahara now fears income tax raid*, The Times of India, March 2, 2013, http://timesofindia.indiatimes.com/business/india-business/Sahara-now-fears-income-tax-raid/articleshow/18757715.cms, last accessed March 18, 2013
[11] *Sahara's Subrata Roy challenges U.K. Sinha to live debate: Dispute with Sebi pertains to the money that two Sahara firms raised from retail investors via securities*, Live Mint, March 17, 2013, http://www.livemint.com/Companies/l7RW7x0FjoQKjeDYb0gjPN/Subrata-Roy-challenges-UK-Sinha-to-live-debate.html, last accessed March 18, 2013
[12] *Gabelli et al. v. Securities and Exchange Commission*, U. S. Supreme Court, February 27, 2013

> *defrauded. And the law does not require that we do so. Instead, courts have developed the discovery rule, providing that the statute of limitations in fraud cases should typically begin to run only when the injury is or reasonably could have been discovered."*[13]

But, for the SEC, the Supreme Court said:

> *"The same conclusion does not follow for the Government in the context of enforcement actions for civil penalties. The SEC, for example, is not like an individual victim who relies on apparent injury to learn of a wrong. Rather, a central "mission" of the Commission is to "investigat[e] potential violations of the federal securities laws."… Unlike the private party who has no reason to suspect fraud, the SEC's very purpose is to root it out, and it has many legal tools at hand to aid in that pursuit. It can demand that securities brokers and dealers submit detailed trading information. … It can require investment advisers to turn over their comprehensive books and records at any time. … And even without filing suit, it can subpoena any documents and witnesses it deems relevant or material to an investigation. … The SEC is also authorized to pay monetary awards to whistleblowers, who provide information relating to violations of the securities laws. … In addition, the SEC may offer "cooperation agreements" to violators to procure information about others in exchange for more lenient treatment. … Charged with this mission and armed with these weapons, the SEC as enforcer is a far cry from the defrauded victim the discovery rule evolved to protect."*[14]

Remedy or Punishment

While hearing the matter[15], the Supreme Court judges had remarked, and it was reported by the Wall Street Journal:

> *"During oral arguments in January, several Supreme Court justices suggested the SEC had other enforcement options if it lost the case and couldn't seek a civil penalty. Some suggested the SEC still could seek disgorgement of a defendant's ill-gotten gains even after the five-year window."*[16]

It needs to be understood that disgorgement is only a remedy and not a punishment. The United States Supreme Court has very clearly reprimanded the SEC for its lousy conduct, given the fact that so much resources were available with the commission, coupled with enormous powers provided by the statute. In such a scenario, the SEC had no reason not to take timely action, more so when it is its primary duty to charge companies and individuals for fraud, including insider trading. It is surely an example of the dog not using the entire length of the leash.

This is not the only case when SEC got an earful from the courts. In 2011, Judge Rakoff refused to approve an agreement between SEC and Citigroup.

Citigroup Settlement: Caught on the Wrong Foot

On 28th November, 2011, the New York District Judge Jed Rakoff denied to rubber stamp a settlement between SEC and Citigroup, a financial behemoth headquartered in New York. Earlier that year, SEC and Citigroup had settled for a fraud which Citigroup was charged with committing some time back. It was regarding mortgage bond during the recession period which made it possible for the bank to earn $160 million in fees, but at the same time resulted in $700 million of losses for investors. According to the settlement, Citigroup had agreed to pay $285 million as fine, but without admitting the guilt. The judge was of the view that there could not be any settlement without admission of guilt.

The judge came down very heavily on the SEC. Citing copiously from the judgment, the Economist wrote:

> *"It would be hard to imagine a more thorough rebuke of how America's Securities and Exchange Commission (SEC) tries to discipline financial firms. … He called the settlement not just a betrayal of the public interest, but the product of an approach "hallowed by history but not by reason". It allowed firms to settle allegations without ever acknowledging guilt. This not only failed investors, but—by obscuring the truth—society. … "The court concludes, regretfully, that the proposed Consent Judgment*

[13] *Ibid.*
[14] *Ibid.*
[15] The Case was argued on January 8, 2013.
[16] Supreme Court Rules Against SEC on Relaxed Time Limits, The Wall Street Journal, February 27, 2013, http://online.wsj.com/article/SB10001424127887323478304578330142186905254.html, last accessed March 18, 2013

> *is neither fair, nor reasonable, nor adequate, nor in the public interest," Mr Rakoff wrote. … The penalty, he wrote, would likely be regarded by Citigroup as merely a cost of doing business and to "maintain a working relationship with a regulatory agency". … By not pushing to link the settlement with a possible crime, Mr Rakoff concluded, the transparency of the financial markets has been compromised. "The SEC, of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges," he wrote."*[17]

'Neither Admit nor Denial' Policy Changed

Within a short period of time – in less than two months – in early January 2012, the SEC changed its policy of settling fraud charges by paying a fine, but without admitting the guilt. In a paradigm shift, the SEC made it known that it would no more allow settling without either admitting or denying civil fraud or insider trading charges. This policy change was obviously prompted by Judge Rakoff's decision in the Citigroup case. It was hailed as a major change by many, however, some people remarked that it was only a tweak in the policy. The New York Times wrote:

> *""It's an important development because it is a change of policy," said James D. Cox, a professor at Duke Law School and co-author of a securities regulation textbook. "It's a small step forward in addressing the concerns" that a federal judge recently voiced about the S.E.C.'s broader settlement policy. … But David S. Ruder, an emeritus professor at Northwestern School of Law and a former S.E.C. chairman, said the change was merely "a tweaking" of policy that would not significantly reduce the commission's reliance on the "neither admit nor deny" policy to settle cases."*[18]

It is too early to judge as to whether the change in the policy resulted in better regulation or not, but, it was surely an aberration and the SEC, after the rap on the knuckles, decided, and rightly so, to rectify it at the earliest. When found wanting, such alacrity is commendable and needs to be replicated. At times SEC has shown exemplary zeal which has been ratified by the courts as in the case of Rajat Gupta.

Rajat Gupta's Insider Trading Case

On October 26, 2011, the SEC charged Rajat Gupta with insider trading. It was alleged that Gupta had illegally tipped Raj Rajaratnam, his friend, with insider information about the quarterly earnings of Goldman Sachs and Procter & Gamble, while he was serving on the board of both the companies, and also about a possible huge investment of about $5 billion by Warren Buffet's Berkshire Hathaway in Goldman Sachs. Allegedly, Rajaratnam used this information, and either made illicit gains or avoided losses to the tune of about $23 million. While charging Gupta, Robert S. Khuzami, Director of the SEC's Division of Enforcement, said:

> *"Gupta was honored with the highest trust of leading public companies, and he betrayed that trust by disclosing their most sensitive and valuable secrets to the disadvantage of investors, shareholders, and fellow directors.… Directors who exploit board room confidences for private gain can be certain they will ultimately be held responsible for their illegal actions."* [19]

Earlier that month, Raj Rajaratnam was sentenced to 11 years in prison for insider trading. About Gupta, prosecutor Preet Bharara, the United States attorney in Manhattan, said:

> *"As alleged, he broke that trust and instead became the illegal eyes and ears in the boardroom for his friend and business associate, Raj Rajaratnam, who reaped enormous profits from Mr. Gupta's breach of duty."*[20]

'Mother Teresa' argument

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[17] *Citigroup and the SEC: Hallowed by history, but not by reason,* The Economist, Nov 29th 2011, http://www.economist.com/node/21540667, last accessed March 18, 2013

[18] *S.E.C. Changes Policy on Firms' Admission of Guilt,* The New York Times, January 6, 2012, http://www.nytimes.com/2012/01/07/business/sec-to-change-policy-on-companies-admission-of-guilt.html?_r=2&ref=business, last accessed March 18, 2013

[19] *SEC Files Insider Trading Charges against Rajat Gupta,* Securities and Exchange Commission (For Immediate Release #2011-223), October 26, 2011, http://www.sec.gov/news/press/2011/2011-223.htm, last accessed March 18, 2013.

[20] *With Gupta's Arrest, Insider Inquiry Goes Beyond Wall St.,* The New York Times, October 26, 2011, http://dealbook.nytimes.com/2011/10/26/gupta-surrenders-to-authorities-on-insider-trading/, last accessed March 18, 2013

Regarding the Rajat Gupta trial, the Wall Street Journal (WSJ) wrote that the large number of letters written to the U.S. District Judge Jed Rakoff by eminent persons like Bill Gates, Kofi Annan – former U.N. Secretary General – and others, eulogising him for all the good he did, might have indicated that he was practically on par with Mother Teresa. The WSJ wrote:

> *"Before former Goldman Sachs Group Inc. director Rajat Gupta reports to prison on Dec. 11, someone should nominate him for sainthood. Gupta, 63 years old, has committed more acts of loving kindness than any felon I can name. Judging from letters that people sent to U.S. District Judge Jed Rakoff, he is practically on par with Mother Teresa."*[21]

But in May 2012, while hearing the case, as reported by the Telegraph, Judge Rakoff had said:

> *""If Mother Teresa were here and charged with bank robbery, the jury would still have to determine whether or not she committed the robbery," US district judge Jed Rakoff said at a pre-trial hearing in a Manhattan court."*[22]

What's sauce for the goose is sauce for the gander – what is true for Rajat Gupta is also true for the Sahara group. No amount of philanthropy or social work can absolve one of the misdeeds, particularly doing an illegal activity, and hopefully, media management and generating public sympathy – by playing the victim – will not work for Sahara also.

Later, Gupta was prosecuted, convicted and sentenced. On October 25, 2012 – in precisely a year's time from him being charged by SEC – he was sentenced to two years in prison, starting from January 8, 2013. Reuters reported:

> *"U.S. District Judge Jed Rakoff told a somber courtroom audience, including Gupta's wife and four adult daughters, that the illegal sharing of corporate secrets at the height of the 2008 financial crisis "was the functional equivalent of stabbing Goldman in the back.""*[23]

SEC has charged two states – Illinois and New Jersey – with fraud. It has accused that the states had misled investors about the public pension system.[24]

The courts in the US rely on the expertise of regulators and the same is true of courts in India. The Supreme Court of India has preferred expert bodies for issues pertaining to technical matters with limited role of the courts.

5. REGULATORS AS EXPERT BODIES

While discussing the highly technical role of electricity regulatory commissions vis-à-vis regular courts of law, the Supreme Court, in a landmark judgment in 2002, observed:

> *"We notice that the Commission…is an expert body and the determination of tariff which has to be made by the Commission involves a very highly technical procedure, requiring working knowledge of law, engineering, finance, commerce, economics and management…Therefore, we think it would be more appropriate and effective if a statutory appeal is provided to a similar expert body, so that the various questions which are factual and technical that arise in such an appeal, get appropriate consideration in the first appellate stage also…. the Central Electricity Regulatory Commission which has a Judicial Member as also a number of other Members having varied qualifications, is better equipped to appreciate the technical and factual questions involved in the appeals arising from the*

[21] Lewis, Al, *Gupta: A good man who did bad things; Commentary: Saintly insider trader gets slap on wrist*, Market Watch, The Wall Street Journal, October 26, 2012, http://articles.marketwatch.com/2012-10-26/commentary/34741644_1_rajat-gupta-raj-rajaratnam-galleon-group, last accessed March 18, 2013
[22] *'Mother Teresa' slap on Rajat Gupta*, The Telegraph, Calcutta, May 19, 2012, http://www.telegraphindia.com/1120519/jsp/nation/story_15505983.jsp#.UUGEhfX3v_h, last accessed March 18, 2013
[23] *Rajat Gupta gets two years in prison for insider trading*, Reuters, October 25, 2012, http://in.reuters.com/article/2012/10/25/rajat-gupta-goldman-insider-trading-idINDEE89N0C420121025, last accessed March 18, 2013
[24] *Illinois Is Accused of Fraud by S.E.C.*, New York Times, March 11, 2013, http://www.nytimes.com/2013/03/12/business/sec-accuses-illinois-of-securities-fraud.html?ref=business&_r=1&, last accessed March 18, 2013

orders of the Commission. Without meaning any disrespect to the Judges of the High Court, we think neither the High Court nor the Supreme Court would in reality be appropriate appellant forums in dealing with this type of factual and technical matters…."[25]

Appeal to SC on 'question of law' only

In the case of the Securities Appellate Tribunal, created under the provisions of the SEBI Act, 1992, the Legislature has granted it ample powers without limiting its jurisdiction. To ensure the freedom and almost unbridled jurisdiction of the Tribunal, just like that of the Board (SEBI), the Legislature, in its wisdom, under Section 15Z of the SEBI Act has limited the jurisdiction of the Supreme Court only to questions of law. Both the Board and the Tribunal have been granted substantial discretionary powers.

Section 15Z, in its present form, reads as follows:

> ***"15Z.Appeal to Supreme Court.-*** *Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Securities Appellate Tribunal to him on* ***any question of law arising out of such order****:*
>
> *Provided that the Supreme Court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding sixty days."*[26]

The Supreme Court observed in *Clariant v. SEBI* in 2004:

> *"The Board exercises its legislative power by making regulations, executive power by administering the Regulations framed by it and taking action against any entity violating these regulations and judicial power by adjudicating disputes in the implementation thereof. The only check upon exercise of such wide ranging power is that it must comply with the Constitution and the Act. In that view of the matter, where an expert Tribunal has been constituted, the scrutiny at its end must be held to be of wide import. The Tribunal, another expert body, must, thus, be allowed to exercise its own jurisdiction conferred on it by the statute without any limitation."* [27]

The courts rely on the expertise of regulatory bodies and it is upto these bodies to work in a professional manner with due alertness, and exercise discretion in a proper manner. It is easier said than done.

Exercise of Discretion and Reasonableness

Discretion is essential for the working of any expert body, including the market regulators. But how should discretion be exercised is a matter to be judged as per the facts and circumstances of any case.

In an Australian case – Kruger v. Commonwealth of Australia, commonly known as the "Stolen Generations case" – which has been cited in *Clariant*[28], the High Court of Australia discussed the relationship between discretionary power and reasonableness and observed:

> *"Moreover, when a discretionary power is statutorily conferred on a repository, the power must be exercised reasonably, for the legislature is taken to intend that the discretion be so exercised. Reasonableness can be determined only by reference to the community standards at the time of the exercise of the discretion and that must be taken to be the legislative intention. Therefore, it would be erroneous in point of law to hold that a step taken in purported exercise of a discretionary power was*

[25] *West Bengal Electricity Regulatory Commission v. Calcutta Electricity Supply Company Ltd.*; Supreme Court of India, October 3, 2002; Bench: N. Santosh Hegde, B. N. Agarwal & B. P. Singh, JJ.; 2002 INDLAW SC 1151, AIR 2002 SC 3588, 2002 (8) SCC 715

[26] Emphasis supplied. Section 15Z in its original form was titled 'Appeal to High Court', which, in 2002, was amended to 'Appeal to Supreme Court'. In both the original and amended forms, the jurisdiction of the High Court and the Supreme Court, respectively, had been specific and limited to questions of law only.

[27] *Clariant International Limited and Another v Securities and Exchange Board of India,* Supreme Court of India 25 August 2004, Bench: S. B. Sinha, N. Santosh Hegde, A. K. Mathur, JJ., 2004 Indlaw SC 677; (2004) 8 SCC 524; AIR 2004 SC 4236.

[28] *Ibid.*

> *taken unreasonably and therefore without authority if the unreasonableness appears only from a change in community standards that has occurred since the step was taken…."*[29]

Similar observations had been made by the Supreme Court of India, long ago in 1979, in R. D. Shetty case:

> *"Now, obviously where a corporation is an instrumentality or agency of Government, it would, in the exercise of its power or discretion, be subject to the same constitutional or public law limitations as Government. The rule inhibiting arbitrary action by Government which we have discussed above must apply equally where such corporation is dealing with the public, whether by way of giving jobs or entering into contracts or otherwise, and it cannot act arbitrarily and enter into relationship with any person it likes at its sweet will, but its action must be in conformity with some principle which meets the test of reason and relevance."*[30]

Deciding on the issue of the powers of the Board (SEBI) and the discretion it must exercise, the Supreme Court in *Clariant* case made it amply clear that the Board surely has discretion to be exercised, however, it must be exercised, keeping in mind the test of reasonableness. The Supreme Court observed:

> *"The Board further having a discretionary jurisdiction must exercise the same strictly in accordance with law and judiciously. Such discretion must be a sound exercise in law. The discretionary jurisdiction, it is well- known, although may be of wide amplitude as the expression "as it deems fit" has been used but in view of the fact that civil consequence would ensue by reason thereof, the same must be exercised fairly and bona fide. The discretion so exercised is subject to appeal as also judicial review, and, thus, must also answer the test of reasonableness."*[31]

Discretion does not mean Inaction

By any stretch of imagination, exercise of discretion does not include inaction in most of the situations. It would be only in rare cases that inaction can be permitted. Regulatory bodies do not have the luxury of inaction.

Reproving the TDSAT for shirking its duty, as detailed in the parent act itself, the Supreme Court minced no words and observed:

> *"TDSAT was required to exercise its jurisdiction in terms of Section 14A of the Act. TDSAT itself is an expert body and its jurisdiction is wide having regard to sub- s. (7) of Section 14A thereof. Its jurisdiction extends to examining the legality, propriety or correctness of a direction/order or decision of the authority in terms of sub-s. (2) of S. 14 as also the dispute made in an application under sub-s. (1) thereof. The approach of the learned TDSAT, being on the premise that its jurisdiction is limited or akin to the power of judicial review is, therefore, wholly unsustainable. The extent of jurisdiction of a court or a Tribunal depends upon the relevant statute. TDSAT is a creature of a statute. Its jurisdiction is also conferred by a statute. The purpose of creation of TDSAT has expressly been stated by the Parliament in the Amending Act of 2000. TDSAT, thus, failed to take into consideration the amplitude of its jurisdiction and thus misdirected itself in law."*[32]

We have come back to the dog on a long leash. This dog cannot afford to be either lazy or inactive; it has to be alert, vigilant and proactive. So, what are the challenges ahead to be faced by the regulators and courts for effective corporate governance?

6. CHALLENGES AHEAD

Corporate governance, in very simple words, can be understood to mean the creation of wealth by remaining within the legal periphery, and without violating societal norms, which includes ethical conduct. Creation of wealth, typically, means creation of jobs, thereby providing employment to many, and these jobs in any

[29] Alec Kruger & Others v. The Commonwealth of Australia, High Court of Australia; July 31, 1997; [1997] HCA 27; (1997) 190 CLR 1; (1997) 146 ALR 126; (1997) 71 ALJR 991, http://www.austlii.edu.au/au/cases/cth/HCA/1997/27.html#fnB7, last accessed March 18, 2013
[30] Ramana Dayaram Shetty v. The International Airport Authority of India, Supreme Court of India; Bench: P. N. Bhagwati, V. D. Tulzapurkar and R. S. Pathak, JJ.; May 4, 1979; AIR 1979 SC 1628
[31] *Ibid.*
[32] *Ibid.*

company include, in a hierarchical manner, right from the top as the Chairperson or President of the company, to the bottom as the errand boy or peon in the company.

Ethical Norms and Legal Compliance

As a company, according to the law, is a distinct legal entity – it can sue and be sued in its own name – all the persons working for a company, as the employer, are truly working to further the business interests of the company. In doing so, each of these persons is supposed to give prime importance to the interests of the company, and his personal interests, if any, must, necessarily, take a backseat. The companies are inanimate, and all the decisions for any company are made by human beings, who act for and on behalf of the company. Thus, it is surely a challenge to make the individuals making decisions for the companies imbibe ethical norms and make legal compliance a habit.

Dynamic Business Environment

The companies do not operate in a vacuum, and there is a definite business environment, quite dynamic in nature, which impacts the operation of the company, and in turn, is also impacted by the functioning of the company. It is, therefore, a two-way process. The business environment, as a whole, can be understood to be relying on several factors, which include political, legal, economic, social, technological, environmental, financial, etc. True corporate governance requires the market regulator to be objective in its working and almost immune from the impact of many forces mentioned hereinbefore. Practically, it is next to impossible to make the impact zilch, but there must be a conscious effort to minimise the impact.

Living without Regulators

The best government is one which governs the least. In a laissez-faire economy, the role of the government is theoretically zero, and practically can be said to be minimal; leaving the business enterprises to do as they wish, with unbridled freedom to do business, without any interference, or at times, with least interference. An ideal laissez-faire economy does not exist for the simple reason that each business enterprise would be working towards the goal of maximising profits, with impunity and ruthlessness. As everyone in the society would be free to do the same, it would undoubtedly lead to chaos. It is very well known and said as one of the fundamental principles of individual and personal freedom that your freedom ends where my nose begins. Thus, in a society, which itself loosely connotes a group of people being together for whatever reason – geographical, business interests, norms, traditions, nationality, etc., state of affairs need to be orderly so that everyone gets an authority to enjoy the freedom, which would thereby mean that each one would never have unconstrained freedom. To ensure that everyone gets that freedom without encroaching upon the freedom of others, there has to be someone – either an institution, or an individual – monitoring the conduct of everyone. This is precisely the role to be played by regulators in evolved jurisdictions, which can either be functioning for particular sector – banking, shipping, insurance, telecom, electricity – or is asectoral, like a financial regulator, or a competition commission. And, hence, living without regulators may not be possible today. But, there is a caveat: the regulators should not be allowed to regulate too much, and also, courts must regulate the regulators.

Specialised Knowledge

The basic purpose of having a regulator is to have professionals or specialists, as contradistinguished with generalists, man the regulatory institution so that the decision-making is speedy, efficacious, and with extremely limited chances of being done by someone who doesn't know the subject. On the contrary, members of the regulatory body are expected to be experts in that particular domain to ensure proper decision-making. Above all, any regulator works as per the provisions of the act, and, in no case, is the part of either the Legislature, or the executive, or the judiciary. Thus, any regulatory body, as envisaged, is independent – particularly from the government, neutral, unbiased, knowledgeable, and fearless. Decisions made by such knowledgeable bodies are extremely difficult to be overruled by courts. Hence, it is essential for the regulators to manage and use the domain knowledge in such a manner that they are highly regarded.

7. CONCLUSION

The job of any regulator is to work in the public interest, however, at the same time it has to take care of the business interests of companies. It is, without any doubt, a tightrope walk. It is quite obvious that the scales cannot be tilted in favour of either the public at large, or the business groups, as doing so would be catastrophic in the long run for both. In case the conditions for businesses are tightened, with commensurate benefits to the

masses, to such an extent, it becomes financially unviable for most of the companies to continue doing business, it would result in a good number of companies shutting shop resulting in creation of a possible monopoly, or making it simply impossible to do business in such a scenario. That would lead to deprivation of any such services to the public, which, at no point of time could be the goal of a regulator. On the other hand, if the regulator is too lenient with the businesses, at the cost of public, it would result in the creation of unhealthy business practices, with incommensurate profits, complacency, and avoiding the adoption of any new technology as there would be hardly any incentive for the company to try to do better, thus depriving the public from the best, the latest, and also the cheapest.

It becomes incumbent on the courts to make the regulators strike a balance between public interest and business interest and work proactively. As public interest is paramount, particularly in a democracy like India and also the United States, the courts actively interpret the black-letter law in favour of public interest. Judges and regulators, as individuals, need to exercise discretion keeping in mind the larger interests of the society and that will ensure that they are on the same page.