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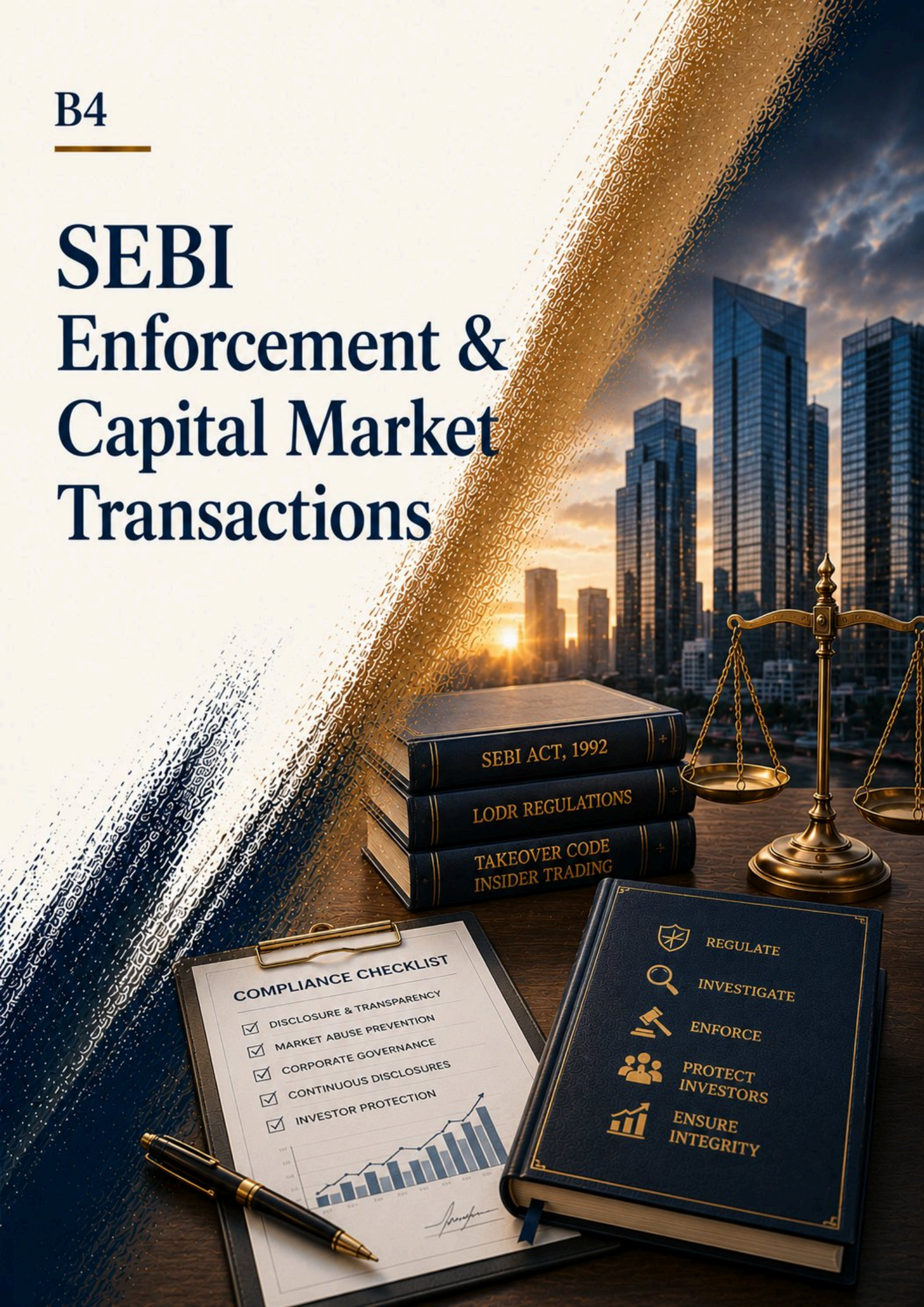
SEBI Enforcement & Capital Market Transactions



BHATT & JOSHI ASSOCIATES — INDIAN BANKING & FINANCE SECTOR LEGAL SERIES

SEBI Enforcement & Capital Market Transactions

Investigations, Insider Trading, SAT Appeals, Settlement & Deal Structuring — The Complete Practitioner's Guide

Booklet IV of VI — Indian Banking & Finance Sector Legal Series

Advocates & Legal Consultants — Ultra-Premium Client Advisory Series

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CHAPTER ONE

SEBI Investigations: Show-Cause Notices, Inspection Powers, Whistleblower Sources & Responding to SEBI Queries

SEBI Act 1992 Sections 11, 11B and 11C, Investigation Powers, Forensic Audit Authority, SEBI's Information Gathering Tools & Strategic Response Framework

> *A SEBI investigation — whether triggered by a whistleblower complaint, a stock exchange surveillance alert, a complaint by a retail investor, or SEBI's own market intelligence — is one of the highest-stakes regulatory proceedings that a listed company, its promoters, or its senior officers can face. The consequences of an adverse SEBI finding range from monetary penalties (up*

> *to Rs. 25 crore or three times the profit made from the violation) to debarment from accessing capital markets, disgorgement of illegal gains, and criminal prosecution under Section 24 of the SEBI Act. The investigation phase — before any formal adjudication — is the period in which the trajectory of the entire proceeding is most strongly influenced by the conduct of the investigated entity. A company that cooperates strategically, provides accurate information, and manages the information disclosure process intelligently — while exercising its legal right to withhold privileged communications and to challenge ultra vires information requests — is far better positioned than one that either obstructs the investigation or cooperates entirely without legal counsel.*

1.1 SEBI's Investigation Powers: Section 11C and the Forensic Audit Regime

Section 11C of the SEBI Act empowers SEBI to appoint any officer to investigate the affairs of any intermediary or person associated with the securities market. The investigating officer's powers under Section 11C include: calling upon any person to furnish information (books of accounts, records, documents, and statements in any form); summoning any person for examination on oath; conducting searches and seizures of documents at business premises (with prior magistrate approval under Section 11C(5)); and directing a bank or financial institution to furnish account statements relating to the investigated entity. SEBI's investigative practice increasingly relies on forensic audits — appointment of a forensic auditor (typically from a big-four accounting firm) to examine a listed company's books for evidence of fraud, fund diversion, or accounting manipulation. The forensic auditor operates under SEBI's authority under Section 11(2)(ia) — to call for information — and the company is legally required to extend full cooperation to the forensic auditor including access to its tally system, bank account records, vendor invoices, and email communications. However, the company's obligation to cooperate with a forensic auditor does not extend to producing communications between the company's directors and its lawyers that are protected by legal professional privilege — and practitioners advising companies under forensic audit investigation must clearly identify and protect privileged communications from the audit's scope while ensuring that the cooperation provided to non-privileged material is genuine and complete.

1.2 Responding to SEBI Queries: The Information Request Strategy

SEBI's preliminary investigation typically begins with formal information requests — letters to the listed company, its promoters, or its registered intermediaries seeking specific documents and explanations. The response to these information requests is the investigated entity's first and most consequential communication with SEBI: it sets the factual record, establishes the entity's cooperative posture, and — if handled poorly — can contain admissions or misleading statements that SEBI uses to build its case. Counsel's standard approach to SEBI information request responses is: review every document requested before deciding what to produce (ensuring that privileged communications are withheld and that the produced documents do not

contain unexplained anomalies that will generate additional adverse queries); draft the covering letter accompanying the document production with precision — neither over-explaining in ways that concede facts not established by the documents, nor under-explaining in ways that invite follow-up for clarification; and where any information requested is not available, state clearly why it is unavailable (document destruction, system failures, or records held by third parties) rather than simply failing to produce it and allowing SEBI to infer an adverse explanation.

1.3 Summons and Examination on Oath: Preparation and Conduct

SEBI's power to summon an individual for examination on oath — exercised by issuing a formal summons under Section 11C — is the most personally challenging aspect of a SEBI investigation for a company director, promoter, or senior officer. The examination on oath is conducted by SEBI's investigating officer, who records the answers in a written statement signed by the examinee. These recorded statements are then used as evidence in any subsequent adjudication proceedings. The examinee has no right to legal representation during the examination itself — the examination is conducted by the SEBI officer directly — but the examinee has the right to request a reasonable time to consult with legal counsel before answering a question, and to have access to documents before answering questions about those documents. Counsel's preparation for a client being examined under Section 11C must cover: a thorough review of all documents that the client is likely to be asked about; preparation of the client on the specific factual questions that SEBI's investigation focus suggests will be asked; and coaching on the discipline of answer-scope — answering only what is asked, not volunteering additional information beyond the scope of the question, and clearly distinguishing between personal knowledge and assumption or hearsay.

CHAPTER TWO

Insider Trading Proceedings: UPSI Definition, Connected Person Liability, Trading Window Violations & SAT Defence

SEBI (PIT) Regulations 2015, UPSI Categories, Designated Person Obligations, Trading Plan Framework, Chain of Communication & SAT Jurisprudence

2.1 UPSI: Defining the Information That Creates Liability

The SEBI (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) define "unpublished price sensitive information" (UPSI) as information relating to a company or its securities, directly or indirectly, that is not generally available — and which, upon becoming generally available, is likely to materially affect the price of the securities. The PIT Regulations contain a non-exhaustive list of deemed UPSI: financial results, dividends, changes in key managerial personnel, material events as specified in the LODR Regulations, mergers, acquisitions, demergers, joint ventures, disposal of the whole or substantially the whole of the undertaking, and changes in promoter shareholding. The "likely to materially affect price" test — which is objective, not subjective — means that SEBI assesses whether a reasonable investor, with access to the information, would have considered it important in deciding whether to trade. Practitioners defending insider trading cases must carefully assess whether the specific information on which the alleged insider trade was based actually meets the materiality threshold: information that is in the public domain (even if not widely known), information that is too speculative to be "price sensitive" until crystallised in a board decision, and information that is specific to industry conditions rather than company-specific may fall outside the UPSI definition even if the accused person had access to it before trading.

2.2 Trading Window and the Designated Person Regime

The PIT Regulations' trading window closure mechanism — the mandatory prohibition on trading by "designated persons" (promoters, directors, key management personnel, and persons with access to UPSI) during the trading window closure period (typically closing 48 hours before UPSI-generating board meetings and re-opening 48 hours after public disclosure) — is the compliance infrastructure most frequently at the centre of insider trading enforcement actions. Trading window violations — where a designated person trades during a closed window period — are often detected by SEBI through stock exchange surveillance data, which monitors trading patterns relative to company event dates. The key legal question in trading window violation cases is whether the trading occurred during a validly closed window: was the trading window closure notified to designated persons in accordance with the company's code of conduct? Was

the trading window closed at the correct time? And did the trading occur within the window closure period as correctly computed? SEBI has, in several enforcement orders, found violations where designated persons have traded on the first day of window re-opening, claiming that the window had reopened — only for SEBI to find that the re-opening notification was premature and the trading therefore occurred during a technically-still-closed window.

> **PRACTITIONER NOTE**
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> Designated persons who receive trading plan approvals under Regulation 5 of the PIT Regulations — which allows a designated person to pre-plan trades to be executed at specified future dates, removing the element of contemporaneous UPSI access — have a statutory defence against insider trading allegations for trades executed in accordance with the pre-approved plan. Practitioners advising promoters of listed companies who anticipate needing to liquidate shareholdings for legitimate personal reasons (estate planning, divorce settlements, personal loan repayment) should proactively structure these disposals through trading plan filings, which provide a strong procedural defence against any subsequent SEBI allegation of insider trading based on UPSI access at the time of the trade.

2.3 Chain of Communication: Communicator and Recipient Liability

SEBI's insider trading enforcement increasingly targets not just the trading beneficiary but the entire chain of communication through which UPSI reached the trader — the "tipper" (the person who communicated the UPSI) is equally liable as the "tippee" (the person who received and traded on the UPSI) under Regulation 3(1) of the PIT Regulations, which prohibits any person from communicating UPSI to any other person except in the legitimate course of business, legal obligations, or discharge of duty. In several high-profile enforcement actions, SEBI has pursued communication chains through call detail records (obtained under the Information Technology Act from telecom companies) and messaging application data — tracing the flow of UPSI from a company insider, through intermediaries, to the ultimate trader. For practitioners defending chain-of-communication cases, the critical defence is demonstrating that: the communication of information was in the legitimate course of business (a director discussing financial results with the company's investment bankers in the context of a capital raising is not communicating UPSI unlawfully); the information communicated did not actually constitute UPSI at the time of communication (because it was not yet crystallised in a board decision, or because similar information was available from public sources); or the alleged tippee did not trade based on the communicated information but for independent legitimate reasons.

CHAPTER THREE

SEBI Settlement Mechanism: Consent Orders, Settlement Terms, Waiver of Adjudication & Negotiating Settlement Amounts

SEBI (Settlement Proceedings) Regulations 2018, Eligible Violations, Settlement Amount Computation, Directions Accompanying Settlement & SAT Review of Settlement Refusals

3.1 Settlement Framework: Eligible Violations and the 60-Day Window

SEBI's settlement mechanism — formally governed by the SEBI (Settlement Proceedings) Regulations, 2018 — allows persons against whom SEBI has issued a show-cause notice or initiated adjudication to propose settlement of the regulatory action by paying a settlement amount and accepting specified directions (such as audits, enhanced compliance obligations, or restrictions on specific activities) in exchange for SEBI not pursuing the enforcement action to its conclusion. The settlement mechanism is available for most categories of SEBI violations — the 2018 Regulations list only a small category of excluded violations (market manipulation in IPOs, fraud, and front-running by intermediaries in certain circumstances) that are ineligible for settlement. The settlement application must be filed within 60 days of receipt of the show-cause notice — a deadline that runs regardless of whether the notice is under active adjudication, and missing this deadline requires an application for condonation that is not automatically granted. The decision to apply for settlement — rather than contest the adjudication — is the most strategically consequential choice a SEBI enforcement respondent makes: settlement forecloses the opportunity to establish a favourable legal precedent, results in a settlement order that is a public record of regulatory action against the respondent, and involves a payment that SEBI's internal guidelines compute as a multiple of the alleged gain from the violation.

3.2 Settlement Amount Computation: SEBI's Internal Guidelines and Negotiating Leverage

SEBI's internal High Powered Advisory Committee (HPAC) — which reviews settlement applications and makes recommendations on settlement terms — applies an internal formula for computing the settlement amount: typically a multiple (between 1.5x and 3x, depending on violation severity) of the "illegal gain" from the alleged violation, plus a disgorgement component of the actual gain. For insider trading cases, the "illegal gain" is computed as the price advantage obtained by trading on UPSI — the difference between the actual trading price and the market price immediately after public disclosure of the UPSI, multiplied by the number of shares traded. For disclosure violations and governance failures, the settlement amount is based on a base penalty matrix in SEBI's Schedule to the 2018 Regulations, adjusted for

aggravating factors (extent of investor harm, duration of violation, repeat offence) and mitigating factors (degree of cooperation, remediation measures taken, and self-reporting). Practitioners can negotiate settlement amounts by: demonstrating that the "illegal gain" computation overstates the actual gain (where the post-disclosure price movement was driven by factors other than the UPSI); establishing mitigating factors that warrant a reduction in the penalty multiple; and offering enhanced compliance measures (board governance improvements, appointment of independent compliance officers, enhanced disclosure commitments) that make the settlement more administratively attractive to SEBI.

CHAPTER FOUR

LODR Compliance Failures: Related Party Transactions, Disclosure Obligations & Promoter Pledge Disclosure

SEBI LODR Regulations 2015, RPT Approval Framework, Materiality Thresholds, Pledge Disclosure Trigger Levels & Penalty Regime for Disclosure Failures

4.1 Related Party Transactions: The LODR Framework and Its Commercial Implications

The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations), as significantly amended in 2021 and 2022, impose a comprehensive framework for the identification, approval, and disclosure of related party transactions (RPTs) — a framework that has dramatically increased the governance burden on listed companies with complex promoter group structures. The key provisions are: all RPTs (with related parties as defined in the Companies Act 2013 and expanded under LODR) require prior approval of the Audit Committee; "material" RPTs (defined as transactions individually or in aggregate during a financial year exceeding Rs. 1,000 crore or 10 per cent of the annual consolidated turnover, whichever is lower) also require prior shareholder approval with related parties not voting; the Audit Committee must have a written policy for RPT identification and approval; and all RPTs must be disclosed in the annual report in the prescribed format. The 2022 amendment expanded the definition of "related party" to include entities in which a director or key managerial person has significant influence — expanding the RPT net significantly for large Indian corporate groups with overlapping management and shareholding structures. For a Gujarat corporate house with a complex group structure — multiple listed entities, numerous subsidiaries, and extensive inter-company transactions for raw materials, services, and shared infrastructure — the LODR RPT framework requires a systematic compliance architecture: real-time RPT identification, transaction-by-transaction Audit Committee approval, and quarterly disclosure of all RPTs in the BSE/NSE filings system.

4.2 Promoter Pledge Disclosure: Trigger Events and Reporting Obligations

The disclosure of promoter shareholding pledges — a requirement under SEBI's pledge disclosure framework (Regulation 31 of the LODR Regulations and SEBI Circular of 2008 and subsequent updates) — has become one of the most scrutinised governance metrics for listed companies in India, after several corporate failures were preceded by undisclosed or under-disclosed promoter pledge positions. The current disclosure regime requires: disclosure of the creation, modification, and revocation of any pledge on promoter shares, within two trading days of the event; disclosure of the aggregate pledged shares as a percentage of the promoter's total

shareholding and as a percentage of total paid-up capital, in each quarterly shareholding pattern filing; and immediate disclosure of any invocation of the pledge by the pledgee (when the pledgee sells the pledged shares to enforce the pledge). The SEBI enforcement record on pledge disclosure failures is significant: where promoters have delayed pledge creation disclosure, disclosed pledges at incorrect percentages, or failed to disclose pledge invocations, SEBI has imposed penalties under Section 15A of the SEBI Act (for failure to furnish information) and under LODR Regulation 98 (for disclosure failures), with penalties up to Rs. 25 crore for material disclosure failures. Practitioners advising listed company promoters on their pledge structures — particularly promoters of mid-cap and small-cap companies who use promoter share pledges as collateral for personal borrowings or for pledging shares to lenders against company group-level credit facilities — must build the LODR disclosure compliance into the pledge documentation itself, with automatic notification mechanisms to the compliance officer triggered by each pledge-related transaction.

CHAPTER FIVE

SAT Appeals: Procedure, Powers, Stay of SEBI Orders & High Court Writ Jurisdiction

SEBI Act Section 15T, SAT Jurisdiction, Appeal Procedure, Stay of SEBI Orders, SAT's Powers to Modify Orders & High Court Jurisdiction

5.1 SAT Jurisdiction: Scope and Exclusions

The Securities Appellate Tribunal (SAT) — established under Chapter VIA of the SEBI Act — is the exclusive appellate forum for challenges to SEBI orders passed under Sections 11, 11B, 15-I, 15J, and 19 of the SEBI Act, and to orders of the depositories and depository participants relating to securities market operations. SAT's jurisdiction encompasses: appeals from SEBI's adjudication orders imposing penalties; appeals from SEBI's directions under Section 11B (remedial directions, trading restrictions, deregistration of intermediaries); and appeals from SEBI's investigation-based orders (disgorgement orders, bar orders against market access). SAT does not have jurisdiction over: SEBI's policy-making functions; challenges to SEBI regulations as ultra vires (which go to the High Court or Supreme Court under Article 226/32); and matters relating to SEBI's regulation-making powers. The 45-day limitation period for SAT appeals — running from the date of communication of the SEBI order — is strict, though SAT has the power to condone delay for sufficient cause. An important strategic consideration is that filing a SAT appeal does not automatically stay the SEBI order: a party appealing to SAT must separately apply for a stay of the SEBI order's operation during the appeal, and SAT's grant of a stay (which is not automatic) requires the applicant to demonstrate that: the appeal raises a prima facie case on merits; the balance of convenience favours the stay; and irreparable harm would result from non-stay.

5.2 SAT's Powers to Modify Orders: The De Novo Review Principle

SAT exercises appellate jurisdiction on both questions of fact and questions of law — it is not limited to the record before SEBI and may receive fresh evidence (though this power is exercised sparingly). More importantly, SAT's power to "pass such orders as it thinks fit" on an appeal (Section 15T(4) of the SEBI Act) enables it to substitute its own findings for SEBI's findings — a power that goes significantly beyond a traditional administrative law review limited to jurisdictional errors and procedural impropriety. SAT's jurisprudence has established that SEBI's penalty orders are subject to a proportionality review: where SEBI has imposed maximum or near-maximum penalties for violations that SAT finds to be technical or minor, SAT will reduce the penalty to a proportionate level, even if the violation itself is established. For practitioners, this proportionality jurisdiction means that even a SAT appeal where the violation

cannot be successfully contested may produce substantial relief through penalty reduction — and the argument for proportionality reduction (demonstrating that the violation was technical rather than fraudulent, that the investor harm was minimal, and that the respondent has taken remedial measures) is independently worth pursuing even where the substantive challenge to the violation finding is weak.

CHAPTER SIX

IPO, QIP and Rights Issue Due Diligence: SEBI ICDR Compliance, Offer Document Liability & Post-Issue Obligations

SEBI ICDR Regulations 2018, Promoter Lock-In, Issue Price Justification, Due Diligence Obligations of Lead Managers & Post-Issue Compliance Monitoring

6.1 IPO Offer Document Liability: Who Bears It and How

The offer document — prospectus or red herring prospectus — for a public issue is the legal instrument through which a company makes representations to the investing public about its business, financial condition, risk factors, and use of proceeds. The Companies Act 2013 (Sections 26, 34, and 35) and the SEBI ICDR Regulations 2018 impose civil and criminal liability for misstatements and omissions in the offer document on: the company (vicarious liability for all directors); every director who authorises the issue; the lead manager (book running lead manager — BRLM) who conducts due diligence on the offer document; and the statutory auditor who certifies the financial statements incorporated in the offer document. The BRLM's due diligence obligation — to verify the accuracy and completeness of the offer document — is the central risk management function in any IPO transaction, and the BRLM's liability for due diligence failures is a real commercial risk that has been enforced by SEBI in several IPO enforcement actions. For practitioners advising companies in IPO transactions — both on behalf of the issuer and on behalf of the lead managers — the due diligence process must cover: verification of material contracts (which must be available for inspection as per Schedule VIII of the ICDR Regulations); verification of regulatory licenses and approvals (particularly sector-specific licenses for regulated industries); litigation due diligence (identifying and accurately characterising all material pending litigations); and related party transaction due diligence (verifying that all RPTs are appropriately identified and disclosed in the offer document's risk factors and financial statements).

6.2 QIP: Placement Document Liability and Institutional Investor Due Diligence

A Qualified Institutional Placement (QIP) — the most efficiently structured capital raising tool for listed companies seeking to issue equity to institutional investors — does not require a full prospectus or SEBI approval for each issuance, but does require a placement document that discloses material information about the company as updated since the most recent annual report. The placement document liability regime is less onerous than the prospectus regime — QIP investors are institutional investors who are expected to conduct their own due diligence — but the company's liability for material misstatements or omissions in the placement document is

not eliminated. For a listed company that has recently received a SEBI show-cause notice, is facing enforcement action, or is aware of an undisclosed material event, the decision to proceed with a QIP is legally fraught: the placement document must disclose all material pending regulatory actions, and a company that proceeds with a QIP without disclosing a material SEBI investigation is potentially liable for securities fraud under Section 24 of the SEBI Act and Section 36 of the SCRA. Practitioners advising listed companies on capital market transactions must conduct a regulatory disclosure audit before any offer document is finalised — reviewing all pending SEBI, MCA, CCI, ED, and sectoral regulator proceedings to ensure that all material regulatory exposures are accurately disclosed in the risk factors and litigation sections of the offer document.

Booklet IV Complete Summary: SEBI enforcement — through investigations, insider trading proceedings, consent settlement, and appellate litigation before SAT — is the principal regulatory risk for listed companies, their promoters, and their senior officers in India's capital market. The PIT Regulations' UPSI framework, the trading window closure regime, and the chain-of-communication liability create a compliance obligation that permeates every aspect of a listed company's operations. LODR's RPT framework and pledge disclosure requirements are the governance obligations most frequently at the centre of SEBI enforcement actions against large promoter groups. SAT's de novo review and proportionality jurisdiction offer meaningful appellate relief even where the underlying violation is difficult to contest. IPO and QIP offer document liability demands systematic due diligence practice that protects both the issuer and the lead manager from post-issue investor claims.