Franklin Templeton Trustee Services ... vs Amruta Garg And Ors. Etc. Etc. on 14 July, 2021

Equivalent citations: AIR 2021 SUPREME COURT 3494, AIRONLINE 2021 SC 334

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Bench: Sanjiv Khanna, S. Abdul Nazeer

REPORTAB

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NOS. 498-501 OF 2021

FRANKLIN TEMPLETON TRUSTEE SERVICES
PRIVATE LIMITED AND ANOTHER ..... APPELLANT(

VERSUS

AMRUTA GARG AND OTHERS ETC. ..... RESPONDENT(S

WITH

CIVIL APPEAL NO. 502 OF 2021

CIVIL APPEAL NO. 503 OF 2021

CIVIL APPEAL NOS. 504-507 OF 2021

CIVIL APPEAL NO. 508 OF 2021

CIVIL APPEAL NO. 509 OF 2021

SPECIAL LEAVE PETITION (CIVIL) NO. 1486 OF 2021

AND

SPECIAL LEAVE PETITION (CIVIL) NO. _____ OF 2021)
(ARISING OUT OF DIARY NO. 1563 OF 2021)

ORDER

SANJIV KHANNA, J.

By the order dated 12th February 2021, interpreting Regulation 18(15)(c) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (hereafter referred to as 'Regulations') and accepting the poll results, we have directed winding up of six mutual fund schemes:

(i) Franklin India Low Duration Fund (Number of Segregated portfolios – 2),

(ii) Franklin India Ultra Short Bond Fund (Number of Segregated portfolios – 1),

(iii) Franklin India Short Term Income Plan (Number of Segregated portfolios – 3),

(iv) Franklin India Credit Risk Fund (Number of Segregated portfolios – 3),

(v) Franklin India Dynamic Accrual Fund (Number of Segregated portfolios – 3), and

(vi) Franklin India Income Opportunities Fund (Number of Segregated portfolios – 2).

2. We would now proceed to interpret Regulations 39 to 42 and their interrelation with Regulation 18(15)(c). We shall also examine and decide the challenge to the constitutional validity of Regulations 39 to 42. As elucidated in the course of hearings and reflected in the order dated 12th February 2021, it would be inopportune to decide and dispose of these appeals, as facts remain disputed and are sub- judice along with other substantive issues in the adjudication proceedings under the Securities and Exchange Board of India Act, 1992 (hereafter referred to as the 'SEBI Act'). The forensic report of the auditors, possibly the foundation of the show cause notice(s), is a subject matter of consideration before the statutory authorities that are bestowed with wide powers. It is not anyone's case that the statutory adjudication proceedings should be eschewed or nullified. At the same time, we are not inclined to dispose of these appeals as this would not be in the interest of the unitholders, who are hopeful, yet concerned and apprehensive. Final and conclusive adjudication, on contested factual and related issues, post the statutory adjudication would be in the interest of the parties. No prejudice should be caused. Directions to await the orders in the adjudication proceeding have been incorporated in the order dated 12th February 2021. We hope and trust that the proceedings under the SEBI Act would conclude expeditiously.

General overview of the Regulations

3. We shall begin with an overview of the Regulations as they would aid us in deciding the two issues; though, to avoid prolixity, we are not reproducing the Regulations. We would subsequently selectively quote the Regulations requiring interpretation.

4. The Regulations envisage a three-tier structure for mutual funds in the form of the sponsor, the board of trustees or the trustee company, and the asset management company (the AMC). The sponsor, as defined by Regulation 2(x), means a person who, acting alone or in combination with another body corporate, establishes a mutual fund. For this purpose, the sponsor is required to make an application to the Securities and Exchange Board of India (hereinafter referred to as the

'SEBI') in the prescribed form for registration of the mutual fund. Chapter II of the Regulations spells out the eligibility criteria and requirements for registration of a mutual fund.

5. The term 'trustees' has been defined in Regulation 2(y) to mean the board of trustees or the trustee company who hold the property of the mutual fund in trust for the benefit of the unitholders. The expression 'unit' has been defined in Regulation 2(z) to mean the interest of the unitholders in the scheme, which consists of each unit representing one undivided share in the assets of the scheme, and the term 'unitholder' has been defined in Regulation 2(z)(i) to mean a person holding a unit in the scheme of a mutual fund.

6. The AMC is a company, approved by SEBI under Regulation 21(2), which undertakes business activities in the nature of management and advisory services provided to the pooled assets. The services may be specified by SEBI from time to time. The AMC is forbidden by the Regulations from acting as a trustee of any mutual fund.

7. Chapter III relates to the constitution and management of mutual funds and operation of trustees etc. Regulation 14 stipulates that a mutual fund shall be constituted in the form of a trust and the instrument of the trust shall be in the form of a deed, registered under the provisions of the Indian Registration Act, 1908, executed by the sponsor in favour of the trustees. Regulation 15(1) requires that the trust deed shall incorporate such clauses as are mentioned in the Third Schedule of the Regulations, and such other clauses as are necessary for safeguarding the interests of the unitholders. Regulation 15(2) mandates that no trust deed shall contain a clause which has the effect of – (a) limiting or extinguishing the obligations and liabilities of the trust in relation to any mutual fund or the unitholders; or (b) indemnifying the trustees or the AMC for loss or damage caused to the unitholders by acts of negligence or acts of commission or omission on part of the trustees or the AMC. Regulation 16 itemises the criteria for disqualification from appointment as a trustee. In effect, it stipulates the eligibility requirements for appointment of the trustees. In particular, it states that two-thirds of the trustees shall be independent persons, not associated with the sponsors in any manner. Further, a person appointed as a trustee of a mutual fund is not eligible to be appointed as a trustee of another mutual fund. An AMC and its directors (including independent director), officers or employees are ineligible to be appointed as a trustee of any mutual fund. Regulation 17 requires prior approval of SEBI before a person is appointed as a trustee. In the case of existing trustees of any mutual fund, they may form a trustee company to act as a trustee, albeit with prior approval of SEBI. The trustees are bound by the Code of Conduct specified in the Fifth Schedule, as well as general and specific due diligence mandates.

8. Regulation 18 is critical as it elaborately enlists the rights and obligations of the trustees, in as many as 29 sub-regulations. The trustees and the AMC, as per Regulation 18(1), can enter into an investment management agreement with the prior approval of SEBI. Such an agreement must contain clauses mentioned in the Fourth Schedule and other clauses as are necessary for the purpose of making investments. The sub-regulations enumerate the requirements to be satisfied before a scheme is launched by the AMC. They obligate that the trustee shall ensure that the AMC has been diligent in empanelling the brokers, and in monitoring securities transactions with the brokers and in avoiding undue concentration of business with any broker. The trustees have to also

ensure and check that the AMC has not given any undue or unfair advantage to any associates or dealt with any of its associates in any manner detrimental to the interest of the unitholders and that the transactions entered into by the AMC are in accordance with the regulations and the scheme. The trustees are entitled to call for details of transactions in securities by the key personnel of the AMC in their own name or on behalf of the AMC and report the same to SEBI, as and when required. The sub-regulations require the trustees to carry out quarterly reviews of all transactions between the mutual funds, the AMC and its associates. The trustees are to also review the net worth of the AMC on a quarterly basis. In case of any shortfall in net worth, the trustees were to ensure that the AMC makes up for the shortfall in terms of Regulation 21(1)(f).1 The trustees are to furnish to SEBI, on a half-yearly basis, a report on the activities of the mutual fund with certificates that there have been no instances of self-dealing or front running by any of the trustees, directors or key personnel of the AMC, and that the AMC has been managing the schemes independently of any other activities, and in case any activities of the nature referred to in Regulation 24(b) have been undertaken by the AMC, that it has 1The position post the SEBI (Mutual Funds) (Amendment) Regulations, 2021 with effect from 5th Marcch 2021 has not been examined.

taken adequate steps to ensure that the interests of the unitholders are protected.2

9. Chapter IV of the Regulations relates to the constitution and management of the AMC and the custodian. The AMC is appointed by the sponsor, or by the trustee, if so authorised by the trust deed. However, the appointment needs approval by SEBI under Regulation 21(2). As per Regulation 20(2), the appointment of the AMC can be terminated by majority of the trustees or by 75% of the unitholders of the scheme. Regulation 20(3) states that any change in the appointment of the AMC is subject to the approval of SEBI and the unitholders. Regulation 21 enumerates the eligibility criteria for appointment as an AMC. The directors of the AMC should be persons having adequate professional experience in finance and financial services related fields and should not be found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws. The key personnel of the AMC should not have been found to be guilty of the above, nor should they have worked for any AMC/mutual fund/intermediary during the period when its registration was suspended or cancelled by SEBI. The board of directors of the AMC must have at least 50% of directors who are not associates, or associated in any manner with the sponsor or any 2 Legal effect of Regulation 24 has not been examined. of its subsidiaries or the trustee. The net worth of the AMC should not be less than Rs.50 crores. Regulation 24 specifies the restrictions on the business activities of the AMC. Regulation 25 specifies the obligations and the responsibilities of the AMC, which include taking reasonable steps and exercising due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of the regulations and the trust deed. The AMC is responsible for the acts of commission or omission by its employees, or persons whose services have been procured by the AMC. Sub-regulation (6) states that the AMC and its directors, notwithstanding any contract or agreement, shall not be absolved of the liability to the mutual fund for their acts of omission and commission, while holding such position or office.

10. There are a number of stipulations and restrictions to ensure objectivity, fidelity and transparency in business transactions by the AMC and compliance with the Regulations. A system of regulation involving checks, responsibility and power of free decision is envisaged. The Chief

Executive Officer, by whatever name called, is mandated by sub-regulation (6A)3 to Regulation 25 to ensure that the mutual fund complies with all the provisions of the Regulations, guidelines and circulars issued in relation thereto from time to time 3 SEBI (Mutual Funds) (Second Amendment) Regulations, 2020, w.e.f. 29.10.2020 and that the investments made by the fund managers are in the interest of the unitholders. This officer is responsible for the overall risk management function of the mutual fund. Sub-regulation (6B)4 to Regulation 25 states that the fund managers, whatever be the designation, shall ensure that the funds are invested to achieve the objectives of the scheme and in the interest of the unitholders.

11. Chapter V deals with schemes of mutual funds and Regulation 28(1) thereunder states that no scheme shall be launched by the AMC unless it is approved by the trustees and a copy of the offer document has been filed with SEBI. Regulations 32 and 33 pertain to the listing and repurchase respectively of units in close-ended schemes, while Regulation 35 deals with the allotment of units and refunds of moneys. In terms of Regulation 38, guaranteed return is not to be provided in a scheme, unless such returns are fully guaranteed by the sponsor or the AMC, and a statement to that effect is made in the offer document, indicating the name of the person who will guarantee the return and the manner in which the guarantee is to be met. Regulation 38A permits launching of a capital protection-oriented scheme subject to: (a) the units of the scheme being rated by a registered credit rating agency from the viewpoint of the ability of its portfolio structure to attain the 4 Ibid.

protection of the capital invested therein; (b) the scheme being close-ended; and (c) compliance with other requirements as may be specified by SEBI. Regulation 48 requires that every mutual fund shall compute the Net Asset Value of each scheme as specified and the same shall be calculated on daily basis and disclosed in the manner as stated by SEBI.

12. Regulation 49 is titled 'pricing of units' and states that the price at which the units may be subscribed / sold / repurchased by the mutual fund shall be made available to the investors in the manner specified by SEBI. The methodology for calculating the sale and repurchase price of the units is to be provided by the mutual fund in the manner specified by SEBI. Sub-regulation (3) states that in determining the price of the units, the mutual fund shall ensure that the repurchase price is not lower than 93% of the Net Asset Value and the sale price is not higher than 107% of the Net Asset Value. As per the second proviso to sub-regulation (3), difference between the repurchase price and the sale price of the unit shall not exceed 7% calculated on the sale price.5

13. Regulations 54 and 55 relate to the annual report and the auditor's report respectively. Regulation 56 requires providing a copy of the 5 Post amendment w.e.f. 5.3.2021 Regulation 49(3) states that the repurchase price of units of an open- ended scheme shall not be lower than 95 % of the NAV. There is no stipulation in the Regulations regarding the sale price.

annual report and the summary thereof to the unitholders.

Regulation 58 mandates periodic and continual disclosures by the AMC, the trustee, the sponsors, and the custodians, requiring them to make such disclosures and submit such documents as may be provided by SEBI and comply with sub-regulations (2) and (3). Regulation 59 deals with half-yearly

disclosures. Regulation 60 imposes a general obligation to disclose information and, being of some importance, is reproduced below:

> "Disclosures to the investors
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> 60. The trustee shall be bound to make such disclosures as are essential in order to keep them informed about any information which may have an adverse bearing on their investments." The trustees are mandated and bound to make such disclosures to the unitholders as are essential to keep them informed about any information that may have adverse bearing on their investments.
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> 14. Chapter VIII relates to and empowers SEBI to authorise and conduct inspection and audit. SEBI, under Regulation 61(1), may appoint one or more persons as the inspecting officers to undertake inspection of the books of accounts, records, documents, and infrastructure, systems, and procedures or to investigate the affairs of the mutual fund, the trustees, and the AMC for the purposes stipulated therein. Regulation 62 requires that SEBI shall issue not less than ten days' notice to the mutual fund, trustees, or AMC, as the case may be, before ordering an inspection or investigation.

However, under sub-regulation (2), notwithstanding sub-regulation (1), SEBI can direct such inspection or investigation without any notice when it is satisfied that in the interest of the investors no such notice should be given. Regulation 63 prescribes the duties and obligations of the mutual fund/ trustees/ AMC whose affairs are being inspected or investigated. The investigating officer can, during the course of the investigation, examine or record the statements of any director, officer, or employee of the mutual fund/ trustee/ AMC and every such mutual fund/ trustee/ AMC is duty-bound to give to the investigating officer all assistance in connection with the inspection or investigation. The inspecting officer is to submit, as soon as possible, a report to SEBI on completion of the investigation. Regulation 65 states that SEBI or the Chairman shall after consideration of inspection or investigation report take such action as SEBI or the Chairman may deem fit and appropriate under Chapter V of the Securities and Exchange Board (Intermediaries) Regulations, 2008.

Regulations 39 to 42 and 18(15) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

15. Regulations 39 to 42 read as under:

> "Winding Up
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> 39. (1) A close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled over for a further period under sub-regulation (4) of regulation 33.

(2) A scheme of a mutual fund may be wound up, after repaying the amount due to the unit holders, — "(a) on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or

(b) if seventy-five per cent of the unit holders of a scheme pass a resolution that the scheme be wound up; or

(c) if the Board so directs in the interest of the unitholders.

(3) Where a scheme is to be wound up under sub-

regulation (2), the trustees shall give notice disclosing the circumstances leading to the winding up of the scheme:

> "(a) to the Board; and
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> (b) in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed.

Effect of winding up

40. On and from the date of the publication of notice under clause (b) of sub-regulation (3) of regulation 39, the trustee or the asset management company as the case may be, shall— "(a) cease to carry on any business activities in respect of the scheme so wound up;

(b) cease to create or cancel units in the scheme;

(c) cease to issue or redeem units in the scheme.

Procedure and manner of winding up

41. (1) The trustee shall call a meeting of the unitholders to approve by simple majority of the unitholders present and voting at the meeting resolution for authorising the trustees or any other person to take steps for winding up of the scheme:

> Provided that a meeting of the unitholders shall not be necessary if the scheme is wound up at the end of maturity period of the scheme.
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> (2)(a) The trustee or the person authorised under sub-

regulation (1) shall dispose of the assets of the scheme concerned in the best interest of the unitholders of that scheme.

(b) The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unitholders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken. (3) On the completion of the winding up, the trustee shall forward to the Board and the unitholders a report on the winding up containing particulars such as circumstances leading to the winding up, the steps taken for disposal of assets of the fund before winding up, expenses of the fund for winding up, net assets available for distribution to the unit holders and a certificate from the auditors of the fund.

(4) Notwithstanding anything contained in this regulation, the provisions of these regulations in respect of disclosures of half-yearly reports and annual reports shall continue to be applicable until winding up is completed or the scheme ceases to exist.

Winding up of the scheme

42. After the receipt of the report under sub-regulation (3) of regulation 41, if the Board is satisfied that all measures for winding up of the scheme have been complied with, the scheme shall cease to exist."

16. Regulation 18(15)(c) reads as under:

> "Rights and obligations of the trustees.
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> 18.
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> xx xx xx (15) The trustees shall obtain the consent of the unitholders –
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> (a) whenever required to do so by the Board in the interest of the unitholders; or
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> (b) whenever required to do so on the requisition made by three-fourths of the unitholders of any scheme; or
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> (c) when the majority of the trustees decide to wind up or prematurely redeem the units." Interpretation of Regulations 39 to 42, their interplay and harmonious construction with Regulation 18(15) (c) of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

17. Regulation 39, as the heading states, relates to 'winding up' of a scheme of a mutual fund. Sub-regulation (1) to Regulation 39 applies to close-ended schemes and is accordingly not relevant as the six schemes in question are open-ended schemes.6

18. Sub-regulation (2) to Regulation 39 uses the expression 'a scheme of a mutual fund,' and accordingly applies to both open-ended and close-ended schemes.7 It is an undisputed position that

sub- regulation (2) to Regulation 39 applies to the six schemes. In terms of sub-regulation (2) to Regulation 39, a scheme of a mutual fund can be wound up: (a) on the happening of any event, which, in the opinion of the trustees, requires the scheme to be wound up; (b) if 75% of its unitholders8 pass a resolution for winding up of the scheme; or (c) SEBI directs winding up of the scheme in the interest of the unitholders. Under each clause the initiator is different, and the condition to be satisfied is stipulated. Clause (a) empowers the trustees, while clauses (b) and (c) empower the unitholders and SEBI respectively.

19. When a scheme "is to be wound up" under sub-regulation (2), the trustees are required by sub-regulation (3) of Regulation 39 to issue a public notice in two daily newspapers having all India circulation 6 Regulation 2(f) – "close-ended scheme" means any scheme of a mutual fund in which the period of maturity of the scheme is specified.

7 Regulation 2(s) – "open-ended scheme" means a scheme of a mutual fund which offers units for sale without specifying any duration for redemption. 8 2(z)(i) of SEBI (Mutual Fund) Regulation 1996, "unit holder" means a person holding unit in a scheme of mutual fund.

and in a vernacular paper having circulation where the mutual fund is located. The public notice should state the circumstances leading to winding up of the scheme. The trustees are also required to write to SEBI and disclose the circumstances leading to winding up of the scheme.

20. On and from the date of publication, the cease and freeze mandate of Regulation 40 triggers. Regulation 40, which is in the nature of statutory injunction, states that on and from the date of publication of notice under Regulation 39(3), the trustees and the AMC shall cease to (a) carry on any business in respect of the scheme to be wound up; (b) create or cancel units of the scheme; and (c) issue or redeem units of the scheme.

21. Regulation 41, as per the heading, relates to the procedure and manner of winding up. The trustees, in terms of sub-regulation (1) to Regulation 41, are required to call a meeting of the unitholders for authorising either the trustees or any other person to take steps for winding up of the scheme. Voting at the meeting is by simple majority of the unitholders present and voting. In this meeting the unitholders do not examine, affirm or reject the decision to wind up the scheme. The voting is restricted to selection of the person – either the trustee or a third person – who would take 'steps for winding up of the scheme'.

22. Regulation 41(2)(a), requires that the person or the trustee authorised under Regulation 41(1) must dispose of the assets of the scheme in the best interest of the unitholders. Clause (b) to sub-regulation (2) to Regulation 41, states that the sale proceeds shall be first utilised towards discharge of liabilities due and payable under the scheme. Secondly, appropriate provision is to be made for meeting the expenses connected with the winding up. The balance amount shall be paid to the unitholders in proportion to their respective interests in the scheme as on the date when the decision for winding up was taken. The clause differentiates between the creditors whose liability is due and payable, and the unitholders. Payment of the amount due and payable to the creditors is prioritised and takes precedent. Thereafter, appropriate provision is required to be made for

expenses connected with the winding up. The balance amount is payable to the unitholders.

23. In terms of Regulation 42(2), the unitholders are to be paid in proportion to their respective interest in the assets of the scheme. The interest of the unitholders in the assets of the scheme as mentioned in Regulation 42(2) is computed on the basis of the date when the decision for winding up of the scheme was taken. As per Regulation 41(3), on completion of winding up, the trustees have to forward to SEBI and to the unitholders a report on the winding up containing particulars such as circumstances leading to the winding up, the steps taken for disposal of the assets for winding up, expenses for winding up, net assets available for distribution to the unitholders and a certificate from the auditors. Sub-regulation (4), a non-obstante provision, states that the requirement in respect of disclosures in the form of half-yearly report and annual report shall continue until winding up is completed or the scheme ceases to exist. Regulation 42 states that after receipt of the report under Regulation 41(3), if SEBI is satisfied that all measures relating to winding up have been complied with, the scheme would cease to exist.

24. Regulation 42A stipulates that the units of the mutual funds scheme shall be delisted from the recognised stock exchange in accordance with the guidelines as may be specified by SEBI.

25. Regulation 18(15)(c), which relates to rights and obligations of the trustees, in simple words requires the trustees to take consent of the unitholders, when they, by majority, decide to wind up or prematurely redeem the units. Words “winding up” in Regulation 18(15)(c), ex-facie refers to the winding up of the open-ended scheme and the expression “prematurely redeem the units” refers to premature redemption of units under the close-ended scheme. Decision of the High Court and contentions of SEBI, the trustees and the AMC.

26. The judgment under challenge, interpreting Regulation 18(15)(c) and Regulation 39(2)(a) holds that the decision of the trustees to wind up a scheme under clause (a) to Regulation 39(2) must muster the consent of the majority of the unitholders as per Regulation 18(15)(c).

27. Contesting this finding and interpretation, the argument of SEBI, the trustees and the AMC is that Regulations 39 to 42 are a complete code dealing with winding up of a scheme of mutual funds. Initiators and conditions to be satisfied under clauses (a), (b), and (c) to Regulation 39(2) are different. It is argued that prior consent of the unitholders is not envisaged when the trustees, on the happening of any event in terms of clause (a), form an opinion that a scheme is required to be wound up, or when SEBI under clause (c) directs winding up of a scheme in the interest of the unitholders. Only when the unitholders want to windup a scheme, in terms of clause (b), a resolution by 75% of the unitholders is mandated. The need to obtain the consent of the unitholders vide Regulation 18(15)(c) refers to the procedure and the manner for winding up as mandated by Regulation 41(1). To put it differently, the unitholders do not come into the picture when the trustees and SEBI, under clauses (a) and (c) respectively of Regulation 39(2), decide to wind up a scheme. Their decision is final and binding on the unitholders. It is submitted:

> “a) Regulation 18(15)(c) requires Trustees to obtain consent of Unit holders “when the majority of the Trustees decide to wind up”. It is thus very clear that consent is

required when Trustees decide to wind up the scheme(s) and when read together with Regulation 41, makes it amply clear that the consent is for the purpose of Regulation 41 i.e. to authorize the Trustee or any other person to dispose of the asset of scheme(s), in the interest of the unit holders.

(b) The consent envisaged under Regulation 18(15)(c) is a general "rights and obligations" of the Trustees and that the said consent shall be read as approval required under Regulation 41(1).

(c) It is submitted that in the event consent under Regulation 18(15)(c) is interpreted to mean that prior consent of unitholders is required before a scheme is wound up pursuant to a decision taken by the Trustees, the provisions of Regulation 39(2)(b) to be rendered otiose as under the said Regulation, a scheme may be wound up at the instance of Unit holders (upon 75% of the Unit holders of a scheme passing a Resolution for winding up).

(d) Regulation 40 comes into effect "on and from the date of publication of notice" by Trustees under Regulation 39(3)(b) and not from the date of "consent of Unit holders", which makes it abundantly clear that consent of Unit holders is not contemplated qua decision of Trustees to wind up a scheme(s).

(e) Further, Regulation 40 (a) provides that on and from the date of publication of notice under 39(3)(b), the Trustees or Asset Management Company, as the case may be, shall cease to carry on any business activities in respect of the scheme so wound up. Therefore, when a decision by Trustee to wind up scheme is taken, in terms of 39(2)(a), the notice is issued and Regulation 40 comes into operation and the requirement of obtaining consent of Unit holders at this stage cannot arise.

(f) It is submitted that Regulation 41(1) casts an obligation on the Trustees to call a meeting of the unit holders to approve a resolution authorising the Trustees or any other person to take steps for winding up of the scheme. Regulation 18(15)(c) of the MF Regulations cannot be erroneously interpreted so as to conclude that before implementing Regulation 41, prior approval of the unit holders has to be taken." The submission accentuates, what is submitted would be the impractical and calamitous effect of reading Regulation 18(15)(c) into Regulations 39 to 42. Prior-consent from the unitholders if necessary even when the trustees 'decide to wind up' a scheme under Regulation 39(2)(a), would inevitably delay the publication of public notices as envisaged by Regulation 39(3). Therefore the cease and freeze legal effect of Regulation 40 would get postponed resulting in chaos and confusion, as business activities such as buying and redemption of units etc., would continue despite the trustees having taken the decision to wind up the scheme. In panic, most unitholders would rush for redemptions, which achingly would be the reason for winding up. The result would be fire-sale of sound assets in a hasty and disorganised manner at discounted valuations in adverse market conditions. The trustees who stand in a fiduciary capacity as domain experts, as mandated by clause (a) to Regulation 39(2), act for and in the interest of the unitholders. The unitholders, a large and disparate body of lay persons without domain expertise, have been erroneously conferred

the right to veto and overrule the decision of the domain experts. Given the grave consequences for the sponsor, trustees and AMC, a decision to wind up a scheme is taken after in-depth analysis with great care and caution. Thus, the findings of the High Court to the contrary should be reversed.

Interpretation of the term 'consent' in Regulation 18(15)(c) vide order dated 12th February, 2021

28. In our order dated 12th February 2021, we have interpreted Regulation 18(15)(c) and the word 'consent' therein in the following manner:

> "8. However, we begin by rejecting the argument raised by some of the objecting unitholders that consent would be binding only on those who have consented to winding up of the mutual fund schemes and cannot be imposed on others. The word 'consent', in the context of the clause, clearly refers to 'consent of the majority of the unitholders', and not consent given by individual unitholders who alone would be bound by their consent, that is, it excludes unitholders who are not agreeable. To accept the second or contra view, as pleaded by some of the objecting unitholders, would be to negate the very object and purpose of clause (c) to sub-regulation (15) of Regulation
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> 18. In fact, the submission, if accepted, will make the Mutual Fund schemes and the winding up provisions in the Mutual Fund Regulations unworkable as there would be two different classes of unitholders – one bound by the consent, and others who are not bound by consent.

Consequently, the scheme would not wind up. The intent behind the provision is to bind even those who do not consent.

9. Black's Law Dictionary (10th Edition) defines the word 'consent' as "a voluntary yielding to what another proposes or desires; agreement, approval, or permission regarding some act or purpose, esp. given voluntarily by a competent person; legally effective assent." The dictionary also defines 'general consent' to mean "adoption without objection, regardless of whether every voter affirmatively approves." Shackleton on the Law and Practice of Meetings, 14th Edn., while defining majority, and the binding effect of majority, has opined:

> "Definition 7-30. Majority is a term signifying the greater number. In legislative and deliberative assemblies, it is usual to decide questions by a majority of those present and voting. This is sometimes expressed as a "simple" majority, which means that a motion is carried by the mere fact that more votes are cast for than against, as distinct from a "special" majority where the size of the majority is critical.
>
> The principle has long been established that the will of a corporation or body can only be expressed by the whole or a majority of its members, and the act of a majority is regarded as the act of the whole.

> A majority vote binds the minority 7-31. Unless there is some provision to the contrary in the instrument by which a corporation is formed, the resolution of the majority, upon any question, is binding on the majority and the corporation, but the rules must be followed." The word/expression 'consent' in sub-regulation (15) to Regulation 18 refers to affirmative consent to winding up by 'the majority of the unitholders'. Conversely, consent is denied when 'majority of the unitholders' do not approve the proposal to wind up the scheme.

10. However, the question which still remains to be answered is whether 'consent' would mean majority of the unitholders who exercise their right in the poll, or majority of all the unitholders of the scheme. Connected with the question is the concern of quorum, which means the minimum number of members of the entire body of members required to be present to legally transact business.

11. Shackleton in the above quotation has referred to distinction between simple and special majority. More appropriate for our discussion is William Paul White's thesis 'History and Philosophy of the Quorum as a Device of Parliamentary Procedure' published in 1967, in which he elucidates:

> "Much of the controversy that has been historically associated with the quorum can be traced to the problem of simply determining just what is meant by a quorum. "From the very earliest times it has been recognised as a general rule that a majority of a group is necessary to act for the entire group." In the case of a public body, the power or authority which establishes the body may also determine what constitutes a quorum. Sturgis states that common parliamentary law fixes the quorum as a "majority of the members". The constitution of the United States sets the quorum requirement in the House of Representatives at a majority of the membership. But to state that a quorum is a majority of the membership opens the way to potential conflict; which is precisely what has happened on numerous occasions." After examining the various definitions of the term quorum, the author observes that the definitions by themselves give no key as to how to determine what is minimum number or what constitutes majority. The expression 'majority' can mean - (i) majority of total membership list;
>
> (ii) exclude or include delinquent members; (iii) members present and voting; or (iv) those present, voting and not voting. Different meanings, he observed, have added to the confusion around the concept of the quorum.

Albeit referring to the position in 1967, the author observed:

> "As we have emerged into the modern era, it is not surprising that by now the method, which has been legally agreed upon by the courts, to determine minimum and majority, is well established."

12. Clause (c) to sub-regulation (15) of Regulation 18 per se does not prescribe any quorum or specify the criterion for computing majority or ratio of unitholders required for valid consent for winding up. Clause (b) of Regulation 39(2), on the other hand, specifies that seventy-five per cent of the unitholders of a scheme can pass a resolution that the scheme be wound up. Similarly, Regulation 41(1) requires the trustees to call a meeting to approve, by simple majority of the unitholders present and voting, a resolution for authorising the trustees or any other person to take steps for winding up of the scheme. Section 48 of the Companies Act, 2013 states that where share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the shareholders of not less than three-fourths of the issued shares of that class. Sub-section (3) to Section 55 of the Companies Act, 2013 in case of failure to redeem or pay dividend refers to consent of holders of three-fourths in value of the preference shares. Section 103 of the Companies Act, 2013 prescribes minimum quorum for shareholder meetings.

13. In Shri Ishwar Chandra v. Shri Satyanarain Sinha and Others, this Court on the question of quorum has held:

> "If for one reason or the other one of them could not attend, that does not make the meeting of others illegal. In such circumstances, where there is no rule or regulation or any other provision for fixing the quorum, the presence of the majority of the members would constitute it a valid meeting and matters considered there at cannot be held to be invalid." This decision had also relied on the exposition on the subject of quorum in the Halsbury's Laws of England, Third Edition (Vol. IX, page 48, para 95), which reads:
>
> "95. Presence of quorum necessary. The acts of a corporation, other than a trading corporation, are those of the major part of the corporators, corporately assembled. In other words, in the absence of special custom or of special provision of the constitution, the major part must be present at the meeting, and of that major part there must be a majority in favour of the act or resolution contemplated. Where, therefore, a corporation consists of thirteen members, there ought to be at least seven present to form a valid meeting, and the act of the majority of these seven or greater number will bind the corporation. In considering whether the requisite number is present, only those members must be included who are competent to take part in the particular business before the meeting. The power of doing a corporate act may, however, be specially delegated to a particular number of members, in which case, in the absence of any other provision, the method of procedure applicable to the body at large will be applied to the select body.
>
> If a corporate act is to be done by a definite body along, or by definite body coupled with an indefinite body, a majority of the definite body must be present.
>
> Where a corporation is composed of several select bodies, the general rule is that a majority of each select body must be present at a corporate meeting; but this rule will

> not be applied in the absence of express direction in the constitution, if its application would lead to an absurdity or an impossibility. ...” (emphasis supplied)

14. The concept of ‘absurdity’ in the context of interpretation of statutes is construed to include any result which is unworkable, impracticable, illogical, futile or pointless, artificial, or productive of a disproportionate counter mischief. Logic referred to herein is not formal or syllogistic logic, but acceptance that enacted law would not set a standard which is palpably unjust, unfair, unreasonable or does not make any sense. When an interpretation is beset with practical difficulties, the courts have not shied from turning sides to accept an interpretation that offers a pragmatic solution that will serve the needs of society. Therefore, when there is choice between two interpretations, we would avoid a ‘construction’ which would reduce the legislation to futility, and should rather accept the ‘construction’ based on the view that draftsmen would legislate only for the purpose of bringing about an effective result. We must strive as far as possible to give meaningful life to enactment or rule and avoid cadaveric consequences.

15. We would neither hesitate in stating the obvious, that modern regulatory enactments bear heavily on commercial matters and, therefore, must be precisely and clearly legislated as to avoid inconvenience, friction and confusion, which may, in addition, have adverse economic consequences. The legislator in the present case must, therefore, reflect and take remedial steps to bring about clarity and certainty in the Mutual Fund Regulations.

16. Reading prescription of a quorum as majority of the unitholders or ‘consent’ as implying ‘consent by the majority of all unitholders’ in Regulation 18(15)(c) of the Mutual Fund Regulations will not only lead to an absurdity but also an impossibility given the fact that mutual funds have thousands or lakhs of unitholders. Many unitholders due to lack of expertise, commercial understanding, relatively small holding etc. may not like to participate. Consent of majority of all unitholders of the scheme with further prescription that ‘fifty percent of all unitholders’ shall constitute a quorum is clearly a practical impossibility and therefore would be a futile and foreclosed exercise.

17. Conscious of the problem of quorum and majority in indefinite electorate, 1st Edition of Halsbury’s Laws of England on the question of quorum and meetings, had referred to the following principles:

> “791. Where a corporation consists of a definite number of corporate electors, a majority of that number must be present in order to constitute a valid election. But where a corporation consists of an indefinite number of corporate electors, a majority only of those existing at the time of the election need be present.
>
> When an election is to be made by a definite body only, or the electoral assembly is to consist of a definite and an indefinite body, the majority of the definite body must, as a general rule, be present in order to render the election legal. It is not necessary that a majority of the indefinite body should be present so long as there is majority of the definite body. If a constituent part of a corporation refuses to be present at an election, it cannot be held, and an election by the remaining parts will be void. But

electors present at an election and abstaining from voting are deemed to acquiesce in the election made by those who vote." The aforesaid exposition, for the purpose of majority and quorum, draws distinction between an electorate consisting of definite number and an electorate composed of indefinite number. Justice Seshagiri Ayyar of the Madras High Court in his concurring judgment in Syed Hasan Raza Sahib Shamsul Ulama and two others v. Mir Hasan Ali Sahib and two others had drawn distinction between definite and indefinite numbers in the following manner:

"...In the first class of cases, the number of the select body is fixed. In the second class of cases, the number is subject to variation every year or at stated periods. For example, the number of electors of a Temple Committee or the number for a Municipality is liable to fluctuation. Residence for a particular period, or the attaining of age of minors can bring in new electors. Whereas in the case of a Select Committee, the number is fixed..." In the case of unitholders, the number is fluctuating and ever changing and, therefore, indefinite. Numbers of unitholders can increase, decrease and change with purchase or redemption. Therefore, in the context of clause

(c) of Regulation 18(15), we would not, in the absence of any express stipulation, prescribe a minimum quorum and read the requirement of 'consent by the majority of the unitholders' as consent by majority of all the unitholders. On the other hand, it would mean majority of unitholders who exercise their right and vote in support or to reject the proposal to wind up the mutual fund scheme. The unitholders who did not exercise their choice/option cannot be counted as either negative or positive votes as either denying or giving consent to the proposal for winding up.

18. Investment in share market, though beneficial and attractive, requires expertise in portfolio construction, stock selection and market timing. In view of attendant risks, diversification of portfolio is preferred but this consequentially requires a larger investment. Mutual funds managed by professional fund managers with advantages of pooling of funds and operational efficiency are the preferred mode of investment for ordinary and common persons. It would be wrong to expect that many amongst these unitholders would have definitive opinion required and necessary voting in a poll on winding up of a mutual fund scheme. Such unitholders, for varied reasons, like lack of understanding and expertise, small holding etc., would prefer to abstain, leaving it to others to decide. Such abstention or refusal to express opinion cannot be construed as either accepting or rejecting the proposals. Keeping in view the object and purpose of the Regulation with the language used therein, we would not accept a 'construction' which would lead to commercial chaos and deadlock. Therefore, silence on the part of absentee unitholders can neither be taken as an acceptance nor rejection of the proposal. Regulation 18(15)(c), upon application in ground reality, must not be interpreted in a manner to frustrate the very law and objective/purpose for which it was enacted. We would rather accept a reasonable and pragmatic 'construction' which furthers the legislative purpose and objective. The underlying thrust behind Regulation 18(15)(c) is to inform the unitholders of the reason and cause for the winding up of the scheme and to give them an opportunity to accept and give their consent or reject the proposal. It is not to frustrate and make

winding up an impossibility. Way back in 1943, Sutherland in Statutes and Statutory Construction, Volume 2, Third Edition at page no. 523, in Note 5109, had stated:

> "Where a statue has received a contemporaneous and practical interpretation and the statute as interpreted is re-enacted, the practical interpretation is accorded greater weight than it ordinarily receives, and is regarded presumptively the correct interpretation of the law. The rule is based upon the theory that the legislature is acquainted with the contemporaneous interpretation of a statue, especially, when made by an administrative body or executive officers charged with the duty of administering or enforcing the law, and therefore impliedly adopts the interpretation upon re-
>
> enactment." With some modifications, the principle can be applied in the present case. Practical interpretation should be accorded greater weight than it ordinarily receives, and can be regarded as presumptively correct interpretation as the draftsmen legislate to bring about a functional and working result.

19. We would not read into Regulation 18(15)(c) a need to have affirmative consent of majority of all or entire pool of unitholders. The words 'all' or 'entire' are not incorporated and found in the said Regulation. Thus, consent of the unitholders for the purpose of clause (c) to sub-regulation (15) of Regulation 18 would mean simple majority of the unitholders present and voting." The above interpretation resolves several grey areas and would underpin the construction of Regulations 39 to 42 and their interplay with Regulation 18(15)(c).

29. The quotation highlights that interpretation is sometimes a three-

stage process. At first, the words being interpreted should be understood according to their grammatical meaning in their literal and popular sense. In the second stage, we consider whether in the given context the plain meaning is obscure as the text gives rise to choice of more than one interpretation, or the propositional interpretation fails to achieve the manifest purpose of the legislation, reduces it to futility, is practically unworkable or even illogical. In such cases at the third stage, the court applying interpretative tools selects or blue-pencils an interpretation advancing the legislative intent without rewriting the provision. The legislative intent is gathered not by restricting it to the language of the provision, rather in the light of the object and purpose of the provision and the legislation. The courts do lean towards a pragmatic and purposive interpretation as there is an assumption that the draftsmen legislate to bring about a functional and working result.

Harmonious interpretation of Regulation 18(15)(c) with Regulations 39 to 42

30. Regulation 39(2) under clause (a) vests the power of winding up of a scheme with the trustees, and with the unitholders under clause (b) and with the SEBI under clause (c), but under Regulation 18(15)(c), the trustees are required to seek consent of the unit holders, when they by majority decide to wind up a scheme. Regulation 18(15)(c) mirrored by use of the word 'shall' is couched as a command. Further, the expression 'when the majority of the trustees decide to wind up' in

Regulation 18(15)(c) manifestly refers to clause (a) to Regulation 39(2) as this is the only Regulation which entitles the trustees to wind up the scheme. Regulation 18(15)(c), when it refers to trustees' decision to wind up, it implies the trustees' opinion to wind up the scheme. Rather than making the decision of the trustees otiose, as suggested by SEBI, the trustees and the AMC, Regulation 18(15)(c) itself would become otiose in case their interpretation is accepted. Principle of harmonious construction should be applied which, in the context of the Regulations in question, would mean that the opinion of the trustees would stand, but the consent of the unitholders is a pre-requisite for winding up.

31. We do not think that this interpretation in any way dilutes or renders clause (b) to Regulation 39(2) meaningless or redundant. This clause applies where the winding up process is initiated at the instance of the unitholders, i.e. upon 75% of unitholders of the scheme passing a resolution for winding up. Clause (b) does not in any manner reflect that clause (c) to Regulation 18(15) should not be read as it ordains in simple words.

32. Regulation 41, as explained above, refers to and relates to the procedure and manner of winding up which cannot be equated with the requirement of consent as postulated by Regulation 18(15)(c). Argument to the contrary, equating Regulation 18(15) (c) with Regulation 41(1) overlooks the difference in language, and the object and purpose behind the two regulations. Regulation 41(1) applies even in cases where 75% unitholders have passed the resolution for winding up of the scheme under Regulation 39(2)(b) or where SEBI directs the scheme to be wound up in the interest of the unitholders under Regulation 39(2)(c). On the other hand Regulation 18(15)(c) applies only when majority of the trustees form an opinion and decide to wind up or prematurely redeem the units in entirety, a situation covered by Regulation 39(2)(a). To ignore the mandate of Regulation 18(15)(c) would nullify the legislative intent by resorting to a rather disordered and knotted argument that Regulations 18(15)(c) and 41(1) are identical and serve the same purpose. Clause (c) to Regulation 18(15) does not duplicate sub-regulation (1) to Regulation 41.

33. Similarly, omission of clause (d) to Regulation 18(15) and insertion of 18(15A) with effect from 22nd May 2000 by SEBI (Mutual Funds) (Second Amendment) Regulations, 2000 is inconsequential. Prior to its omission, clause (d) to Regulation 18(15) read:

> "(d) when any change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme or affect the interest of the unitholders is proposed to be carried out unless the consent of not less than three- fourths of the unit holders is obtained: Provided that no such change shall be carried out unless three fourths of the unit holders have given their consent and the unit holders who do not give their consent are allowed to redeem their holdings in the scheme.
>
> Provided further that in case of an open ended scheme, the consent of the unitholders shall not be necessary if:

(i) the change in fundamental attribute is carried out after one year from the date of allotment of units.

(ii) the unitholders are informed about the proposed change in fundamental attribute by sending individual communication and an advertisement is given in English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is situated.

(iii) the unitholders are given an option to exit at the prevailing Net Asset Value without any exit load.

Explanation: For the purposes of this clause "fundamental attributes" means the investment objective and terms of a scheme."

By the same amendment9, sub-regulation (15A) has been inserted and reads:

"(15A) The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unitholders, shall be carried out, unless –

(i) a written communication about the proposed change Is sent to each unitholder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of region where the Head Office of the mutual fund is situated; and

(ii) the unitholders are given an option to exit at the prevailing Net Asset Value without any exit load." The distinction between Regulation 18(15A) and Regulation 18(15)(c) is evident. The words 'winding up or premature 9 SEBI (Mutual Funds) (Second Amendment) Regulations, 2000.

redemption of units' in Regulation 18(15)(c) refers to a situation covered by Regulation 39(2)(a), that is, when the scheme is being wound up pursuant to a decision of the trustees. On the other hand, Regulation 18(15A) does not apply when the scheme is being wound up, rather it applies when there is a proposal to change the fundamental attributes of the scheme, fee or expense or any other change that would modify the scheme and affect the interests of the unitholders. The effect should be not to wind up the scheme thereby bringing it to an end, but to continue with the scheme as modified. Therefore, for Regulation 18(15A) to apply, the scheme should not cease to exist.

34. In cases under clause (a) to Regulation 39(2) the unitholders have no right or option to exit or not exit the scheme and are paid in terms of Regulation 41. Regulation 18(15A) gives the option to the unitholders to exit at the prevailing 'Net Asset Value' without any exit load or continue with the altered/modified scheme. Under the omitted clause (d) to Regulation 18(15), consent of three-fourths of the unitholders for fundamental changes to the scheme was sometimes necessary.

This is not necessary under Regulation 18(15A). Omission of clause (d) to sub-regulation 18(15) and insertion of sub-regulation (15A) to Regulation 18, as observed above is inconsequential and not relevant to the present dispute. If anything, the draftsmen having retained clause (c) to 18(15), re-

enforces its link with clause (a) to Regulation 39(2). Accordingly, the need to obtain consent of the unitholders is mandated under clause

(c) to sub-regulation 15 to Regulation 18 when the trustees under clause (a) to Regulation 39(2) decide to wind up a scheme.

35. The argument that the unitholders are lay persons and not well-

versed with the market conditions is to be rejected in light of the order dated 12th February 2021. Relevant portion of this order, at the risk of repetition, is being reproduced below:

> "18. Investment in share market, though beneficial and attractive, requires expertise in portfolio construction, stock selection and market timing. In view of attendant risks, diversification of portfolio is preferred but this consequentially requires a larger investment. Mutual funds managed by professional fund managers with advantages of pooling of funds and operational efficiency are the preferred mode of investment for ordinary and common persons. It would be wrong to expect that many amongst these unitholders would have definitive opinion required and necessary voting in a poll on winding up of a mutual fund scheme. Such unitholders, for varied reasons, like lack of understanding and expertise, small holding etc., would prefer to abstain, leaving it to others to decide. Such abstention or refusal to express opinion cannot be construed as either accepting or rejecting the proposals. Keeping in view the object and purpose of the Regulation with the language used therein, we would not accept a 'construction' which would lead to commercial chaos and deadlock. Therefore, silence on the part of absentee unitholders can neither be taken as an acceptance nor rejection of the proposal.
>
> Regulation 18(15)(c), upon application in ground reality, must not be interpreted in a manner to frustrate the very law and objective/purpose for which it was enacted. We would rather accept a reasonable and pragmatic 'construction' which furthers the legislative purpose and objective. The underlying thrust behind Regulation 18(15)(c) is to inform the unitholders of the reason and cause for the winding up of the scheme and to give them an opportunity to accept and give their consent or reject the proposal. It is not to frustrate and make winding up an impossibility...." Investments by the unitholders constitute the corpus of the scheme. To deny the unitholders a say, when Regulation 18(15)(c) requires their consent, debilitates their role and right to participate. It is an in-contestable position that the unitholders exercise informed choice and discretion when they invest or redeem the units.

> Regulations envision the unitholders not as domain experts, albeit as discerning investors who are perceptive and prudent. The trustees are therefore commanded to inform and be transparent.
>
> Summary reports, periodic and continual statements, annual reports, audit reports, etc., mentioned in paragraph 11 above are intended to reveal the current status of the investments, future prospects, risks and factors that may have bearing on the returns to enable the unitholders to take deliberative decisions, be it purchase, redemption or exercise of the right to vote. The unitholders, when in doubt, as prudent investors may be advised to abstain, but they are not placid onlookers, impuissant and helpless when the trustees decide to wind up the scheme in which they have invested. The stature and rights of the unitholders can co-exist with the expertise of the trustees and should not be diluted because the trustees owe a fiduciary duty to them. Thus, the contention that the trustees being specialists and experts in the field, their decision should be treated as binding and fait accompli has to be rejected not only in view of the specific language of Regulation 18(15)(c), but to be in concinnity with the objective and purpose of the Regulations.

36. A hypothetical submission that the unitholders may reject a valid and well-considered opinion of the trustees for winding up, and therefore Regulation 18(15)(c) is directory, should be rejected. Assumptions cannot be a ground to wrongly interpret Regulation 18(15)(c). Situations could arise when the trustees may err in their opinion, in which event the unitholders may correct them. Money and investment of the unitholders being at stake, a wrong decision would obviously have inimical impact on the unitholders themselves. We would brace the argument that a good and intelligible decision of winding up would invariably be accepted by the unitholders.

37. 'Consent' for the purpose of Regulation 18(15)(c) refers to the consent of the majority of the unitholders present and voting, and in case of a poll, the computation would be with reference to the number of units held by the unitholder. In fact, in the course of hearing, it was conceded that majority of the unitholders belong to provident fund trusts or pension funds. The voting pattern referred to in our earlier order reflects that voting under Regulation 18(15)(c) is possible and can work smoothly without much difficulty. The apprehensions expressed, therefore, do not carry much weight. It is obvious that where the unitholders vote against winding up, consequences would follow and accordingly the scheme would not be wound up. This is a natural and normal consequence which will have to be given effect to. It would, as stated above, happen rarely and that too would not happen without any genuine and good reason.

38. SEBI is a Member of International Organisation of Securities Commissions (IOSCO). IOSCO in a consultation report published in August, 2016 on good practices for the termination of investment funds, states that the termination plan should identify rationale for terminating the investment fund. Key steps to be taken as part of the termination process should be identified. Clauses (28), (29) and (30) of the good practices under the heading 'Decision to terminate' read as follows:

"28. In the majority of cases, the decision to terminate is that of the responsible entity. However, in some jurisdictions national law or regulatory requirements will mandate that the decision of the responsible entity is approved by investors, or the custodian in some cases. The first step in preparing for the voluntary termination of an investment fund is to determine whether investor approval is required. This may depend on the legal structure of the investment fund and whether voting rights are attributed to shares / units.

29. Investment in an investment fund usually carries with it the right to vote on certain matters and the voting requirements for the approval of investors on, inter alia, liquidations and terminations are generally prescribed in the constitutional documents and the prospectus / offering document of the investment fund, or legal and regulatory regime of the national regulator, or both. The termination plan should set out the process for obtaining investor approval, where required.

30. Where investor approval is required and investors are asked to vote on the decision to terminate with the outcome achieving the minimum voting requirements for approval, the decision is binding on all, including those who do not vote. Where investor approval is required, the rights of investors should be clear from the termination plan. In particular, the termination plan should document how the interests of dissenting investors will be treated." Good practices, as recommended by IOSCO, commend the unitholders' right to vote/approve on matters of termination and liquidation.

39. On and from the date of publication of notices under Regulation 39(3), the cease and freeze effect of Regulation 40 applies. The words used in sub-regulation (3) to Regulation 39 are 'where a scheme is to be wound up in sub-regulation (2)', that is, a scheme is to be wound up in terms of clauses (a), (b) or (c) to Regulation 39(2). Sub-regulation (3) to Regulation 39 also mandates the trustees to disclose in the public notice the circumstances leading to winding up of the scheme. This obviously means that where the trustees form an opinion to wind up a scheme, they must disclose the reasons, and thereupon, the unitholders exercise their right to vote and give or deny consent. This is the true legal effect on harmonious reading of Regulation 18(15)(c) and Regulation 39(2)(a).

40. The language of clauses (a) and (c) to sub-regulation (2), and sub-

regulation (3) to Regulation 39 does not envisage involvement of the unitholders till the publication of notices in case of clauses (b) and

(c) to sub-regulation (2) to Regulation 39. Therefore, when clauses

(a) or (c) of Regulation 39(2) apply, the unitholders are to be informed about the winding up by the trustees or SEBI by way of public notice. Publication in terms of Regulation 39(3) is even required when the unitholders vote for winding up of a scheme under clause (b) of Regulation 39(2).

41. It is manifest that publication of notices under Regulation 39(3) should be instantaneous without any interstice between the decision of winding up by the trustees under clause (a), by the unitholders under clause (b) or by SEBI under clause (c). Delay would hold up the cease-and-freeze effect of Regulation 40 and consequently nullify the salutary purpose and object behind it.

42. In view of the above discussion and harmoniously interpreting Regulations 39 to 42, we hold that the consent of the unitholders, as envisaged under clause (c) to Regulation 18(15), is not required before publication of the notices under Regulation 39(3). Consent of the unitholders should be sought post publication of the notice and disclosure of the reasons for winding up under Regulation 39(3).

43. Read in this manner, we can interpret clause (c) to Regulation 18(15) and Regulations 39 to 42 without the disarray as suggested, while not displacing the legal effect of either Regulation 40 or Regulation 18(15)(c). This interpretation takes care of the apprehension expressed by SEBI, the trustees and AMC that delay or time gap between a decision of the trustees under clause (a) to sub-regulation (2) to Regulation 39 and publication of notice under sub-regulation (3) to Regulation 39 would postpone the cease-and- freeze effect of Regulation 40.

44. We have referred to Regulation 41(1) and that it requires calling of a meeting of the unitholders for authorising the trustees or any other person to take steps for winding up of the scheme. In case where the scheme is being wound up under Regulation 39(2)(a), it is possible to hold a meeting of the unitholders under the said provision where if the resolution for winding up is passed, the unitholders can also decide by simple majority of the unitholders present and voting whether the trustees or any other person should take steps for winding up of the said scheme. One meeting in many a cases would suffice.

45. To complete interpretation of Regulation 18(15), we have to record that clause (a) applies and requires the trustees to obtain consent of the unitholders whenever required by SEBI in the interest of the unitholders. Clause (b) states that the trustees would obtain consent of the unitholders whenever required to do so on the requisition made by three-fourths of the unitholders of any scheme. Accordingly, clause (a) would apply whenever SEBI mandates and clause (b) applies whenever three-fourths of the unitholders of the scheme make a requisition.

46. The impugned judgment, from paragraph 211 onwards, specifically refers to the responsibilities and duties of the trustees incorporated in the statement of additional information published by the mutual fund, which reads:

> “(b) The Trustees shall obtain consent of the unit holders of the Scheme(s):
>
> i) When the Trustee is required to do so by SEBI in the interests of the unit-holders; or
>
> ii) Upon the request of three-fourths of the unit holders of any Scheme(s) under the Mutual Fund; or

> iii) If a majority of the directors of the Trustee company decide to wind up the Scheme(s) or prematurely redeem the units." Clause (iii) of the aforesaid quotation dealing with responsibilities and duties of the trustees, requires the trustees to obtain consent of the unitholders of the scheme if the majority of the directors of the trustee company decide to wind up the scheme or prematurely redeem the units. The language of clause (iii) of the aforesaid quotation is identical to clause (c) of sub-regulation (15) to Regulation 18. The High Court was, therefore, right in observing that the trustees and the AMC have understood and accepted that the consent of unitholders of the scheme would be necessary if the majority of the directors of the trustee company decide to wind up a scheme.

47. The impugned judgment, in paragraph 221, observes that no material was placed on record to show compliance with sub- regulation (3) to Regulation 39. The trustees and AMC have disputed the said position by relying upon notice dated 23rd April 2020 enclosed at page 1262 and the newspaper publications in both English and vernacular languages made on 24th April 2020 enclosed at pages 3304-3313. In view of the aforesaid factual position, which was not seriously disputed by most of the unitholders, we would accept that there was compliance with clause (b) of sub-regulation (3) to Regulation 39 and accordingly the cease and freeze effect of Regulation 40 had become effective.

48. Our attention was drawn to the Circular dated 31st May 2016 issued by SEBI as per which the trustees have the option to suspend redemption of units for a period of 10 days in a period of 90 days. The relevant portion of the said circular reads as under:

> "b. Restriction on redemption may be imposed for a specified period of time not exceeding 10 working days in any 90 days period" SEBI has taken the stand that the benefit of this circular should not be taken when the question of winding up is pending consideration before the trustees. The position not being ironclad, SEBI may re-
>
> examine whether the trustees/AMC can be permitted to take similar benefit pending the decision on the question of winding up, when they face frightful redemption pressure.
>
> Challenge to the constitutional validity of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996

49. This challenge has been raised by one of the appellants, namely, Amruta Garg. The contentions forwarded can be summarised as under:

> (a) The expression 'happening of any event' in Regulation 39(2)(a) is unspecified and suffers from the vice of excessive delegation as it does not give any indication of the type of events which would be relevant for winding up of the scheme. It gives unbridled power to the trustees to wind up a scheme which, in the opinion of the trustees, should be wound up.

(b) In comparison, vide clause (c) to Regulation 39(2), SEBI has been invested with the power to issue directions for winding up a mutual fund scheme only when it is in the interest of the unitholders.

(c) Further, SEBI has not prescribed/issued guidelines or policy regarding formation of opinion by the trustees to wind up the scheme.

(d) The opinion of the trustees is given paramountcy and is supreme. Even SEBI accepts that it has no role and cannot examine and set aside the decision of the trustees. Thus, SEBI, as per its own contention and submission, being bound by the opinion of the trustees, cannot interfere even when it is necessary to do so in the interest of unitholders or when the trustees have acted in their own vested interest. This is contrary to the scheme of the SEBI Act whereunder SEBI has been constituted primarily to act as a watchdog and to protect interests of the investors in the capital market, including the unitholders.

(e) There is no provision for appeal or internal challenge against the decision of the trustees who may in a given case form a wrong opinion regarding winding up of the scheme.

(f) For the above reasons, clause (a) to Regulation 39(2) suffers from manifest arbitrariness in the absence of any prescription regulating the exercise of the power by the trustees. Reliance is placed upon State of Tamil Nadu and Another v. T. Krishnamurthy and Others;10 Shayara Bano v. Union of India and Others;11 Senior Superintendent of Post Offices, Allahabad and Others v. Izhar Hussain;12 Director General, Central Reserve Police Force and Others v. Janardan Singh and Others.13 10 (2006) 4 SCC 517 11 (2017) 9 SCC 1 12 (1989) 4 SCC 318 13 (2018) 7 SCC 656

(g) Regulation 39(3) equally suffers from the vice of manifest arbitrariness as SEBI merely acts as a drop-box. Though the trustees are required to give notice disclosing circumstances leading to winding up of the scheme to SEBI, this requirement is meaningless and superficial as SEBI cannot go into the question and circumstances to be satisfied as to existence of an event warranting the extreme action of winding up.

(h) Regulation 41(2)(b) is manifestly arbitrary as it states that the sale proceeds under clause (a) shall be first discharged for such liabilities as are due and payable under the scheme and only the balance amount shall be paid to the unitholders in proportion to their respective interests in the assets of the scheme as on the date of the decision for winding up was taken. Regulation 41 does not prescribe any mechanism or manner in which the authorised person or the AMC can ascertain the liabilities which are due and payable under the scheme. Secondly, the unitholders have been placed below the creditors of the scheme and would therefore receive only the leftover. This undermines the paramount place and position of the unitholders. Further, the SEBI has failed to protect the interest of the unitholders who are not only financial creditors but, as explicitly provided in

Regulation 18(12), their money is held in the mutual fund in trust and for their benefit. Reliance is placed upon Pioneer Urban Land and Infrastructure Limited and Another v. Union of India and Others14 where the home buyers have been held to be financial creditors under the Indian Bankruptcy Code. Principle of pari passu should be made applicable.

(i) Regulation 42 is also manifestly arbitrary as SEBI is to perform only ministerial functions, much less than the functions of a regulator. Conspicuously, during the winding up process, SEBI has been given a minimalistic role which is contrary to the paramount object of the Act.

50. We would begin by referring to the provisions of the SEBI Act and by elucidating the powers of SEBI. Section 11 of the SEBI Act prescribes the functions of SEBI. Sub-section (1), in general terms, states that it will be the duty of SEBI to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market. SEBI is empowered to take measures in this regard as it thinks fit. Sub-section (2), without prejudice to the generality of sub-section (1), lists out as many as 17 specific clauses and states that SEBI is entitled to provide for measures relating to those clauses. Thereunder, Clause (e) relates 14 (2019) 8 SCC 416 to prohibiting fraudulent and unfair trade practices relating to securities markets. Clause (g) concerns prohibition of insider trading in securities. Clauses (b), (i), (ia), (ib) and (la) relate to registering and working of the trustees or trust deeds, investment advisors and such other intermediaries who may be associated with the securities market in any manner and permits SEBI to call for information from, undertaking inspection, conducting inquiries and audits of mutual funds and other persons associated with the securities market, intermediaries and self-regulatory organisations. They can also ask for records from any persons, including any bank, any other authority or board or corporation established or constituted by or under a central or state Act relevant for investigation or inquiry by SEBI. It is also authorised to call for and require any agency to furnish information as may be considered necessary by SEBI for discharge of its functions. Clause (m) is a residuary clause which states that SEBI can perform such other functions as may be prescribed. Sub-section (2A) to Section 11 is a non-obstante provision which authorises SEBI to take measures to undertake inspection of any book or register or other document or record of any listed public company or a public company, etc. which intends to get its securities listed on a recognised stock exchange. Sub-section (3), again, is a non-obstante provision and states that SEBI shall exercise the same powers as are vested in a civil court under the Code of Civil Procedure while trying a suit in respect of discovery and production of books of account and other documents, summoning and enforcing attendance of persons and examining them on oath, inspection of any books, registers and documents of any person referred to in Section 12, inspection of any book, or register, or document, or record of a company, and issuing commissions for examination of witnesses or documents. Sub-section (4) states that without prejudice to the provisions contained in sub-section (1), (2), (2A) and (3) and Section 11B, SEBI may, by an order in writing in the interest of the investors or securities market, take the measures stipulated thereunder either pending investigation or inquiry or upon completion of investigation or inquiry. These include suspension of trading of any security; restraining any person from accessing security markets; attaching, for a period not exceeding 90 days subject to conditions and for a further period beyond 90 days subject to confirmation by the special court, bank accounts and other properties of any intermediary or any person associated with the securities market in any manner involved in violation of the provisions of the SEBI Act, or Rules

or Regulations made thereunder; direct any intermediary associated with securities market in any manner not to dispose of or alienate any asset forming part of any transaction under investigation subject to the condition that before or after passing such orders an opportunity of hearing shall be given to such intermediaries or persons concerned. Sub-section (4A) authorises SEBI to conduct an inquiry in the prescribed manner notwithstanding the provisions of sub-sections (1), (2), (2A), (3) and (4), Section 11B and Section 15-I by an order and for reasons to be recorded in writing levy penalty under Sections 15A, 15B, etc. Under sub-section (5), the amount disgorged pursuant to the directions issued under Section 11B of the Act or 12A of the Securities Contracts (Regulation) Act, 1956 etc. is to be credited to the Investor Protection and Education Fund established by SEBI and to be utilised in accordance with the regulations framed under the Act.

51. Section 11B of the Act reads as under:

> "Power to issue directions and levy penalty.– (1) Save as otherwise provided in section 11, if after making or causing to be made an enquiry, the Board is satisfied that it is necessary–
>
> (i) In the interest of investors, or orderly development of securities market; or
>
> (ii) to prevent the affairs of any intermediary or other persons referred to in section 12 being conducted in a manner detrimental to the interests of investors or securities market; or
>
> (iii) to secure the proper management of any such intermediary or person, it may issue such directions, –
>
> (a) to any person or class of persons referred to in section 12, or associated with the securities market;

or

(b) to any company in respect of matters specified in section 11 A, as may be appropriate in the interests of investors in securities and the securities market.

(2) Without prejudice to the provisions contained in sub-section (1), subsection (4A) of section 11 and section 15-I, the Board may, by an order, for reasons to be recorded in writing, levy penalty under sections 15A, 15B, 15C, 15D, 15E, 15EA, 15F, 15G, 15H, 15HA and 15HB after holding an inquiry in the prescribed manner. Explanation.– For the removal of doubts, it is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention."

52. As the heading of Section 11B states, the provision empowers SEBI to issue directions and levy penalty. It stipulates that such powers can be exercised if and after making or causing any inquiry SEBI is satisfied that it is necessary – (i) in the interest of the investors or orderly development of the securities market, (ii) to prevent affairs of any intermediary or other persons referred to in Section 12 being conducted in a manner detrimental to the interest of the investors or securities market; or (iii) to secure proper management of such intermediary or person. SEBI may issue directions to – (a) any person or class of persons referred to in Section 12 or associated with the securities market, or (b) to a company in respect of the matters specified in Section 11A as may be appropriate, in the interest of the investors in securities and in the securities market. The explanation to the Section is important for it clarifies, by way of removal of doubt, that the directions under this Section shall include and shall always deem to include power to direct any person, who has made profit or averted loss by indulging in any transaction or activity in contravention of the provisions of the Act, or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention. The provisions of Section 11B have been held to be procedural in nature and include not only an individual but also a company. Therefore, any person associated with the securities market who commits breach of the SEBI Act, Rules and Regulations, can be subjected to such directions and measures as may be imposed and issued by SEBI. Sub-section (2) to Section 11B states that SEBI may after holding an inquiry pass an order in writing, and, without prejudice to the provisions of Section (11), levy penalty under Sections 15A, 15B, etc.

53. Referring to the provisions, the Division Bench of the High Court in the impugned judgement has held as under:

> "291. Another question is about the powers of SEBI under Section 11B of the SEBI Act. We have already held that the power to issue directions under Section 11B(1) can be exercised to issue directions to AMC and the Trustees. The said direction can be issued when SEBI, after making or causing to be made an enquiry, is satisfied that (a) it is necessary to issue directions in the interest of investors or orderly development of securities market; (b) to prevent the affairs of any intermediary or other persons referred to in Section 12 being conducted in a manner detrimental to the interests of investors of securities market; or (c) to secure the proper management of any such intermediary or person. The first question is whether SEBI has power to interfere with the decision taken by the Trustees under Regulation 39(2)(a). If SEBI is to test the correctness or validity of such decision of the Trustees, an adjudication is required. The Trustees and AMG will have to be heard in the adjudication process. Section 11B does not contemplate any such adjudication. If an entity to whom a direction under Section 11B has been issued commits any breach thereof or disobeys the same, it will attract penalty under Section 15HB. Before imposing penalty, adjudication as contemplated by Section 15-I is required to be made. There is no provision made in SEBI Act for issuing a notice of the proposed direction under Section 11B and hearing the Trustees or AMC before issuing the direction. No adjudication is contemplated before issuing the directions. Therefore, it is not possible for this Court to accept the contention of the petitioners, AMC as well as the

> Trustees that by exercising power under Section 11B, SEBI has power to adjudicate upon the correctness of the decision taken by the Trustees to wind up a Scheme. However, when SEBI finds that the Trustees or AMC are not abiding by the specific provisions of the Mutual Funds Regulations, the power to issue directions can be exercised by SEBI. By way of illustration, we refer to hypothetical cases. After invoking the provisions of Regulation 39(2)(a), if the Trustees stop redemption the units by taking recourse to Regulation 40 without complying with the mandatory requirements of sub- clause (a) and (b) of clause (3) of Regulation 39, SEBI can always issue a direction under Section 11B not to stop redemptions, unless compliance is made with clause (3) of Regulation 39. If it is found that the Trustees continue to carry on business activities of the Schemes even after action under clause (3) of Regulation 39 is taken, a direction under Section 11-B can be issued by SEBI to stop all business activities."

54. We have reservations on the said observations for the simple reason that if there is a violation of the regulations, i.e. clause (a) to Regulation 39(2), 39(3), 40, 41 or 42 by the trustees or the AMC, it is open to SEBI to proceed in accordance with law and in terms of Section 11 and 11B of the Act. It would be, therefore, incorrect to state that the decision of the trustees under clause (a) to Regulation 39(2) cannot be made subject matter of inquiry or investigation and therefore no directions or orders under Section 11 or 11B of the Act can be passed. No doubt, clause (a) to Regulation 39(2) gives primacy to the opinion of the trustees and does not require prior approval of SEBI, yet SEBI is entitled to conduct an inquiry and investigation when justified and necessary to ascertain whether the trustees have acted in accordance with their fiduciary duty and also for reasons which would fall within the four corners of clause (a) to Regulation 39(2). If the trustees have acted for extraneous and irrelevant reasons and considerations, the action would be in violation of clause (a) to Regulation 39(2) and therefore amenable to action under the SEBI Act, including directions under Section 11B.

55. The view we have taken is in consonance with the earlier decision of the Gujarat High Court in Alka Synthetics and Trading v. SEBI,15 wherein it was observed that power under Section 11B is in the nature of issuing a command to persons referred to in the provision to do a certain act or to forbear from doing a certain act, if as a result of an enquiry, SEBI is satisfied about the necessity of issuing such direction for the purposes mentioned in clauses (a), (b) and (c). The Gujarat High Court, in our opinion, rightly observed that while Section 11 operates in the field of laying down general regulatory measures as a matter of policy, Section 11B operates in the field of prescribing a specified code of conduct in relation to specified persons or classes of persons. On the issue of application of principles of natural justice, it was noted that Section 11B empowers SEBI to issue directions only after it is satisfied about the conditions referred to in the provision, as a result of making or causing to be 15 (1999) 95 Comp Cas 663 made an enquiry – which necessarily implies a pre-decisional hearing. Similar view was subsequently expressed in Nikhil T. Parikh v. Union of India16, wherein the same High Court was of the view that Section 11B, being an enabling provision, must be so construed as to subserve the purpose for which it has been enacted. As the term 'measure' is not defined in the SEBI Act, the High Court gave it a meaning prescribed in general parlance, as incorporating anything desired or done with a view to the accomplishment of a purpose,

a plan or course of action intended to obtain some object, any course of action proposed or adopted by a Government. The Securities Appellate Tribunal in Sterlite Industries (India) Ltd. v. SEBI,17 has given an expansive interpretation to Section 11 and Section 11B of the SEBI Act, observing that they give enormous authority to SEBI. As long as the power exercised under Section 11B is subject to the provisions of the SEBI Act and well within the legal and constitutional frame work, intended to achieve the purposes of the SEBI Act and subjecting the persons specified in the section, the power will sustain. The Appellate Tribunal called it a wholesome provision designed to achieve the objectives of the SEBI Act.

16 (2014) 2 GLH 582 17 2001 SCC OnLine SAT 28.

56. The Trustees and the AMC in their written submissions filed before the High Court interpreting the SEBI Act and the Regulations had conceded that SEBI has extensive powers with respect to the regulation of mutual funds including the trustee's decision to wind up a scheme of the mutual fund. Section 11(1) of the SEBI Act states that it is the duty of SEBI to protect the interest of investors in securities and to promote the development of, and to regulate the securities market, by "such measures as it thinks fit". Under Section 11B of the SEBI Act, SEBI has broad powers to issue appropriate directions if it is satisfied after inquiry that such directions are necessary in the interest of investors or for orderly development of securities market or to prevent the affairs of any intermediary being conducted in a manner detrimental to the interest of investors or the securities market or to secure proper management of any intermediary or other person. The power of SEBI extends to regulating and monitoring the functioning and decisions taken by mutual funds, the trustees and the AMC. SEBI has the power to pass any direction if it deems fit in the interest of unitholders. The trustees and the AMC have specifically stated:

> "It is evident form the aforesaid provisions that the SEBI has extensive powers to regulate, supervise, issue directions with respect to and inspect and investigate into the affairs of a mutual fund, including with respect to the decision of the trustee to wind up a mutual fund scheme under Regulation 39(2)(a) of the Mutual Funds Regulations, including to even stop the winding up of a mutual fund scheme, if deemed necessary. The existence of such powers of the SEBI is further reinforced by Section 11D of the SEBI Act, which empowers the SEBI to pass an order requiring any person who, 'has violated, or is likely to violate, any provisions of this Act, or any rules or regulations made thereunder" to 'cease and desist' from committing such violation. It is submitted that whether SEBI would choose to exercise this power is a matter, which may be determined by SEBI in its wisdom and there may be numerous reasons why SEBI may not wish to interfere in a winding up decision by a trustee under Regulation 39(2)(a) including the reasons submitted by SEBI in its affidavit such as the fact that reversal of a decision to wind up a mutual fund scheme would likely cause a run on the scheme as well as severe market contagion (Reference is made to Paras 18,19 at Pg. 6 and 7 of the Delhi Reply; Paras 34 and 35 at Pg. 11 and 12 of the Gujrat Reply; and Paras 11 and 12 at Pgs. 5 and 6 of the Madras Reply); however, on a reading of the scheme of the SEBI Act and regulations as a whole, it is submitted that it is clear that such a power does exist."

57. However, we agree with the High Court that the Regulations have been framed in exercise of power conferred by Section 30 of the SEBI Act which authorises them to make regulations consistent with the provisions of the SEBI Act to carry out the purpose of the SEBI Act. The very object of the SEBI Act is to preserve confidence of the investors and to regulate the capital market, including mutual funds. In the first portion of this order, we have elaborately referred to the Regulations which thereby create a three-tier system of the sponsor, the AMC and the trustees. There are stipulations regulating the activities of the trustees and the AMC whose powers, obligations and rights have been expressly laid down. The power to regulate mutual funds, once accepted, would include the power to make regulations for winding up of a scheme of the mutual fund. Not framing any regulation in this regard would have amounted to dereliction of duty on the part of SEBI and subjected it to adverse comments.

58. It cannot be accepted that the trustees under clause (a) to Regulation 39(2) have been given absolute and unbridled power to wind up a scheme. Language of clause (a) to Regulation 39(2) states that the trustees must form an opinion on the happening of any event which requires the scheme to be wound up. Further, as per Regulation 39(3), the trustees are bound to give notice disclosing the circumstances leading to the winding up of the scheme. These notices along with the reasons have to be communicated to SEBI and made known to the unitholders by publication in two daily newspapers having circulation all over India and a vernacular newspaper having circulation at the place where the mutual fund is formed. The trustees are, therefore, required to come to a conclusion that due to specific circumstances articulated in writing, the scheme is required to be wound up. Two-thirds of the trustees are independent persons who are not associated with the sponsor,18 and no director, officer or employee of the AMC can be appointed as a trustee.19 The trustees hold the assets of the scheme in fiduciary capacity on behalf of the investors. They are experts in the field and, therefore, conferred the power under Regulation 39(2)(a) to decide whether or not a scheme should be wound up. The words used in the statute including delegated legislation are to be understood in the light of that particular statute and not in isolation. A duly enacted law cannot be struck down on the mere ground of vagueness unless such vagueness transcends into the realm of arbitrariness (See Nisha Priya Bhatia v. Union of India and Another20). In the context of the present case, the expression 'occurrence of any event' is not to be read in isolation but with the words 'requires the scheme to be wound up'. The expression 'any event' is therefore qualified with the said requirement. Read in this manner, there is no vagueness which can be described as transcending into realm of arbitrariness, on the other hand, the pre- requisite statutory mandate is clear. This is not a case of excessive delegation wherein the legislative function has been abdicated and passed on to the trustees who can act as per their whims and fancies. The essential legislative function is the determination of legislative policy and its formulation as a rule of conduct. In 18 Regulation 16(5) 19 Regulation 16(3) 20 (2020) 13 SCC 56 commercial matters varied and different situations can arise which may warrant winding up. Complexities in matters of business and commerce can be bafflingly intricate and riddled with urgencies and difficulties. Therefore, there is need for flexibility. Otherwise, the trustees would be compelled to first take the approval of SEBI, which may have its own consequences.

59. The Statement of Additional Information dated 30th June, 2019 issued by Franklin Templeton Mutual Fund, under Heading VI – 'Duration of the Scheme and Winding Up', provides a general

indication as to when a scheme can be wound up under the Regulations, the relevant portion of which is extracted below:

> "VI. DURATION OF THE SCHEME AND WINDING UP xx xx xx However, in terms of the SEBI Regulations, the Scheme may be wound up if:
>
> i. There are changes in the capital markets, fiscal laws or legal system, or any event or series of events occurs, which, in the opinion of the Trustee, requires the Scheme to be wound up; or xx xx xx "

60. We have agreed with the High Court that the opinion of the trustees under clause (a) to Regulation 39(2), therefore, must be consented to by the unitholders in terms of the mandate of Regulation 18(15)(c). In view of this interpretation, the argument challenging constitutional validity of the Regulations on the ground that they give unbridled and absolute power to the trustees loses much of its sting and force. There are, therefore, sufficient guidance and safeguards in the Regulations itself on the power of the trustees to decide on winding up of the fund.

61. The Regulations, in our opinion, rightly draw the distinction between creditors and the unitholders. The unit holders are investors who take the risk and, therefore, entitled to profits and gains. Having taken the calculated risk, they must also bear the losses, if any. Unitholders are not entitled to fixed return or even protection of the principal amount (See Regulations 38 and 38A).21 Creditors, on the other hand, are entitled to fixed return as per mutually agreed contracts. Their rate of return is in the nature of interest and not profit or loss. Creditors are not risk takers as is the case with the unitholders. In this sense, unitholders are somewhat at par with the 21 Guaranteed Returns

38. No guaranteed return shall be provided in a scheme, -

(a) unless such returns are fully guaranteed by the sponsor or the asset management company;

(b) unless a statement indicating the name of the person who will guarantee the return, is made in the offer document;

(c) the manner in which the guarantee is to be met has been stated in the offer document. Capital Protection oriented schemes 38A. A capital protection oriented scheme may be launched, subject to the following:

> (a) the units of the scheme are rated by a registered credit rating agency from the viewpoint of the ability of its portfolio structure to attain protection of the capital invested therein;
>
> (b) the scheme is close ended; and
>
> (c) there is compliance with such other requirements as may be specified by the Board in this behalf.

shareholders of a company. The waterfall mechanism under the Companies Act, or the Indian Bankruptcy Code, gives primacy to the dues of the creditors over the shareholders. Identical is the position of the unitholders. In fact, the argument that the unitholders should be treated pari passu with the creditors is farfetched. Similarly, the contention that unitholders are identically placed as home buyers under the Indian Bankruptcy Code is equally frail and a weak argument. Home buyers pay money to the builder and enter into a contract for purchase of immovable property. Home buyers are not risk or partakers in gains or losses like investors in a mutual fund. Home buyers under the Bankruptcy Code are treated as creditors till the ownership rights in the immovable property are transferred to them, but they do not take the risks and are not entitled to benefit of profits or suffer losses, as are taken by the unitholders who invest in the mutual funds without any guarantee of returns and know that the investment, including the principal, are subject to market risks. To equate the unitholders with either the creditors or the home buyers will be unsound and incongruous.

62. The expression 'due and payable' with reference to the liabilities is significant. The words 'due and payable' have to be interpreted with reference to the context in which the words appear.22 In the context in question they refer to the present liabilities which may be in praesenti or in futuro. There must be an existing obligation though the appointed date of payment may not have arrived. 'Payable', in this context, means capable of being paid, suitable to be paid and legally enforceable. It would exclude labilities that are time barred or those not payable in facts or in law.23 In case of any dispute a summary but thorough inquiry may be made to ascertain whether the liability is due and payable.24 Obviously, the liabilities which are not due and payable would not get preferential treatment, thereby reducing the amounts payable to the unitholders.

63. Since the Regulations are in the nature of economic regulations, while exercising the power of judicial review, we would exercise restraint unless clear grounds justify interference. We would not supplant our views for that of the experts as this can put the marketplace into serious jeopardy and cause unintended complications. Policy decisions can only be faulted on the grounds of mala fides, unreasonableness, arbitrariness and unfairness, in addition to violation of fundamental rights or exercise of power beyond the legal limits. The principle of manifest arbitrariness 22 B.K. Educational Services Private Limited v. Parag Gupta and Associates, (2019) 11 SCC 633. 23 Union of India v. Raman Iron Foundry, (1974) 2 SCC 231 24 Regulations do not bar civil remedy.

requires something to be done in exercise in the form of delegated legislation which is capricious, irrational or without adequate determining principle. Delegated legislations that are forbiddingly excessive or disproportionate can also be manifestly arbitrary. In view of the interpretation placed by us and the discussion above, the Regulations under challenge do not suffer from the vice of manifest arbitrariness.

64. However, we must now refer to a grey area, which we would, at this stage, not like to decide till we have full facts and decision in the adjudication proceedings. The issue relates to interpretation of Regulation 53, which reads:

> "53. Every mutual fund and asset management company shall,

> (a) despatch to the unitholders the dividend warrants within 189[30] days of the declaration of the dividend;
>
> (b) despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase;
>
> (c) in the event of failure to despatch the redemption or repurchase proceeds within the period specified in sub-

clause (b), the asset management company shall be liable to pay interest to the unitholders at such rate as may be specified by SEBI for the period of such delay;

(d) notwithstanding payment of such interest to the unit- holders under sub-clause (c), the asset management company may be liable for penalty for failure to despatch the redemption or repurchase proceeds within the stipulated time.

Clause (b) to Regulation 53 requires that the AMC shall despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase. Regulation 40, as noticed above, states that on or from the date of publication of notice under Regulation 39(3)(b), the trustees of the AMC, as the case may be, shall cease to cancel or create units of the scheme; cease to issue or redeem units of the scheme; and cease to carry on any business activity in respect of the scheme so wound up.

65. Issue in question would, therefore, arise whether the AMC or the trustees are bound to honour and pay the redemption or repurchase proceeds for requests received before the date of publication of notice in terms of Regulation 39(3). Interpreting the word 'business' in clause (a) of Regulation 40, the Division Bench of the High Court has held that this expression refers to business activity and, therefore, would include payment of redemption proceeds to the unitholders, which would include the request for redemption received prior to the date of publication under Regulation 59(3). The High court has, accordingly, held:

> "228. As regards redemption requests received prior to compliance with clause (3) of Regulation 39, the argument of AMC and the Trustees was that in view of clause (d) of Regulation 53, the redemption or repurchase proceeds are required to be dispatched within ten working days from the date of redemption notwithstanding the decision of winding up. As held earlier, the dispatch of redemption proceeds or repayment of redemption proceeds is also a part of business activity of a Scheme which is completely prohibited once the Regulation 40 triggers in. Therefore, the argument that the redemption requests made by the unit-holders on 23rd April, 2020 were required to be honoured even after Regulation 40 had triggered in cannot be accepted. Once there is a compliance with clause (3) of Regulation 39, the mandatory provisions of Regulation 40 forthwith operate. There is no exception carved out to any of the clauses in Regulation 40. It is obvious that such a failure to dispatch the redemption or repurchase proceeds due to applicability of provision of Regulation 40

> cannot be termed as a failure within the meaning of sub-clause (c) of Regulation 53. Therefore, the consequences such as payment of interests and penalty as provided in clause (c) of Regulation 53 may not follow."

66. On the aspect of borrowings etc. by the AMC to make payment towards redemption, the High Court has held:

> "225. But, in the context of the Scheme of the Mutual Funds Regulations, this Court will have to consider the meaning of 'business activities'. As stated in the earlier part of our discussion, a Scheme is launched by AMC with the approval of the Trustees. There are different categories of Schemes in which the investments are made by the members of the public. From plain reading of the provisions of Regulation 43, it is clear that the money received from the unit-holders and investors is required to be invested by AMC strictly in accordance with Regulation 43. The investments are to be made subject to investment restrictions specified in the seventh schedule. As far as borrowings are concerned, clause (2) of Regulation 44 provides that the Mutual Fund shall not borrow except to meet temporary liquidity needs of the Mutual Fund for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit-holders. The proviso to clause (2) of Regulation 44 clearly provides that a Mutual Fund shall not borrow more than twenty percent (20%) of the net assets of the Scheme and the duration of such borrowing shall not exceed a period of six months.

Thus, in short, the business of a Mutual Fund consists of (i) launching Schemes, (ii) receiving the investments from the unit-holders/investors, (iii) investing the money so collected from the unit-holders/investors in accordance with Regulation 43 and other relevant Regulations and (iv) paying the returns in various modes to the unit-holders/investors. The returns can be in the form of repurchase of the units, redemption of units, payment of interest or dividend to the unit- holders, as the case may be, depending upon the nature of the Scheme. Making such returns is certainly a business activity of a Scheme. The income so generated by investments made in accordance with Regulation 43, can also be invested by AMC. Clause (3) Regulation 44 provides that save as otherwise expressly provided, a Mutual Fund shall not advance any loans for any purposes. However, clause (4) of Regulation 44 provides that a Mutual Fund may lend and borrow securities in accordance with the framework relating to short selling and securities lending and borrowing specified by SEBI. The provisions of Mutual Funds Regulations are intended to regulate activities of Mutual Funds for promoting its healthy growth and for protecting interest of unit- holders. In a case of Taxation law, the rules of interpretation applicable provide that if there are two interpretations possible, the one in favour of assessee will have to be preferred. In case of Mutual Funds Regulations, a construction needs to be adopted which will subserve the object of SEBI Act.

226. It is pertinent to note here that clause (a) of Regulation 40 uses the words "business activities in respect of the Scheme" and not merely business of the Scheme. As siated earlier, the activities of repurchase of units, redemption of units or payment of interest or dividend are also a part of business of a Scheme. In view of clause (2) of Regulation 44, a Mutual Fund can borrow only for the

purposes of meeting temporary liquidity needs for the purpose of repurchase, redemption of units, payment of interests or dividend to the unit-holders. For example, if there are large number of requests for redemption of units by the unit-holders in respect of 'open ended Scheme', a Mutual Fund may face temporary liquidity crunch. In such a situation, it is permissible for a Mutual Fund to make borrowings only for payment of redemption amount. Therefore, borrowings made as specified in clause (2) of Regulation 44 will certainly amount to 'business activities' of a Mutual Fund or a Scheme, inasmuch as, such borrowings are made for the purpose of meeting demand for redemption which is a part of business of the Scheme.

227. Regulation 40 is interlinked with Regulation 41. In view of Regulation 40, the moment compliance is made with clause (3) of Regulation 39, the 'business activities' of the Scheme of a Mutual Fund must stop. The creation or cancellation of units and issue or redemption of the units of the said Scheme must also cease. The reasons is, as required by sub-clause (a) of clause (2) of Regulation 41, all the assets of the Scheme under winding up are required to be disposed of in the best interest of unit-holders and thereafter, as per sub-clause (b) of clause (2) of Regulation 41, the proceeds of the sale are required to be applied firstly towards discharge of liabilities of the Scheme. Secondly, the expenses in connection with the winding up are required to be set apart and thirdly, the balance amount remaining after clearing the liabilities has to be distributed to the unit-holders in proportion to their respective interest in the assets of the Scheme. The object of Regulation 40 of the Mutual Funds Regulation is to ensure that the moment compliance is made with clause (3) of Regulation 39, the assets available at that point of time should be made available for sale. The assets cannot be allowed to be depleied by creating more liability. That is the reason why the redemption must immediately cease. Therefore, it must be held that the borrowings made by AMC, in terms of clause (2) of Regulation 44, are business activities' of a Scheme within the meaning of clause (a) of Regulation 40. If borrowings are made in accordance with clause (2) of Regulation 44, the act of replacement of the borrower, as done by the AMC and the Trustees in the present case, will have to be also held to be a part of business activities in respect of the Scheme."

67. The case set up by some parties is at variance with the dictum pronounced by the High Court. They have submitted that the mutual fund must honour the request for redemptions received on or before the date of publication of notice under Regulation 39(3). In other words, Regulation 53(b) must be honoured and complied with even if the time of payment of redemption, the 10 days period stipulated therein, would fall after the date of publication of the notice under Regulation 39(3). They are of the opinion that it would be illegal not to honour the valid redemption requests. They are also of the opinion that the AMC should be allowed and permitted to borrow money within the prescribed limits to honour such valid redemption requests as long as the valid redemption requests are received prior to the cut-off date for winding up.

68. Before we answer this aspect, we would like to have greater clarity on the factual matrix, which would be possible once the proceedings in pursuance of show-cause notices etc. are concluded. Notably, many of the appellants have not addressed us on this aspect, their grievance being that the Forensic Audit Report has not been made available to them. At the same time, they did refer to news reports or articles to suggest irregularities and illegalities of different kinds, including preferential payments, breach of trust and mis- management in deployment of funds of the scheme, violation of

investment objectives stated in the offer document or scheme information document and breach of trust by withholding price sensitive information etc. Once the facts are clear and ascertained, we would be able to appreciate and understand the practical impact of the respective interpretations, i.e. the interpretation placed by the High Court and the interpretation sought to be placed and preferred by SEBI, the appellants, the trustees and the AMC. This is also the reason why we have refrained from referring and commenting on facts and left the several issues open at this stage. Nevertheless, we clarify that our observations in this Order and the earlier Order should not be read as binding factual findings or conclusions on any disputed facts, which could be a subject matter of a show-cause notice and consequent decision. Of course, the legal interpretation of Regulation 18(15)(c) and Regulations 39 to 42 to the extent indicated above are conclusive and binding. For clarity, we would also observe that any finding given by the High Court on facts or even on legal issues not subject matter of this Order or our earlier Order dated 12th February, 2021 would not be treated as conclusive and binding as the findings are sub-judice and pending before this Court on interpretation as well as merits.

.....J. (S. ABDUL NAZEER) .....J. (SANJIV KHANNA) NEW DELHI;

JULY 14, 2021.