

# BEST ANSWER - CASE STUDY - MARCH, 2026

## Brief of the Case

A medical practitioner investor subscribed to shares of a company promoted by his father-in-law and was later classified as a promoter despite having no role in management. The company failed to submit financial results under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. Acting under SEBI SOP circulars, stock exchanges directed the freezing of the petitioner's demat account, including securities in other companies. Aggrieved by this action, the petitioner approached the Securities Appellate Tribunal and subsequently filed a writ petition before the High Court.

**Issue 1: Whether SEBI can authorize freezing of promoters' personal demat accounts through circulars issued under the LODR Regulations?**

### Statutory Framework:

SEBI derives regulatory powers from the **Securities and Exchange Board of India Act, 1992**, particularly:

- ◆ **Section 11** – Duty to protect investors and regulate securities market
- ◆ **Section 11A** – Power to specify disclosure requirements
- ◆ **Section 30** – Power to make regulations

Pursuant to these powers, SEBI framed the **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015**, which impose compliance obligations on listed companies.

Stock exchanges relied on **SEBI SOP Circulars dated 30 November 2015 and 26 October 2016**, issued under LODR Regulations 97 and 98, to freeze promoter/promoter group shareholding for non-compliance.

### Legal Position:

However, a **circular cannot create substantive coercive powers unless supported by the parent statute or regulations.**

The Bombay High Court in *Neil Pradeep Mehta v. Union of India* held:

- ◆ Circulars cannot authorize **freezing of personal demat accounts containing securities unrelated to the defaulting company.**
- ◆ Such drastic measures must trace their authority to **statutory provisions**, not merely executive instructions.
- ◆ The action was described as **arbitrary and beyond regulatory power.**

### Application to Present Case: In the present case

- ◆ The freeze extended to **securities of other companies** held by the petitioner.
- ◆ The action was based solely on **SOP circulars**, not a statutory order under Section 11(4) or 11B of the SEBI Act.

Therefore, **SEBI cannot authorize freezing of promoters' personal demat accounts solely through circulars**, particularly when the freeze extends to unrelated securities. Such action **exceeds the scope of the LODR Regulations and lacks statutory backing.**

### Other Supporting Case Laws:

#### ◆ **Alpana R. Kirloskar & Others vs SEBI & Another (SAT/High Court)**

Similar to Mehta, this case involved challenges to the freezing of promoters' demat accounts. While SAT initially didn't quash the circulars, the Bombay High Court has consistently highlighted the lack of statutory basis for freezing personal holdings.

#### ◆ **Harhit Kadhi & Anr. vs SEBI (SAT, 2020)**

SAT held that once the non-compliance (e.g. The stock exchange cannot continue the freeze, even if other breaches are alleged).

**Issue 2: Whether freezing of demat accounts without individual notice and hearing violates Articles 14, 21 and 300A of the Constitution?**

### Constitutional Principles:

Relevant constitutional protections include:

- ◆ **Article 14 of the Constitution of India** – equality before law
- ◆ **Article 21 of the Constitution of India** – due process and fairness
- ◆ **Article 300A of the Constitution of India** – protection of property rights

Freezing a demat account effectively **restricts ownership and alienation of securities**, thereby impacting property rights.

### Fundamental Principles of Natural Justice:

The doctrine *Audi alteram partem* (“hear the other side”) requires:

1. Notice of allegations
2. Opportunity of hearing
3. Reasoned decision

### Application to Present Case : In the present case

- ◆ No **show-cause notice** was issued to the petitioner.
- ◆ The freeze was **automatic** under SOP circulars.
- ◆ The petitioner discovered the freeze **only through his account statement.**

The Bombay High Court in *Neil Pradeep Mehta v. Union of India* held that: Freezing of demat accounts without notice or hearing is arbitrary and violative of constitutional protections.

Therefore, **Freezing the petitioner's demat account without notice or hearing violates Articles 14 and 300A and principles of natural justice.** Such action is **procedurally ultra vires and unconstitutional.**

### Other Supporting Case Laws:

- ◆ **In Maneka Gandhi v. Union of India (1978),**

Passport was impounded without a hearing by the passport authority (an administrative body), the Supreme Court ruled that natural justice must be read into administrative actions, even when the statute is silent. The right to be heard is fundamental.

◆ **In A.K. Kraipak v. Union of India (1969);**

A board member involved in the selection was also a candidate. The court quashed the decision due to bias, asserting that administrative decisions must adhere to natural justice if they affect individual rights.

◆ **Vidya Devi v. State of Himachal Pradesh (2020):**

Held that the state cannot deprive citizens of their property without following due process of law. Forcibly dispossessing a person without legal procedure is a violation of both human rights and Article 300A.

◆ **Bimal Kumar Shah & Ors. v. State of West Bengal (2024):**

The SC laid down that the “authority of law” requires following procedural safeguards: notice, right to be heard, reasoned decision, and fair compensation.

**Issue 3: Whether classification as “Promoter” without management control justifies coercive regulatory action?**

• Legal Framework:

Under **Section 2(69) of the Companies Act, 2013**, a promoter includes:

- ◆ a person named as a promoter in the prospectus or annual return;
- ◆ a person having control over the affairs of the company; or
- ◆ a person in accordance with whose directions or instructions the board of directors’ acts.

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity.

While the statutory definition is broad, **mere designation as a promoter does not automatically establish control, participation, or liability for regulatory violations.** Regulatory responsibility must be based on **actual involvement, influence, or decision-making power** in the affairs of the company.

• **Judicial Interpretation:**

The Courts have consistently applied the principle of “**substance over form**”, examining the **real degree of control and participation** rather than relying solely on a formal label.

The Bombay High Court in **Neil Pradeep Mehta v. Union of India** observed:

- ◆ A person classified as a promoter merely due to relationship or historical shareholding cannot automatically be subjected to regulatory sanctions.
- ◆ Coercive measures against promoters must be supported by evidence of control, participation, or responsibility for the alleged non-compliance.
- ◆ Blanket regulatory action against all persons categorized as promoters without examining their actual role is arbitrary.
- ◆ **Application to Present Case:** In the present matter, the petitioner:

- ◆ holds less than 0.01% of the paid-up share capital of the company;
- ◆ has never served as a director or officer of the company;
- ◆ had no involvement in the management, decision-making, or compliance functions of the company; and
- ◆ was categorized as a promoter solely due to his familial relationship (son-in-law) with the chief promoter.

The record reveals no material indicating that the petitioner exercised control over the company or influenced its operations. Consequently, attributing regulatory liability to him solely on the basis of promoter classification disregards the factual realities of the case.

Therefore, accordingly, mere classification as a promoter, without proof of control, participation, or responsibility in the affairs of the company, cannot justify coercive regulatory action such as the freezing of demat accounts.

Regulatory enforcement must be individualized and evidence-based, and any blanket action against persons merely labelled as promoters would be **arbitrary and legally unsustainable**.

• **Other Supporting Case Laws:**

◆ **Weavers Mills Ltd. v. Balkis Ammal (1969):**

The court observed that a promoter is one who undertakes to form a company and takes steps to accomplish that purpose. The judgment emphasized active participation in formation or promotion. Therefore, a person who merely subscribes to shares but does not participate in promotion or control cannot automatically be treated as a promoter.

◆ **Narayandas v. Industrial Bank of Western India (1977)**

The court held that liability as a promoter arises only where a person has played a role in the promotion or control of the company. Mere investment or share subscription does not by itself make the person a promoter.

**Final Decision:**

**Upon consideration of the facts and law, the Court holds:**

1. **SEBI cannot freeze personal demat accounts of promoters through circulars alone**, particularly where such action affects securities unrelated to the defaulting company.
2. **Freezing of demat accounts without notice or hearing violates constitutional protections** under Articles 14 and 300A and the principles of natural justice.
3. Mere classification as a promoter, without management control or involvement, does not justify coercive regulatory action.

**Order:**

**Accordingly, the Court:**

1. Quashes the freezing of the petitioner’s demat accounts.
2. Directs SEBI, the stock exchanges, and the depository to **lift all restrictions on the petitioner’s demat accounts forthwith**.
3. Declares that SOP circulars cannot be used to freeze personal demat accounts without statutory authority and due process.
4. Grant liberty to SEBI to initiate action **only in accordance with law**, after issuing notice and conducting proper adjudication.