20

SCRA

20.1 Introduction

The Securities Contracts (Regulation) Act, 1956 or the SCRA is the earliest piece of legislation on capital markets. It regulates contracts in securities and the stock exchanges in India. It is very important for the definition of the term “securities”.

20.2 Securities

S.2(h) of the SCRA defines the term securities. This definition is used for all purposes of the SEBI Act as well as various Rules, Regulations and Guidelines issued under the SEBI Act. The Companies Act defines the term securities to mean securities as defined in the SCRA and includes hybrids. Thus, even the Companies Act relies on the SCRA definition. Hybrids are defined to mean any security which has the character of more than one type of security, including their derivative. An example of a hybrid would be a partly convertible debenture, which has the characteristics of shares as well as debentures. The SCRA contains an inclusive definition of the term:

(i) Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate

(ii) Derivative – see para 20.6

(iii) Units of a collective investment scheme or CIS

(iv) Security receipts issued under the Securitisation and Reconstruction of Financial assets and Enforcement of Security Act, 2002

(v) Units of a Mutual Fund scheme – till sometime ago, there was a controversy over whether or not the units of a Mutual Fund could be treated as securities. The matter was settled by the Securities Appellate Tribunal in the case of PCS Industries wherein it held that units are also securities. The Ministry of Finance also issued a clarification to a similar effect. The matter is now beyond doubt, since the SCRA was expressly amended in 2004 to provide that securities include units of a mutual fund.

(vi) Government Securities – it is defined to mean a security created and issued, by the Central or State Government for the purposes of raising a public loan and which is in one of the forms specified in the Public Debt Act, 1944

(vii) Such other instruments as may be declared by the Central Government to be securities

(viii) Rights or interests in securities.

20.3 Applicability

The SCRA applies to the transactions in securities. There are judicial controversies whether or not the SCRA applies to:

(a) Securities of a public limited company not listed on a stock exchange; and

(b) Securities of a private limited company.

The following case laws are relevant in this respect:

(i) In Dahiben Umedbhai Patel v. Norman James Hamilton, (1985) 57 Comp Cases 700 (Bom) - where shares of private limited company were involved; Brooke Bond India Ltd. v. U. B. Ltd., (1994) 79 Comp Cases 346 (Bom) – where shares of an unlisted public limited company were involved, the Court held that since the subject-matter of the agreement was shares of an unlisted company, the SCRA had no application to them, and therefore, the contract was not violative of the SCRA.

(ii) The Calcutta High Court in the case of B. K. Holdings (P.) Ltd. v. Prem Chand Jute Mills, (1983) 53 Comp Cases 367 (Cal); East Indian Produce Ltd. v. Naresh Acharya Bhaduri, (1988) 64 Comp Cases 259 (Cal); Turner Morrison & Co. v. Shalimar Tar Products, (1980) 50 Comp Cases 296 (Cal); has taken a contrary view that shares of an unlisted public limited company are “securities” within the meaning of section 2(i) of the SCRA, and therefore, the SCRA would apply.

(iii) The decision of the Special Court (Trial of Offences Relating to Transaction in Securities) at Bombay in the case of A. K. Menon v. Fairgrowth Financial Services, (1994) 81 Comp Cases 508 (Special Court) is also relevant in this respect.

S. 28(1)(a) of the SCRA exempts the following categories of agencies from its provisions:

- Government
- Reserve Bank of India
- Any local authority
- Any corporation set up by a special law
- Any person who has effected any transaction with or through the agency of any such authority referred to above.

20.4 Contracts

The SCRA defines a "contract" to mean a contract for or relating to the purchase or sale of securities. The Supreme Court in the case of Madhubhai Amathalal Gandhi v. Union of India, AIR 1961 SC 21 has held that a contract in securities are of three types, namely:

(a) Spot delivery contracts, i.e., a contract which provides for the actual delivery of securities on the payment of consideration either on the same day of the contract or the next day, excluding the period taken for despatch of securities or the remittance of money from one place to another.

(b) Ready delivery contracts, i.e., a contract for the purchase or sale of securities of which the time for its performance is not specified and such contract is to be performed immediately or within a reasonable time.

(c) Forward contracts, i.e., a contract whereunder the parties to the contract agree for its performance at a future date.

The definition of the term "contract" provided by section 2(a) merely specifies a contract for or relating to the purchase or sale of securities. To understand the meaning of the term "contract", the definition under section 2(a) should be read in conjunction with sections 10, 11 and other provisions of the Indian Contract Act, 1872.

20.5 Permitted Contracts

20.5.1 The following are the three ways of entering into non-derivative contracts in securities:

- Through a member of a recognised stock exchange
- Through a licensed dealer in securities
- Spot delivery contracts

20.5.2 According to the provisions of s.13, every contract in securities in a notified State or area shall be illegal unless it is entered into between the members of a recognised stock exchange, or through or with a member of such recognised stock exchange. The notified areas are wide enough to cover almost all places in India.

20.5.3 Section 14(1) makes any contract entered into in a State or the area notified under section 13, void, if it is in contravention of any of the bye-laws of the recognised stock exchange.

20.5.4 The provisions of sections 13 and 14 do not apply to "spot delivery contracts" by virtue of specific exemption provided. Section 2(i) defines a "spot delivery contract" to mean "a contract which provides for:

(a) actual delivery of securities and the payment of a price therefor either on the same day as the date of the contract or on the next day, the actual period taken for the despatch of the securities or the remittance of money therefor through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;

(b) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository;

20.6 Derivative Contracts

The Securities Laws (Amendment) Act, 1999 has, w.e.f. 22nd February, 2000, inserted a new section 18A legalising the entering into of the contracts in derivatives subject to the conditions that such contracts must be traded on a recognised stock exchange and settled on the clearing house of the recognised stock exchange, in accordance with the rules and bye-laws of such stock exchange. The SCRA defines a "derivative" to include-

(a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security;

(b) a contract which derives its value from the prices, or index of prices, of underlying securities (a contract is defined to mean a contract for or relating to the purchase or sale of securities);

20.7 Options

The SCRA prohibited entering into of options in securities. After the deletion of section 20 by the Securities Laws (Amendment) Act, 1995, w.e.f. 25th January, 1995, entering into of options in securities has become legal. Further, the words "by prohibiting options" used in the preamble to the SCRA have been omitted, thus removing the prohibition on options in securities.

Section 2(d) defines the term "option in securities" to mean a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, or teji mandi, a galli, a put, a call or a put and call in securities.