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Franklin Templeton Trustee Services Pvt Ltd & Ors. v. Amruta Garg

21 July 2021 | Case Comments

FRANKLIN TEMPLETON INVESTMENTS

This case comment is inscribed by Oshmi Jaiswal, a Law Graduate from Amity University, Lucknow.

Wind up allowed; Mutual Funds Regulations by SEBI not arbitrary; Trustees required mandatory approval by majority of the Mutual fund holders, wh they in majority decide to wind up mutual fund scheme: Apex Court in Franklin Templeton case

[Authored on- 16 Jul 2021]

CASE DETAILS

Civil Appeal No. 498-501 of 2021

Petitioners: Franklin Templeton Trustee Services Private Limited & Ors

Respondents: Amruta Garg & Ors

Date Decided: 14 Jul 2021

FACTS

The Special Leave Petition was filed in the Apex Court wherein the challenge in substance was to the winding up, as well as the procedure for winding up, of the Franklin Templeton Mutual Fund's six schemes. It also included an appeal filed by Franklin Templeton, against the Karnataka High Court order restraining the company from winding up its six of credit-oriented mutual fund schemes without obtaining the consent of the unit holders[1](the "mutual fund holders" or "investors") by a simple majority.

PROCEDURAL HISTORY

In April, 2020 while India was suffering through the drastic economic crisis due to the unprecedented COVID-19 pandemic, Franklin Templeton announced to wind up its six mutual funds credit-oriented schemes, which are: Franklin India Ultra Short Fund/Ultra Short Bond Fund, Franklin India Income Opportunities Fund, Franklin India Low Duration Fund, Franklin India Short Term Income Fund/Plan, Franklin India Credit Risk Fund and Franklin India Dynamic Accrual Fund. After being hit by the strike of unprecedented pandemic and redemptions in large measures, when Franklin Templeton became incapable to meet investor's redemptions due to the lack of liquidity in the market, then it froze these six debt mutual fund schemes.

Thereafter, the aggrieved investors moved to the different High Courts filing petitions and appeals which were barely different, to get their money back in order to meet their liquidity requirements. The Apex Court directed all the cases to be heard by Karnataka High Court.

CONTENTION ON BEHALF OF THE APPELLANTS

The Franklin Templeton Trustee Services Private Limited (the "trustees") along with the Securities and Exchange Board of India (SEBI) and asset management company (the "AMC"[2]) contended that when the trustees[3]and the SEBI decide to wound up a scheme, under Regulation 39(2) clauses (*a*) and (*c*) of SEBI (Mutual Funds) Regulations, 1996 (the "MF Regulations") respectively, the mutual fund holders' opinion is not required; which is to say that their decision stands binding and f on the mutual fund holders. And, the mutual fund holders only come into play t wind up a scheme in terms of Regulation 39(2)(c), a resolution by 75% of the

mutual fund holders is mandated. Thus, they challenged the judgement of Karnataka High Court calling interpretation as “erroneous”.

CONTENTION ON BEHALF OF THE RESPONDENTS

The Respondents referred the Appellants’ decision to wind up the scheme as “a smokescreen to conceal misfeasance and malfeasance”. They objected to the Appellants’ contention and maintained their primary allegations in the writ petitions which stated, they have suffered harassment and privation including fraud, mismanagement, and breach of the fiduciary duty by the AMC and the trustees amounting to violation of the SEBI Act, 1992 and MF Regulations. It submitted a finding of fraud committed by the AMC and the trustees stating that more than Rs. 15,000 crores were withdrawn from the abovementioned six schemes two weeks prior to the decision for winding up. Some of the Respondents also argued that consent would only be binding on those who agreed to the mutual fund schemes' winding up, and that it could not be imposed on others.

ISSUES

1. Whether the trustees who has the authority under Regulation 39(2)(*a*) of the MF Regulations to decide whether or not a mutual fund scheme should be wound up, also require the majority of the mutual fund holders’ consent as per Regulation 18(15)(*c*)?
2. Whether MF Regulations itself has some unconstitutional provisions?

ANALYSIS & JUDGEMENT

The two-judge bench comprising justices S. Abdul Nazeer and Sanjiv Khanna, directed to wind up the scheme in the interest of the Respondents as it is the only way to provide liquidation and disbursement of funds/securities/assets to them. It further held that mutual fund holders’ consent is needed by the trustees as per the Regulation 18(15)(*c*) of the MF Regulations to wind up any mutual fund scheme. And, consent by majority of the mutual fund holders should be sought post-publication of the notice along with the reasoning for winding up. Further in regard to the constitutional validity challenge against MF Regulations, the court held that the Regulations do not suffer from the vice of manifest arbitrariness. *The several key* highlights of the holding are as follows:

i. **Mandatory for Trustees to seek Mutual fund holders’ consent**

The Apex Court said, Regulation 18(15)(c) uses the term "shall" which must be taken as a command. Thus, as per Regulation 18(15)(c) mutual fund holders’ consent is a pre-requisite mandate to wind up any mutual fund scheme by the trustees who is vested the power to wind up the scheme by Regulation 39(2)(a). Rule of harmonious construction should be applied while interpreting the Regulation 39(2)(a), Regulation 39(2)(b), Regulation 39(2)(c) in harmony with Regulation 18(15)(c). The court is of the opinion that the phrase "when the majority

of the trustees decide to wind up" in Regulation 18(15)(c) clearly relates to Regulation 39(2)(a), because that is the only regulation that allows the trustees to wind up the scheme. When Regulation 18(15)(c) refers to the trustees' decision to wind up, it refers to the trustees' opinion that whether or not the scheme should be wound up. Therefore, the trustees are under obligation to seek consent of mutual fund holders to bring the wind up in action.

ii. **Interpretation of the term 'Consent' in Regulation 18(15)(c)**

The court referred to the judgement laid by the Allahabad High Court in the case of ***Wahid Ullah Khan v. District Magistrate, Nanital***[4] where the term "majority" was discussed stating that the term is used in contradiction to minority; implies that a minority vote and a majority vote both has to co-exist together. The Apex Court emended the meaning of "consent" and held, "***Thus, consent of the unit holders for the purpose of Regulation 18(15)(c) would mean simple majority of the unit holders present and voting***". The court clearly said that the decision does not need to have affirmative consent of majority of all or entire pool of mutual fund holders as words 'all' or 'entire' are not incorporated and found in the said Regulation. Regulation 18(15)(c) is there to provide an opportunity to the mutual fund holders to know the reason behind the winding up of the scheme and participate in the winding process. The provision is to facilitate the winding up process in just & fair manner, not to make it exhaustive and troublesome.

iii. **Consent has to be taken after publication of notice**

The consent of mutual fund investors are pre-requisite for winding up but it is sought post-publication (i.e. after the publication of notice) by the trustees, and the consideration has to be given by the investors which may or may not be affirmative to the winding up decision. Also, the trustees are obliged under Regulation 39(3) to give proper reasons for the winding up of such schemes.

iv. **Mutual fund investors are not the same as the creditors or home buyers**

The Court used the MF Regulations to draw a distinction between mutual fund investors and creditors, citing that mutual fund holders are investors who bear the risk and are thus entitled to profits and gains. They must also suffer the losses, if any, after taking the assessed risk. Creditors have a contractual right to a fixed return. Unlike creditors, mutual fund holders are neither entitled to a guaranteed return nor the principal amount return. Rather than profit or loss, their rate of return is in the form of interest. Creditors, unlike unit holders, do not accept risks. Thus, in the light of such facts the court concluded that the idea that mutual fund investors should be treated *pari passu* with creditors was dismissed. Similarly, the notion that unit holders are treated on an equal footing with property buyers under the Insolvency and Bankruptcy Code was dismissed terming as "unsound and incongruous".

v. **No unbridled and arbitrary power conferred on trustees under Regulation 39(2)(a)**

The court while refuting a contention said, Regulation 39(3) has imposed an obligation on the trustees to disclose the reasoning behind wind up. No excessive delegation is been conferred by the Regulation 39(2)(a) or any other provision of the legislation on the trustees which would enable them to act on their own whims and fancies. The Regulation itself contains several provisions to restrain, safeguard and guide the power of trustees to decide the wind up of any mutual fund scheme.

vi. **SEBI is entitled to investigate, inquire and intervene in the Trustees' decision**

When appropriate and necessary, SEBI under Section 11B of the SEBI Act of 1992 has the authority to conduct an inquiry and investigation to determine whether the trustees or the AMC have acted in line with their fiduciary duties. In case of any violation of Regulations 39 to 42 by the AMC or the trustees, it becomes open to SEBI to act in furtherance with the legislation.

CONCLUDING REMARKS

The proceedings are still under appeal and pending before the court on interpretation and merits. For the time being, the court avoided referring to or commenting on facts, leaving various key issues (like interpretation of Regulation 53) unresolved and open. It did clarify, however, that the observations in the order passed on 14-02-2021 and the previous order[5] (dated 12-02-2021) should not be interpreted as binding factual findings or conclusions on any contested facts. The Apex Court clearly stated that the MF Regulations only the legal interpretations made in the reference of Regulation 18(15)(c) and Regulations 39 to 42 are conclusive and binding.

However, its decision to wind up the schemes is correct as this was the only way to disburse the funds, and it will undoubtedly redress the grievance of the investors and provide much-needed liquidation.

Citations:

[1] 'Unit holder' means a person holding a unit in the scheme of a mutual fund. It may be understood as akin to shareholder in a company (as per the Regulation 2(*z*)(*i*) of MF Regulations).

[2] The AMC is a company which undertakes business activities in the nature of management and advisory services provided to the pooled assets (approved by SEBI under Regulation 21(2) of MF Regulations).

[3] 'Trustees' refers to the board of trustees or the trustee company who hold the property of the mutual fund in trust for the benefit of the unit holders (as per t Regulation 2(*y*) of MF Regulations).

[4] Wahid Ullah Khan v. District Magistrate, 1993 SCC OnLine All 175

[5] Franklin Templeton Trustee Services Private Limited v. Amruta Garg, 2021 SCC OnLine SC 88

References:

1. Franklin Templeton Trustee Services Private Limited and Ors. vs. Amruta Garg and Ors. (14.07.2021 - SC) : MANU/SC/0430/2021
2. Franklin Templeton Trustee Services Private Limited v. Amruta Garg., 2021 SCC OnLine SC 88.

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